Banking Regulation

In 27 jurisdictions worldwide

Contributing editor
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Banking Regulation 2015

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Preface

Banking Regulation 2015

Eighth edition

Getting the Deal Through is delighted to publish the eighth edition of *Banking Regulation*, which is available in print, as an e-book, via the GTDT iPad app, and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the 27 jurisdictions featured. Our coverage this year includes new chapters on Austria, Cyprus, Mexico, Norway, Portugal and Spain.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to David E Shapiro of Wachtell, Lipton, Rosen & Katz, the contributing editor, for his continued assistance with this volume.

GETTING THE
DEAL THROUGH

London
April 2015

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Austria

Christoph Moser and Stefan Weber
Weber & Co

Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

Austrian governmental and regulatory policies for the banking sector primarily aim at maintaining a stable and robust financial system. Trust in the stability of the banking and financial system is indispensable for the smooth and efficient supply of funds to the corporate, private and public sectors, and this trust must be consistently upheld. To this end, the entire financial market must observe a strict rule-based framework.

The main goals of the regulatory framework for the banking sector are:
- increasing the financial stability and the financial institutions' loss-bearing capacity;
- ensuring the efficient supply of credit to businesses and individuals;
- strengthening and harmonisation of the supervision of banks, securities, insurance and financial conglomerates; and
- requiring better institutions' internal control systems and more effective institutions' internal control by the management board.

2 Summarise the primary statutes and regulations that govern the banking industry.

As a member state of the European Union, the developments of Austria's banking regulations are extensively connected with European measures. The key Austrian legislation applicable to credit institutions includes:
- the Banking Act (BWG), including additional regulations (eg, relating to capital requirements, liquidity, ownership, notification duties, etc), provides for the fundamental framework applicable to credit institutions and financial institutions in Austria, including, inter alia, the licensing regime, supervision, capital and liquidity requirements, anti-money laundering, as well as receivership proceedings and penalties;
- the Payment Service Act (ZaDiG) and the E-Money Act 2010 (E-GeldG) implement the Payment Service Directive (Directive 2009/110/EC, PSD) and provide for the licensing and capital requirements for payment and e-money institutions; a proposal for a revised Payment Service Directive (PSD II), published by the European Commission in 2013, is currently discussed among policymakers;
- the Bank Recovery and Resolution Act (BaSAG) implements the Bank Recovery and Resolution Directive (Directive 2014/59/EU, BRRD) and provides for the obligation of credit institutions to draw up recovery and resolution plans. The BaSAG entered into force on 1 January 2015;
- the Securities Supervision Act 2007, including additional regulations, provides for licensing of investment service providers, customer protection provisions, disclosure and notification requirements, etc;
- the Capital Markets Act, which primarily implements the Prospectus Directive (Directive 2003/71/EC, PD), provides in particular for the prospectus framework relevant to securities offerings and offerings of investments in Austria;
- the Investment Fund Act (InvFG 2011), together with selected provisions of the BWG, is the main legal source governing activities of investment fund management companies;
- the Real Estate Investment Fund Act regulates the issuance of open-end real estate funds and the activities of investment fund management companies for real estate;
- the Alternative Investment Fund Manager Act implements the AIFM Directive (Directive 2011/61/EU) and governs the activities of alternative investment fund managers;
- the Stock Exchange Act (BörseG) and the Takeover Act provide the legal framework relating to listing and trading of securities as well as public takeover offerings;
- the Act on the Financial Market Authority, including additional regulations, governs the organisation of the Austrian Financial Market Authority (FMA), the cooperation with other regulatory authorities and the applicable cost framework;
- the Mortgage Bond Act applies to the issuance of mortgage bonds by credit institutions;
- the Financial Conglomerate Act contains provisions regarding the additional supervision of financial conglomerates by regulatory authorities; and
- specific other laws, inter alia, apply to Sparkassen, Bausparkassen and Hypothekenbanken.

In addition to Austrian law, certain EU regulations are directly applicable to Austrian credit institutions, including in particular the Capital Requirements Regulation (Regulation No. 575/2013, CRR) which is to a large extent based on the Basel III standards issued by the Basel Committee on Banking Supervision. The CRR includes most of the technical provisions governing the prudential supervision of Austrian credit institutions.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The European Central Bank (ECB), as the new prudential supervisor of banks in the eurozone, the FMA and the Austrian National Bank (OeNB; and together with the FMA, the Austrian Regulatory Authorities) are the regulatory authorities primarily responsible for overseeing Austrian banks. Since November 2014, banking supervision is shaped by the Single Supervisory Mechanism (SSM) based on the SSM Regulation (Regulation No. 1024/2013) and the SSM Framework Regulation (Regulation No. 17/2014). Since then, banking supervision is performed by the ECB having extensive micro- and macroprudential powers. All credit institutions of the eurozone are under the SSM's remit; however, the ECB does not directly supervise all of them. Supervisory tasks and responsibilities are divided between the ECB and the national competent authorities and are allocated on the basis of the significance of the supervised credit institutions. Credit institutions are classified as 'significant' or 'less significant', based on criteria set forth in the SSM Regulation and the SSM Framework Regulation. The ECB directly supervises only the first category comprising of approximately 120 credit institutions.

The following Austrian banks (including their subsidiaries or affiliates) are directly supervised by the ECB: BAWAG PSK AG, Erste Group Bank AG, Raiffeisen-Holding Niederösterreich-Wien reg.GenmbH, Raiffeisenlandesbank Oberösterreich AG, Raiffeisen Zentralbank Österreich AG, Österreichische Volksbanken-AG and – owing to significant cross-border assets – Sberbank Europe AG and VTB Bank (Austria) AG. UniCredit Bank Austria AG, as a subsidiary of UniCredit SpA, is also supervised by the ECB directly. The day-to-day supervision is conducted by joint supervisory teams, which comprise staff from both the ECB and the Austrian Regulatory Authorities.

Less significant banks remain under the supervision of the Austrian Regulatory Authorities subject to the oversight of the ECB. The ECB may

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take on the direct supervision of less significant institutions if required to ensure the consistent application of the high supervisory standards. Austrian Regulatory Authorities have to report on a regular basis to the ECB about their supervisory activities. Banking supervision in Austria itself has been divided between the FMA and the OeNB since 1 January 2008.

The FMA is particularly responsible for licensing, authorisation, notification and supervisory procedures, supervising intra-bank models, commissioning the OeNB to carry out on-site inspections, monitoring actions taken by credit institutions to remedy shortcomings, collecting and analysing qualitative information, evaluating analysis results with respect to official measures and legislation related to banking supervision, sending departmental representatives to international bodies, supervising branches and representative offices of foreign credit institutions in Austria, as well as cross-border supervision. Furthermore, the FMA is the competent authority with respect to securities supervision.

The OeNB is responsible for the ongoing prudential supervision of credit institutions, including regular inspections as well as ad hoc inspections of credit institutions. Moreover, the OeNB obtains data on other financial intermediaries from the FMA to analyse financial conglomerates and also draws up off-site banking analyses. The OeNB notifies the FMA if the risk situation of a credit institution has changed significantly or if a violation of supervisory provisions by a credit institution is suspected. The OeNB provides the FMA with the findings of its inspections and analyses, which are the basis for official actions by the FMA.

Pursuant to the BWG, the Federal Minister of Finance has to appoint a state commissioner and a deputy state commissioner for each Austrian bank with total assets of more than €1 billion to assist in the supervision of such bank. State commissioners ensure that no decisions are taken by the credit institution's shareholder meetings and supervisory board meetings which, in their view, violate federal laws, regulations or orders by authorities. If the state commissioner objects to any resolution proposed at a credit institution's shareholder meeting or supervisory board meeting, he must notify the FMA immediately. The effectiveness of such resolution is suspended until the FMA has determined the validity of the shareholders' or supervisory board's resolution.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposit guarantee schemes are harmonised on a European level. In 1994, the Deposit Guarantee Schemes Directive (Directive 94/19/EC) introduced the obligation to implement deposit guarantee schemes. However, in their national implementations of the Directive the EU member states introduced significantly different schemes in view of the level of coverage, the scope of covered depositors and products and the payout delay. In the aftermath of the recent financial crises, a new Directive on Deposit Guarantee Schemes (Directive 2014/49/EU) became effective as of June 2014, imposing an obligation to bring into force most of the provisions by July 2015.

Any credit institution accepting deposits or providing specific investment services must belong to an investor compensation scheme. Otherwise the FMA would render a decree declaring the credit institution's licence to be expired. The investor compensation schemes are established within the framework of the respective trade associations. By regulation of the Federal Minister for Economy governing the establishment of these trade associations and specialised groups, credit institutions accepting deposits or providing investment are assigned to one of the five trade associations:

- the Austrian Bankers' Association;
- the Regional Mortgage Banks Association;
- the Rural Credit Cooperatives Association;
- the Savings Banks Association; or
- the Credit Cooperatives' Association according to the Schulze-Delitzsch system.

Each trade association is obliged to maintain an investor compensation scheme that all member institutions accepting deposits or providing investment services may join.

Based on the BWG (section 93 BWG):

- deposits and building saving deposits;
- credit balances which result from funds left in an account or from temporary positions in the course of banking transactions, the provision of payment services or the issuance of e-money and which the credit institution must repay according to the applicable legal and contractual provisions; and
- any debt evidenced by a certificate issued by a credit institution, with the exception of mortgage bonds, municipal bonds and funded bank bonds

of private persons and undertakings are guaranteed in full up to an amount of €100,000. Additionally, liabilities of a credit institution arising from custody business, trading for one's own account or on behalf of others in certain instruments, third-party securities underwriting or severance and retirement fund business are covered by the investor compensation scheme and guaranteed in full up to an amount of €100,000; regarding undertakings, such claims have to be deducted by a deductible of 10 per cent.

In addition to deposit guarantee schemes, several sectors (eg, Sparkassen, Raiffeisen, Volksbanken) established a liability network providing for reciprocal liability of all member of the network for the liabilities of a single member. This liability is in excess of the statutory guaranteed amount of €100,000 and therefore offers additional security.

During the financial crisis 2008 and its aftermath, various Austrian banks had to be rescued or at least supported by the Republic of Austria. Kommunalkredit Austria AG, which later demerged into Kommunalkredit Austria AG and KA Finanz AG, and Hypo Alpe Adria International AG were fully taken over by the government; in Österreichische Volksbanken-AG, the government acquired a 43.3 per cent stake. KA Finanz AG and Hypo Alpe Adria International AG (whose wind-down unit is now operating under the name Heta Asset Resolution AG) are bad banks and will be fully liquidated. Kommunalkredit Austria AG is intended to be privatised. The Volksbanken sector recently decided on substantial reorganisation plans that include a split of Österreichische Volksbanken-AG and liquidation of the remaining non-core business.

Other banks, including the listed Erste Group Bank AG and listed Raiffeisen Bank International AG, have been supported with participation capital issuances purchased by the Republic of Austria, which have already been paid back (including interest).

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Pursuant to section 70a para 5 BWG, the FMA is entitled to supervise the transactions between the credit institutions, superordinate holding companies and its subsidiary undertakings when the parent undertaking of a credit institution is a mixed financial holding company, parent mixed financial holding company or a mixed activity holding company. For this purpose a mixed financial holding company is a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the EU, and other entities, constitutes a financial conglomerate. Such term is defined in article 4 (21) CRR in conjunction with article 2 (15) of Directive 2002/87/EC.

Credit institutions must have in place adequate risk management processes and internal control mechanisms, including sound reporting and accounting procedures, so that the credit institution's transactions with the parent undertaking and its subsidiaries can be identified, measured, monitored and controlled appropriately. Intra-group transactions trigger particular reporting obligations towards the FMA. Credit institutions must report all material intra-group transactions, especially loans, guarantees, off-balance sheet transactions, cost-sharing agreements, reinsurance transactions, capital investment transactions and transactions concerning own funds, on at least a quarterly basis. These reporting obligations go beyond the mandatory reports to the Central Credit Register pursuant to section 75 BWG. Where intra-group transactions impose a threat to a credit institution's financial position, the FMA can take appropriate measures.

The affiliation of credit institutions requires the conclusion of a contract between the central body and the affiliated credit institutions, the approval of the shareholders' or general meeting of each participating credit institution and amendments of the articles of association. The formation of an affiliation of credit institutions is subject to an application to and an approval by the FMA. The application must be accompanied by documents reflecting in particular the control, monitoring and risk management

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processes, the ability of the affiliation to comply permanently with the prudential requirements, and other significant information. An affiliation of credit institutions is not a group of credit institutions, which is formed by a superordinate institution and its subsidiaries.

Various provisions of the BWG, for example, relating to licences, freedoms of establishment and to provide services, capital requirements and liquidity, or supervision, are not applicable to affiliated credit institutions. The affiliated credit institutions are subsequently exempt from those notification and reporting duties that are intended exclusively for the monitoring of these provisions.

Under the BWG, financial institutions are authorised to conduct one or more of the following activities for commercial purposes if they are conducted as the institution's main activities:

- conclusion of lease agreements (leasing business);
- provision of advice to undertakings on capital structure, industrial strategy and related questions, as well as advice and services related to mergers and the purchase of undertakings;
- provision of credit reporting services;
- provision of safe deposit services;
- provision of payment services pursuant to section 1 para 2 of the ZaDiG; and
- issuance of e-money pursuant to section 1 para 1 of the E-GeldG.

6 What are the principal regulatory challenges facing the banking industry?

Contributions to the resolution financing arrangements (eg, national resolution funds and the Single Resolution Fund) will prove as a remarkable challenge for the Austria banking industry. All Austrian credit institutions already have to pay the above-average amount of the bank levy. It is uncertain whether or to what extent the Austrian legislator will approach this double burden and thus avoid competitive disadvantages for Austrian banks.

Other burdens inhere in the rapid development of banking regulations and the resulting necessity for banks to react quickly. Provisions regarding the professional qualifications and experience necessary for operating the credit institution for both the executive and supervisory board of credit institutions have been tightened in recent years. Such enhanced rules strengthen the overall confidence in the financial markets but are also likely to hinder effective governance, especially in smaller banks which cannot find appropriate board members easily. Further, the high number of credit institutions on the small Austrian market, their exposure in the CEE/SEE region, aggregate total assets of €265 billion (as of end 2013), and the low margins in Austria may lead to a restructuring of the credit institutions' business strategy, particularly driven by acts of risk minimisation.

In general, credit institutions will face challenges in banking supervision to different extents, based on whether they are designated a significant or a less significant credit institutions. Nevertheless, all banks of the eurozone must comply with ECB-issued guidelines and use standardised templates for data collection and information requests, and this may temporarily cause multi-track processes in credit institutions and require organisational changes in a medium to long term perspective.

7 Are banks subject to consumer protection rules?

Banking activities rendered towards consumers are subject to consumer protection rules, most of which are provided for in the Consumer Protection Act (KSchG) and the Consumer Credit Act. The BWG also provides for consumer protection rules (eg, section 34 BWG relating to consumer current account agreements and stipulating that such account agreements must at least contain the annual interest rate applicable to credit balances, apart from the information required under the ZaDiG, and section 37 BWG which provides for specific value dates for money transactions with consumers in connection with savings deposits, credit accounts or current accounts). In relation to credit agreements and credit transactions and when dealing with consumers as defined in the KSchG, banks must comply with the Consumer Credit Act.

Apart from regulatory authorities, other organisations (eg, Organisation for Consumer Protection, Chamber of Labour) monitor the conduct of banks towards consumers and make infringements of consumer protections rules public or bring them to court. Recent practices that have drawn intense scrutiny particularly relate to wrong or misleading investment advisory services (eg, shipping funds).

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

We expect that comprehensive legislative changes on a European level will continue and, thus, will significantly influence the Austrian banking industry in the upcoming years.

In its Work Programme 2015 published on 16 December 2014, the EU Commission announced to set out an action plan to build a Capital Markets Union. The EU Commission intends, inter alia, to reduce fragmentation in financial markets, to improve access to finance for SMEs and to strengthen cross-border capital flows in the single market. The EU Commission revealed that it will propose a framework for high-quality securitisation and review the Prospectus Directive to reduce administrative burdens on SMEs.

These and other regulatory changes will to a large extent concern entities and activities that do not directly belong to the banking industry. If alternative forms of financing may continue to become of major importance, a concurrent slowdown in the banking industry cannot be excluded. However, entities and activities that do not directly belong to the banking industry may also face stricter regulations, as they can carry systemic risks as well.

We expect that Europe-wide cooperation with regard to the supervision of banks will still intensify, particularly between the ECB and the national competent authorities but also closer cooperation among other European institutions and bodies such as the European Systemic Risk Board and the European Banking Authority.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The Austrian Regulatory Authorities supervise credit institutions by means of:

- on-site inspections (yearly and ad hoc);
- mandatory information to be submitted on a regular basis (annual reports, regular notification requirements, etc); and
- requests for other information and documents that seem necessary at any time.

The FMA monitors the adequacy of the capital and liquidity available for the quantitative and qualitative coverage of all significant risks arising from banking transactions and banking operations, the systemic risk emanating from a credit institution for the stability of the financial system and the risks as determined on the basis of stress tests. Moreover, the FMA supervises the exposure of credit institutions to the interest rate risk arising from non-trading activities and takes measures when the economic value of a credit institution declines by more than 20 per cent of its own funds as a result of a sudden and unexpected change in interest rates.

FMA and OeNB jointly define an inspection plan for each upcoming calendar year, taking into account inspections of systemically important credit institutions, an appropriate frequency of inspections of institutions that are not systemically important, resources for ad hoc inspections, thematic focuses of inspections, and review of measures taken to remedy the defects identified. The Austrian Regulatory Authorities regularly publish and update directives and guidelines regarding supervision and how they will approach certain issues.

10 How do the regulatory authorities enforce banking laws and regulations?

The FMA is authorised to exclusively enforce banking laws and regulations, including:

- requesting certain kind of information or documents pursuant to section 70 para 1 BWG;
- implementing certain measures pursuant to section 70 paras 2, 4 and 4a BWG (eg, prohibition of profit distributions, complete or partial prohibition of the continuation of business operations, imposing additional capital requirements or fines, withdrawal of the banking licence);
- requesting reorganisation measures (receivership or insolvency proceedings) pursuant to section 81 et seq BWG;
- collecting penalty interest for violation of capital requirements pursuant to section 97 BWG; and
- imposing fines due to administrative offences stipulated in section 98 and 99 BWG.

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11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

According to the FMA's annual report for 2013, the FMA conducted 62 management talks (the purposes of the meetings is to maintain contact with the management of credit institutions and to examine in greater detail their risk assessment and strategy), and 40 bank audit and early recognition meetings with bank auditors of the auditing associations of the decentralised sectors, issued 47 audit engagements to the OeNB and 12 on-site activities related to model approval took place. The FMA ordered 7 credit institutions, under threat of a coercive penalty, to establish compliance with statutory provisions within an appropriate period of time. Furthermore, the FMA once imposed a minimum capital requirement that is higher than the statutory minimum and charged interest pursuant to section 97 BWG in 16 occasions.

12 How has bank supervision changed in response to the 2008 financial crisis?

The Austrian Regulatory Authorities have revised their structure in order to react to the difficulties raised by the 2008 financial crisis and the following legislative changes in the supervision framework. The measures have resulted in an enhanced efficiency and effectiveness in fulfilling the tasks prescribed by the statutes of law.

In addition, the FMA has intensified its pre-emptive approach to investigate banking, investment and insurance service businesses of unlicensed entities to validate the compliance with regulatory laws and implement prosecution measures, if necessary. This, in particular, related to certain crowd funding and public participation schemes which have been held to breach the banking license requirements set forth in the BWG.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The Financial Market Stability Act entitles the Federal Minister of Finance to take measures for the recapitalisation of credit institutions and insurance undertakings (relevant entities) in order to remedy a considerable disruption within Austria's economy, in order to ensure the macroeconomic balance, and for the protection of Austria's national economy.

Apart from monetary measures (eg assumption of liabilities or provision of facilities and own funds), the Minister of Finance is entitled to acquire shares in a relevant entity and, if performance of a relevant entity's obligations as regards its creditors is jeopardised, may – as a final remedy – take over such relevant entity for reasonable consideration. The shares acquired in accordance with the provisions of the Financial Market Stability Act have to be privatised upon the achievement of the intended purpose, taking into consideration the prevailing market conditions.

The Federal Minister of Finance is entitled to set forth further conditions and requirements for the measures specified in the Financial Market Stability Act. In this context, additional conditions and requirements were imposed, in particular, with regard to the following aspects: the business focus (the pursuance of sustainable business policies), the application of the funds received, the remuneration of managers, the Tier 1 requirements, the dividend policy (payment of dividends only to the extent reasonable in consideration of the profit situation), measures for safeguarding jobs, measures for the prevention of distortion of competition, as well as the legal consequences of non-compliance with the aforementioned conditions and requirements.

The Austrian government has taken over or has supported several banks pursuant to the Financial Market Stability Act (see question 4). Regarding new legislation please see the Update and trends section.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Managing directors of a credit institution are responsible for defining and supervising the internal principles of a proper management to ensure due diligence in managing the credit institution, and for providing for an organisational segregation of duties and the prevention of conflicts of interest. The effectiveness of these principles has to be regularly verified and appropriate steps to correct any deficiencies have to be taken. Managing directors and members of the supervisory board have to observe statutory, regulatory, organisational and capital requirements as well as specific rules of conduct.

Pursuant to the BaSAG, every credit institution (in case of a group only the superordinate institution, central organisation or central institution) is obliged to draw up a recovery plan and a resolution plan. The FMA reviews the recovery plan and the resolution plan as to mandatory content and compliance with all requirements set by law. In this regard, the FMA also requests an expert opinion from the OeNB. In case the FMA detects any deficiencies, the credit institution is required to change the recovery plan or the resolution plan accordingly. The recovery plan and the resolution plan must be updated at least annually; in any event immediately, if a material change to the credit institution's legal or organisational structure, its business activity or its financial position could have an impact on the recovery plan or the resolution plan.

15 Are managers or directors personally liable in the case of a bank failure?

Managing directors and members of the supervisory board are subject to the liability scheme of general civil and corporate law. Subsequently, a managing director or a member of the supervisory board can be held liable for the failure of a credit institution, when acting deliberately or without the required diligence (see question 14).

16 How has bank resolution changed in response to the recent crisis?

Please see the Update and trends section.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The CRR and Directive 2013/36/EU (CRD IV) implement the Basel III guidelines and harmonise EU banking supervision.

As to capital requirements, the CRD IV provides for a change in the structure and quality of own funds. Tier I capital was divided into common equity Tier I capital (CET I capital) and additional Tier I capital. While Tier II capital is still eligible, Tier III capital has been eliminated. Banks must satisfy the requirement of 8 per cent of own funds in relation to the total risk exposure amount, consisting of at least 4.5 per cent CET I capital and 6 per cent Tier I capital. Further, the CRD IV implemented various capital buffers, such as: a capital conservation buffer of 2.5 per cent of CET I capital, a countercyclical capital buffer, which is calculated for each bank individually and amounts to up to 2.5 per cent of CET I capital, or a systemic risk buffer of up to 2.5 per cent CET I capital. Also, higher capital requirements for counterparty credit risk exposures arising from derivatives, repos and specific securities financing activities were implemented.

On liquidity requirements, the CRD IV provides for a harmonised system with regard to quantitative liquidity standards. Regarding liquidity measures, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) are applicable. The LCR is a short-term liquidity measure equal to the ratio of high-quality liquid assets to net cash outflows during a 30-day stress period. The NSFR is based on a long-term horizon, during which available stable funding must exceed required stable funding. Finally, a leverage ratio, calculated as the ratio between Tier I capital and the sum of the exposure values of all assets and off-balance sheet items, was also implemented to improve the system stability.

18 How are the capital adequacy guidelines enforced?

The capital adequacy guidelines are enforced through the ongoing supervision by the Austrian Regulatory Authorities, in particular through FMA's authority to enforce banking laws and regulations (please see questions 10, 19 and 20). Additionally, credit institutions are obliged to submit certain monthly, quarterly, half-yearly and yearly reports to the Austrian Regulatory Authorities, especially stating qualitative and quantitative information on their own funds, capital adequacy and the risks they have incurred and their risk-management procedures. Such reports are analysed by the OeNB and the results are provided to the FMA.

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19 What happens in the event that a bank becomes undercapitalised?

If a credit institution does not comply with the capital and liquidity requirements or appears likely to violate these requirements, the FMA shall intervene. Violation shall be assumed likely if:

- the credit institution's total capital ratio pursuant to article 92 (2) (c) CRR falls below the threshold of 8.625 per cent;
- the Common Equity Tier 1 capital ratio pursuant to article 92 (2) (a) CRR falls below the level of 5 per cent; or
- the credit institution does not initiate recovery measures according to its recovery plan although a triggering event has occurred.

The specific measures for early intervention by the FMA include:

- the implementation of one or more recovery measures contained in the recovery plan;
- specific improvements of the risk management;
- the convening of a general meeting, particularly to introduce capital measures, or inclusion of certain items on the general meeting's agenda or the proposal to adopt certain decisions; the FMA may also call the general meeting itself, if necessary;
- the preparation of a negotiation plan which provides for a voluntary restructuring of the credit institution's obligations towards its creditors; and
- an on-site inspection by the OeNB to asses the assets and liabilities of the institution.

Additionally, the FMA shall impose a penalty interest on credit institutions for the following amounts:

- 2 per cent on the amount by which the credit institution falls below the capital requirement pursuant to article 99 (1) CRR in conjunction with section 70 para 4a no 1 BWG, calculated on an annual basis, for 30 days, except in the case of supervisory measures pursuant to section 70 para 2 BWG or in cases where the credit institution is over-indebted;
- 5 per cent over the applicable bank rate on the amount by which the credit institutions falls below Liquidity 1 funds pursuant to section 25 para 5 BWG, calculated on an annual basis, for 30 days; the amounts by which the credit institution falls short of its minimum reserve requirement (article 5 para. 1 and 2 of Regulation (EC) No 1358/2011) are to be deducted from the Liquidity 1 shortfall;
- 2 per cent on the amount by which the credit institutions falls below Liquidity 2 funds pursuant to section 25 para 10 BWG, calculated on an annual basis, for 30 days; and
- 2 per cent on the amount by which the credit institution exceeds large exposure limits pursuant to article 395 para 1 CRR, calculated on an annual basis, for 30 days, except in the case of supervisory measures pursuant to section 70 para 2 BWG or in cases where the credit institution is over-indebted.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Either the credit institution that is over-indebted or insolvent itself, or the FMA may request receivership from the competent court if it appears likely that the credit institution's over-indebtedness or insolvency can be remedied. Receivership can only be granted for one year and has various specific consequences determined in section 83 et seq BWG. During the receivership, with regard to liabilities established prior to the arrangement of receivership and being subject to statutory deferment of payment, neither insolvency proceedings over the assets of the credit institution can be initiated nor can a court-ordered lien or right to satisfaction be obtained. The receivership ends by order of the court or opening of insolvency proceedings.

In general, only the FMA may file for the opening of insolvency proceedings; during receivership, only the receiver may file such a request. The substantive insolvency requirements are determined according to section 66 et seq Insolvency Act (IO). The court must consult the FMA before appointing or dismissing a receiver or a liquidator. The insolvency proceedings follow the IO, with the exception that recapitalisation proceedings cannot be initiated. The implications of the BaSAG (see Update and trends) to these procedures are yet to be determined.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The most recent changes of capital adequacy guidelines relate to CRR and CRD IV and its implementation in the BWG. Further changes are still subject to discussion on European and international level and seem likely to occur.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

There is no limit to the type of entities and individuals that may own a controlling interest in a credit institution or a financial institution. The FMA, however, may prohibit an acquisition of a qualifying holding in case specific criteria are not met (see question 27).

The BWG, in connection with the CRR, distinguishes between:

- participation means the ownership, direct or indirect, of 20 per cent or more of the voting rights or capital;
- qualifying holding means a direct or indirect holding which represents 10 per cent or more of the capital or voting rights or entitling to exercise a significant influence;
- control means the relationship between a parent undertaking and a subsidiary or a similar relationship between any natural or legal person and undertaking; and
- close links means a situation in which two or more natural or legal persons are linked (eg, by participation of ownership or via a third party).

A qualifying holding is already sufficient to trigger notification requirements (see question 27).

23 Are there any restrictions on foreign ownership of banks?

Foreign ownership of an Austrian bank is neither prohibited nor restricted under Austrian law. Nevertheless, the FMA may prohibit the acquisition or increase of a qualifying holding after examination of the necessary criteria (see answers to questions 27, 28 and 30).

24 What are the legal and regulatory implications for entities that control banks?

In case the influence exercised by the entity having a qualifying holding imposes a risk for the sound and prudent management of the credit institution, the FMA must take required measures, including:

- prohibition of profit distributions, appointment of a government commissioner, completely or partly prohibition of the continuation of business operations, etc;
- sanctions completely or partly prohibiting the directors to manage the credit institution; or
- submission of a motion with the competent court to suspend the voting rights controlled by entity in question during the risk prevails or until the shares are purchased by a third party (see question 27).

Depending on its legal form, an entity having a qualified holding in a credit institution may become subject to consolidated group supervision, including group financial statement requirements.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Any person controlling a credit institution shall, in particular:

- notify the FMA of any intention to increase, sell or reduce the holding in a way that it exceeds, reaches or falls below certain thresholds (see question 27);
- make available information and documents that the FMA needs to fulfil its duties; and
- not prevent effective and efficient supervision by the Austrian regulatory authorities.

Transactions between a credit institution and its shareholder or other entities controlled by the shareholder have to be at arm's length in order to avoid breaches of Austrian capital maintenance rules. Transactions between the credit institution and certain individuals or entities (eg, managing directors, members of the supervisory board, and board members

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Update and trends

Federal Law on Remedial Measures for Hypo Alpe-Adria-Bank International AG

In 2009, Austria nationalised Hypo Alpe-Adria-Bank International AG (HAA). After examining different options, the government enacted four acts on the reorganisation of HAA which came into force on 1 August 2014 and are intended to ensure that the bank's assets are sold on the best possible terms and that previous shareholders and subordinated bond holders bear a share of the restructuring costs. The FMA, as competent authority, issued a regulation setting forth the subordinated obligations and the liabilities towards (former) shareholders (the Restructuring Obligations) that cease to exist. Additionally, any guarantees and sureties given for the benefit of Restructuring Obligations cease to exist. Measures in favour of creditors of Restructuring Obligations are also enacted in this regard: a dividend distribution ban, effective until 2019, was imposed and any liquidation proceeds after completion of the liquidation of HAA's assets shall be distributed proportionally to the creditors of Restructuring Obligations. The legislation also affects the rights of creditors not directly affected by the bail-in: any statutory or contractual rights on termination, consent or any other right to alter a legal relationship (eg, adverse change or cross-default clauses) or to request security for its claims triggered by the measures of the legislation cannot be exercised.

Banking Union – Single Supervisory Mechanism (SSM), Single Resolution Mechanism (SRM) and Common Deposit Guarantee Scheme (CDGS), Bank Recovery and Resolution Directive (BRRD)

In addition to the CRD and CRR, further common rules for credit institutions in the EU member states were implemented and, together as a single rulebook, form the foundation of the European banking union. These rules aim at preventing a crisis (CRD and CRR) and, if a bank is in a crisis, offer a framework to manage the process, including structured winding downs (BRRD). Additionally, deposits up to €100,000 (per depositor or per bank) are protected at all times and everywhere in the EU (CDGS). The establishment of the SSM was the first step towards a banking union, ensuring the common implementation of such rules in the eurozone. The SSM applies to all the eurozone member states and is open to the participation of other member states. Non-eurozone member states may decide to join the SSM by establishing a close cooperation between their competent authorities and the ECB. The regulation confers key supervisory tasks and powers to the ECB and, since 4 November 2014, the ECB is exclusively responsible for key tasks concerning the prudential supervision of credit institutions; in particular it will:

- authorise and withdraw the authorisation of all credit institutions in the eurozone;
- assess acquisition and disposal of holdings in banks;
- ensure compliance with all prudential requirements laid down in EU banking rules and set;
- carry out supervisory stress tests to support the supervisory review, and carry out supervision on a consolidated basis;
- closely cooperate with national competent authorities in the exercise of macro-prudential powers and impose higher capital buffers than national competent authorities subject to specific conditions;
- carry out supplementary supervision over credit institutions in a financial conglomerate;
- apply requirements for credit institutions to have in place robust governance arrangements, processes and mechanisms and effective internal capital adequacy assessment processes; and
- carry out supervisory tasks in relation to early intervention when risks to the viability of a bank exist, in coordination with the relevant resolution authorities.

National authorities will assist the ECB and will prepare and implement the ECB acts under the oversight of the ECB, including day-to-day supervision activities. The ECB's supervisory powers will be the same as the powers granted to the competent national authorities under applicable EU law.

The SRM will implement the new rule set for all 28 member states in the Eurozone by means of the BRRD. The provisions relating to the cooperation between the Single Resolution Board and the national resolution authorities apply since 1 January 2015 and the SRM should be fully operational from 1 January 2016.

Act on Recovery and Resolution of Banks

The BaSAG implements the BRRD and became effective on 1 January 2015. The BaSAG introduces the following four main areas:

- *preparation and prevention*: credit institutions will be obliged to draw up a recovery plan and a resolution plan and submit it to the FMA.
- *early intervention*: Austrian regulatory authorities are empowered to intervene in credit institutions facing financial distress, even before being in a crisis. The BWG already provides the FMA with several powers (see questions 10 and 19).
- *resolution tools*: should the distressed bank continue to fail, resolution authorities will be provided with a credible set of resolution tools. These tools will ensure that any critical functions are preserved without the need to bail out the bank. Further, they shall ensure that shareholders and creditors of the bank under resolution bear an appropriate part of the losses and that the extent to which the cost of a bank failure is borne by the state and its taxpayers is minimised. The resolution authorities will be entitled to:
  - effect private sector acquisitions (parts of the bank can be sold to one or more purchasers without the consent of shareholders);
  - transfer business to a temporary structure (bridge bank) to preserve essential banking functions or facilitate continuous access to deposits;
  - separate clean and toxic assets between 'good' and 'bad' banks through a partial transfer of assets and liabilities; and/or
  - bail in creditors (mechanism to cancel or reduce the liabilities of a failing bank or to convert debt to equity, as a means of restoring the institution's capital position).
- *cooperation and coordination*: if a cross-border banking group fails national authorities will be able to coordinate resolution measures to protect financial stability in all affected member states and to achieve the best outcome for the group as a whole.

Moratorium on debt repayments by Heta Asset Resolution AG

On 1 March 2015, the FMA, as the Austrian resolution authority, imposed a moratorium on debt repayments by Heta Asset Resolution AG until 31 May 2016. The administrative decision by the FMA is based on the BaSAG and is a reaction to an audit of Heta Asset Resolution AG's balance sheet that exposed a shortfall of assets of between €4 billion and €7.6 billion which the Austrian government, as Heta's sole shareholder, refuses to fill. The moratorium should give the FMA time to draw up a resolution plan, ensuring equal treatment of all creditors. In principle, such resolution plan could provide for a creditors' contribution to the costs of winding down Heta (bail-in).

of controlling or controlled entities) require unanimous resolution by all managing directors and are subject to the consent of the supervisory board or any other supervisory body competent according to applicable law or the articles of association.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Under Austrian law, a credit institution may only be established in the legal form of a corporation, a cooperative society or a savings bank. In general, only cooperation members of a credit institution organised as cooperative society may be held liable for the liabilities of the institution in case of insolvency.

With regard to new legislation on including shareholders and certain creditors in the event of a crisis, see the Update and trends section.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Already the intention to directly or indirectly hold a qualifying holding (ie, 10 per cent of the voting rights or capital) in a credit institution, or to increase such a qualifying holding in order to reach or exceed the thresholds of 20 per cent, 30 per cent or 50 per cent of the voting rights or capital, or in such a way that the credit institution becomes a subsidiary of that party, must be pre-notified to the FMA (see question 30). To ensure the sound and prudent management of the credit institution in which an acquisition is proposed, and having regard to the likely influence of the potential acquirer on the credit institution, the FMA shall appraise the suitability of the proposed acquirer and the financial soundness of the proposed acquisition based on the following criteria:

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- the reliability of the potential acquirer;
- the reliability, professional qualification and experience of any person who will direct the business of the credit institution as a result of the proposed acquisition;
- the financial soundness of the potential acquirer, in particular in relation to the type of business pursued and envisaged by the credit institution;
- whether the credit institution will be able to comply and continue to comply with regulatory requirements, in particular, whether the group it will become a part of has a structure that may jeopardise effective supervision; and
- whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing within the meaning of article 1 of Directive 2005/60/EC is being or has been committed or attempted, or that the potential acquisition could increase such risk.

If the FMA does not prohibit the intended acquisition within 60 days (in some cases 80 or 90 days) after confirming receipt of the notification, the acquisition shall be deemed approved.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

In principle, there is no difference in the regulatory process for a foreign acquirer. If the FMA requests additional documents from a non-EEA proposed acquirer or a proposed acquirer not subject to supervision under Directives 2013/36/EU, 2009/65/EC, 2009/138/EC or 2004/39/EC, the 60-day period can be suspended for up to 30 days (see questions 27, 30 and 31).

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The FMA will review and assess all information provided by the proposed acquirer in connection with the notification, focusing on the criteria set by law (see answers to questions 27 and 30).

30 Describe the required filings for an acquisition of control of a bank.

Specific information to be filed is provided for in the Ownership Control Regulation, including information about:

- the identity of the proposed acquirer, bylaws, management board, economic beneficiaries, etc;
- the reliability of the acquirer with regard to criminal or administrative offences, insolvency proceedings, etc;
- the participations with a group of companies as well as other possible ways to exercise influence;
- the relevant business relationships, family ties or other relevant relationships as well as acquisition interests;
- the financial situation and credit standing of the acquirer;
- the funding of the intended acquisition, including disclosure of all relevant agreements; and
- the business plan, including a description of strategic objectives and plans, if the acquirer gains control.

In case the bank is an Austrian stock exchange listed entity, an acquirer must also comply with the provisions of the BörseG and the Takeover Act (eg, filing and notification obligations, mandatory takeover bid, etc).

Similar requirements must be fulfilled if the proposed acquirer intends to acquire a qualified holding in an insurance company pursuant, an investment firm, an investment service provider or a payment institution.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Within two working days, the FMA has to confirm receipt of the notification to acquire a qualifying holding. From that day, the FMA has 60 days to examine the intended acquisition and to prohibit it. In the case of the FMA requesting additional documents, the 60-day period is extended for up to 20 days (in some cases up to 30 days). If the FMA does not prohibit the acquisition within 60 days (or 80 or 90 days), the acquisition shall be deemed approved. In this case, the acquirer could still request the FMA to issue a decision approving the acquisition.

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Brazil

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The main governmental and regulatory policies that govern the banking sector involve the use of legal measures such as decrees, laws, resolutions, circulars, etc, as issued by the government, the National Monetary Council (CMN) or the Central Bank of Brazil (CBB), as the case may be. It is the CMN's responsibility to formulate monetary and credit policies for the purposes of currency stability to promote the economic and social development of the country, to allow allocation and distribution of resources, and to stabilise the economy.

2 Summarise the primary statutes and regulations that govern the banking industry.

The Brazilian financial system is governed by Law No. 4595/64, which outlines the financial system's role, the capacity and authority of the CBB, and how financial institutions are regulated by it. It also created the CMN, whose responsibility is to formulate credit and money policies. Besides Law No. 4595/64, a considerable number of rules and requirements applicable to financial institutions (eg, capital requirements, accounting procedures and managers' liabilities) are enacted by the CMN and the CBB.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The CBB is the primary authority responsible for overseeing financial institutions. The Brazilian Securities Commission (CVM) is also responsible for overseeing financial institutions whenever they act in the Brazilian capital markets environment. With a broader function, the CMN is the authority that issues rules and regulations and defines policies and general guidance for the successful operation of the Brazilian financial system. The CMN's members are the Minister of Finance, the chief executive officer of Banco do Brasil SA and the chief executive officer of the National Bank for Economic and Social Development (BNDES), and seven members appointed by the President.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Contributions from financial institutions are used to form a fund, the purpose of which is to insure certain deposits made into such institutions: the Credit Guarantee Fund (FGC). The FGC's function is to guarantee repayment of deposits made into deposit accounts, investment accounts and savings accounts, as well as deposit certificates issued by banks. Central Bank of Brazil Resolution No. 4,222, enacted on 23 May 2013, has significantly raised the maximum amount that the FGC pays to investors from 70,000 reais to 250,000 reais.

The Brazilian federal government has significant ownership interest in two institutions: the National Bank for Economic and Social Development (BNDES) and Banco do Brasil SA. The BNDES, which is wholly owned by the government, is a federal public company with legal personality under private law, with its own patrimony. The BNDES forms part of the Ministry of Development, Industry and Foreign Trade and aims to support projects that contribute to the country's development. Its support lines include long-term financing at competitive rates for the development of investment projects and the commercialisation of new machinery and equipment, manufactured in the country, as well as for the growth of Brazilian exports. Banco do Brasil SA is a semi-public corporation (controlled by the federal government, with shares traded in the stock market) and one of its main purposes is the implementation of the credit and financial policy of the federal government.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Banks are prohibited by law and regulation from extending loans and financing to controlling shareholders, to companies controlled by its controlling shareholders and to companies controlled by them. The granting of guarantees to such parties is also prohibited.

Law No. 4595/64 outlines the permissible activities of financial institutions, which encompasses public or private corporations whose main or secondary activities are the collection, intermediation or investment of resources owned by them or by third parties, either in national or foreign currency, or the custody of any resources owned by third parties. Any activity not mentioned herein is prohibited under such regulation.

6 What are the principal regulatory challenges facing the banking industry?

One of the challenges facing the banking industry in Brazil is the regulation and provision of a safe mechanism for financial inclusion of the less privileged social groups, allowing this significant section of the population access to banking products, including microcredit. Another challenge is the lack of regulations regarding 'crowd funding' in Brazil, which should receive more attention by regulators in the future.

7 Are banks subject to consumer protection rules?

Consumer relations in Brazil are regulated mainly by the Federal Constitution and the Brazilian Consumer Defence Code (CDC). The CDC stipulates that banking, financial, credit and securitisation activities may be characterised as a consumer relation and therefore may be subject to the protection rules established by it. However, not all banking relations are necessarily a consumer relation. In order to be characterised as such, a consumer must be a counterparty to the transaction. According to the CDC, a 'consumer' is any person or entity that acquires or uses a product or service as an 'end-user', as well as any group of people (even if undetermined) that has intervened in the consumer relations.

Any consumer may claim reparation and liquidated damages in court for damages caused by banks in consumer relations. The Consumer Protection Agency (PROCON) also has legitimacy to impose certain penalties to banks. Administratively, the CMN and the CBB have also issued certain resolutions and circulars aiming to regulated rules regarding conduct with clients. Clients that feel damaged by the misconducts of banks may file a complaint with the CBB (without prejudice to the option to seek remedies in Brazilian courts), which may impose penalties to the banks if determined that they have violated any rule.

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8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Legal and regulatory policies are gradually converging with Basel standards. In addition, the development of the regulations tend to increase the obligations regarding compliance, anti-corruption and anti-money laundering measures.

There is also significant attention being directed at the implementation of the Principles of Financial Market Infrastructure published jointly by the Committee on Payment and Settlement System (CPSS) and the International Organization of Securities Commission (IOSCO). The CMN, the CBB and the CVM have issued certain rules aiming to implement such principles, allowing Brazil to be granted maximum ratings (4 out of 4) in accordance with the updated Level 1 assessment report issued by CPSS and IOSCO on May 2014. Consequently, services regarding central depositories, custody and registration of financial assets and securities are subject to new regulations from Brazilian regulators.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

A bank is required to provide the CBB, on a periodic basis, with information and reports regarding its financial situations, portfolio credit records and details on how its relevant operations are conducted.

The CBB, through its auditors, audits banks from time to time for the purpose of verifying whether they are complying with regulations and also to check whether all the information provided to the regulator and the market is accurate. Thus, the referred audits can focus on the operations of the bank as a whole or on a specific matter. Such audits do not happen on a regular basis and may vary according to specific situations.

10 How do the regulatory authorities enforce banking laws and regulations?

The CBB may disqualify a bank from performing a specific activity if it does not comply with proper regulations. An administrative proceeding against the relevant financial institution may also be opened by the CBB in the event of non-observance of the regulations.

The results of such administrative proceedings range from a simple warning to the cancellation of the authorisation to operate as a financial institution. In addition, the regulations also establish administrative, civil and criminal penalties on the controlling shareholders, directors and officers of financial institutions who violate the applicable laws and regulations governing the financial system.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Most judicial enforcement actions involving the CBB relates to criminal activities against the Brazilian Financial System, where the CBB usually acts as accusation assistant, as well as those involving financial institutions under special management regime which are debtors of the CBB. In this last case, if losses against CBB are identified in relation to such institutions, the Ministry of Public Prosecution may file a lawsuit against former officers of such institutions seeking reparation of damages.

12 How has bank supervision changed in response to the 2008 financial crisis?

As referred to above, in response to the 2008 financial crisis, National Monetary Council Resolution No. 4,019, enacted on 29 September 2011, revoked National Monetary Council Resolution No. 3,398 and provided broader measures to ensure the liquidity, stability and regular functioning of the National Financial System (SFN).

Additionally, the CBB authorised the functioning of the Credit Assignment Centre (C3) operated by the Interbank Payment Chamber, which is a system dealing with records, settlement and clearing of credit assignments. Such mechanism aims to reduce any operational risk and to increase liquidity in the interbank credit assignment market, resulting in an improvement in the stability and efficiency of the SFN and of the Brazilian payments system.

The aforementioned mechanism provided the CBB with the necessary tools to supervise and track any records regarding movement of credit within the Brazilian financial system.

Law No. 12,543, dated 8 December 2011 also introduced significant changes with respect to derivative contracts. It states that for derivative contracts to be valid, as of 26 July 2011, they must be previously registered with the clearing and settlement companies authorised by the CBB or the CVM, specifically with BM&FBovespa SA or Cetip SA Mercados Organizados.

Also, as referred in item 8 above, Brazilian regulators are endeavouring to implement the Principles of Financial Market Infrastructure published by CPSS jointly with IOSCO through the enactment of several regulations concerning the financial market infrastructure. As an example of such regulations, the CVM enacted Instructions No. 541, No. 542 and No. 543, on 20 December 2013, which regulate, respectively, the activities of central depositories, custody and bookkeeping of securities. More recently, the Brazilian Central Bank enacted Circular No. 3,743 on 8 January 2015, regulating the activities of central depositories and registration of financial assets.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Banks may be taken over by the CBB under the following procedures: intervention, which may lead to an extra-judicial liquidation of the relevant bank; and a special temporary management regime.

Intervention is a precautionary administrative measure, created according to Law No. 6,024, dated 13 March 1974, the purpose of which is to avoid the exacerbation of any irregularity committed by a bank or any situation concerning its assets and capable of jeopardising its stakeholders. Under such circumstances an intervenor is appointed by the CBB, whose role it is to assume direct management of the institution, to suspend its normal activities and to replace its officers and directors. Usually, an intervention lasts no longer than six months, with a possible extension of six months, and it may lead to a return to the bank's activities, to a decree of its extra-judicial liquidation or to bankruptcy.

The special temporary management regime (RAET), which was created according to Decree No. 2,321, dated 25 February 1987, is a type of intervention that does not interrupt or suspend the bank's normal activities, but results in the relevant managers' dismissal and their replacement by a management board appointed by the CBB, with broad management powers. Its main purpose is to adopt measures to enable its return to normal activities. If this is not possible, such proceeding may be transformed into an intervention or into an extra-judicial liquidation.

Extra-judicial liquidation is the most severe and definite measure. It is used to wind down a bank when evidence of an irretrievable insolvency is imminent and when many infractions of applicable regulations have been committed. In such case, the sale of the bank's existing assets to pay creditors and stakeholders is mandatory. Finally, in the event of any positive balance the relevant amount must be returned to the controlling shareholder or, in the event of a negative balance, the controlling shareholder will be liable.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Managers of financial institutions that are going through interventions, RAETs or extra-judicial liquidations will have their assets frozen and cannot, directly or indirectly, sell or disturb them until final investigation and determination of their respective liabilities. By analysing the report made by the intervenor, the CBB may authorise him or her to request the financial institution's or bank's failure in the event that its assets are not sufficient to cover at least half of the value of its unsecured claims, or in the event of irrefutable proof of bankruptcy crimes.

15 Are managers or directors personally liable in the case of a bank failure?

Managers of financial institutions are jointly and severally liable for the obligations undertaken by them during their respective terms in office.

16 How has bank resolution changed in response to the recent crisis?

No, the regulations have not changed recently.

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Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

In compliance with the recent recommendations of the Basel Committee, on 1 March 2013 the CMN enacted Resolutions 4,192, 4,193, 4,194 and 4,195 aimed at strengthening the regulation, supervision and risk management of the banking industry to improve the ability of financial institutions to absorb economic and financial shocks, and to reduce the risk of contagion in the financial sector spreading to the real economy, as well as in response to Basel III.

In respect of minimum capital requirements, Brazilian regulations establish three different types of capital: reference capital (PR), Tier I capital and main capital (*capital principal*). PR is a reference capital limit used to verify operational, credit and risk limits of financial institutions and is the sum of Tier I and Tier II capital.

National Monetary Council Resolution 4,192/13 divided Tier I capital into main capital and complementary capital. The main capital basically comprises the bank's equity and accrued profits, while the complementary capital comprises hybrid capital and debt instruments, but is subject to a number of additional requirements related, for example, to subordination, and perpetual and non-cumulative dividends. Tier II refers to the bank's ability to absorb losses and comprises hybrid instruments, subordinated debt and redeemable shares, bearing in mind that subordinated debt now has to meet a number of new requirements, including the absence of step-up clauses and the possibility of cancellation of payments and conversion into shares.

18 How are the capital adequacy guidelines enforced?

One of the CBB's roles defined by law is to monitor the banks' and other financial institutions' capital adequacy on a periodic basis. Therefore, the CBB has the necessary authority to impose administrative sanctions on institutions that do not comply with the applicable regulations for these purposes.

19 What happens in the event that a bank becomes undercapitalised?

In the event that a bank becomes undercapitalised, the CBB will instruct the relevant bank's representatives to adjust the entity's regulatory requirements. A plan must be settled by the bank and approved by the CBB. In the event that the plan does not accomplish its goal or is not approved by the CBB, the Central Bank has the authority to liquidate the bank.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

See questions 13 to 16.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The adoption of the Basel Accords in Brazil was accompanied by increased regulatory rigour in relation to international standards. The Basel I ratio was 11 per cent, while international standards suggested a value of 8 per cent for this parameter. During the subsequent transposition of Basel II into the Brazilian regulatory framework, the CBB retained the 11 per cent in the requirements of the new agreement; in other words, the minimum Basel ratio required for Brazilian institutions has always been higher than the international figure, a fact that has contributed to Brazilian banks maintaining a reserve that is essential to ensuring their robustness and resilience.

The minimum rate to be observed for the purposes of Basel III fluctuates within the range of 10.5 per cent to 13.0 per cent, up to 5 percentage points above the formerly required international rate. With the adoption of Basel III, the CBB will match the requirements applied in Brazil to international standards, which, as mentioned above, will require banks to maintain a minimum regulatory ratio of between 10.5 per cent and 13 per cent.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

National Monetary Council Resolution No. 4,122, dated 2 August 2012, which deals with, inter alia, controlling interests in banks, establishes that any direct equity participation that affects the control of financial institutions may only be made by individuals, financial institutions located in Brazil or abroad, any other institution duly authorised by the CBB, or any other legal entity located in Brazil the exclusive corporate purpose of which is to hold equity interest in financial institutions.

Resolution No. 4,122 also brings the concept of 'control', establishing that any direct or indirect participation equivalent to 15 per cent or more shares or quotas representing the capital stock of the financial institutions named therein shall be considered a 'qualified shareholder interest', and any person or group bound by a shareholders' agreement holding the majority of the voting capital of a corporation, or 75 per cent of the capital stock of a limited liability company, shall be considered a 'control group'. If it is not possible to identify the control of the institutions based on the above criteria, the CBB shall take into consideration other elements to determine the control group.

23 Are there any restrictions on foreign ownership of banks?

Yes. Pursuant to the Brazilian Federal Constitution, any increase in the participation by a foreign person in a Brazilian financial institution must be authorised by a decree enacted by the Brazilian president. As a rule, the purchase by foreigners of non-voting shares of listed banks is authorised by a general presidential decree.

It is also important to note that the operation of any financial institution in Brazil is subject to prior authorisation from the CBB, which also has to review and approve the election of directors and officers, as well as any corporate restructurings and changes in the by-laws, inter alia.

24 What are the legal and regulatory implications for entities that control banks?

Entities that control banks basically have the same legal responsibilities as controllers of non-financial institutions. When exercising their power of control they must promote the achievement of the corporate purposes of the entities controlled by them. Controllers are also subject to several duties and responsibilities that are described in general regulations and specific laws, depending on the area in which they act.

According to Corporate Law No. 6404/64, controllers in general are responsible for any damages caused by acts committed as a result of abuse of power.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Shareholders who control banks have the same duties and responsibilities as any controlling shareholder of any legal entity. Thus, they have the legal duty to use their influence to make the company carry out its purpose and fulfil its social functions. In addition, the controlling shareholder of a financial institution is responsible jointly with the bank for the obligations incurred by it during the course of its business. As mentioned above, in the event that the bank is subject to intervention, extra-judicial liquidation or bankruptcy, the assets of the controlling shareholders are frozen until the repayment of the obligations or the termination of the proceedings.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

See question 25 above.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Any transfer of control or change, whether directly or indirectly, in the group of control that can bring about the substitution of people who exercise the effective management of the institution needs to be authorised by the CBB in order to become effective. For a better description of the definition of 'control', please refer to question 22. The relevant regulations provide that authorisation from the CBB is a condition precedent for the

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closing of any share purchase agreement that would result in a transfer of control.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

As mentioned above, pursuant to the Brazilian Constitution, the acquisition by any non-resident of shares in a Brazilian financial institution is subject to the approval of the president by means of a presidential decree. Such approval is granted only if the acquisition is in the interest of the Brazilian government, or if it derives from international treaties entered into by Brazil or reciprocity with a foreign country. Successive Brazilian governments have issued several such authorisations in the past two decades based on the 'interests of the Brazilian government'.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

According to the CBB's Circular No. 3,317, dated 29 March 2006, the following factors are considered relevant: the purpose of the acquisition and its importance for the Brazilian economy; the understanding of how such acquisition fits into the overall business strategy of the acquirer; the business plan presented to the CBB; and the financial situation of the acquirer.

30 Describe the required filings for an acquisition of control of a bank.

The application to the CBB for authorisation of an acquisition must be made before any steps are taken to implement the transaction.

The application must contain the following documents and information as required by the CBB under National Monetary Council Resolution No. 4,122, dated 2 August 2012:

- a purpose statement issued by the future controlling shareholder of the bank, substantially in the form required by the CBB;
- identification of the future controlling shareholder and holders of qualified shareholder interest, with their respective equity interest, accompanied by signed affidavits asserting that there are no imputations relating to any of them that may, at the CBB's discretion, affect their reputation;
- identification of the individuals and legal entities that compose the economic group that will be part of the institution and that may exert direct or indirect influence on its business;
- affidavits and documents stating that members of the control group are sufficiently knowledgeable about the type of business and the segment in which the institution intends to operate, including issues related to market dynamics, sources of operational resources, management and risks related to operations;
- express authorisations from all members of the bank's controlling group and all holders of qualified shareholder interest;
- an economic and financial feasibility study, in line with the size, nature and purpose of the transaction;
- from all individual and entities that are part of the controlling shareholders group and by holders of qualified shareholder interest, authorisation to:
- the Federal Revenue Secretariat, to deliver copies of the respective tax returns relating to the past three fiscal years to the CBB; and
- the CBB, to access information regarding such persons in all public and private information registries;
- evidence of the origin of the funds to be used in the transaction;
- a copy of the agreement, corporate document or instrument that formalises the operation; and
- a complete chart of the economic conglomerate, containing the identification of all societies with a registration number on the National Register of Legal Entities.

The CBB, during the analysis of the above proceeding, may also summon any concerned parties for a technical interview, request additional documents, and request compliance with other conditions.

The following additional information must be also filed with the CBB in the event that the proposed acquirer is a non-resident of Brazil:

- the amount of foreign equity interest to be held in the bank;
- a description of the importance of the bank for the Brazilian economy, its benefits in connection with the relationship between Brazil and the country in which foreign investor is located and also the expected contribution of the bank to the development of the Brazilian financial system;
- a description of the activities carried out by the foreign investor and the importance of the bank in Brazil in relation to such activities;
- the relevance of the bank to activities conducted by the foreign investor or by the foreign investor's economic group;
- a rating of the foreign investor and of its economic group provided by a well-known ratings agency;
- identification of any financial institutions in any way related or affiliated to the foreign investor (if any);
- identification of the authorities responsible for the control and supervision of the foreign investor and any related or affiliated financial institutions in its countries of origin (if any); and
- any additional information that my be considered a significant advantage for the Brazilian government.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The regulatory approval process may last between six and 12 months in most cases, and acquisitions by a non-resident normally between nine and 12 months.

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Canada

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

Canada has a centrally regulated banking system with a focus on macro-prudential regulation and stability of the financial system. The Bank Act, the principal federal statute governing all aspects of banking, indicates its main purposes as fostering a strong and efficient banking sector comprising of competitive and resilient institutions, protecting the interests of depositors and consumers, and maintaining stability and public confidence in the financial system. The Bank of Canada (the central bank) exercises a monetary policy focusing on an inflation-control target of around 2 per cent and a policy of non-intervention in a flexible foreign exchange rate.

Canada is a strong supporter of the Financial Stability Board and has been a leading jurisdiction in the adoption of the Basel III international regulatory framework. The Office of the Superintendent of Financial Institutions (OSFI), Canada's primary bank regulator, introduced revised capital adequacy requirements in 2011, which came into effect in 2013. A further revised capital adequacy requirements guideline was released in 2014 and came into effect in the first fiscal quarter of 2015. The revised capital adequacy requirements are consistent with Basel III and have an aggressive schedule in lockstep with the Basel III timeline for the planned implementation.

The thrust of Canadian banking regulation is guided by principles-based regulation as opposed to bright-line rule making. OSFI has issued guidelines on capital adequacy, prudential limits, accounting and disclosure, and sound business and financial practices that are considered 'best' or 'prudent' practices for banks and set industry standards for the financial services sector as a whole.

To ensure the safety and protection of the Canadian banking system, Canada also imposes a public ownership requirement on banks, requiring large domestic banks to be 'widely held' by the public and listed on a prominent Canadian stock exchange and medium-sized domestic banks to be at least 35 per cent publicly owned and listed. Similarly, Canadian banks are prohibited from engaging in any business other than the 'business of banking' through various ownership restrictions resulting in a separation between banking, insurance, auto leasing and securities dealing sectors of the economy.

As of February 2015, there are 29 domestic banks, 24 foreign banks, and 29 foreign bank branches operating in Canada. There are also 23 foreign bank representative offices established to represent foreign banks in Canada. Canada's six largest banks, being Royal Bank of Canada, Toronto-Dominion Bank, Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and National Bank of Canada, have been identified by OSFI as domestic systemically important banks (D-SIBs).

2 Summarise the primary statutes and regulations that govern the banking industry.

Regulation of the banking industry falls under the exclusive jurisdiction of the federal government. Although provincial governments have jurisdiction to incorporate and regulate certain deposit-taking institutions, such as credit unions, only a financial institution incorporated under the Bank Act can conduct business as a 'bank' in Canada.

The Bank Act regulates domestic banks (listed on Schedule I of the Bank Act), foreign subsidiary banks that are controlled by eligible foreign institutions (Schedule II) and bank branches of foreign institutions (Schedule III). The Bank Act regulates, inter alia, the ownership, capital and corporate governance structures of banks, prohibits certain business undertakings and associations, prescribes capital and liquidity adequacy requirements, and regulates consumer disclosure, transparency and record-keeping.

The Bank Act also contains a sunset clause that provides for a statutory review and update of the Bank Act every five years. New legislation tabling the Bank Act together with any proposed amendments must be brought into force by March 2017.

The Bank Act is also supplemented by numerous regulations that set out various banking requirements, regarding, for example, the disclosure of charges and interest on banking services, the cost of borrowing for loans under a credit agreement and notice of uninsured deposits. OSFI publishes guidelines and advisories (discussed further below) to provide more guidance and clarity for participants.

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA) also forms an important part of the Canadian regulatory landscape for banks.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The federal government enacted the Office of the Superintendent of Financial Institutions Act, which established OSFI as the primary regulator of banks in Canada. OSFI administers the Bank Act and supervises banks in accordance with its published Supervisory Framework, which involves assessing the safety and soundness of banks, providing feedback, and intervening when necessary. Under the Supervisory Framework, OSFI's primary supervisory goal is to safeguard depositors against loss. As such, OSFI focuses on material risks to banks on a consolidated basis, which involves an assessment of all of a bank's material entities (including subsidiaries, branches and joint ventures), both in Canada and internationally.

Where OSFI identifies issues that may impact the stability of the financial system, it reports those issues to the Financial Institutions Supervisory Committee (FISC). The FISC comprises representatives from the federal Department of Finance, the Bank of Canada, OSFI, the Canada Deposit Insurance Corporation (CDIC) and the Financial Consumer Agency of Canada (FCAC). The FISC meets regularly to share information, coordinate actions and advise the federal government on financial system issues.

The FCAC is an independent agency of the government of Canada and is responsible for, inter alia:

- supervising and monitoring compliance with federal consumer protection measures;
- promoting the adoption by financial institutions of policies and procedures designed to implement voluntary codes of conduct designed to protect the interests of their customers;
- monitoring the implementation of voluntary codes of conduct that have been adopted by financial institutions;
- promoting consumer awareness about the obligations of financial institutions and of external complaints bodies under consumer provisions applicable to them;
- fostering, in cooperation with other government departments and participants, an understanding of issues relating to financial services;
- monitoring trends and issues that may affect consumers of financial products and services; and
- collaborating its activities with stakeholders to strengthen the financial literacy of Canadians.

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The FCAC is also similarly responsible for supervising payment card network operators.

The CDIC, a Canadian federal Crown corporation, insures eligible deposits held at member financial institutions to protect consumers in the event of a bank failure.

Additionally, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), Canada's financial intelligence unit, oversees compliance with the PCMLTFA and its regulations. FINTRAC's mandate is to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities. As such, FINTRAC requires all banks to keep and retain prescribed records, to submit reports for certain types of transactions, to take specific steps to identify prescribed individuals or entities, and to implement a compliance programme.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

CDIC insures eligible deposits up to $100,000 (principal and interest combined) per depositor per institution. To qualify as an eligible deposit, the deposited funds must be in Canadian dollars and payable in Canadian currency. Eligible deposits include savings and chequing accounts, term deposits repayable no more than five years after the date of deposit, accounts holding funds to pay realty taxes on mortgaged properties, and money orders, bank drafts, certified cheques and travellers' cheques issued by a member institution. CDIC does not protect against fraud or theft and does not insure most debentures, treasury bills or investments in mortgages, stocks, bonds, or mutual funds.

As of February 2015, 78 financial institutions, including 35 banks, are CDIC members. CDIC members fund CDIC deposit insurance through premiums paid on the insured deposits they hold. CDIC members are required to display CDIC signage, file annual returns and comply with additional member requirements set out in the Canada Deposit Insurance Corporation Act (CDIC Act), the Financial Administration Act and the CDIC by-laws.

Neither the federal government nor any provincial government has taken any ownership interest in banks or other financial institutions.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Subject to certain limited exceptions under the Bank Act, a bank cannot enter into any transactions with a related party, including providing a guarantee on behalf of a related party, making an investment in the securities of a related party, assuming a loan owed by the related party or taking a security interest in the securities of a related party. A related party includes a person holding a 'significant interest' in the bank, an entity in which the person who controls the bank has a significant investment, directors or senior officers of the bank or a bank holding company, and the spouse, common-law partner or child under 18 years of age of any of the foregoing persons.

Federally regulated banks are prohibited from engaging in any business other than the business of banking and such business as generally appertains thereto, except as specifically permitted under the Bank Act. The business of banking includes the provision of financial services, investment counselling and portfolio management, acting as financial agent, and issuing of payment and credit cards. Also, a Canadian bank or a major shareholder or parent of a Canadian bank may not hold a substantial investment in entities engaging in fiduciary activities (unless such subsidiary is a federally registered trust company), certain restricted securities activities, restricted leasing activities (such as automobile leasing), restricted residential mortgage activities (such as high loan-to-value mortgages) or certain insurance activities. Foreign governments and agencies or entities controlled by them (other than foreign banks) cannot incorporate a bank in Canada or acquire a significant ownership interest in a Canadian bank.

6 What are the principal regulatory challenges facing the banking industry?

The primary regulatory challenge facing the Canadian banking industry is OSFI's implementation of the Basel III capital and liquidity requirements and the systems, administration and accounting changes that result from the imposition of these requirements.

Canadian banks are also affected by regulatory changes taking place in the United States, both as a result of conducting a considerable amount of business in the United States but also because of the potential extraterritorial reach of certain US laws. The Volcker Rule and the related set of US laws have meant that large Canadian banks with US subsidiaries have to deal with two very different regulatory environments on cross-border and transnational business lines.

Similarly, the recent adoption of the Foreign Account Tax Compliance Act (FATCA) in the US has been a cause for concern for the Canadian banks. On 5 February 2014, Canada and the US entered into the Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-US Tax Convention to implement FATCA in Canada which came into force on 27 June 2014. Under this Intergovernmental Agreement, information related to US residents and citizens is reported to the Canada Revenue Agency rather than directly to the IRS in compliance with Canadian privacy laws. Furthermore, certain provisions of FATCA are not applicable to Canada, including the withholding tax, and certain accounts are exempt from reporting requirements.

7 Are banks subject to consumer protection rules?

FCAC is a federal government agency responsible for ensuring financial entities comply with consumer protection provisions in various federal acts including the Bank Act, the Insurance Companies Act, the Trust and Loan Companies Act, the Cooperative Credit Associations Act, the Green Shield Canada Act, the Payment Card Networks Act and the Financial Consumer Agency of Canada Act.

FCAC addresses consumer protection issues that arise from time to time. In 2012, the FCAC opened a total of 77 cases against banks related to credit card issues, account fee charges or refusals to open accounts. The FCAC issued a total of five violations and imposed related penalties in the aggregate amount of C$275,000 (total for all financial services entities including insurance companies, payment card operators, etc).

In a recent landmark decision, *Bank of Montreal v Marcotte*, the Supreme Court of Canada held that Québec consumer protection legislation applied to federally regulated bank credit card issuers. The decision indicates that in some circumstances provincial consumer protection law may apply to federally regulated financial institutions. The impact of the decision is that federally regulated financial institutions may need to consider both provincial and federal consumer protection laws.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The Canadian banking regulatory landscape will continue to evolve towards more principles-based regulation and oversight of individual banking institutions and the banking industry as a whole. Regulatory policy resulting from OSFI's ongoing implementation of Basel III and increased attention to corporate governance will continue to develop over the next few years. Financial institutions are adjusting to the increased regulatory burdens that have been imposed in recent years as a result of the implementation of Basel III. This includes more onerous liquidity requirements and leverage requirements and the implementation of the forward-looking accounting method, the International Financial Reporting Standard 9, for D-SIBs.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

OSFI requires disclosure from all federally regulated banks on a monthly, quarterly and annual basis. For example, banks must file consolidated balance sheets, deposit liabilities and interbank exposures as at the last day of each month; income statements, statements of mortgage loans and non-mortgage loans, and a statement of retail portfolio on a quarterly basis; and an impairment charge filing on an annual basis. Additionally, the Bank Act requires OSFI to conduct an examination of every bank on an annual basis to determine compliance with regulations and assess its financial condition.

10 How do the regulatory authorities enforce banking laws and regulations?

The Bank Act contains penalty and sanction provisions that can be exercised by OSFI. In practice, however, OSFI does not generally exercise

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these penal powers and instead relies on other mechanisms such as requiring binding compliance agreements or issuing compliance directives. In addition, the FCAC and CDIC also have limited enforcement powers. The FCAC's consumer protection powers are briefly discussed in response to question 7. CDIC has the authority to be appointed as a receiver over a troubled member bank with significant CDIC-insured deposits, but this power has not been exercised in the past decade.

OSFI has a four-stage intervention framework that enables OSFI – and, where appropriate, CDIC – to work collaboratively with a bank to develop a process to bring the bank into full compliance with regulations or improve the bank's financial viability. The first stage entails an early-warning system whereby senior management may be required to meet with OSFI (which may involve site visits by OSFI), and OSFI may issue public supervisory letters calling on the bank to undertake certain measures. In the second stage, OSFI can require mandatory implementation of corrective measures and increase its monitoring of the bank. OSFI may also engage an auditor to undertake an external audit of the procedures, processes and reporting mechanisms of the bank. The third stage anticipates a future failure of the bank and involves assessing asset quality, full-time on-site monitoring and enhanced planning for full regulatory administration of the bank. The fourth stage denotes that the bank is no longer viable. OSFI will take over the affairs of the bank and commence restructuring under the Winding-Up and Restructuring Act (WURA), which likely results in the sale of assets of the bank to another institution approved by federal government.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Based on the information released by OSFI, FINTRAC and the FCAC, there are no recurring regulatory compliance issues or common enforcement measures related to the banking industry in Canada. Supervisory and regulatory bodies rarely initiate enforcement action with the exception of consumer protection issues. FCAC's consumer protection enforcement is discussed in response to question 7. In 2014, OSFI released a Guideline on the regulation of the benchmarking of CDOR (the Canadian Dealer Offered Rate – the Canadian equivalent of LIBOR); however, this seems to be in response to international banking investigations related to LIBOR. There has been no commentary to suggest any manipulation of CDOR by Canadian banks. The Guideline states that it is in furtherance of OSFI's work with banks to meet international standards. The Guideline is intended to complement OSFI's Corporate Governance Guideline and Supervisory Framework as well as OSFI's general principles-based approach. OSFI requires adequate governance controls, annual reports by senior management to the board of directors of the bank, independence between oversight functions and operational management, and timely disclosure of material breaches in the submission process to senior management and the board. Banks are expected to include CDOR submission process compliance in their annual audit plans. OSFI will review banks' CDOR submission controls, may require copies of any related reports and may discuss findings with senior management, the board and the oversight functions.

12 How has bank supervision changed in response to the 2008 financial crisis?

There have been no significant changes to Canada's bank supervision regime since the financial crisis. The financial crisis resulted in a heightened emphasis on regulatory oversight and sound capital management. OSFI's intention to implement the Basel III requirements is not a significant departure from its supervision and oversight approach of banking institutions prior to 2008.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

While the government is under no legal obligation to take over a failing bank, there is a widely held assumption that the government would not permit a large Canadian bank to fail due to the negative impact on the greater Canadian economy. Banks may be taken over by OSFI or the CDIC in cases of insolvency or regulatory non-compliance. OSFI four-stage intervention process described at question 10, above, and the establishment by CDIC of a 'bridge-bank', described at question 16, are tools that these regulatory authorities may use to take over a bank.

Bank failures are very rare in Canada and consequently, government or regulatory authority intervention by way of bank takeover is also very rare. The Bank of Canada and the Canadian Mortgage and House Corporation provided liquidity support during the recent financial crisis, including short-term loans, purchasing mortgage-backed securities and providing guarantees for Canadian banks. The government was not, however, required to intervene in the Canadian banking industry to the extent witnessed in other jurisdictions, nor did the government take an equity stake in any Canadian bank during the crisis.

Canadian banking regulation is strongly focused around the protection of depositors. This is demonstrated by CDIC's insuring of a depositor's first C$100,000 of eligible funds in a given bank. OSFI recently implemented more stringent capital requirements designed to better protect depositors by providing additional funds in a bank crisis scenario, including requiring the inclusion of non-viable contingent capital (NVCC) provisions in non-common share capital instruments.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

If OSFI takes control of a bank pursuant to the four-stage intervention process, directors' legal roles are suspended until either the period of control expires or a winding-up is requested. Once a liquidator is appointed by the court pursuant to a bank's winding-up proceedings, the directors' powers are vested in the liquidator.

Currently, banks are not required to have a resolution or 'living will' plan that sets out the protocol for a failure or recovery following a failure, but OSFI and the CDIC have been working with financial institutions to implement such plans from a prudential standpoint. In March 2013, OSFI designated Canada's six largest banks as D-SIBs and requires each of these banks to establish a resolution plan. In addition, the CDIC recently amended its by-laws, whereby deposit-taking CDIC-insured institutions are required to provide certain information on an annual and on-request basis to facilitate resolution planning.

15 Are managers or directors personally liable in the case of a bank failure?

Officers or directors are not personally liable in the case of a bank failure, but directors may be liable for certain actions that could result in a bank failure. Directors are liable for any breach of a duty imposed under the Bank Act or other applicable legislation or a duty under common law. For example, directors may be liable under the Bank Act if the directors authorised subordinate indebtedness or a reduction in stated capital when there were reasonable grounds for believing that the bank was, or the reduction would cause the bank to be, in contravention of capital adequacy provisions or liquidity provisions. There is a two-year limitation period from the date the resolution passed authorising the prohibited action after which directors would no longer be liable. There are several defences available to directors including the 'business judgement rule', whereby a director would not be found liable for properly informed business decisions made in good faith and in the absence of conflicts of interest, fraud or illegality.

In the event of a bank failure, directors are also jointly and severally liable for up to six months of unpaid wages for each employee. There is a six-month limitation period from the date wages are owed but go unpaid, a winding-up order is issued or liquidation proceedings have commenced, and a two-year limitation period after the director ceases to be in that role. Banks can purchase directors' and officers' insurance in order to ensure indemnification for such claims.

16 How has bank resolution changed in response to the recent crisis?

In response to the financial crisis, bank resolution options were introduced that are designed to reduce the likelihood of taxpayer-funded bail-outs, as seen in other jurisdictions. One such resolution technique is the use of 'bridge-banks' introduced through amendments to the CDIC Act, which allows CDIC to take over the deposits and healthy assets of a troubled bank with the ultimate goal of effecting a private sale of the bank.

More recently, further requirements were introduced to eliminate the perceived 'moral hazard' that arises when banks are bailed out by government funds and thereby become incentivised to take risks. OSFI implemented contractual NVCC requirements consistent with the Basel

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III capital regime. Any bank issuing preferred shares or subordinated debt after 1 January 2013 is required to provide a mechanism within the document by which the non-common capital would be converted into equity or be written off should the bank become non-viable.

In March 2013, the government of Canada announced its plan to introduce the concept of a bank recapitalisation or 'bail-in' plan. In the event that one of the D-SIBs were to deplete its capital, certain liabilities and the 'unsecured and uninsured creditor claims' of that bank would be converted into capital. In August 2014 the Department of Finance released a consultation paper for comment on the proposed bank 'bail-in' regime.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The Bank Act requires banks to maintain adequate capital and permits OSFI to establish guidelines setting out these requirements. The current Capital Adequacy Guidelines implement the Basel III Accord. The Capital Adequacy Guidelines require banks to have capital requirements that meet or exceed the Basel III minimums. Among those requirements, Canadian banks must have total capital ratios of 8 per cent, which will gradually increase to 10.5 per cent by 2019 through the phase-in of a capital conservation buffer starting in 2016. Banks that issue preferred shares or subordinated debt must contractually provide for the conversion of such instruments into common equity should the institution become non-viable, as discussed above. OSFI implemented a Leverage Requirements Guideline in November 2014. Institutions must maintain a leverage ratio that meets or exceeds 3 per cent beginning in the first quarter of 2015. Individual institutions may be prescribed their own confidential authorised leverage ratios by the Superintendent.

Banks are required to establish and maintain policies relating to liquidity consistent with OSFI's current liquidity guideline. These policies must be approved by the board of directors and reviewed annually. In November 2014 OSFI revised the Liquidity Adequacy Requirement Guideline consistent with Basel III, including the liquidity coverage ratio and net stable funding ratio. The revised and reissued Liquidity Adequacy Requirement Guideline is in effect as of January 2015.

Foreign banks carrying on business through a foreign subsidiary incorporated in Canada are subject to the same capital requirements and regulatory framework as domestic banks. Foreign banks operating through a foreign bank branch (whether through a full-service branch or a lending branch) are not subject to Canadian capital requirements. The rationale for this approach is that foreign banks operating through a foreign bank branch are subject to capital requirements and regulation in their home jurisdiction; full-service branches are, however, required to hold a capital equivalency deposit (CED) of C$5 million or 5 per cent of their branch liabilities, whichever is greater, with an approved Canadian financial institution. A lending branch is only required to hold a CED of $100,000.

18 How are the capital adequacy guidelines enforced?

Section 628 of the Bank Act obliges banks to provide OSFI with such information, at such time and in such form as OSFI may require. OSFI requires banks to submit quarterly reports detailing compliance with capital adequacy requirements. If issues are identified, OSFI will subject the bank to the four-stage intervention process described above.

19 What happens in the event that a bank becomes undercapitalised?

Undercapitalisation may result in OSFI requiring a bank to increase its capital. OSFI has the ability to intervene through its four-stage intervention process. Ultimately, OSFI has the ability to take control of a bank's assets or take control of a bank for an interim period. Also, the federal government is permitted to invest in the shares of a bank if it believes it will assist in stabilising the financial industry.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Once OSFI controls a bank, it may request that the Attorney General apply to wind up the bank under WURA. A liquidator of a bank must be a trustee licensed under the CDIC Act or the Bankruptcy and Insolvency Act. The statutory duties of a liquidator are set out in WURA and include controlling all property of the bank, carrying on business that is beneficial during the winding up, repaying indebtedness and distributing assets.

The CDIC Act permits CDIC to take certain measures if a CDIC-insured bank becomes insolvent. Such measures include requesting an order vesting the shares of the bank with CDIC so as to be sold to a third party and also the option to request the establishment of a 'bridge-bank' from the Minister of Finance such that the bank's viable assets could be sold to a third party.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As described above, the Basel III capital adequacy requirements have been implemented for Canadian banks through the revised Capital Adequacy Requirements Guidelines. In addition, as previously noted, in March 2013, OSFI designated the six largest Canadian banks as D-SIBs and announced a 1 per cent common equity surcharge for all D-SIBs. As of 1 January 2016, D-SIBs will be required to meet the target common equity Tier 1 (CET 1) ratio of 7 per cent of risk-weighted assets that all institutions are already required to meet, plus the additional 1 per cent owing to its D-SIB designation. Such restrictions were implemented in recognition of the importance of D-SIBs to the Canadian economy as the largest six banks account for more than 90 per cent of total banking assets. As discussed in question 17, above, OSFI introduced a number of regulatory guidelines in 2014 which are, for the most part, in effect or soon to be in effect.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Limitations on the ownership or control of Canadian banks will vary depending on the size of a bank's equity. Banks are divided into three categories for the purposes of determining the applicable ownership rules:

- 'large banks', which have equity capitalisation of C$12 billion or more;
- 'medium banks', which have equity capitalisation of between C$2 and C$12 billion; and
- 'small banks', which have equity capitalisation of less than C$2 billion.

Large banks must be widely held, such that no single shareholder may own more than 20 per cent of any class of voting shares, or more than 30 per cent of any class of non-voting shares. A bank holding company may control a large bank, so long as the bank holding company is itself widely held.

Medium banks may be closely held, so long as at least 35 per cent of the voting shares of the bank are listed on a recognised stock exchange in Canada and are publicly held.

Small banks are not subject to ownership limits as long as the Minister of Finance is satisfied with the character and integrity of the applicant or, for a corporate applicant, its reputation for being operated in a manner that is consistent with the standards of good character and integrity.

In addition to these constraints on ownership, no person may acquire or increase a 'significant interest' in a bank without the consent of the Minister of Finance. A 'significant interest' equals 10 per cent or more of any class of shares of a bank.

23 Are there any restrictions on foreign ownership of banks?

If a foreign bank that is not a resident of a World Trade Organization (WTO) member country wishes to acquire or increase a 'significant interest' in a bank, as part of the application, OSFI will determine whether banks are treated similarly in the jurisdiction in which the applicant principally carries on business, either directly or through a subsidiary.

The government of a foreign country and any political subdivision thereof, and any agent thereof, cannot acquire shares of a Canadian bank.

24 What are the legal and regulatory implications for entities that control banks?

An entity that seeks approval from the Minister of Finance to acquire or increase a 'significant interest' in a bank must provide a range of information that enables the regulator to investigate the applicant, including information that demonstrates that the applicant has sufficient resources to provide continuing financial support to the bank, and that the applicant's business record and experience is appropriate. The proposed ownership structure will be scrutinised.

An application for approval of a significant interest in a bank must also include an acknowledgement in writing of OSFI's expectation that the applicant will provide ongoing financial, managerial and operational support to the bank if such support becomes necessary. The 'Support

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Principle' letter articulates the expectation of the regulator but does not create a legally binding obligation on the applicant. Such ongoing support may take the form of additional capital, the provision of managerial expertise or the provision of support in such areas as risk management, internal control systems and training for bank employees.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

See question 24.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The Support Principle sets out the expectation of the regulator, but does not impose a legal obligation and does not constitute a basis for a legal claim by the regulator against a controlling entity. Shares issued by a bank are non-assessable, so a controlling entity is not liable to the bank or its creditors by virtue of holding such shares. OSFI will take over the affairs of an insolvent bank or commence restructuring under the WURA (or both), which will likely result in a sale of assets of the bank to another approved institution. In the event of liquidation, a controlling entity would be likely to lose the entire value of its investment since depositors and other creditors rank ahead of shareholders in a distribution of the proceeds from the liquidation.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The Minister of Finance must approve the acquisition of, or increase in, a 'significant interest' in a bank, which equals 10 per cent or more of the outstanding shares of a class of shares. In addition, the Minister must approve the acquisition of control of a small or medium bank. With limited exceptions, no person may control a large bank.

For this purpose, 'control' means control in fact – not necessarily legal control. Many factors are relevant in determining whether an entity has 'control in fact' of another entity, and a specific analysis is required in each case to make a determination.

OSFI will review an application and then make a recommendation to the Minister.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

If a foreign bank that is not a national of a WTO member country wishes to acquire or increase a significant interest in a bank, as part of the application, OSFI will determine whether banks are treated as favourably in the jurisdiction in which the applicant principally carries on business, either directly or through a subsidiary, and will scrutinise the vigour of the regulatory regime of that jurisdiction.

Update and trends

Implementation of the Basel III framework will continue to be a major focus of the OSFI and banks in Canada during 2015. Also, as discussed in our response to question 7, the Supreme Court of Canada's decision in the *Marcotte* case suggests that some provincial consumer protection legislation may be applicable to federally regulated financial institutions. The impact of this decision is yet to be fully revealed as financial institutions will need to sort through various consumer protection legislation to determine which laws may be applicable to their institutions.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

OSFI and the Minister will assess whether an applicant is suitable to control a bank, and will make this determination by obtaining a range of information from the applicant and assessing its character, expertise and financial resources to determine whether the applicant is 'fit and proper'. A variety of factors are considered, and are outlined in the transaction instructions published by OSFI.

30 Describe the required filings for an acquisition of control of a bank.

The transaction instructions describe the information to be included with an application to OSFI, and provide administrative guidance about the application process. In addition to certain basic information about the applicant, the applicant is also expected to provide information that will help OSFI make a determination about whether the applicant is 'fit and proper' to control a bank – including a business plan and financial information. Background and security assessments must be conducted for certain key individuals of the applicant, and an OSFI security information form must be submitted for each such individual for this purpose. The applicant must submit an acknowledgement of the Support Principle (see question 24).

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Applicants should always ensure that an application is complete, and that an OSFI security information form is submitted as early as possible in the application process, as OSFI does not control how long it takes to complete these background assessments. Most applications will receive a response within three to six months. Where an applicant is a WTO-member foreign bank, additional information may be requested and the process may take longer.

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Curaçao

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

According to the Central Bank of Curaçao and Sint Maarten (CBCS), its prudential supervision of the banking sector is aimed primarily at promoting the stability, integrity, efficiency, safety and soundness of the financial system of Curaçao and Sint Maarten and safeguarding the interest of depositors and other creditors of the credit institutions.

Supervision mainly entails the licensing of financially sound institutions and the performance of ongoing supervision using a risk-based approach through both on-site and off-site supervision, with emphasis on monitoring the liquidity and solvency of the credit institutions. Furthermore, CBCS monitors, among other things, compliance by the credit institutions with regulations on the detection and deterrence of money laundering and terrorist financing and regulations on the disclosure of information to the public.

2 Summarise the primary statutes and regulations that govern the banking industry.

The banking industry is governed by the following statutes and regulations:

- The National Ordinance on the Supervision of Banks and Credit Institutions and certain rules promulgated thereunder;
- Admission Requirements issued by the CBCS;
- the CBCS Policy Memorandum on the Change of External Auditors of a Credit Institution;
- the CBCS Policy Memorandum on the Periodic Filing of a Management Report;
- the CBCS Policy Memorandum on the Sale or Transfer of Shares in a Supervised Credit Institution;
- the CBCS Supervisory Regulations; and
- various CBCS guidelines; for example, on the detection and deterrence of money laundering and terrorist financing for credit institutions, on disclosure of pricing information on consumer credit, on the disclosure of consolidated financial highlights of domestic banking institutions and for safe and sound electronic banking.

These statutes and regulations are all available on the CBCS website (www.centralbank.an).

3 Which regulatory authorities are primarily responsible for overseeing banks?

The CBCS is responsible for overseeing banks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured by the government. PSB Bank NV is the only bank that is a government entity. To our knowledge, the government has no intention of decreasing that ownership interest.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

CBCS Supervisory Regulations 2 provide for restrictions on transactions with affiliates and loans to affiliates. The restrictions depend on the type and volume of transactions with affiliates and the resulting receivables from these affiliates. An 'affiliate' of a supervised credit institution is defined for the purpose of the regulation to be:

- any company for which commonality of ownership exists with the credit institution: any company that controls the credit institution (parent company or other) and any other company that is controlled by the company that controls the credit institution (sister companies) and any company that controls the company that controls the credit institution (ultimate parent company or companies);
- subsidiaries of the credit institution;
- any company for which a commonality of directors exists with the credit institution: any company in which the majority of its (supervisory or managing) directors constitute a majority of the directors of the credit institution or any company that is controlled by the credit institution; or
- any company that the CBCS determines to have a relationship with the credit institution or its subsidiaries and affiliates, such that transactions with that company may be affected by the relationship of the company with the credit institution, its subsidiaries or affiliates.

The definition of affiliate does not include companies engaged solely in the following activities: holding the premises of the credit institution, conducting a safe deposit business, holding obligations of governments or holding real estate for execution on the short term. However, no transaction should be concluded with these affiliates other than those that are strictly necessary for the facilitation of their respective businesses to the benefit of the credit institution.

CBCS Supervisory Regulations 1 provide for rules limiting the amount of lending to executive officers, supervisory directors, principal shareholders being natural persons (including the related interests of those persons) and employees of the institution. The intended limitation will be applied to mentioned persons individually in relation to the equity of the credit institution. However, for employees the limitation is on an aggregate basis for all employees.

6 What are the principal regulatory challenges facing the banking industry?

The biggest challenges facing the banking industry in Curaçao are not of a regulatory nature but of a monetary nature. The CBCS currently has a deficit in its foreign exchange account. A structural turnaround in the foreign exchange balance is not expected soon and as a result the CBCS continues to direct its monetary policy towards reducing liquidity in the domestic money market. The main instrument used is to increase the percentage of the reserve requirements (which at the time of writing is 15 per cent). This instrument aims at influencing commercial banks' liquidity and, hence, the growth in credit extension.

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7 Are banks subject to consumer protection rules?

There are no consumer protection rules applicable pursuant to regulatory legislation, except for certain provisions on minimum interest rate. Consumer protection rules can, however, follow (indirectly) from general tort and civil law provisions and case law.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Recently, there have been discussions of a complete reform of the regulatory regime in Curaçao. This is mainly because of a reform that took place in the Netherlands in 2007.

The most important change would be an increase in market and business conduct rules for banks in Curaçao (eg, provisions with respect to credit assessments, marketing, etc), which also means more consumer protection. Whereas the current regulatory regime is divided into separate legislation for each regulated industry, the contemplated reform would result in a functional model in which all industries would be regulated by the same legislation. This model has already been introduced for the other Dutch Caribbean islands of Bonaire, Saba and St Eustatius, which have formed part of the Netherlands since 2010 owing to constitutional changes within the Kingdom of the Netherlands.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

According to the CBCS, its prudential supervision of credit institutions is aimed primarily at promoting the stability, integrity, efficiency, safety, and soundness of the financial system of the countries of Curaçao and Sint Maarten and safeguarding the interest of the depositors and other creditors of the institutions. Bank supervision mainly entails the licensing of financially sound institutions and the performance of ongoing supervision using a risk-based approach through both on-site and off-site supervision with emphasis on monitoring the liquidity and solvency of the credit institutions. Furthermore, the CBCS monitors, among other things, compliance by the credit institutions with regulations on the detection and deterrence of money laundering and terrorist financing and regulations on the disclosure of information to the public.

Examinations are conducted first on an off-site basis by account managers within the CBCS. An on-site inspection will only take place if during an off-site inspection it is ascertained that there are high-risk issues and an on-site inspection is necessary. On-site inspections take place on average three or four times a year.

10 How do the regulatory authorities enforce banking laws and regulations?

Whenever the CBCS is of the opinion that a credit institution is not in compliance with the applicable laws and regulations, it may engage in informal discussions with a credit institution. The CBCS also has the power to issue warnings or orders to a bank. The CBCS also has the legal authority to impose a fine upon such credit institution, after first providing a written notice. In the event that violations are committed with wilful intention, the same shall be regarded as a felony and can be punished by imprisonment, a fine or both. If not committed intentionally, the violation shall be considered as a misdemeanour and can be punished by imprisonment, a fine or both.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

This is hard to determine as the CBCS's enforcement policy and cases are confidential.

12 How has bank supervision changed in response to the 2008 financial crisis?

Lately there has been a slight increase in on-site inspections of all regulated entities, however, this is not specifically aimed at banks, nor is it a direct result of the recent crisis.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

In Curaçao a bank has never been taken over by the government or regulatory authorities. The CBCS has the authority to withdraw a banking licence under certain circumstances (such as non-compliance with a warning), but this does not mean that the bank is 'taken over' by the government or regulatory authorities.

The CBCS has the authority to request the court of first instance in Curaçao to issue an emergency measure in the case where the interests of the joint creditors in the liquidation of a bank whose licence has been cancelled calls for special measures. The CBCS shall safeguard the interests of the joint creditors. The CBCS has issued emergency measures on certain occasions in the last couple of years.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

In the event an emergency measure is issued, the CBCS will to the exclusion of any other party, exercise all the powers of the directors and supervisory directors of the credit institution. The CBCS may appoint persons to exercise these powers. The directors and the supervisory directors of the bank must cooperate with the CBCS in any manner the CBCS requests. The CBCS has the power to authorise the directors to perform certain acts and to dismiss directors and supervisory directors.

15 Are managers or directors personally liable in the case of a bank failure?

From a regulatory perspective, prosecution can be instituted and punishments can be pronounced against any person who has instructed the bank to commit the punishable act or who has actually directed the prohibited acts or neglects. A punishable act shall be considered to have been committed by or on behalf of the bank if it is committed by persons who, either on account of an employment relationship or otherwise, are acting in the sphere of the bank, regardless of whether these persons have each of them individually committed that punishable act, or whether elements of that act are present with all of them collectively.

From a corporate law perspective, the members of the board of directors are personally and severally liable towards the legal entity for any loss caused by the improper performance of duties. A member of the board is not liable if they can prove that he or she cannot be blamed for such improper conduct and that the activities concerned fall outside the scope of activities assigned to him or her, and that he or she has not been negligent in taking steps to avert the related consequences. A division of tasks among members of the board can influence the liability. A claim based on this provision can be instituted by the bankruptcy trustee.

16 How has bank resolution changed in response to the recent crisis?

Curaçao banks have not been affected directly by the crisis and resolution has not changed in response.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

A local general bank and a subsidiary of a foreign general bank must have a minimum equity capital of at least 5 million Netherlands Antillean guilders, free and unencumbered.

18 How are the capital adequacy guidelines enforced?

The capital adequacy requirements are requirements for granting a licence. Hence, if they are not met, the CBCS could withdraw an existing licence.

19 What happens in the event that a bank becomes undercapitalised?

See question 18.

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20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

An action or petition filed for bankruptcy of a bank – including the institution's own petition – shall not be considered, unless the bank is in possession of a banking licence. If the bank's licence has been rescinded, no decision will be taken about the action of the petition for bankruptcy until the court of first instance has given the CBCS the opportunity to express its opinion about the matter. The CBCS has the authority to request the court to issue an emergency measure if the interest of the joint creditors in the liquidation of a bank whose licence has been cancelled calls for special measures.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

To our knowledge, they have not changed and nor are they expected to.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Persons exercising a considerable influence on the affairs of the bank by means of voting rights derived from shares, or in any comparable manner, must be of high personal integrity. The objectives or antecedents of these persons must not influence the bank in an undesirable way. The ultimate beneficial owners must be known to the CBCS. A natural person, may not, without the approval of the CBCS, directly or indirectly control or hold more than 5 per cent of the bank's capital. The total of individual shareholding by natural persons may not, without the approval of the CBCS, exceed 25 per cent of the total share capital.

23 Are there any restrictions on foreign ownership of banks?

There are no specific restrictions on foreign ownership, but at all times at least two members of the board of managing directors must be residents of Curaçao. Also, the CBCS may decide not to grant a banking licence if the CBCS is of the opinion that the central bank or the authority of the country of origin of the corporation, which is responsible for the supervision of credit institutions, cannot exercise sufficiently adequate and effective supervision on a consolidated basis.

24 What are the legal and regulatory implications for entities that control banks?

The financial statements of the past three years of the parent or affiliated companies of the bank should reflect an unqualified opinion. A banking licence will not be granted or a licence may be withdrawn if, in view of the plans or antecedents of one or more persons exercising a considerable measure of authority in the corporation or institution by means of voting rights derived from shares in the general meeting of shareholders or in a comparable manner, the CBCS is of the opinion that there is or might be undesirable influencing of the corporation or institution. Also, the CBCS may decide not to grant a licence if it has reason to assume that the corporation has applied for the licence with the purpose of circumventing the rules and regulations with respect to the supervision in another state or if the structure of the group to which the bank belongs is such that the CBCS is not in a position to exercise adequate and effective supervision of the bank.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

No specific conditions or restrictions follow from the law. However, the CBCS may attach certain conditions and restrictions to the banking licence.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The CBCS has regulatory authority over the regulated entity and not its controlling entity. That means that controlling entities indirectly face the consequences that are imposed on the level of the regulated entity.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Sale or transfer of shares in a supervised credit institution is subject to the prior written approval of CBCS. Banks are prohibited from, among other things, merging or reorganising without approval from the CBCS.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Yes. There is no difference. It depends on all the circumstances and information. The CBCS applies different requirements depending on whether the new shareholders are natural persons, non-bank companies or supervised credit institutions, whether foreign or local.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The management of the credit institution should inform the bank of the intention to sell or transfer the shares by the present shareholders to others by means of a letter, detailing the reasons why the shares are being sold or transferred, and the consideration paid per share by the new shareholder. The CBCS must also review the antecedents and plans of the prospective shareholders.

In order to evaluate prospective shareholders, reference is made to information related to the identity, financial position and background of the prospective shareholders.

Among the most important factors are the business plan, background of the new shareholders, annual accounts and market analysis. There are numerous other factors that are considered as well.

30 Describe the required filings for an acquisition of control of a bank.

The CBCS needs to provide its prior written approval to an acquisition of control over a bank.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

That depends on how fast the required information is delivered and whether the CBCS is of the opinion that more information is required. It is difficult to provide a hard estimate as all instances differ.

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Cyprus

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

In the past few years the banking sector in Cyprus has undergone intense legislative and regulatory activity, mainly in connection with the resolution of troubled local banks and its aftermath, but also in connection with the implementation of major European Union (EU) legislative initiatives. The main government and regulatory policies that govern the banking sector are therefore of EU origin and relate to the creation of a banking union within the eurozone (the Banking Union).

The objectives of the Banking Union are to establish a regulatory, supervisory and bank resolution structure that minimises the likelihood and severity of a future banking crisis, while lessening its potential impact on EU economies and taxpayers. It also aims at creating a more competitive banking environment, better able to sustainably finance European growth. The main pillars of the Banking Union are:

- introducing a more robust prudential regulation framework with common rules for banks in all 28 member states (the Single Rulebook), targeting excessive risk-taking by banks, introducing stronger risk-absorbing capital buffers and addressing the issue of regulatory arbitrage;
- introducing common implementation of the Single Rulebook in the Eurozone through a centralised bank supervision structure under the European Central Bank (the ECB), leveraging the independence of the ECB while also utilising the local expertise of national competent authorities (the NCAs) (the Single Supervisory Mechanism or SSM); and
- introducing a uniform approach to bank resolution within the Eurozone, for those cases where a bank fails notwithstanding the enhanced supervisory regime (a Single Resolution Mechanism, SRM) administered by a centralised body (the Single Resolution Board) and prioritising private sector tools, most notably the allocation of losses to shareholders and the bail-in of creditors to recapitalise the bank.

Further major government and regulatory policies not directly connected to the Banking Union initiatives but of particular relevance in Cyprus are the establishment of a sound arrears management framework and the ongoing initiatives to address money laundering.

2 Summarise the primary statutes and regulations that govern the banking industry.

As a member state of the EU since 2004 and of the eurozone since 2008, Cyprus's banking legislation is largely based on directly enforceable EU legislation and the transposition of EU directives into national law. The primary statutes and regulations that govern the banking industry relate to the licensing of banking activities, the regulation and supervision of credit institutions and their resolution:

- The Business of Credit Institutions Law of 1997 to 2015, Law 66(I) of 1997 as amended, (the Banking Laws) is the basic banking legislation, into which the provisions of Directive 2013/36/EU (CRD IV) on access to the activity of credit institutions and the prudential supervision of credit institutions have been transposed;
- Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions (CRR) setting out own funds requirements, limits on large exposures, liquidity requirements and public disclosure requirements and reporting requirements relating to leverage;
- The Macro-prudential Supervision of Institutions Law of 2015, Law 6(I) of 2015 (the Macro-prudential Supervision Law), which transposes the relevant provisions of Directive 2013/36/EU and sets out requirements for the establishment of additional capital buffers to address systemic and other risk;
- Regulation (EU) No. 1093/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority) as amended by Regulation No. 1022/2013 of the European Parliament and of the Council as regards the conferral of specific tasks on the European Central Bank;
- Council Regulation (EU) No. 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (Single Supervisory Mechanism Regulation);
- Regulation (EU) No. 468/2014 of the European Central Bank establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and the national competent authorities and with national designated authorities SSM Framework Regulation);
- Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions (Bank Recovery and Resolution Directive, BRRD);
- Regulation (EU) No 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (SRM Regulation);
- The Resolution of Credit and Other Institutions Law, Law 17(I) of 2013 as amended (the Resolution Law),
- The Central Bank of Cyprus Laws of 2002 to 2014, Law 138(I) of 2002 as amended, setting out the mandate and responsibilities of the Central Bank of Cyprus (CBC), including macro and micro-prudential supervision;
- The Law on the Establishment and Operation of Deposit Protection and Resolution of Credit and Other Institutions Scheme, Law 16(I) of 2013 as amended (the Deposit Protection Scheme Law);
- The Prevention and Suppression of Money Laundering Activities Law of 2007 to 2013, Law 188(I) of 2007 as amended (the AML Law), which transposes Directive 2005/6/EC (the AML Directive);
- The Payment Services Laws of 2009 to 2010, Law 128(I) of 2009 as amended;
- The Consumer Credit Law, Law 106(I) of 2010 (the Consumer Credit Law), which transposes Directive 2008/48/EC on credit agreements for consumers; and
- The Enforcement of Restrictive Measures on Transactions in case of Emergency Law of 2013, Law 12(I) of 2013 (the Restrictive Measures Law), which sets the legal framework under which the Minister of Finance issue, on the governor of the CBC's recommendation, issues decrees restricting certain transactions for the purposes of protecting the stability of deposits in Cyprus banks following the adoption of bail-in measures in the course of resolution of two of the Cyprus banks in 2013.

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Key directives and decrees issued by the CBC and the Minister of Finance under powers granted by the Banking Laws and other relevant legislation include:

- the CBC Directive on the Assessment of the Fitness and Probity of Members of the Management Body and Managers of Authorised Credit Institutions of 2014;
- the CBC Directive on Governance and Management Arrangements in Credit Institutions of 2014;
- the CBC Directive on the Preparation and Submission of Recovery Plans of 2014;
- the CBC Directive on Loan Impairment and Provisioning Procedures of 2014;
- the CBC Directives on Arrears Management of 2013 and 2014; and
- Ministry of Finance decrees issued under the Restrictive Measures Law.

3 Which regulatory authorities are primarily responsible for overseeing banks?

Banks licensed and operating in Cyprus are supervised by both the ECB and the CBC in accordance with the SSM Regulation establishing the Single Supervisory Mechanism composed of the ECB and the NCAs and the SSM Framework Regulation, establishing a framework for cooperation between the ECB the NCAs.

Under the SSM Framework Regulation, the ECB has direct supervisory competence in respect of credit and other institutions established in participating member states that are classified as being significant, with NCAs assuming responsibility for directly supervising entities that are less significant. In September 2014 the ECB published lists of significant and less significant supervised entities, which listed four Cyprus banks as being significant supervised entities on the basis that they each held assets equivalent to more than 20 per cent of the country's GDP, namely Bank of Cyprus Company Ltd, Co-operative Central Bank Ltd, Hellenic Bank Ltd and RCB Bank Ltd.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured by the Cyprus government. The Deposit Protection Scheme Law establishes a scheme (the Scheme) under which two funds have been set up to provide for compensation of depositors of eligible credit institutions that are not in a position to repay the deposits. The two funds are the Deposit Protection Fund for Banks and the Deposit Protection Fund for Cooperative Credit Institutions (the Deposit Protection Funds).

The Scheme and the Deposit Protection Funds are administered by a committee (the Committee), headed by the governor of the CBC. Under the Deposit Protection Scheme Law and related regulations issued by the Committee, depositors of banks and cooperative credit institutions covered by the Scheme are entitled to maximum compensation of €100,000 from funds held by the Deposit Protection Funds, payable within 20 days of the date when a deposit is rendered unavailable. The funds held by the Deposit Protection Funds are collected through mandatory contributions made by the institutions covered by the Scheme. Such contributions are calculated as a percentage of the deposit base of covered institutions, with the target balance of the Deposit Protection Funds being 1 per cent of each covered institution's deposit base.

The Deposit Protection Scheme Law and the regulations issued by the Committee address matters such as the categories of deposits and persons that are entitled to compensation, the timing of contributions, circumstances under which exceptional contributions will be made and powers of the Scheme to borrow in situations where the Deposit Protection Funds have insufficient balances to address compensation needs.

It is expected that the Deposit Protection Scheme Law will be amended through the transposition of the provisions of Directive 2014/49/EU of the European Parliament and of the Council on deposit guarantee schemes, in accordance with the July 2015 and May 2016 deadlines set out in it.

In March 2014, the Cyprus government injected €1.5 billion into the Central Cooperative Bank, acquiring a 99 per cent stake in the ownership structure of the institution, for the purposes of recapitalising and restructuring the cooperative credit institution sector. The funds for this capital injection were provided by the European Stability Mechanism, as part of a €10 billion financial assistance package for Cyprus agreed under a Memorandum of Understanding (MoU) prepared by the European Commission in liaison with the ECB and the International Monetary Fund.

The terms under which the capital injection was made include an option for the Central Cooperative Bank to buy out the government's stake through retained profits (on terms assuring a specified minimum rate of return for the government). After 1 January 2019 the government can offer its stake for sale to third parties, subject to pre-emptive rights in relation to this stake granted to the 1 per cent minority shareholders of the institution.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Banking Law (article 11) sets limits on a credit institution's exposure to members of its board of directors and shareholders holding more than 10 per cent of its share capital, and the CRR sets limits on a credit institution's large exposures (and imposes greater capital requirements for breach of such limits). There are no additional regulatory limitations on transactions between a bank and its subsidiaries.

The CBC Directive on Governance and Management Arrangements in Credit Institutions of 2014 does, however, impose an obligation on credit institutions to establish conflict of interest policies governing its relationships with its stakeholders, including shareholders, staff and subsidiaries.

Permitted activities for financial institutions are set out in Annex IV of the Banking Laws and include:

- taking deposits and other repayable funds;
- lending including: consumer credit, credit agreements relating to immoveable property, factoring, with or without recourse, and financing of commercial transactions (including forfaiting);
- financial leasing;
- payment services as defined in article 4(3) of Directive 2007/64/EC;
- issuing and administering other means of payment (eg, travellers' cheques and bankers' drafts) insofar as such activity does not fall under the scope of payment services;
- guarantees and commitments; and
- trading for own account or for account of customers in any of the following:
  - money market instruments (cheques, bills, certificates of deposit, etc);
  - foreign exchange;
  - financial futures and options;
  - exchange and interest-rate instruments;
  - transferable securities;
  - participation in securities issues and the provision of services relating to such issues;
  - advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings;
  - money broking;
  - portfolio management and advice;
  - safekeeping and administration of securities;
  - credit reference services;
  - safe custody services; and
  - issuing electronic money.

The Banking Laws (article 12) prohibit the ownership of real estate other than in the ordinary course of business (for example, real estate used as headquarters and branches) or which is obtained as a result of enforcement of security, and the CRR (article 89) prohibits ownership of controlling stakes in a business which is not a banking or financial services business.

Cyprus legislators have also inserted a clause in the latest amendment to the Banking Laws prohibiting a licensed financial institution established in Cyprus from selling or otherwise transferring all or part of its loan portfolio or rights pertaining to such loans, other than to credit institutions that are licenced in Cyprus (and only following written approval from the CBC). This move reflects a broader resistance by political parties in Cyprus to any legislative action that would allow sales of bank assets to entities that are perceived as less accommodating to borrowers in difficulty. This restriction on banking activity appears to limit the tools available to banks to manage their assets and restore their balance sheet health, and the CBC has

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submitted a further amendment to the Banking Laws to the legislature in order to remove them.

6 What are the principal regulatory challenges facing the banking industry?

While the regulatory regime establishing the Banking Union, as transposed into Cyprus law, is now considerably reinforced, the enforcement of regulations in the areas of arrears management and corporate governance will be particularly important for the future performance of Cyprus banks (see Update and trends section).

7 Are banks subject to consumer protection rules?

The Consumer Credit Law reinforces the Cyprus legal framework for the conduct of most forms of consumer credit involving sums between €200 and €75,000.

The Consumer Credit Law addresses the following issues:

- minimum information requirements to be provided in any marketing or advertising material before a consumer enters into a consumer credit contract;
- requirement for the conduct of a credit assessment on the borrower prior to entry into a consumer credit contract;
- minimum information requirements to be included in consumer credit contracts, including type of credit, duration, amount of credit, interest rate and method of calculation and reference rate, instalments, charges, default interest rate and rights of advance repayment;
- circumstances under which a consumer may withdraw from the consumer credit contract;
- conditions related to advance repayment;
- retention of rights following assignment of a consumer credit contract to another provider; and
- method of calculation of the annual percentage rate.

The Consumer Credit Law also grants supervisory and administrative powers to the Director of the Competition and Consumer Protection Authority of the Ministry of Trade, Industry and Tourism for the purposes of enforcing its provisions, subject to any contrary provisions of the Banking Laws. These powers include the power to supervise providers of consumer credit, to conduct research, to impose administrative fines and apply for court orders against entities violating the Consumer Credit Law.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Given Cyprus's membership of the EU and the eurozone, it is anticipated that legal and regulatory change will be involve the evolution and further refinement of the three pillars of the Banking Union.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

In accordance with the provisions of the Single Supervisory Mechanism Regulation and the SSM Framework Regulation the ECB assumes supervisory responsibility for banks classified as systemically significant institutions and also maintains exclusive supervisory responsibility in relation to the following matters:

- Authorisation of credit institutions and withdrawal of authorisation;
- Assessment of notifications of acquisition and disposal of a qualifying holding (a direct or indirect holding in an undertaking which represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking) in a credit institution; and
- In carrying out its prudential tasks in relation to Cyprus banks, the ECB applies all relevant EU laws and, where applicable, the national legislation transposing them into Cyprus law. Where the relevant law grants options to Cyprus, the ECB will also apply the national legislation exercising those options. The ECB is supported by the CBC through participation in supervisory teams, exchange of information and notifications, where the CBC is the point of contact with the supervised institution.

Joint supervisory teams have been established for the supervision of each of the four Cyprus banks designated as a significant supervised entity by the ECB. Each joint supervisory team is led by an ECB staff member and composed of staff members from the ECB and from the CBC. They perform on- and- off-site supervisory examinations, the extent and frequency of which are determined by the systemic importance of the institution, its compliance status with regulatory requirements and the level of perceived systemic risk at any point in time.

Under the same supervisory framework the CBC retains supervisory responsibility over less systemically significant credit institutions established in Cyprus, under the oversight of the ECB.

10 How do the regulatory authorities enforce banking laws and regulations?

Under the SSM Framework Regulation and the Banking Laws, the ECB and the CBC have been granted powers to impose sanctions on banking institutions and individuals that are in breach of EU and national banking laws and regulations.

The SSM Framework Regulation empowers the ECB to directly impose administrative pecuniary penalties on significant banking institutions that are in breach of a requirement under relevant directly applicable acts of EU law (eg, requirements under the CRR) amounting to up to twice the amount of profits gained or losses avoided as a result of the breach, or, if these amounts cannot be ascertained, penalties of up to 10 per cent of total annual turnover (defined as gross income consisting of interest receivable and similar income, income from shares and other variable or fixed-yield securities, and commissions or fees receivable).

In the cases where the ECB seeks to impose a non-pecuniary penalty, or a pecuniary penalty against an individual, it must initiate infringement proceedings through the CBC. Such penalties are set out in the Banking Laws (article 30) in relation to breaches of the Banking Laws or the CRR and involve powers to require the credit institution to adopt corrective measures, or to limit its operations by restricting the scope of its operating licence. These measures include, but are not limited to:

- the imposition of restrictions on collection of deposits, granting of loans or undertaking of investments;
- the imposition of restrictions on any other type of transactions;
- requiring a credit institution remove any member of its board of directors or any executive;
- requiring the credit institution to maintain capital levels higher than those set out under the Banking Laws;
- requiring a credit institution to reinforce its governance structure, risk management procedures and policies and internal control mechanisms;
- requiring a credit institution to implement specific provisioning policies;
- restricting or prohibiting the distribution of profits by a credit institution;
- requiring a credit institution to reduce the proportion of variable executive pay;
- requiring a credit institution to submit a step plan for compliance with prudential standards; and
- withdrawing the credit institution's authorisation to provide banking services.

The CBC maintains the power to impose pecuniary and non-pecuniary penalties in accordance with the relevant provisions of the Banking Laws, in relation to less significant banks.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

There are only three publicly available decisions of the CBC imposing fines on Cyprus banks. They relate to the breach of the AML Regulation and the breach of obligations in connection with investment services to clients.

12 How has bank supervision changed in response to the 2008 financial crisis?

The current legislative framework has been initiated by the EU and has been largely designed to address the fallout from the global financial crisis. The EU's response has been the adoption of the Banking Union as a means of establishing a regulatory, supervisory and bank resolution structure that minimises the likelihood and severity of a future banking crisis, while lessening its potential impact on EU economies and taxpayers.

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Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Cyprus has obtained concrete experience in bank resolution since 2013, when, as part of its MoU (see question 4) it undertook the resolution of its two largest banks under a newly drafted Resolution Law, on terms effectively imposed by its lenders under the MoU.

The restructuring of the Cyprus banking sector through the resolution of the two largest banks involved:

- the immediate resolution of Laiki Bank through the creation of a 'bad' bank and the transfer of certain of its assets and of insured deposits to Bank of Cyprus;
- the recapitalisation of Bank of Cyprus through the bail-in of uninsured depositors, shareholders and other creditors of the bank; and
- the sale of the Greek branches of Bank of Cyprus, Laiki Bank and Hellenic Bank.

Although the Resolution Law has yet to be amended to transpose the BRRD (the 31 December 2014 deadline for transposition having passed), it nevertheless reflects the main principles underlying the BRRD as well as the main resolution tools provided in it.

The Resolution Law sets out the following circumstances under which the Resolution Authority (defined as the CBC in the Resolution Law) may initiate resolution measures with the agreement of the Finance Minister:

- where the supervisory authority body in cooperation with the Resolution Authority jointly decide that the credit institution concerned is not viable or may become non-viable with reasonable risk that it may not be able to fulfil its obligations;
- where the supervisory authority considers that the in the absence of resolution measures, any other actions that may be reasonably taken by the credit institution will not be sufficient to allow it comply with minimum capital and liquidity requirements; and
- where the adoption of resolution measures is necessary for public benefit and public interest purposes.

The Resolution Law makes explicit reference to the protection of shareholder and creditor rights. Accordingly, where the Resolution Authority applies any of the available resolution measures such as sale of operations, sale of assets and liabilities to a bridge bank, transfer of assets and rights to an asset management company and bail of shareholders and creditors, the rights of parties to guarantee agreements, financial collateral agreements, set-off agreements, netting agreements, assignment and indemnity agreements and structured finance agreements are preserved.

Beyond this point, and to the extent that there are clear public policy and public interest considerations in the application of resolution measures, including the maintenance of confidence in the banking sector and shifting the cost of resolution away from taxpayers, the protection of creditor and shareholder rights is subordinated to those other considerations. In terms of the losses that may be imposed on shareholders and creditors, the Resolution Law does, however, specify that the adoption of resolution measures should not result in greater losses than would have been incurred had the credit institution been liquidated instead.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Under the Banking Laws (article 30B), credit institutions are obliged to put in place recovery plans, which set out the steps that the institution would take to restore its financial state in the event of an adverse occurrence.

The CBC has also issued a directive (the Directive on the Preparation and Submission of Recovery Plans of 2014) specifying that such plans are to be submitted by the governing body of the credit institution and that they should involve private sector means for achieving recovery, such as raising capital, restructuring liabilities and divesting assets.

The submission of recovery plans by bank management is also a key tenet of the BRRD.

15 Are managers or directors personally liable in the case of a bank failure?

Although supervisory authority sanctions on credit institutions under the Banking Laws can be extended to bank directors and management, and both the Banking Laws and the Resolution Law include the power to require the removal of directors and management, bank failure does not of itself result in liability on the part of directors.

Nonetheless, under both the BRRD and SRM Regulation, it is specified as one of the principles governing the application of resolution measures that natural and legal persons are made liable, subject to national law, under civil or criminal law, for their responsibility for the failure of the institution under resolution.

It remains to be seen whether this resolution principle will translate into the widening of criminal liability in Cyprus for actions related to bank failures. For the time being, bank directors may be held liable under civil law for breach of their fiduciary duties and duty to exercise care and skill owed to the bank, under common law and equity principles.

16 How has bank resolution changed in response to the recent crisis?

Before the recent banking crisis, which was particularly severe in Cyprus given the large size of the banking sector relative to the size of the economy, and before the adoption of the Resolution Law, it was understood that the CBC in accordance with the Banking Laws (as they stood at the time) together with the government would have broad discretion to devise a rehabilitation scheme and provide the necessary financial support.

Prior to the adoption of the euro in 2008, when Cyprus maintained its own currency, the Cyprus pound, the options available could have included the recapitalisation of the banks and the injection of liquidity through the issue of additional currency.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Article 4(2)(b) of the Banking Laws specifies a minimum initial capital requirement for the commencement of banking activities (subject to certain exceptions) of €5 million. The form of the initial capital is prescribed in subparagraphs (a) to (e) of paragraph 1 of article 26 of the CRR.

In terms of the ongoing own funds requirement for credit institutions, the CRR (article 92) specifies a total capital ratio of 8 per cent composed of a Common Equity Tier 1 capital ratio (CET 1) of at least 4.5 per cent, with the overall Tier 1 capital ratio being at least 6 per cent. The capital ratios are expressed as a percentage of the total risk exposure amount. In terms of the calculation of CET 1, additional Tier 1 and Tier 2 capital certain items that were considered eligible under the previous regulations will gradually be phased out by 2017.

The Banking Laws (article 22B) also require that credit institutions create a capital conservation buffer composed of CET 1 capital equal to 2.5 per cent of their total risk exposure to cover possible losses under adverse economic scenarios. The ECB or the CBC, as applicable, have additional discretion under the Banking Laws (article 30) to further increase a credit institution's capital requirements if, pursuant to their supervisory duties, they determine that it is deficient in any significant area of corporate governance or risk management or that it is exposed to particular risks that would justify a larger capital buffer.

Over and above the basic ongoing capital adequacy ratios set out in the Banking Laws and the CRR, the Macro-prudential Supervision Law, which enters into force from January 2016, provides for additional capital elements to be established by credit institutions, as follows:

- individual countercyclical capital buffers, reflecting the risk to the banking sector of excessive credit growth, of up to 2.5 per cent of risk exposure calculated for different markets and composed of CET 1;
- systemic risk capital buffer reflecting long-term non-cyclical systemic or macro-prudential risks not covered by the CRR, of at least 1 per cent of risk assets composed of CET 1 elements; and
- capital buffers on systemically important institutions (global systemically important institutions G-SII and other systemically important institutions O-SII) of up to 3.5 per cent for G-SIIs and 2.0 per cent for O-SSIs composed of CET 1 elements and reflecting the particular need to mitigate risks of failure of such institutions that could have far-reaching impact on the broader economy.

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18 How are the capital adequacy guidelines enforced?

The Banking Laws (article 30) set out the actions (including the imposition of sanctions) that can be taken by the ECB or CBC, as applicable, for the purposes of enforcing the capital adequacy guidelines. They include the following measures:

- request that the credit institution rectify any breach of the provisions of the Banking Laws and of the CRR (including any capital adequacy provisions); and
- impose any one or more of the sanctions listed in article 30 (see question 10, above), including the requirement that the credit institution apply net profits towards the reinforcement of minimum capital adequacy ratios, or the imposition of restrictions on operations or the divestment of certain operations.

19 What happens in the event that a bank becomes undercapitalised?

In the event that a bank becomes undercapitalised, the ECB or CBC, as applicable may require it, under the powers vested in them by the Banking Laws (including the powers set out in question 18, above) and under any recovery plans that have been approved (as set out in question 14, above), to take the necessary corrective action (such as raising additional capital or disposing of operations) to restore its capital levels.

To the extent that such measures as are required to restore capital adequacy ratios cannot be taken or fail to address the issue, the ECB will notify the Single Resolution Board (in case of a systemically significant bank) or CBC in its capacity as Resolution Authority (in case of a systemically less significant bank), either of which may initiate a resolution process or insolvency proceedings.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Single Rulebook and the Single Supervisory Mechanism are designed to reduce the likelihood of a bank becoming insolvent. The ECB or CBC, as applicable, should be in a position to recognise that a bank is facing financial difficulties at an early stage and take steps to prevent further deterioration by requiring the bank to implement its recovery plan, or such other action that the ECB or CBC may demand, in accordance with their powers under the Banking Laws. At a second stage, and to the extent that the bank's efforts to restore its financial condition fail, the Single Supervisory Board or the CBC in its capacity as Resolution Authority would determine whether the bank should enter a resolution process.

A bank liquidation process would be considered in circumstances where the CBC or the Single Resolution Board, as applicable, decides that as a matter of public policy or public interest, liquidation would be preferable to a resolution process, or, where, as part of a resolution process involving the sale of business tool, the bridge institution tool or the asset separation tool, the surviving entity is to be wound down.

Article 33B-bis of the Banking Laws provides for a special liquidation process applicable to banks. This involves the appointment of a special liquidator, who applies the relevant provisions of the Companies Law Cap.113 or the Cooperative Companies Law, except where specific powers and restrictions set out in the Banking Laws prevail. A key feature of special liquidation applying to banking institutions is that the special liquidator is nominated by the CBC and that the exercise of his or her functions is subject to CBC instructions.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The latest changes were adopted through the transposition of CRD IV into the Banking Laws and directly through the CRR. Certain forms of additional capital will be phased in gradually through the Macro-prudential Supervision Law.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The Banking Laws, which govern the authorisation of credit institutions in Cyprus and the approval of any controlling interest, do not set any explicit limitation on the type of entity or individual that may own a controlling interest. However, in the assessment of the potential acquirer of a controlling stake, the structure of the acquiring entity and the impact that such structure might have on the ability of the competent authorities to exercise effective supervision are taken into account. The full list of factors that are considered in the assessment of a potential acquisition (in accordance with the Banking Laws) is set out in question 29.

A controlling stake is referred to as a 'qualifying holding' in the Banking Laws, which is defined in the CRR as 'a direct or indirect holding in an undertaking which represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking'.

23 Are there any restrictions on foreign ownership of banks?

There are no legislative restrictions on the foreign ownership of banks. Under the Banking Laws, the factors that may be taken into account in the assessment of a potential acquisition relate primarily to the potential acquirer's capacity to ensure the sound management of the credit institution in question.

24 What are the legal and regulatory implications for entities that control banks?

An entity which controls a bank will be assessed based on the criteria set out in question 29, should it wish to acquire a qualified holding, and will need to satisfy the requisite criteria for the duration of the holding period.

If the controlling entity of bank qualifies as an EU financial holding company or an EU mixed financial holding company (as these terms are defined in the CRR) it will be subject to consolidated supervision.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

An entity or individual that controls a bank is required to notify the CBC or ECB, as applicable, of any intention to sell a qualifying holding or increase or decrease its holding in the bank beyond or below the 20 per cent, 30 per cent and 50 per cent thresholds.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

A controlling entity or individual is likely to be requested to inject additional capital under the terms of a recovery plan in the event that the bank is in danger of becoming insolvent.

A controlling entity or individual may incur liability on the insolvency and liquidation of the bank for any role they may have had in transactions that are found to be void or illegal under the insolvency provisions of the Companies Law Cap. 113.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The Banking Laws (article 17) specify that any potential acquirer acting alone or in concert with other persons and wishing to acquire directly or indirectly a qualifying holding (as defined in question 22, above) in a credit institution, or increase his or her holding in a credit institution such that his or her voting rights exceed 20 per cent, 30 per cent or 50 per cent or otherwise such that the credit institution becomes a subsidiary, must notify the CBC in writing.

Within two days of receiving the notification the CBC must issue written confirmation of receipt and specify the information that the potential acquirer will need to provide for the purposes of assessing the proposed change in control, and confirm of the deadline for completion of the assessment. The assessment period is set at 60 days, subject to a 20-day extension should the CBC request additional information.

If the ECB (which has ultimate decision-making authority following a recommendation from the CBC) refuses the proposed acquisition, it must respond in writing before the assessment deadline, setting out the rationale for its decision. If the ECB does not respond in writing within the assessment deadline, the proposed acquisition is deemed to be accepted.

The ECB can set the deadline within which the proposed acquisition must be completed.

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Update and trends

The Cyprus banking sector underwent very significant changes under the resolution regime adopted in 2013 and although surviving banks have been recapitalised, it will take further significant efforts to fully restore depositor confidence in the banking sector and for the banks to fully resume their role in financing the economy.

One major challenge is to fully remove the restrictive measures on deposit withdrawal, which were imposed as a matter of urgency in March 2013 in connection with the bail-in of depositors' funds as part of the resolution of Bank of Cyprus and Laiki Bank. The measures adopted under the Restrictive Measures Law in a series of CBC and Finance Ministry decrees were aimed at preventing a run on deposits and while they have been progressively eased following the gradual improvement in the economic climate and the recapitalisation of the banking sector, a firm date for their complete removal has not been set.

A second major challenge, which may also influence the speed with which the restrictive measures will be lifted, is the high proportion of non-performing loans in the portfolio of Cyprus banks. It remains to be seen how the much anticipated foreclosure legislation (already approved by the Cyprus parliament, though with implementation effectively postposed) will be applied and whether it will indeed provide the banks with the necessary tools to effectively and quickly realise the value of their real estate security. The large volume of real estate collateral relative to the size of the economy will probably limit the banks' ability to proceed with substantial foreclosures on loans without unduly depressing real estate prices.

Finally, the implementation of stricter corporate governance practices is another important objective that must be attained if the Cyprus banking sector is to achieve a sustainably stronger and more solid future. In this respect, the appointment of experienced foreign bankers on the board of Bank of Cyprus following its recent recapitalisation (through the participation of foreign funds) is a welcome development, reinforcing both the independence and the skills available to the board.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Under the Banking Laws, there is no differentiation between domestic and foreign owners, with the same assessment criteria being used to assess both (as set out in question 29).

The only slight difference is that the CBC can extend the time frame for assessment of a potential acquirer's notification by 10 days (to 30 days in total) when requesting additional information from a potential acquirer who is not based in a member state that has transposed EU Directives, including the CRD IV.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The factors taken into account by the CBC in its recommendation to the ECB, regarding approval of acquisition of control are set out in the Banking Laws (article 17A) relate primarily to the proposed acquirer's capacity to ensure the sound management of the credit institution in question, having in mind the likely influence the acquirer will have on it. The factors the CBC considers are:

- the reputation of the proposed acquirer;
- the reputation, knowledge, competence and experience of the directors and management team which may be put in place following the acquisition;
- the financial health of the proposed acquirer;
- the ability of the credit institution to continue to comply with regulatory requirements under the Banking Laws and the CRR and other legislation relevant to its operations, with due consideration to the structure of the acquiring group (if applicable) and the ability of the relevant competent authorities to cooperate and exercise effective supervision; and
- the extent to which there is any reasonable suspicion that the proposed acquisition is related to money laundering or financing of terrorist activities as defined under the AML Law.

In assessing the proposed acquisition, the CBC does not impose any conditions precedent with regard to the size of the acquisition, nor does it take into account the economic needs of the market.

30 Describe the required filings for an acquisition of control of a bank.

Article 17A of the Banking Laws specifies that the CBC should publish the information requirements for the purposes of the assessment of the potential acquisition. Such information should address the assessment factors (set out in question 29) and should be adapted to the nature of the potential acquirer and to the nature of the potential acquisition.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

See response to question 27.

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Dominican Republic

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The principal laws that govern the Dominican monetary and financial system are the Constitution of the Dominican Republic (specifically section II, chapter I, title XI – articles 223 to 232), the Monetary and Financial Law (MFL) (Law 183-02), Systemic Risk Law No. 92-04 and the Law for the Development of the Mortgage Market and Trusts, along with the regulations for their respective applications, which, depending on the nature of the subject matter, may be issued by the Tax Administration, the Monetary Board, the Central Bank of the Dominican Republic or the Superintendency of Banks (SIB).

Please note that the laws and regulations of the Dominican Republic pertaining to banking regulations follow the principles and standards of two of the Basel Accords, specifically Basel I and certain principles and standards contemplated by Basel II.

2 Summarise the primary statutes and regulations that govern the banking industry.

In broad terms, the MFL and the legal framework applicable to financial institutions in the Dominican Republic seek to regulate areas and operations of importance within the institutions such as: operational risks, corporate governance, foreign exchange operations, solvency and asset evaluation, related-party transactions, systemic risk, liquidity risks and other risks. Moreover, the law requires financial entities to maintain legal reserves as a percentage of the total funds collected from the public in any form or instrument, local or foreign currency with the central bank. Credit institutions and banks must also maintain, at all times, the minimum capital level required by law.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The Constitution establishes that regulation of the monetary and banking system is the responsibility of the Monetary Board, which is the highest authority of the Central Bank. Dominican banks and other Dominican financial institutions are regulated by the Monetary and Financial Administration, which is composed of the Central Bank, the Monetary Board and the SIB. As indicated above, the regulatory framework for the operation of the Dominican financial sector is currently set out in the MFL, in rulings and regulations issued by the Monetary Board (regulations are approved by the Monetary Board through resolutions) and in circulars and ruling application guidelines issued by the SIB. Please note that if a financial institution becomes a participant in the capital markets, then it will also be subject to the regulations set out by the Superintendency of Securities.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are insured by the regulator up to the amount of 500,000 Dominican pesos.

Banco de Reservas, one of the largest in the country, is wholly owned by the government; however, it is subject to the same regulations applicable to all financial institutions in the Dominican Republic.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Pursuant to the Regulation on Risk Concentrations approved by the Monetary Board, the total amount of direct and indirect credits granted in favour of a person or risk group may not exceed 10 per cent of the bank's regulatory capital. 'Risk group' is defined as a group of two or more individual or juridical persons related or joined by reason of property, management, family or control. This 10 per cent limit may be extended to a maximum of 20 per cent depending on the type of collateral securing the excess above such limit.

The Regulation covers both direct and indirect credits and establishes certain cases where the existence of a risk group may be presumed. Such cases include when the person exercises a controlling participation in the financial or operational policies of an enterprise but does not control such policies; when the person is an associate or shareholder; when the person forms part of a consortium; when there is common control (through contractual arrangements); and when the management controlling planning, decisions or activities is shared by more than one person.

Loans granted to spouses and close relatives of the borrower and to juridical persons controlled by the borrower are considered under the same lending limit for purposes of determining the individual limit that can be loaned to such person. Loans to corporations and juridical persons forming part of the same economic or financial group, as well as loans to shareholders controlling 20 per cent or more of the capital of a juridical person and who are involved in management will be considered under the same lending limit when determining the limit that can be loaned to a borrower.

The total aggregate limit on loans to related parties must not exceed 50 per cent of a bank's regulatory capital. Within this limit, the total aggregate amount of loans granted by a financial intermediary to its employees may not exceed 1.5 per cent of regulatory capital, and individual loans to employees must not exceed 10 per cent of this 1.5 per cent limit. According to the Regulation, none of the preceding limits can be used by a financial intermediary for the purpose of investing in its own shares or in those of its parent company, controlling company or holding.

The Regulation considers the following persons as related parties to a financial intermediary: physical or juridical persons who participate in a financial intermediary as shareholders, board members, managers, executives, legal representatives or employees, as well as spouses and certain relatives of those persons. Enterprises or risk groups that participate directly or indirectly in a financial intermediary (without having a direct ownership relationship), as well as enterprises controlled (through equity of management) by a financial intermediary, are also considered related parties.

For the purposes of the Rules on Credit Limits to Related Parties, direct or indirect ownership of 3 per cent or more of a financial intermediary's equity capital or revenues is considered to constitute a relationship with such financial intermediary. Ownership of 10 per cent or more is considered to constitute an influential participation. Ownership of 20 per cent or more is considered as constituting a controlling participation. The power to appoint the majority of the board of directors or management and the power to influence decisively a financial intermediary's decisions or management also constitutes control.

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6 What are the principal regulatory challenges facing the banking industry?

The main challenges are to keep the local regulatory framework according to the international standards applicable to the industry. The Dominican Republic is civil law legislation; at some point this may become a challenge since the approval of Congress, upon request of the Monetary and Financial Administration, would be required for major changes in the existing legislation.

7 Are banks subject to consumer protection rules?

Yes. The Regulation for the Protection of Users of Financial Services in general terms establishes the rules aimed to protect consumers' rights in connection with the services provided by financial institutions. It sets forth the guidelines that financial intermediaries must follow in order to ensure that the formats or templates of financial services agreements and adhesion contracts used in their operations do not contain clauses or provisions that imply the existence of abusive contracts, as well as establishes the procedures that must be followed by consumers, financial intermediaries and the SIB in attention to claims and complaints filed by the users of financial services.

The SIB has the responsibility for enforcing these rules in the banking sector. Notwithstanding the foregoing, please note that in 2010, a public debate ensued on whether the National Institute for the Protection of Consumers (PROCONSUMIDOR) also had rights to review the forms of financial services contracts. Ultimately, the SIB and PROCONSUMIDOR reached an agreement whereby PROCONSUMIDOR also has the rights to review the templates of financial services agreements in order to verify the existence of abusive clauses as regards the framework of the General Law on Consumer Protection Rights No. 358-05.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The regulatory authorities have, for years now, expressed their interest in consolidating some of the existing regulation in what would be an amendment to the MFL. In the context of such amendment, certain provisions would be included to promote the development of products that are currently offered by the industry, but which are difficult to implement because of regulatory constraints. Likewise, the new legislation will seek to provide a regulatory framework for the transformation of savings and loans into full service or universal banks.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are subject to extensive reporting requirements that range from daily, weekly, monthly to annual reports. At least one annual site visit is made by the SIB for a comprehensive review of the operations of the institution. This visit may last for up to six weeks, and at the end a report with an evaluation and recommendations is issued. The institution subject to the site visit must comply with the recommendations set out in the report within the timetable indicated by the authorities.

An institution's annual audited financial statements are filed with the authorities and published in a newspaper of nationwide circulation.

10 How do the regulatory authorities enforce banking laws and regulations?

The monetary and financial system is regulated and managed exclusively by the Monetary and Financial Administration, including the setting of policies, regulations and the imposition of sanctions. Any violation of the existing regulation will result in administrative and legal responsibly punishable in accordance with the law.

The law describes two types of violation under its regulation: quantitative infringements and qualitative infringements.

Quantitative infringements refer to the non-compliance by financial entities in respect of the rules of reasonable care, asset evaluation norms, and violations related to legal reserves. Penalties regarding these infractions vary as they are fixed percentages related to the amount of capital, reserves or provisions that failed to be adequately fulfilled under the legal limits.

Qualitative infringements are divided into three groups:

- very serious infractions such as carrying out brokerage activities without authorisation, making corporate changes without prior authorisation, not allowing supervision by the authorities, undertaking activities prohibited by law, non-compliance with regulations such as accounting regulations, placing clients' deposits at risk, violating criminal laws and in general breaching any standard banking practice or the law;
- serious infractions such as undertaking abusive banking practices with customers, non-compliance with reporting duties to authorities, and others; and
- slight infringements such as unauthorised modification of the business hour, delays in submission of the information to authorities, violations of applicable principles, and others.

Each of the qualitative violations described above would allow the authorities to apply different levels of penalties including fines of up to 10 million Dominican pesos, cancellation of the operating licence and closing the establishment. These penalties and fines could be imposed by one or more of the institutions that compose the Monetary and Financial Administration.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Major enforcement issues are not frequent. As for minor enforcement issues, most have to do with reporting requirements, miscalculations of reserves or incomplete documentation, and fines are usually applied and a reasonable cure period is given to remedy the breach.

12 How has bank supervision changed in response to the 2008 financial crisis?

In April 2010, the SIB changed its method of supervision from compliance-based supervision to risk-based supervision, which is likely to require the implementation of more strict risk management measures by financial institutions.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

In general, under Dominican banking regulations, financial entities can be subject to intervention, dissolution or liquidation by the SIB.

Grounds for dissolution are:

- the non-payment of liquid, due, or enforceable obligations;
- a solvency ratio insufficiency representing more than 50 per cent of the minimum capital requirement;
- when required by banking laws or regulations, the failure to present a regularisation plan to, or the rejection of such plan by, the SIB;
- while executing a regularisation plan, engaging in operations that make such plan unfeasible;
- upon completing a regularisation plan, not correcting the causes which originated the need for regularisation; and
- the revocation of the licence to operate imposed as a penalty upon the financial intermediary entity.

Based on the grounds set out in the paragraph above, the Monetary Board, when proposed by the SIB, must decide on the dissolution of the affected financial intermediary entity. The Monetary Board's decision implies an automatic revocation of the entity's licence to operate and banking operations are immediately suspended.

The SIB must immediately intervene and take possession of all offices and branches, books, documents and records. Stockholders' and creditors' rights will become suspended in connection with the internal control organs, board of directors and managers.

Set out below are the first order obligations under the MFL:

- private sector deposits in checking accounts, savings accounts and time deposits, excluding operations with other financial institutions and related parties in accordance with the following guidelines:
- 100 per cent of the securities or obligations for housing finance and construction issued and outstanding under the Law for the Development of the Mortgage and Fiduciary Market;
- 100 per cent of the deposits covered by the guarantee of the contingency fund at the time of the dissolution, up to 500,000 Dominican

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pesos per depositor; in the case of deposits where the amount is not fully secured, at least the portion that is secured will be segregated and transferred; and
- up to 100 per cent of the amount of deposits exceeding the guaranteed value;
- cash mandates, including trade prepayments, tax withholdings, transfers and transfers established on signed contracts. If the holder of such instruments is not a public institution, such instruments must have been properly documented and recorded in the financial statements of the bank prior to the dissolution procedure;
- judicial deposits;
- labour obligations: the SIB will satisfy all labour liabilities of the bank prior to foreclosure and transfer of assets and liabilities. In the event that this is not possible due to lack of funds, these liabilities are segregated and transferred; and
- the price payable for the technical assistance contract with the SIB, if applicable.

Set out below are the second order obligations under the MFL:
- deposits or current accounts, savings and time deposits of public institutions;
- liabilities to the central bank;
- obligations with other financial institutions;
- tax liabilities; and
- unsecured and non-privileged credits.

In practice, takeover of banks occurs only very rarely. In the past few decades we have only seen two cases.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Pursuant to the MFL, a financial intermediary is required to submit to the SIB for its approval a plan of regularisation (corrective action) when it is in violation of certain requirements established in the Law, the Banking Regulations and other regulatory requirements. A financial intermediary must present a plan of regularisation to the SIB when one or more of the following causes is present:
- its regulatory capital or its equivalent is reduced between 10 per cent and 50 per cent during a 12-month period;
- its solvency ratio is lower than the minimum required and the insufficiency of its solvency ratio is greater than the limit established by the MFL;
- the legal reserves are deficient;
- the entity repeatedly requires credit facilities from the central bank as lender of last resort;
- false financial information or fraudulent documentation has been submitted to the SIB or to the central bank;
- there have been recurrent breaches of the MFL or the Banking Regulations;
- it engages in actions that put the public's deposits or the entity's liquid assets and financial solvency in grave danger; or
- its external auditors submit a qualified opinion regarding the entity's regulatory solvency or the entity publishes incomplete audited financial statements.

In the event of a bank failure, it is likely that the SIB will immediately intervene and take possession of all offices and branches, books, documents and records. Shareholders' and creditors' rights will become suspended in connection with the internal control organs, board of directors and managers.

15 Are managers or directors personally liable in the case of a bank failure?

They are personally liable if they failed to act with due care and to observe their fiduciary duties.

16 How has bank resolution changed in response to the recent crisis?

No additional changes have been made since the legislation passed as a result of a crisis in the mid-1990s. The process and scenarios whereby the SIB is entitled to intervene in a bank were clarified then and the clarifications made at that time still remain in full force and effect.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Banks in the Dominican Republic are required to have regulatory capital of at least 10 per cent of risk-weighted assets. Multiple-service banks and credit institutions that do not comply with the capital adequacy ratio are legally considered to be insolvent.

Multiple-service banks and credit institutions are required to maintain minimum subscribed capital determined by the Monetary Board. Currently the amounts are as follows:

Financial institution	Minimum subscribed capital (in Dominican pesos)
Multiple-service banks	275 million
Savings and credit banks	55 million
Credit corporations	15 million
Savings and loan associations	17 million

Multiple-service banks, savings and credit banks and credit institutions must request the prior approval of the SIB for increases and reductions of paid-in capital.

The Monetary Board, in accordance with inflation and as determined by the central bank, could change the minimal amounts of capital required for the opening and operation of each type of financial institutions. The authorised capital will be entirely subscribed and paid in cash. No entity may increase or reduce the company capital without the prior approval of the SIB.

The financial institutions that fail to maintain a minimum solvency ratio are required to supplement the shortfall in capital. The capital increases paid to comply with the capital adequacy ratio may be made only in cash or retained earnings.

Regulated financial institutions are also required to maintain, at all times, the minimum level of regulatory capital required in relation to risk-adjusted assets, as determined by law.

The total regulatory capital of multiple-service banks and credit institutions is defined as the sum of Tier I Regulatory Capital and Tier II Regulatory Capital, excluding capital invested in other financial institutions; the excess capital invested according to the provisions of the MFL; the capital invested locally to support agencies and related services, to the extent the bank is majority owner of such agencies; and the accumulated losses, current losses, unincorporated provisions and other non-expensed losses, all as determined by applicable regulation.

The primary capital (Tier I Regulatory Capital) consists of paid-in capital, legal reserves required by the law, non-distributable profits, mandatory statutory reserves, and voluntary and non-distributable share premium on the basis of criteria defined by regulation. Secondary capital (Tier II Regulatory Capital) is made up of other capital reserves, provisions for risky assets above a minimum amount up to a ceiling of 1 per cent of contingent assets and risk-weighted assets, mandatory convertible debt instruments in shares, subordinated debt with a duration of over five years and the net income from revaluation surplus, all as determined by applicable regulation.

18 How are the capital adequacy guidelines enforced?

Capitalisation requirements are supervised by the SIB. The law requires regulated financial institutions to maintain legal reserves as a percentage of the total of the funds collected from the public in any form or instrument, local or foreign currency with the central bank.

Multiple-service banks must keep a reserve ratio of 20 per cent over liabilities for foreign currency-denominated deposits and 15.6 per cent for local currency-denominated deposits, in each case subject to reserve requirements.

The law grants the Monetary Board the authority to adjust the reserve ratio in accordance with market, systematic or macroeconomic conditions. This compulsory reserve must be maintained at the central bank.

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19 What happens in the event that a bank becomes undercapitalised?

Failure to comply with the current regulation may result (if not cured in a given period of time granted by the authorities) in the application of fines or in extreme cases the intervention, dissolution or liquidation of the institution by order of the SIB.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Systemic Risk Law provides that the central bank may grant special financial assistance to troubled banks in exceptional situations of liquidity or insolvency crisis that may pose a threat to the market. The Systemic Risk Law creates a special fund to consolidate the banks, and access to such funds is subject to specific conditions regarding low risk collateral and correct valuation of the assets provided as collateral. Furthermore, such assistance must be authorised by the Monetary Board and the implementation of a special programme would be required for the bank to complete the requirements set out by the regulator.

This programme would make banks subject to several obligations and strict supervision by the Monetary and Financial Administration. During or after the special programme, the authorities could order the sale of the bank, the merger with another institution or the sale of its assets.

Dominican courts would be vested with jurisdiction in any insolvency proceedings and would apply the laws of the Dominican Republic in any such insolvency proceeding. Other than in connection with the amicable settlement process mentioned below, Dominican bankruptcy law does not provide for reorganisation similar to that provided for in chapter 11 of the US Bankruptcy Code or for an automatic stay on collection or foreclosure efforts by secured creditors.

In general, under Dominican banking regulations, financial entities can be subject to intervention, dissolution or liquidation by the SIB. Grounds for dissolution are detailed in question 13.

The SIB will immediately intervene and take possession of all offices and branches, books, documents and records. Stockholders' and creditors' rights will become suspended in connection with the internal control organs, board of directors and managers. In the event of intervention the payment of interest and principal on the notes will be suspended until the SIB determines and distributes the liquidation amounts according to the priority of payments set out in the regulations relating to the dissolution and liquidation of financial institutions (see question 13).

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

They have changed as outlined in the answers above. As for changes in the near future, none are expected.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The law does not refer to term 'control' when addressing the requirements for ownership; a 30 per cent shareholding interest is considered a 'relevant participation' and as such, the proposed investor will undergo scrutiny from the SIB and the Monetary Board. In addition to the foregoing, financial institutions may include in their by-laws further requirements that may indirectly restrict the participation of new investors as shareholders.

23 Are there any restrictions on foreign ownership of banks?

Article 39 of the MFL, establishes certain restrictions on foreign direct investment in the banking system and on a foreign bank establishing a branch or subsidiary in the Dominican Republic. Specifically, a foreign investor may not acquire 30 per cent or more of the outstanding shares of a Dominican financial institution without the prior approval of the Monetary Board.

Moreover, if a foreign financial institution seeks to establish a subsidiary or open a branch in the Dominican Republic, the prior authorisation of the Monetary Board is also required. In such instance, the Monetary Board's approval will only be granted with the coordination of the regulators of the country of origin of such foreign financial institution.

24 What are the legal and regulatory implications for entities that control banks?

The transfer of a controlling interest in such entities is subject to the approval of the Monetary Board.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Other than the restrictions applicable to the transfer of a controlling interest in the shareholding structure, the holding of a financial institution is subject to the provisions of the Law on Corporations of the Dominican Republic. Likewise, entities and individuals are subject to the same tax treatment as other individuals not related to financial institutions at a controlling level would be.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The extent of the controlling entity liability will be determined during the process for the declaration of insolvency, to be carried out by the monetary and financial authorities. The shareholders are the last to recuperate their investment, if the recovered amount suffices.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The approval of the Monetary Board is required in order to acquire a significant participation, which is defined as 30 per cent or more of the shareholding interest of a financial institution.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Yes. As for the process, it may take longer depending on whether foreign individuals or entities are involved (whether previously involved in the financial sector or not); translations (if the language used is not Spanish) may be required, as well as certifications of good conduct, good standing and further documentation evidencing the origin of the capital to be invested in the local entity and the identity of the acquirers.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

Compliance with the provisions set out by the law to the full satisfaction of the SIB for the subsequent approval of the Monetary Board.

30 Describe the required filings for an acquisition of control of a bank.

For individuals the following must be filed:
- official documentation indicating name and legal domicile with the signature duly notarised, copy of the passport, at least two banking and two commercial references;
- curriculum vitae;
- a certification of good conduct issued by the Office of the Attorney General of the Dominican Republic or the equivalent authority of the acquirer's jurisdiction indicating that there are no past or current criminal claims against the acquirer;
- certified financial statements along with sworn declaration indicating the origin of the funds to be invested;
- percentage of the institution that the individual will acquire, indicating the total amount of the investment and the value per share; and
- a copy of the latest tax declaration.

For corporations, the following must be filed:
- name and domicile of the potential investor and if it is a financial institution, the authorisation granted by the regulatory authority of its jurisdiction to act as such;
- certified copies of its incorporation documents duly no, including a certified copy of the minutes of the shareholder meeting or the resolution approved by the board of directors in connection with the potential investment in the Dominican Republic;
- balance sheet and financial statements for the past two years, including the auditor's letter and any additional information in connection thereto;

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Update and trends

During the past two years, the Monetary Board has approved a number of regulations with the purposes of promoting access to financial services and strengthening the regulatory framework of the financial sector.

Such regulations include the regulation for banking subagents, which establishes the legal framework applicable to financial intermediaries in the contracting of banking subagents for the provision of certain banking operations and services.

Additionally, the Monetary Board approved the Regulation on Credit Cards which establishes the criteria, standards and rights applicable to financial intermediaries offering credit card products, as a way of guaranteeing the equitable treatment and protection for its users. The Credit Card Regulation establishes the minimum requirements that must be followed by financial intermediaries that issue or represent credit cards, as well as all other entities that intervene in the processing and use of this payment instrument, with respect to their policies, procedures and operations, as well as providing guidelines on the calculation of interest rates, fees, insurance and other charges. The Credit Card Regulation also governs the obligations between the contracting parties, credit card security and the information that shall be provided by financial entities to the Monetary and Financial Administration.

- personal identification and notarised signature of the legal representative appointed by the institution;
- domicile within the Dominican Republic chosen by the representative to receive any notice sent by the Monetary and Financial Administration; and
- the percentage of the institution that the potential buyer seeks to acquire and evidence of the origin of the funds to be invested in the purchase.

All documents must be certified at the nearest Dominican consulate and subsequently at the Ministry of Foreign Affairs of the Dominican Republic.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The time frame may vary depending on the workload of the authorities and the completeness of the information provided. Assuming the worst-case scenario it may take up to five to 10 months to obtain the approval of the Monetary Board. In the best-case scenario it can be from three to six months.

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France

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

Various governmental and regulatory policies have shaped the French banking sector at different times at national level and increasingly at European level, notably:

- protecting the banking monopoly – only authorised banks may engage in certain activities – illustrated in 2012 and more recently in 2013 by hostility over 'shadow banking', which was the subject of the EU Commission's proposal No. 2014/0017 on transparency of securities financing transactions in January 2014;
- maintaining the solvency and stability of the French banking sector and preventing systemic default risk – the regulatory powers of the Prudential Control and Resolution Authority (the ACPR, formerly known as the ACP), already significant and far-reaching, were expanded by the Separation and Regulation of the Banking Sector Act of 26 July 2013 (the SRBS Act) and the Ordinance adopted on 20 February 2014;
- strengthening governance standards regarding risk-monitoring through the mandatory introduction of risk committees (separated from the audit committees) and nomination committees in banks as effected by the Ordinance dated 20 February 2014, which completed the implementation of the CRD IV package into French law favouring the centralisation of supervision and resolution at the European level, with a view to setting up a potential European banking union; and
- favouring global initiatives open to emerging market governments through the G20 summits and initiatives in favour of more banking transparency.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary laws and regulations governing the French banking industry are:

- the Civil Code (which includes general rules applicable to loans – see question 7), the Consumer Code (which includes rules applicable to consumer loans) and the Commercial Code (which includes rules applicable to commercial paper), providing the general basis;
- more specifically, the Monetary and Financial Code (MFC), incorporating the main provisions of the Banking Act of 24 January 1984, the Financial Activity Modernisation Act of 2 July 1996, the Banking, Financial Regulation Act of 22 October 2010 (the LRBF Act) and the SRBS Act, the Ordinance of 27 June 2013 and the Ordinances of 20 February 2014 and 6 November 2014;
- regulations issued by regulatory authorities, such as orders of the minister of the economy, regulations issued by the Advisory Committee on Financial Legislation and Regulation (the CCLRF) and regulations issued by the French Financial Market Authority (AMF);
- European banking legislation, and in particular, Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (the Capital Requirements Regulation) and Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (together with the Capital Requirements Regulation, the CRD IV package), EU Regulation No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank (ECB) concerning policies relating to the prudential supervision of credit institutions, Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the single supervisory mechanism framework, Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) and Regulation (EU) No. 806/2014 establishing a Single Resolution Mechanism (SRM); and
- international banking rules, especially those resulting from the Financial Action Task Force (regarding money laundering) and the Basel Committee on Banking Supervision (regarding prudential standards), the latest example being the substantive implementation of the Basel III Accord by the CRD IV package (see question 7).

3 Which regulatory authorities are primarily responsible for overseeing banks?

As explained in questions 12 and 13, the EU Single Supervisory Mechanism (SSM) and, most recently, the SRM promoted the ECB as the main regulatory authority of significant banks.

An accelerated shift of supervision authority of the French banking industry to the European level began in October 2013 through the 'comprehensive assessment' on 130 banks, led by the ECB, involving supervisory risk assessments, stress tests and asset quality reviews of 85 per cent of the banking assets in the eurozone, the results of which were published on 26 October 2014.

At national level, the French central bank (the Banque de France) has, subject to the powers granted to the ECB under the SSM regarding significant banks (see question 12), ultimate responsibility for oversight of French banks.

The Banque de France performs its various regulatory and supervisory duties through an independent administrative authority, the ACPR. The chairman of the ACPR's supervision and resolution commissions (see below) is the governor (or deputy governor) of the Banque de France. As the authority supervises both the banking sector and the insurance sector, the ACPR is required to have as its vice-chairman a person with experience in insurance.

Regarding banks which are under its direct supervision, the ACPR is entrusted with supervisory authority and is in charge of the supervision and licensing of entities and persons involved in the insurance and financial services industries, any other person performing insurance or reinsurance activities and intermediaries in banking operations and payment services. The SRBS Act has extended the ACPR's scope to the prevention and resolution of banking crises and the Ordinance of 20 February 2014 increased the ACPR's ability to take preventive measures.

The ACPR is divided into one supervision commission composed of a certain number of independent members (in charge of all responsibilities falling within the scope of the ACPR), one sanction committee and one resolution commission.

The ACPR exercises administrative, supervisory and disciplinary powers (see question 10).

As a result of the transposition of the CRD III requirements on compensation limitations, the distribution of bonuses is spread over a minimum of three years and the ACPR was given additional authority over bank compensation policy (note that as a result of one of the new government's reforms the annual total remuneration of CEOs of state-owned banks is capped at €450,000, along with the CEOs of all state-owned companies).

Apart from the ACPR, the AMF is the competent supervisory authority for investment firms exclusively providing asset management services. As such, the AMF authorises and licenses such firms' activities, monitors

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compliance with the standards of sound professional practice by credit institutions' investment-services arms and supervises their asset-management activities. In its capacity as the authority charged with supervising securities markets, the AMF also monitors most major French banks, as they are either listed on the Paris stock market (Crédit Agricole SA, BNP Paribas, Société Générale and Natixis) or issuers of financial instruments falling within its authority.

The ACPR and the AMF coordinate their activities through a joint unit in charge of implementing supervision of the marketing of financial products and compliance by the regulated entities with their obligations towards their clients, borrowers, insured persons, members and beneficiaries.

Furthermore, the MFC provides for three consultative authorities:

- the Advisory Committee on Financial Legislation and Regulation (CCLRF). The CCLRF provides opinions to the French government on draft statutes, ordinances and EU rules (before examination by the Council of European Union) that relate to the insurance sector, the banking sector or investment firms (other than legislation relating to the AMF or falling within its jurisdiction);
- the Advisory Committee on the Financial Sector (CCSF). The CCSF is responsible for examining all issues regarding relations between credit institutions, financial companies, investment firms and insurance companies and their clients, and for proposing appropriate measures related thereto, in particular in the form of opinions or general recommendations; and
- the High Council for Financial Stability (which replaces the Financial Regulation and Systemic Risks Council and has an extended remit covering prevention and supervision of systemic risks) (see question 12).

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured by the government but by the Deposit Guarantee and Resolution Fund in accordance with the MFC, as regulated by CRBF Regulation No. 99-05 dated 9 July 1999. Any credit institution duly authorised to do business in France (and any financial companies, mixed financial holding companies or investment companies pursuant to the SRBS Act) is required to belong and contribute to the Deposit Guarantee and Resolution Fund in charge of indemnifying depositors in the event that their deposits become unavailable and may also be called upon by the ACPR in the context of resolution mechanisms. However, indemnification by the Deposit Guarantee and Resolution Fund upon request of the ACPR is limited to €100,000 per depositor and some deposits are excluded from the guarantee (deposits made by other credit institutions, insurance companies, pension funds, etc). Indemnification claims falling within the scope of the fund's guarantee must be compensated within 20 business days from the request made by the ACPR.

Also, the Public Investment Bank (bpifrance) shares similarities with a governmental agency. It is jointly controlled by the French state and the Deposits and Consignments Fund (CDC), and supports French businesses either through minority ventures or cash facilities.

The French state has direct and indirect ownership interests in banks such as La Banque Postale, a subsidiary of the state-controlled postal service, and Caisse Française de Financement Local (100 per cent of which is held by Société de Financement Local in which the French state holds a 75 per cent direct shareholding, indirectly holding 20 per cent through the CDC and 5 per cent through La Banque Postale). It also owns an indirect interest in Banque PSA through its equity interest in PSA.

At EU level, an intergovernmental agreement was signed in May 2014 regarding the transfer and mutualisation of contributions to the Single Resolution Fund (SRF) that will be established as part of the banking union (see question 6).

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

While no specific limitation is applicable to transactions between a French bank and its affiliates other than usual corporate law 'conflict of interest' limitations applicable to a bank as a corporation, some regulatory limitations apply when a bank owns financial interests in another company that essentially does not belong to the financial sector.

Pursuant to CRBF Regulation No. 90-06 of 20 June 1990, unless the ACPR gives special authorisation, the shareholding interests owned by a bank in any such non-financial company must comply with the following two requirements: each interest must not represent more than 15 per cent of the bank's capital and all interests taken together must not represent more than 60 per cent of the bank's capital.

For purposes of this regulation, an 'interest' is defined as the ownership of at least 10 per cent of the share capital or voting rights of a company or the exercise of significant influence on a company.

In addition, pursuant to CRBF Regulation No. 96-16, any transaction resulting in a change of control of a credit institution, finance company or investment company or allowing a company to reach one or more ownership thresholds in a bank must be brought to the attention of ACPR when such transaction is undertaken by two companies that are effectively controlled by the same enterprise. For applicable thresholds and a definition of 'effective control' see question 27.

Finally, it should be noted that the BRRD enables banking groups to enter into intra-group financial support agreements. Nevertheless, these agreements are subject to a certain number of conditions including the fact that they do not jeopardise the liquidity or solvency of the group entity providing the support.

Last, the SRBS Act requires significant credit institutions, financial companies and mixed financial holding companies with trading activities to conduct proprietary trading through a dedicated subsidiary licensed as an investment firm or a credit institution (except for certain activities including the provision of investment services to clients, clearing of financial instruments, hedging of risks other than those of such subsidiary and market making). In this context, institutions are considered significant as soon as the threshold of trading activities on financial instruments meets 7.5 per cent of these institutions' balance sheet, on a consolidated basis as the case may be. Such subsidiary will be prohibited from practising high-frequency trading and prudential ratios will be applicable to it on an individual basis. Banks and financing companies that cross this threshold have six months starting from the closure of their accounts to identify the relevant activities and 12 months to perform the required segregation.

6 What are the principal regulatory challenges facing the banking industry?

The most imminent challenge facing the banking industry is to remedy the shortfalls identified in the ECB's 'comprehensive assessment' by the end of April 2015 for shortfalls under the baseline stress test scenario and by the end of July 2015 for those identified under the adverse stress test scenario.

Another regulatory challenge faced by the banking industry is the implementing of the SRM, including the formalisation of recovery and resolution plan (see questions 13 and 14). In particular, the BRRD sets out new resolution rules for all EU banks, including a national prefunded resolution fund which will be built up for a transitional period of eight years in order to reach at least 1 per cent of the amount of covered deposits of all EU credit institutions (ie, approximately €55 billion). The contributions by banks shall initially be raised at a national level before gradually being pooled together.

Finally, a single rulebook for the resolution of failing banks, which aims at enhancing the tools for dealing with bank crises across the EU, entered into force on 1 January 2015. The coordination role of the European Banking Authority shall be crucial in the respect.

7 Are banks subject to consumer protection rules?

Consumer laws in France govern relationships between professionals and consumers, and therefore apply to banks when they are dealing with their customers.

The Consumer Credit Act of 1 July 2010 sets out consumer protection rules specifically applicable to banks. More recently, the Consumer Protection Act of 17 March 2014 introduced a certain number of additional duties for professionals. In this context, a consumer is defined as a natural person acting for purposes which are outside his or her trade, business, craft or profession.

Banks, as any other professional engaging with consumers, is under a broad obligation to provide adequate information to consumers prior to entering into any agreement. This information must cover the main characteristics of the goods or services and their financial terms and conditions. Clauses must therefore be drafted in plain and intelligible language.

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More generally, consumers have a 14-day withdrawal right (Decree dated 17 September 2014).

Specific duties apply when banks are granting loans to consumers in order to ensure that consumers fully understand the extent of their commitments. In the event banks breach these obligations, they may lose their right to claim interest and be exposed to civil and criminal liability.

In addition, the SRBS Act increased transparency of banking fees (such provisions shall enter into force on 1 January 2016) and provided that banks must verify the clients' solvency.

Under well-established French case law, banks also have a general obligation to provide advice and guidance to borrowers who lack sufficient knowledge to fully understand the extent of their undertakings or the risks they would be exposed to. In this respect, the borrower's capacity to measure the financial risk incurred, the borrower's profession and the complexity of the transaction are taken into account. This duty may however be waived in the event the borrower conceals or withholds relevant information.

The Directorate General for Competition Policy, Consumer Affairs and Fraud Control (DGCCRF) is in charge of verifying that consumer laws are complied with and may impose administrative fines upon professionals up to €15,000 per infringement.

The ACPR is also entrusted with the power to supervise banks in order to ensure their clients are adequately protected.

Furthermore, it should be noted that the Consumer Protection Act of 17 March 2014 introduced class actions into French law. Although these may only be introduced by a limited number of authorised consumer associations and plaintiffs may only join on an 'opt-in' basis, this represents a significant increase in potential liability for banks.

Finally, certain suspect practices have been evidenced by the DGCCRF in recent years including lack of clarity regarding variable rates of loans.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Limiting systemic risk while increasing the stability and competitiveness of the banking system remains a central issue in Europe. The EU has, inter alia, increased the banks' capital requirement through several pieces of legislation over the past five years (CRD I, CRD II, CRD III and CRD IV package). The CRD IV package implements most Basel III measures and contains detailed prudential requirements for credit institutions and investments firms. It requires banks to hold more and better capital to resist future shocks. In addition, it introduces rules relating to bonuses paid to material risk takers, governance, capital buffers and prudential rules that are harmonised through a single rule book. Implementation of the CRD IV package into French law was anticipated by the SRBS Act and completed by the Ordinance adopted on 20 February 2014.

Along with the European banking union, the implementation of the CRD IV package and the SRBS Act at the national level, the overarching objective of the eurozone is to strengthen the resilience of the EU banking sector with the harmonised application of the new banking regulations throughout Europe while ensuring that banks continue to finance economic activity and growth. In addition to the transposition of the Basel III Accord through the CRD IV package, the road to European banking union has taken a path through the implementation of the SSM and the setting up of the SRM.

The next set of European legislation is likely to consist of adjustments to the newly-created framework once it has been fully implemented.

Eventually, a debate is likely to take place on whether the European banking union has been fully and properly completed despite political union not yet having been realised in the eurozone.

At a national level, it remains necessary to fix troubling discrepancies between banking regulations and insurance-specific regulations and to finalise a comprehensive single book of regulation for the banking and insurance sectors.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Apart from the powers to be exercised by the ECB under the SSM (see question 3) and the SRM (see question 13), the ACPR has primary responsibility for supervising banks that it has authorised to conduct business in France. In addition, as indicated in question 3, the AMF has investigative powers regarding financial activities.

The ACPR is vested with broad administrative powers allowing it to carry out various types of examination. In practice, banks are subject to such supervision in two different ways:

- off-site monitoring – each quarter, based on the findings of quarterly or semi-annual accounting and prudential reports, the senior management of banks meets with the ACPR for a general discussion of potential issues relating to the evolution of their business, the management and monitoring of risks and the soundness of their financial conditions; and
- on-site inspections.

The ACPR's supervision may result in two types of on-site inspections:

- general inspections – these are carried out every one or two years, with the purpose of evaluating whether the information disclosed by a bank accurately reflects its situation, and typically concern the bank's organisation, the soundness of its management, its risks and its financial condition (for large banks, the ACPR tends to favour the investigation of certain business segments or specific risks over a general inspection); and
- specific inspections – the ACPR may, at any time, carry out more specific inspections, usually based on its review of the bank's periodic disclosures. In addition, the ACPR may decide to proceed with a series of inspections targeting a particular segment of the banking industry, to increase its knowledge of such segment.

Pursuant to the SRBS Act, when services are provided via the internet, inspectors are entitled to use a false identity. The ACPR may also address and hear collectively the members of the board of directors. In addition, extension of inspections to foreign subsidiaries is now possible, outside any bilateral agreement, upon express consent by the foreign supervisory authority.

As a consequence of the implementation of the 2007/64/EC Directive, a new category of banking entity referred to as the 'payment institution' has been recognised. Payment institutions are providers of payment services but do not take deposits or issue electronic money. They are supervised by the ACPR and need its authorisation before offering or performing payment services (that is, services enabling cash to be used in a payment, activities required for operating a payment account, services enabling cash withdrawal from a payment account, execution of payment transactions, issuing or acquiring payment instruments, remittance of money and execution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication and the payment is made by the payment institution acting only as an intermediary between the payment service user and the supplier of the goods and services). In addition to obtaining the authorisation of the ACPR, the payment institutions must also meet regulatory prudential criteria and are bound by professional secrecy rules.

10 How do the regulatory authorities enforce banking laws and regulations?

The ACPR ensures that banking regulations are observed through the exercise of its administrative powers.

First, the ACPR issues instructions, notes and circulars that typically intend to clarify the reporting requirements imposed on banks.

Second, as a result of its off-site monitoring and on-site inspections, the ACPR sends follow-up letters to banks, stating the main findings of the examinations and pointing out the improvements that must be achieved. In practice, the ACPR may take the following actions:

- send a cautionary notice to management of the bank, allowing it to provide the ACPR with an explanation for not complying with the applicable regulations;
- issue a recommendation to a bank, describing the necessary measures to improve the bank's financial condition or management methods; the bank must respond to a recommendation within two months and give details of the measures undertaken; and
- issue an order to the bank requiring that certain measures be taken within a certain period of time.

Through its sanction powers, the ACPR may impose a wide range of sanctions on a bank, either because the latter has violated applicable regulations or because it has failed to comply with a cautionary notice,

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a recommendation or an order issued by the ACPR. These 'disciplinary' sanctions are:

- a warning to cease certain practices;
- a reprimand;
- a prohibition on engaging in certain operations or limitations on the conduct of certain banking activities;
- a temporary suspension of one or more senior managers or members of the board of directors of the bank (with or without the appointment of a provisional administrator);
- requiring the resignation of one or more senior managers or members of the board of directors (with or without the appointment of a provisional administrator); or
- striking a bank off the list of credit institutions authorised to conduct banking activities in France (with or without the appointment of a liquidator). Regarding this sanction, the ACPR's decision to withdraw the authorisation of a credit institution is subject to confirmation by the ECB.

Also, the ACPR may impose a monetary fine up to €100 million, prohibit or limit the payment of dividends to shareholders and order the sanction to be published at the expense of the bank. In the event the relevant institution has breached a provision under the Capital Requirements Regulation, the fine can reach 10 per cent of the net annual turnover and twice the amount of the benefit obtained from the infringement when it can be determined.

Lastly, the ACPR's sanction power can reach the level of public order administrative measures. The ACPR can order a bank to take any measures necessary to achieve compliance within a set time or to submit for the ACPR's approval a recovery plan covering all the measures needed to restore or strengthen its financial situation, or to improve its management methods or organisation. And where the solvency or the liquidity of the bank (or the interests of its clients or beneficiaries) are likely to be compromised, or when a bank is likely to breach its obligations under the Capital Requirements Regulation in the next 12 months, the ACPR may:

- place the entity under special supervision;
- ask its agents to exercise permanent supervision within the bank in order to closely follow the situation;
- limit or temporarily prohibit the execution of certain transactions or activities;
- suspend, restrict or temporarily prohibit the free disposal of all or some of the bank's assets (the 2013 reform broadens this power);
- order the bank to cease activities;
- limit the number of agencies or branches;
- order the bank to suspend or limit payments, including the payment of interest on common equity Tier 1 instruments unless this triggers an event of default;
- require the reduction of risks inherent to the activities, the products and systems of the relevant institution;
- order the transfer, without consultation, of some or all of the insurance contracts and settlement portfolios or credit portfolios and deposits;
- decide to prohibit or limit the distribution of a dividend to the shareholders or a return on the membership shares of said entities;
- suspend one or more of the bank's senior managers and board members when they fail to comply with the requirements of respectability, competence or experience; or
- appoint a provisional administrator to manage the bank.

Since the SRBS Act, the ACPR may also limit or suspend the execution of certain transactions when the relevant entity's activity is likely to adversely affect financial stability or in the event of such emergency situations as contemplated in EU Regulation 1093/2010.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Issues that have most commonly been addressed by the ACPR in the course of examinations relate to counterparty risk and information systems. The ACPR has raised the counterparty risk issue in connection with a variety of business segments (such as the credit business and securitisation), whereas inspections carried out by the ACPR typically focus on the efficiency of banks' information systems, especially after an external growth transaction. One of the ACPR's most recurring concerns is the ability of a bank to build a comprehensive and integrated information system allowing global assessment and management of accounting, production, etc.

Issues that have recently triggered ACPR investigations and sanctions include failure to comply with corporate governance, internal control and accounting rules. More specifically, several credit institutions and investment firms have been sanctioned for unsatisfactory compliance with their internal control obligations.

12 How has bank supervision changed in response to the 2008 financial crisis?

As explained in question 8, the most dramatic change in banking supervision lies in the increasing integration of supervision at the European level.

For the purposes of the SSM, a credit institution is considered significant most notably if the total value of its assets exceeds €30 billion or exceeds 20 per cent of national GDP (unless the total value of assets is below €5 billion) or if it is one of the three most significant credit institutions established in a member state.

Following the implementation of the SSM, the powers of the ECB and the ACPR have been allocated in the following manner:

- the ECB directly supervises all institutions that are classified as significant, with the assistance of the ACPR, whereas the ACPR continues to supervise directly less significant institutions, subject to the oversight of the ECB.
- Regarding the granting of bank licences and acquisitions of qualifying holdings, regardless of the significance of the institution, applications are sent to the ACPR. If the ACPR determines the application complies with national conditions, it proposes to the ECB a draft decision containing its assessment and recommendations. The final decision rests with the ECB. Regarding withdrawal of banking licences, both the ECB and the ACPR have the right to propose the withdrawal but the ECB finally decides. These are known as the 'common procedures'.
- Regarding passporting procedures, the applicant must notify the ACPR. For significant institutions, the ECB will conduct an assessment of the application. Unless a decision to the contrary is taken by the ECB, the application will be deemed accepted within two months of its receipt. For less significant institutions, the ACPR is competent.

The cooperation between the ACPR and the AMF on the one hand and the new European supervisory bodies on the other, has been eased through the transposition of Directive 2010/78/EU 'Omnibus I' (as amended by Directive 2013/36 EU) into the MFC.

Moreover, since the Ordinance of 20 February 2014, as soon as the ACPR is aware of an event which is likely to threaten market liquidity or the stability of the financial system of any member state, it shall alert the European supervisory authorities including the European Banking Authority and the European Systemic Risk Board as soon as possible.

At a national level, further to the creation of the High Council for Financial Stability (previously known as the Financial Regulation and Systemic Risk Council) in 2010, the SRBS Act granted new powers to the ACPR for prevention, sanction and resolution (see questions 10 and 13).

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Prior to the SRBS Act, the powers granted by the MFC to the ACPR (see question 10) were sometimes used to persuade banks to halt or dispose of loss-making activities or subsidiaries. The SRBS Act created actual binding resolution mechanisms at a national level and granted additional powers to the ACPR (see question 14).

Pursuant to the SRBS Act, alongside the preventive recovery plans (see question 14), the ACPR must establish a preventive resolution plan for credit institutions and investment firms (except portfolio management companies) of a certain size (the threshold has not yet been determined at the time of writing, although it will presumably be limited to institutions under the direct supervision of the ACPR, more significant institutions being covered by the ECB). Should the ACPR consider that the organisation or operation of any such entity may hinder the efficient execution of such plans, it may ask the relevant entity to take appropriate measures to reduce or remove such hindrance.

Once the ACPR has been seized, the resolution commission must assess whether the entity, taken individually or within its group, is defaulting and

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whether there is any prospect of this default being avoided within a reasonable time frame without implementing resolution measures.

Default by an entity is constituted by breach of capital requirements conditioning its authorisation to operate, inability or imminent ability to make its payments or need for exceptional financial support from the state.

In the context of resolution, the ACPR may notably:

- appoint a provisional administrator;
- remove the 'top-two' management;
- decide on the transfer of all or part of certain lines of business;
- impose a share capital decrease or a cancellation of shares;
- temporarily limit or prohibit the implementation of certain transactions; and
- limit or prohibit distribution of dividends.

The MFC provides that such measures pursue the public interest goals of preserving financial stability and ensuring continuous operation of the relevant entity's business (the BRRD is more stringent as it provides that resolution action must be necessary in the public interest in that it achieves and is proportionate to one or more of the resolution objectives, whereas winding up under normal insolvency proceedings would not).

It should be noted that the current resolution powers of the ACPR are likely to be modified once the SRM is implemented.

Under this new regime, in the context of a resolution, the ACPR ensures that the loss suffered by the shareholders, partners or creditors of the defaulting bank is no greater than what it would have been had the bank been liquidated in accordance with general bankruptcy laws. It should be noted that the BRRD extends resolution tools available to resolution authorities (ie, the sale of business, recourse to a bridge institution, asset separation and bail-in). These have not yet been implemented into French law.

As regards the EU level, the Supervisory Resolution Board (SRB) is currently working on the elaboration of resolution plans in cooperation with the national resolution authorities. The SRB should be fully operational as from 1 January 2016.

Legislation which the French government has been authorised to pass by a law dated 30 December 2014 in order to implement EU Directive 2014/59 will probably complete these measures.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

According to the SRBS Act, banks of a certain size (the threshold has not been defined at the time of writing although it will presumably be limited to institutions under the direct supervision of the ACPR, more significant institutions being covered by the ECB) must have prepared and submitted a resolution plan to the ACPR. Pursuant to the SRBS Act, credit institutions and investment firms (except portfolio management companies) of a certain size (the threshold has not yet been determined at the time of writing) will be bound to establish and submit preventive recovery plans to the ACPR setting out the measures that are contemplated in the event of significant deterioration of their financial position. Such measures may not take into account any potential bail out by the state or the Deposit Guarantee and Resolution Fund. As indicated in question 13, it is likely that these provisions will be amended in order to reflect the powers of the ECB under the SRM.

When the resolution plan is implemented (see question 13), the ACPR may remove the 'top-two' management (in which case no severance package will be payable) in addition to the broader right to suspend board members and directors for lack of respectability, competence or experience. The 'top-two' management is defined as the two individuals 'effectively directing the bank' pursuant to the MFC.

The transfer of business, rights or obligations of the defaulting bank imposed by the ACPR (see question 13) could result in limiting the scope and powers of the managers in practice. Last, the SRBS Act provides that when a provisional administrator has been appointed by the ACPR, the severance package of the suspended managers cannot be paid up until the end of the provisional administrator's assignment, following which it needs to be approved by the shareholders.

15 Are managers or directors personally liable in the case of a bank failure?

In certain circumstances general French bankruptcy law can hold managers and directors of failing banks liable, particularly in cases of mismanagement, shortfall of assets, fraud and tort liability.

More specifically, article L.612-40, VII of the MFC provides that effective managers can be fined up to €5 million for an infringement of any rules under the CRD IV Package.

16 How has bank resolution changed in response to the recent crisis?

The SRBS Act granted the ACPR powers to ensure the development and implementation of prevention and resolution of banking crises under articles L. 613-31-11 to L. 613-31-19 of the MFC, the purposes of which are to preserve financial stability, to ensure the continuity of activities, services and operations of institutions whose failure could have serious consequences for the economy, to protect depositors and to avoid or minimise the use of public financial support.

To this end, article L. 613-31-16 of the MFC ensures the ACPR with a wide range selection of tools, including the power to sell or merge the business with another bank, to set up temporary bridge-bank to operate critical functions and to separate good assets from bad assets.

Another important change lies in the establishment of preventive recovery and resolution plans for credit institutions of a certain size made mandatory by the SRBS Act (see questions 12 and 13).

At the European Union level, two mechanisms have been implemented to ensure that shareholders and creditors bear the cost of bank failure and minimising the burden on taxpayers.

The most noticeable change in banking resolution lies in the provisions of the BRRD, which provide a bail-in mechanism enabling the ACPR to write down and convert the debt of failing credit institutions or finance companies (as opposed to a bailout, which leads to saving the failing bank with public money). The bail-in mechanism has already been implemented into French law through provisions of article L. 511-42 of the MFC. When a credit institution or a finance company faces financial difficulties, the Governor of the Banque de France invites shareholders to provide financial support. If the credit institution is significant, the Governor of the Banque de France must seek the ECB's opinion.

Furthermore, as discussed in question 13, an SRM has been set up.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Credit institutions and finance companies must have an initial paid-up capital or an endowment of a minimum amount between €1 million and €5 million depending on the authorisation granted (article L. 511-11 of the MFC). For instance, banks must have an issued share capital of at least €5 million (CRBF Regulation No. 92-14 as amended).

In addition to the minimum share capital requirement, credit institutions and finance companies are required to comply with management standards to ensure their liquidity and solvency in respect of depositors and, more generally, third parties, and the balance of their financial structure. To this end, credit institutions and finance companies must comply with prudential ratios to guarantee their liquidity and solvency (article L. 511-41 of the MFC). Below are the main applicable ratios:

- CRBF Regulation No. 91-05 (as amended) relating to the solvency ratio – credit institutions are required to maintain, at all times, a solvency ratio (ie, the ratio of capital to aggregate operating credit risk exposure) of at least 8 per cent. Under the CRD IV Regulation, while the total capital an institution will need to hold remains at 8 per cent , the share that has to be of the highest quality and that allow an institution to continue – common equity Tier 1 (CET 1) – increases from 2 per cent to 4.5 per cent.
- The Regulation establishes five capital buffers: the capital conservation buffer, the countercyclical buffer, the systemic risk buffer, the global systemic institutions buffer and the other systemic institutions buffer. These additional own funds obligations have been transposed into French law by the Decree dated 3 November 2014.
- CRBF Regulation No. 93-05 (as amended) relating to the supervision of large exposures – the ratio of a credit institution's overall exposure to any counterparty may not exceed 25 per cent of the credit institution's capital. When the counterparty is a credit institution or a group of credit institutions, the total sum of net risk-weighted assets shall not exceed the greater of €150 million and 25 per cent of the funds of the credit institution concerned; and

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- the Decree dated 5 May 2009 (as amended in November 2014) relating to the identification, measure, management and control of the liquidity risk on a short-term as well as on a long-term period – a credit institution's ratio of liquid assets to liquid liabilities (or liquidity coefficient) shall be above 100 per cent at all times. Liquid assets and liabilities include cash positions, claims (including repo-related claims with up to one month of remaining maturity) and negotiable securities, as well as off-balance sheet commitments and available liquidity lines. The ratio of liquid assets to liquid liabilities uses a weighting scheme defined by the ACPR to reflect the likelihood of items being rolled over or being available in event of a liquidity squeeze. Accordingly, bank liquidity management involves not only the liquidity of assets but also the nature and structure of, and changes in, liabilities.

Credit institutions must also maintain adequate liquidity buffers (article L. 511-41-1-B of the MFC).

Applicable liquidity buffers are:

- First, to improve the short-term (over a 30-day period) resilience of the liquidity risk profile of financial institutions, there is a liquidity coverage requirement.
- Second, to ensure that an institution has an acceptable amount of stable funding to support the institutions assets and activities over the medium term (over a one-year period), there is a net stable funding requirement (NSFR). The European Commission will prepare, if appropriate, a legislative proposal by 31 December 2016 to ensure that institutions use stable sources of funding (NSFR).

Under French law, the Decree of 5 May 2009 provides that institutions must implement a general policy to assess the liquidity risk that meets the criteria set out in sections 148 to 167 of the Decree dated 3 November 2014. Article 148 of this later Decree transposes the long-term and the short term liquidity buffers mentioned above. Article 149 compels credit institutions to set up internal policies and procedures proportional to their scale, the nature and complexity of their activities, and to the risks incurred to determine and manage their risks on a permanent and proactive basis. The scope of the internal control includes rules relating to anti-money laundering and terrorism financing.

18 How are the capital adequacy guidelines enforced?

As mentioned above, the ACPR receives (through secure IT systems and databases) monthly, quarterly and semi-annual accounting and prudential reports from all banks, allowing for periodic assessment of compliance with capital adequacy guidelines (L. 612-23 and L. 612-24 of the MFC). Moreover, every bank must justify at all times that its assets actually exceed the minimum share capital amount.

In addition, changes in capital of a credit institution or a finance company must be notified to the ACPR (article L. 511-12-1 of the MFC).

Banks must also implement an adequate system of internal control enabling them to assess the risks and profitability of their activities, and to produce useful information for the ACPR's surveillance (articles L. 511-41 and seq of the MFC).

As a result of such assessment, a wide range of administrative remedies or sanctions are available to the ACPR to ensure that the capital adequacy guidelines are enforced. Sanctions range from simple warnings and formal notice to the withdrawal of the banking licence (article L. 612-39 of the MFC).

The CRD IV package reiterates that the European Banking Authority is in charge of monitoring the quality of own-fund instruments issued by institutions across the EU, in particular by organising stress tests on a regular basis.

19 What happens in the event that a bank becomes undercapitalised?

The ACPR will first typically give notice to a bank to take appropriate actions to restore or increase its financial position.

To this end, and pursuant to article L. 511-41-3 of the MFC, when the financial situation of a credit institution, an investment firm or a finance company is compromised or likely to be, the ACPR may:

- require the company to publish additional information;
- order the company to take within a specified period all measures to restore or increase its financial position or liquidity, improve its management or to ensure the adequacy of its organisation, its activities or its development objectives;
- order the company to submit to a specific liquidity requirements, including restrictions on asymmetrical maturities between assets and liabilities;
- request that the company holds total assets of an amount greater than the minimum stipulated by the applicable regulations and require the application of a specific provisioning policy's assets or specific treatment under the capital requirements;
- require the company to assign its profits to the strengthening of its total assets; and
- require the company to curb variable compensation as a percentage of total net income.

Pursuant to article L. 511-42 of the MFC, when appropriate, the Governor of the Banque de France is entitled to 'invite' (not 'request') the shareholders of a bank to provide the necessary support (concerning significant banks, the governor must first seek the ECB's opinion).

If the measures taken by the credit institution are not sufficient to restore or increase its financial position, the ACPR must, under its administrative police powers, take several actions to ensure that a lack of capitalisation is remedied in due course (see question 10).

Since the SRBS Act, if necessary and where applicable, ACPR may also order resolution decisions (see questions 12 and 13).

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Further to question 13, French legislation governing the insolvency of credit institutions mainly consists of the general bankruptcy provisions set forth in the Commercial Code regarding the insolvency of corporations.

However, article L. 613-24 et seq of the MFC provide for three main rules unique to the insolvency of a credit institution:

- a specific definition of 'insolvency' for credit institutions – a bank is considered insolvent when it is unable to meet its current liabilities immediately (ie, ability to repay demand deposits) or in the near future (ie, ability to repay short-term savings);
- the ACPR may appoint a liquidator which can transfer all powers of administration, management and representation of the corporation; and
- the president of the competent commercial court is entitled to initiate bankruptcy proceedings against a credit institution only after ACPR's assent.

In addition, France has implemented Directive No. 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions, providing, inter alia, for a single bankruptcy proceeding when a bank with branches in several EU member states becomes insolvent.

Finally, the French Deposit Guarantee and Resolution Fund may intervene upon request from the ACPR to compensate depositors in case of unavailability of their deposits or securities (see question 4). This mechanism will be replaced by the SRF once it is fully operational.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

Since the implementation of the CRD IV package, it is not expected that capital adequacy guidelines will change in the near future (see questions 8 and 17).

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The creation of a bank and the investment in a bank are subject to authorisation.

When a bank applies for authorisation to carry out banking activities in France, or when a proposed acquirer applies for authorisation to invest in a bank, the ACPR examines several criteria that are considered as equally important to the outcome of its decision; among which are the identity of the shareholders, the amount of their participation (article L. 511-10 of the MFC) and the honorability and financial solidity of the proposed acquirer (article R. 511-3-1 of the MFC).

These criteria are justified by the substantial liabilities borne, and the significant influence exercised, by the main shareholders of a bank.

The Decree of 3 November 2014 states that any company seeking authorisation indicates, in support of its request, the identity of its direct or

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indirect capital providers, natural or legal persons having a qualifying holding (directly or indirectly, at least 10 per cent of the capital or voting rights, or any ability to exercise significant influence over the management of the enterprise) or, alternatively, the identity of the 20 main capital providers and the amount of their participation.

Pursuant to article L. 511-10 of the MFC, the ECB or the ACPR refuse to grant the authorisation when:
- the exercise of the monitoring mission on the applicant company is likely to be impeded either by the existence of capital links or direct or
- indirect control between the company and other natural or legal persons or by the existence of laws or regulations of a state which is not a party to the Agreement on the European Economic Area which govern these persons; and
- in the light of the assessment criteria, there are reasonable grounds to believe that the quality of capital providers does not ensure a sound and prudent management or if the information communicated is incomplete.

On a practical level, the ACPR also generally scrutinises the following:
- when the effective control of a bank is not held by a single shareholder, the ACPR ensures that the allocation of the share capital is sufficiently stable, requires certain undertakings from the main shareholders, and usually recommends that the bank's shareholders enter into a shareholders' agreement (which shall provide mechanisms to avoid deadlock situations);
- the ACPR does not tend to grant authorisations to banks that are owned by a single individual; in general, the level of ownership that can be held by an individual depends on the type of bank, the identity of the other shareholders and the personal condition of such individual; and
- the ACPR prefers bank shareholders to hold their interests directly in the bank rather than through holding companies or special purpose vehicles.

23 Are there any restrictions on foreign ownership of banks?

The ACPR may require that if the majority shareholders of a bank are foreign, an EU-authorised bank should act as sponsor of such foreign shareholders. In such a case, this sponsor is usually required to own a blocking minority and to be represented on the bank's board of directors. But, this is not systematic, and there is no other specific restriction on foreign ownership of banks.

24 What are the legal and regulatory implications for entities that control banks?

The ACPR may require the holding company of a bank which is under its supervision the communication of all necessary information, and to disclose publicly an annual description of its legal structure, and of its governance and organisational structure.

The ACPR tends to consider that when a controlling position is owned by entities that are not subject to the supervision of the banking authorities, the authorisation is granted (or maintained) only if the entities' investment in the bank is reasonable given their assets and available capital. In addition, the non-banking activities of such entities have to generate annual financial results sufficient to satisfy future needs to reinforce the capital of the bank. The ACPR often requires non-banking controlling shareholders to be sponsored by an EU-authorised bank. It could also ask for a comfort letter from such entities (providing for long-term ownership of the bank, permanent supervision of the bank's business and a commitment to provide financial support to the bank, if necessary).

Notwithstanding the foregoing, the ACPR may decide to qualify an entity that controls a bank as a 'finance company' and, hence, impose reporting duties and prudential supervision on such controlling entity. A finance company is not, however, required to be registered with or granted a licence by the ACPR (pursuant to article L. 517-5 of the MFC). The ACPR may do so only if the controlling entity is a company whose subsidiaries are, mainly or exclusively, financial institutions.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

As explained in question 19, there is no obligation for a shareholder to provide additional capital in the event that a bank becomes under-capitalised, absent an explicit commitment by such shareholder to do so. The governor of the Banque de France is only entitled to 'invite' shareholders of a bank to provide financial support (article L. 511-42 of the MFC). In this case, article L. 613-31-16 MFC provides for the ACPR to ensure that the loss suffered by the shareholders, partners or creditors of the defaulting bank will not be greater than what it would be if the bank was liquidated in accordance with general bankruptcy laws.

Nevertheless, in practice, shareholders of a credit institution may be required to give support to a bank upon request of the ACPR. Indeed, article L. 511-10 of the MFC provides that the ACPR may attach special conditions to the authorisation granted for purposes of carrying out certain banking activities. As a result of such conditions, that could be materialised into a comfort letter, an entity or individual controlling a bank may be subject to duties and responsibilities such as an obligation to contribute additional capital upon request of the ACPR.

The BRRD sets out a bail-in mechanism which forces shareholders to provide financial support to the bank. This obligation is expected to be transposed into French law in 2016.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Articles L. 612-33, L. 613-24 and L. 613-31-16 MFC contain provisions that could be applied to controlling entities or individuals if a credit institution becomes insolvent.

Pursuant to those articles, if a bank becomes insolvent or if its solvency or liquidity is likely to be compromised, the ACPR may impose the following sanctions that could affect its controlling entity or individual:
- suspend, restrict or temporarily prevent the disposal of all or part of the assets of the controlled bank;
- restrict or prevent the distribution of dividends to the shareholders of the bank;
- order the mandatory transfer of all or part of the credit or deposit portfolio of the credit institution; and
- upon a petition presented to the Paris Court of First Instance, order the mandatory sale of the shares of the bank.

Pursuant to article L. 613-31-16 MFC, if a bank becomes insolvent or its solvency or liquidity is likely to be compromised, the ACPR may impose the following conditions that could affect its controlling entity or individual:
- order the mandatory transfer of all or part of the assets of the controlled bank to a dedicated entity;
- with the approval of the controlled bank, order the transfer of the shares of the banks to the Deposit Guarantee and Resolution Fund or a dedicated entity; or
- order a reduction of the subscribed capital, a cancellation of title of the capital or the conversion of liabilities elements.

The general bankruptcy provisions set out in the Commercial Code regarding the insolvency of corporations may also be applicable. As to those general principles, the controlling entity shall not assume any liability if it has not intervened in the daily management of the bank and if it did not force the bank and its management team to make decisions that directly led to bankruptcy.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Pursuant to article L. 511-12-1 of the MFC, modifications in the distribution of capital of a credit institution or a finance company must be notified to the ACPR.

Direct or indirect acquisitions of qualifying holdings (means a direct or indirect holding which represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management) or increases in holdings in any bank must, be notified to the ACPR, and approved by the ECB, in compliance with sections 4 and 15 of EU Regulation No. 1024/2013 of 15 October 2013.

In this context, the ACPR must notably evaluate the suitability of the proposed acquirer and the financial soundness of the proposed acquisition (article R. 511-3-2 of the MFC). The ACPR must also verify that this transaction does not affect the conditions under which the licence to operate was granted to the relevant institution (article L. 511-12-1 of the MFC).

The ACPR shall examine the contemplated acquisition, and forward the notification and a draft decision to the ECB.

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Update and trends

The ECB issued a recommendation in January 2015 regarding dividends by significant banks under which it recommends to adopt a conservative policy when distributing dividends, stating that banks with a residual shortfall following the comprehensive assessment should not distribute any dividends.

Driven by the AMF and the Banque de France, the High Legal Committee of the Financial Centre of Paris was set up in January 2015. It is an independent committee which mainly aims at proposing reforms that are likely to increase Paris' attractiveness as a financial centre and publishing answers to legal questions of financial actors in order to enhance legal certainty.

If the ECB fails to respond to a duly documented application for more than 60 days authorisation is deemed granted. This deadline may be suspended by 20 days more or 30 days when the acquirer is a non-EU state, or is not subject to EU legislation or does not fall within the scope of the surveillance set up under the 2013/36/EC, 2009/65/CE, 2009/138/CE or 2004/39/CE Directives (Decree of 23 October 2014).

In addition, if the bank is listed on a regulated stock exchange and the change in control is meant to occur as a result of a tender offer, the AMF's approval is also required prior to the filing by the offeror of its tender offer prospectus (see question 30). Any person intending to launch a takeover offer on the shares of a credit institution authorised in France or a finance company may first inform the Governor of the Banque de France and President of the ACPR eight business days before the filing of the draft tender offer prospectus with the AMF, or the public announcement of such tender offer, whichever is earlier (article R. 511-3-5 of the MFC).

Finally, the acquisition of control may often require the approval of French or EU competition authorities.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

It should be noted that the Ordinance dated on 6 November 2014 has aligned the process for EU and non-EU acquirers by repealing section L. 511-12 of the MFC.

However, no acquisitions of control of significant French banks by foreign acquirers have taken place in the past four years and, thus it is difficult to assess the ACPR's reaction in future in relation to this type of purchaser. One of the consequences of the results of the comprehensive review at the time of writing might be an increase in cross-border consolidation transactions, within or without the eurozone, in which undercapitalised financial institutions would be a key part.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

As stated above, the ACPR shall verify that the acquisition does not affect the conditions attached to the authorisation granted to the credit institution or finance company (see question 27).

To that end, the ACPR must assess the suitability of the proposed acquirer and the financial soundness of the proposed acquisition in accordance with the following criteria:

- the reputation of the proposed acquirer;
- the reputation, skills and experience of any member of the management body and any member of senior management who will direct the business of the credit institution as a result of the proposed acquisition;
- the financial soundness of the proposed acquirer;
- the ability of the acquirer to comply with the prudential requirements as defined in the CRD IV package (Directive and Regulation (EU) No. 575/2013); and
- whether there are reasonable grounds, in connection with the proposed acquisition, to suspect the existence of money laundering or terrorist financing (article R. 511-3-2 of the MFC).

30 Describe the required filings for an acquisition of control of a bank.

To receive the authorisation for an acquisition of control of a bank a comprehensive application (available online on the ACPR website) must be filed by the acquirer with the ACPR. This application includes information regarding the target, the acquirer, the shareholders agreement if any, the proposed transaction, and its consequences on the parties (especially, where applicable, with respect to their prudential ratios – see question 17). The ACPR may request any additional information or clarification.

The ACPR also examines the contemplated acquisition (notably evaluate the suitability of the proposed acquirer and the financial soundness of the proposed acquisition), and shall forward the notification and a draft decision to the ECB.

In addition to this application, and in the event that the acquisition of control takes the form of a tender offer, the governor of the Banque de France may be formally informed (usually by a letter) of the tender offer eight business days before the filing of the draft tender offer prospectus with the AMF, or the public announcement of such tender offer, whichever is earlier (article R. 511-3-5 of the MFC). In addition, customary competition filings may be required based on the nature of the transaction. Moreover, the offeror and the target must proceed with all the ordinary prospectus filings with the AMF that are necessary for the implementation of a tender offer.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Depending on the size and nature of the transaction, the regulatory approval process usually takes two to three months from the date the application is made, though it could be completed faster if some publicly known risks are present (see question 27).

In practice, preliminary discussions with the regulators are necessary to evaluate the feasibility of the transaction. No application is filed and no transaction is implemented unless the banking authorities give a favourable informal opinion on the proposed transaction structure. As a result, dismissed applications are fairly rare and mainly result from the occurrence of adverse developments after the filings.

As described in question 28, although there is no significant difference between a foreign and a domestic acquirer, the process may be longer for a foreign acquirer, as the regulator may require specific undertakings to be made or impose certain conditions on the transaction.

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The main objective of the German banking supervision is to ensure stability, efficiency and integrity of the domestic financial market. Regulatory provisions aim at preventing irregularities in Germany's credit sector as such irregularities could jeopardise the assets entrusted to the credit institutions, compromise the proper conduct of banking business or create disadvantages for the overall economy. The scope and intensity of supervision primarily depends on the nature and extent of the transactions executed by the credit institutions. In general, banking supervision's primary concern is that financial institutions are vested with sufficient capital, maintain appropriate liquidity reserves and have installed adequate risk control mechanisms.

2 Summarise the primary statutes and regulations that govern the banking industry.

The German banking sector is mainly governed by the following regulations:

- the German Banking Act (KWG) provides regulatory provisions which the credit institutions have to observe and comply with when setting up business and running operations;
- the German Investment Code covers all collections of capital considered investment assets and serves the implementation of Directive 2011/61/EU on Alternative Investment Fund Managers and Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities;
- the Payment Services Regulation Act (ZAG) comprises specific provisions for payment service providers (in particular e-money, credit and payment institutions) and implements the Payment Services Directive (Directive 2007/64/EC on payment services in the internal market) as well as Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions;
- the Ownership Control Ordinance standardises reporting duties for persons who intend to acquire a substantial holding in a credit institution, a financial service institution, an insurance undertaking, a pension fund or an insurance holding company. The acquirer must provide both personal information and information regarding its business intentions;
- the Securities Trading Act (WpHG) governs the securities trading in Germany, providing in particular for comprehensive rules of conduct, organisational and transparency obligations;
- the Anti-Money Laundering Act (GwG) serves to prevent money laundering and thus serves fighting organised crime. Banks and the institutions specified in section 2 GWG are encouraged to monitor suspicious transactions and to report any suspicions of money laundering;
- the German Industrial Code (GewO) even subjects fee-based financial investment advisers (section 34h GewO) to a licensing and registration duty;
- the German Pfandbrief Act governs the issuance of mortgage-backed bonds (*Pfandbriefe*) and stipulates specific requirements, exceeding the provisions of KWG, regarding the necessary licensing of credit institutions that intend to engage in Pfandbrief operations;
- the German Civil Code (BGB) comprises general provisions on payment transactions and lending rights;
- the Stock Exchange Act contains provisions on business transactions at German stock exchanges;
- the Securities Acquisitions and Takeover Act governs public offers regarding the acquisition of shares in companies insofar as trading the shares of the issuing company has been admitted to an organised market;
- the Securities Prospectus Act obliges providers of securities to publish a securities prospectus, containing relevant information on the company and the issued security; and
- the regulations, circulars, guidance notices and other announcements of the Federal Financial Supervisory Authority (BaFin).

3 Which regulatory authorities are primarily responsible for overseeing banks?

Since the implementation of the new uniform supervisory mechanism of the new European System of Financial Supervisors in November 2014, banking supervision in Germany is carried out by the European Central Bank (ECB) in cooperation with the national regulatory authorities BaFin and Deutsche Bundesbank. The ECB's supervisory actions cover so-called significant institutions, ie inter alia, institutions whose total value of assets exceeds €30 billion or 20 per cent of national GDP. The national supervisory authorities provide support to ECB, yet they remain in charge of supervising the less significant small and mid-sized institutions. In Germany, BaFin shall continue to exercise supervision over some 2,000 banks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits of private individuals, partnerships and small companies are legally protected up to an amount of max. €100,000 by the Compensation Scheme of German Banks (EdB). In addition, private banks may voluntarily join and participate in the Deposit Protection Fund of the Association of German Banks. Protection provided by the Deposit Protection Fund starts where the coverage by EdB ends. In case of an insolvency of a participating institution, the Deposit Protection Fund assumes the deposit parts up to the respective protection cutoff (since 1 January 2015: 20 per cent of liable equity capital). The Deposit Protection Fund provides protection for all 'deposits held by non-banking institutions' (ie, assets held by private individuals, business enterprises and public bodies).

A different protection schemes applies to the German cooperative banks, as well as the German savings banks. The protection scheme run by the National Association of German Cooperative Banks offers its affiliated institutions a 100 percent protection without amount-related restrictions for all customer deposits and bearer bonds. The protection scheme applicable to German savings banks guarantees the liquidity and solvency of its affiliated institutions by a mutual unlimited assumption of liability.

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5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Pursuant to section 13c KWG, the supervisory authorities must be notified of significant intra-group transactions with mixed-activity holding companies. Here, an intra-group transaction shall be presumed to be significant if its volume exceeds at least 5 per cent of the total amount of capital adequacy requirements at group level. The performance of such transactions is not only subject to a unanimous decision of all the institution's managing directors but also to prior approval of BaFin. If these requirements are not fulfilled, the legal effectiveness of the single legal transactions is not affected but BaFin may, however, request the backing of the transaction's excess amount with own funds or, if this is not possible, to prohibit the transaction through application of the regulatory measures available to it (see question 10).

German regulatory law moreover includes specific restrictions as to the granting of loans, inter alia, to the institution's managing directors, to members of the institution's supervisory body or holders of substantial holdings (institutional credits). Pursuant to section 15 KWG, such loans may be granted only by virtue of a unanimous decision by all managing directors and the explicit approval of the supervisory body of the institution, and only on prevailing market terms. If loans are granted contrary to these requirements, they shall be repaid immediately unless all managing directors and the supervisory body approve of the granting of these loans subsequently without undue delay. BaFin may impose upper limits for the granting of institutional credits in individual cases.

Moreover, the KWG includes a catalogue of business transactions which credit institutions and financial services institutions may, a priori, not perform. Pursuant to section 3 KWG this includes, for example, the prohibition of:

- the conduct of deposit business if the majority of the depositors are persons employed by the undertaking;
- the acceptance of sums of money if the majority of the investors has a legitimate claim to loans being granted to them on credit out of these sums of money; and
- the conduct of lending business or deposit business if, by agreement or in line with normal business practice, it is impossible or very difficult to withdraw the amount of the loan or deposits in cash.

6 What are the principal regulatory challenges facing the banking industry?

One of the major challenges banks are faced with is the fulfilment and implementation of the constantly increasing requirements regarding risk management, liquidity and capital adequacy as well as compliance. In addition, increasingly stringent reporting obligations in accordance with the KWG or due to European legislation are applied. Such development primarily means a bigger financial burden for institutions but also business downturns. In particular, many bank advisers tend to avoid retail business with private customers owing to the numerous legal risks related to it. Further difficulties arise for the institutions as regards the bulk of laws (national laws, European directives and their implementation through German legal instruments as well as directly applicable European regulations or detailing Level II legislation) and their interaction.

7 Are banks subject to consumer protection rules?

In Germany, banking institutions are, in fact, subject to extensive consumer protection rules. The WpHG, for example, includes specific record-keeping obligations in connection with providing investment advice to retail clients. When providing investment advice to a retail client, written minutes always have to be taken which must indicate the reason for and period of the consultancy, the client's personal situation and investment interests as well as the bank adviser's recommendations and the adviser's underlying reasons. The minutes are to be signed by the adviser who has rendered the consultancy and the client shall be provided with a copy.

Furthermore, before an acquisition of securities or investment fund units is carried out, consumers must be informed by means of product information sheets or key investor documents in a brief (not more than two A4 pages) and easily understandable manner on the substantial risks and rewards of the respective investment. The information to be given shall include:

- the nature of the investment products;
- its functioning;
- the related risks;
- the prospects of capital repayment and proceeds under various market conditions; and
- the costs incurred by the investment.

In addition, the BGB contains special provisions regarding consumer loan agreements, which provide for specific rights of consumers as regards banks, such as specific revocation rights. Disputes in this context and their settlement are, however, not included in the scope of work of supervisory authorities, but are exclusively referred to ordinary courts.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

We continue to expect a progressive harmonisation of the regulatory frame, especially through European rules and guidelines in the future as well as a stronger, increased focus on consumer protection by both the European and the national legislative authority. The draft of a Retail Investors Protection Act, passed by the German Federal Cabinet in November 2014, does, however, point in this direction. The draft bill is to contribute to improving the protection of retail investors and reduce the risk of losses on capital investments. In particular, the transparency of investment offerings on the unregulated capital market is to be further increased to provide investors with complete and up-to-date information on the investment offering at the time of investment. Each potential investor should be able to properly assess a capital investment's prospect of success and the risks associated with it so that it will be easier for the investor to make a well-informed, risk-aware decision. This shall avert potential financial losses for investors, thus strengthening confidence in financial services and products offered in Germany. The draft bill basically contains rules and guidelines on:

- specification and extension of prospectus requirements;
- additional details regarding personnel interweavement of the initiators;
- obligation to provide specific information even after expiration of the offer of securities to the public;
- introduction of a minimum term for capital investments;
- introduction of a product governance process; and
- tightening of accounting and financial reporting obligations.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Within the framework of its ongoing supervisory work, BaFin reviews any regulations, strategies, procedures and processes an institution has developed and established to ensure compliance with the regulatory requirements, and, taking into account the kind, scope and complexity of an institution's business activities, it assesses the risks to which the institution is or may be exposed. Based on such review and assessment, BaFin evaluates in summary and with a forward-looking view whether the risk management processes an institution has implemented and the liquidity and own funds it maintains provide for an adequate and efficient risk management and ensure sound coverage of any risks.

Frequency and depth of these reviews and assessments depend on the size, its relevance to the banking system and the kind, scope and complexity of an institution's business activities, but are carried out at least once a year (section 6b (4) Sent. 2, 3 KWG) in coordination with Deutsche Bundesbank.

Owing to the system of reporting obligations for significant business transactions and organisational measures (section 24 KWG) as well as routine reports on the ongoing business development (eg, sections 25 and 26 KWG, referring to financial information, annual accounts, etc) enshrined in the KWG, provision of continuous information to BaFin is guaranteed, thus establishing the basis for efficient supervision. In addition, BaFin may without special cause request any supervisory information; in particular, BaFin may request information on all business activities and submission of books and other relevant documentation pursuant to section 44.

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10 How do the regulatory authorities enforce banking laws and regulations?

The majority of ongoing regulatory measures are carried out in the course of informal procedures. BaFin, in general, requests information, notifies single institutions of the authorities' opinion on business transactions and other proceedings and more or less clearly pronounces warnings and announces consequences in case the institution does not comply with the requirements of the banking supervision. Usually, these informal administrative procedures result in a clarification or even an actual change in the institution's practice so that formal administrative acts in the ordinary course of the institutions' business only occur relatively infrequently.

In order to perform its duties, BaFin may issue orders such as revoking the licence (section 35 KWG), dismissal of managing directors (section 36 KWG) or the taking of measures to avert dangers (sections 46 et seq. KWG). BaFin may enforce the orders it issues within the scope of its statutory powers by taking enforcement measures as, for example, the imposition of coercive fines of up to a maximum amount of €250,000 (section 17 of the German Act Establishing the Federal Financial Supervisory Authority. Furthermore, the violation of numerous supervisory requirements carries administrative fines (section 56 KWG) or punishments (sections 54 to 55b KWG).

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

As indicated in BaFin's annual report for 2013 (the annual report for 2014 was not yet available at the time of printing, publication is expected in May 2015), BaFin conducted 305 special audits, 220 of which were initiated by BaFin itself (previous year: 273). A total of 94 audits initiated by BaFin were conducted for a specific reason; the remaining 126 cases were scheduled examinations; in addition, there were 67 requested special audits and 18 statutory cover audits. As a result, BaFin lodged serious objections in 116 cases. In 20 cases, BaFin imposed sanctions by ordering measures to improve own funds or liquidity or, as the case may be, measures owing to having exceeded the large exposure limit pursuant to sections 10, 13 and 45 KWG. In total, 48 new administrative fine proceedings were initiated, 33 of these owing to violations of duties of conduct and organisation or information and transparency requirements while 15 proceedings were initiated because of missing investment advice minutes). In eight cases cautions against managing directors were issued, whereas in 10 cases such cautions were issued against supervisory board members.

12 How has bank supervision changed in response to the 2008 financial crisis?

In response to the financial crisis in 2008, the legislative authority has adopted a number of stabilisation measures, including, in particular the establishment of the Federal Agency for the Stabilisation of Financial Markets (FMSA) as well as the Special Fund for Financial Market Stabilisation (SoFFin) and the Restructuring Fund. The original time limitation for stabilisation measures of SoFFin as per expiry of the year 2009 has been extended several times; currently, financial institutions can draw on SoFFin until the end of 2015. Further attention was paid to an improvement of consumer protection, especially through the implementation of rules for the standardisation of documentation and disclosure duties.

Further, as a consequence of the financial crisis, the information and intervention rights of supervisory authorities in emergency situations and crises were strengthened. BaFin's options, for example, to impose measures in case of insufficient capital adequacy or liquidity or to take measures in case of imminent danger, were enhanced. Finally, specific qualification requirements regarding the members of an institution's administrative or supervisory body were enshrined in the KWG. Should the members concerned lack the required expertise, qualification or reliability, BaFin may request their dismissal or prohibit their activities as members of corporate bodies.

Summed up, BaFin's supervisory practice has become more rigorous, a fact that becomes obvious in a clearly more critical attitude of BaFin towards licensing applicants.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The German Act on Ringfencing and Recovery and Resolution Planning for Credit Institutions (SAG), tracing back and thus attributable to European requirements (Directive 2014/59/EU), has entered into force on 1 January 2015. Under section 3 (1) SAG, the FMSA as a resolution authority is entitled under certain conditions to impose the transfer of a Capital Requirements Regulation (CRR) credit institution (article 4 (1) No. 1 of the Regulation (EU) No. 575/2013) or a CRR investment firm (article 4 (1) No. 2 of the Regulation (EU) No. 575/2013) to an already existing institution or to a state bridge bank, established solely for the purpose of transfer (section 107 SAG). The subject of transfer can either be the shares issued by the respective institution or all or part of the assets of the institution. The accepting legal entity must give its consent to the transfer (section 109 SAG). Moreover, the issuance of a transfer order by the FMSA pursuant to section 62 SAG requires that:

- the institution concerned is faced with a going-concern threat;
- the execution of the transfer in order to achieve one or more resolution objectives such as averting systemic risks or the protection of public funds (section 67 SAG) is required and proportionate; and
- it will not be possible to eliminate the going-concern threat within the available period of time through application of other regulatory measures in accordance with sections 36 to 38, 45 et seq. KWG or measures applied by the private sector, including an institutional guarantee system (ultima ratio principle).

The required going-concern risk of an institution is deemed to exist if:

- the institution violates the requirements related to the licence granted pursuant to section 32 in a way that would justify a revocation of the licence by the supervisory authority, or if there are objective indications that this could occur in the near future;
- the institution's assets fall short of the amount of its liabilities, or there are objective indications that this could occur in the near future; or
- the institution has become insolvent or if there are objective indications that in the near future the institution will not be able to meet its existing payment obligations when due.

After execution of the transfer, the FMSA has to have an independent expert to assess if and to which extent unit holders and creditors are disadvantaged due to the imposition and execution of measures compared to the situation which would have arisen if insolvency proceedings over the institution's assets had been opened and carried out (section 146 SAG). Any disadvantages suffered by the parties concerned give rise to a compensation claim against the Restructuring Fund in the amount of the difference (section 147 SAG in connection with section 8 German Restructuring Fund Act.

The FMSA executes its tasks within the framework of the SAG, regularly coordinating its activities with BaFin (section 2 SAG). Apparently, the option of transfer pursuant to SAG has not been realised up to now.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Under the German Bank Restructuring Act, which entered into force in January 2011, institutions requiring recovery shall be enabled to avoid insolvency through application of recovery and reorganisation procedures. Both procedures shall be applied on a voluntary basis and are initiated upon the initiative of the institution concerned. In order to carry out a recovery procedure, the institution has to notify BaFin that it requires recovery, submit a recovery plan and propose a recovery adviser. The recovery plan can include any measures which are likely to achieve a recovery of the institution, however, the recovery procedure does not permit intervention in third-party rights. Intervention in third-party rights such as deferment or (partial) waiver of the institution's receivables shall be admissible only within the framework of a reorganisation procedure. The initiation of a reorganisation procedure can be immediately applied for by notifying BaFin, either submitting a reorganisation plan in the event that an attempted recovery procedure has failed or, if the credit institution believes that a recovery procedure has a priori no prospects of success.

Since 1 January 2015, CRR credit institutions and CRR investment firms (see question 13) are obliged to draw up a recovery plan which has to be regularly updated, at least once a year (section 12 SAG). If certain requirements are met, credit institutions that are members of an institutional guarantee system may be exempted from such obligation by BaFin with the consent of the Bundesbank (section 20 SAG).

In such recovery plan the institutions have to explain the arrangements which will ensure or recover their financial stability if their financial

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position deteriorates substantially and such deterioration may trigger a going-concern risk for the institution (crisis). The SAG establishes very detailed and comprehensive requirements for the contents of a recovery plan. The recovery plan has to comprise, for instance, an outline of its essential contents including an assessment of an institution's potential for recovery, a strategic analysis of the institution's structure and a presentation of available options for action, including an analysis of its feasibility and consequences (as regards requirements in detail, see section 13 SAG). With the consent of Bundesbank, BaFin may in certain circumstances deviate from the above statutory requirements on the content and level of detail of a recovery plan and impose simplified requirements for individual institutions (section 19 SAG).

In the event that recovery and reorganisation measures have a priori no prospects of success, or if measures taken do not lead to results and an institution is facing insolvency, insolvency proceedings must be opened over its assets (see question 20).

15 Are managers or directors personally liable in the case of a bank failure?

The liability of supervisory board and managing board members is subject to general rules of German corporate law. Accordingly, they may be liable for any breaches of their statutory management duties. This includes, for example, reporting duties pursuant to KWG as well as the general duties of care as, for example, to refrain from any acts which could cause damage to the institution. The claims terminate and expire after 10 years, irrespective of any general provisions on limitation periods. The time limit begins upon the claim arising.

16 How has bank resolution changed in response to the recent crisis?

The financial crisis has shown that conventional insolvency law lacks adequate means to effectively handle unsound or distressed institutions. This has prompted the German legislator to implement comprehensive reforms and adopt the KredReorgG, which became effective in January 2011 (see question 14). Recovery and reorganisation procedures are the instruments that the KredReorgG provides to institutions and supervisory authorities in order to facilitate the management of a crisis at an institution without jeopardising financial stability or falling back on taxpayers' money. European legislative authorities have also not failed to act, creating a frame for recovery and resolution of CRR credit institutions and CRR investment firms through adoption of Directive 2014/59/EC. These guidelines were implemented in Germany with the introduction of SAG (see question 13 and 14).

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Depending on the type of transactions carried out, the institutions have to comply with specific minimum requirements as to their capital resources. The KWG, for example, stipulates that credit institutions and financial services institutions must provide evidence of a minimum initial capital of €25,000 up to €5,000,000 (in the case of CRR credit institutions) prior to taking up business. Depending on their business activities, the ZAG requires e-money and payment institutions to prove a minimum capital of €20,000 up to €350,000. Furthermore, such minimum capital must be maintained during the entire term of business operation so that fulfilment of any obligations towards the creditors is guaranteed.

The European rules and guidelines now have a significant impact on the requirements in respect of capital resources in Germany, most recently being harmonised by the CRD IV reform package. The CRD IV reform package, inter alia, serves the implementation of Basel III, the framework published by the Basel Committee on Banking Supervision in 2010: EU Regulation No. 575/2013 (CRR) and the Directive 2013/36/EU (CRD IV). While the CRR provisions are directly applicable in Germany since 1 January 2014, the CRD IV Implementation Act, also put into force on 28 August 2013, was generated to transpose the provisions set forth in CRD IV, incorporating particular adjustments of the KWG into German law.

CRR/CRD IV stipulate not only which own funds (capital resources) shall be acknowledged by national supervisory authorities but also in which amount institutions must maintain own funds to adequately cover their risks. To that effect, article 107 et seq. CCR specifies in detail the methods to be applied for calculation of the capital adequacy with regard to single types of risks, in particular name risks, market risks and the operational risk. Moreover, CCR includes in its article 431 et seq the specification of disclosure requirements for the institutions.

In certain cases credit institutions and relevant investment firms are required to hold, in addition to other own fund requirements, a capital conservation buffer and a countercyclical capital buffer to ensure that they accumulate, during periods of economic growth, a sufficient capital base to absorb losses in stressed periods.

18 How are the capital adequacy guidelines enforced?

Compliance with the capital resources requirements is monitored by the supervisory authorities within the framework of their ongoing supervision. Therefore, credit institutions have to meet different reporting obligations as, for instance, reporting on own funds requirements and financial information (article 99 CRR) or liquidity reporting (article 415 CRR), enabling authorities to identify risks.

19 What happens in the event that a bank becomes undercapitalised?

If an institution gives reason to presume that it will not be able to comply with the CRR requirements regarding capital adequacy, based on section 45 KWG, the supervisory authorities may, inter alia:

- order the institution to provide a report including suitable measures to increase the Tier 1 capital, own funds and the institution's liquidity;
- request the institution to present a concept to avoid a potentially dangerous situation or to present a restructuring plan;
- prohibit or limit withdrawals by the owners or partners and the distribution of profits;
- prohibit or limit accounting measures taken to settle an annual shortfall or report a balance sheet profit; and
- order that the payment of all kinds of proceeds on own funds instruments be cancelled without substitution in whole or in part.

KWG provides the supervisory authorities with further options for action, covering a scope from appointing a special commissioner and conferring upon him supervisory or management functions (section 45c KWG) up to the revocation of the licence for the conduct of business (section 35 KWG).

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

If an institution is facing insolvency (ie, if it becomes insolvent or over-indebted), the managing directors shall report this fact to BaFin without undue delay. Notwithstanding the general provisions of the German Insolvency Code (InsO), the application for the initiation of insolvency proceedings over the institution's assets may only be filed by BaFin (section 46b KWG). Otherwise, the execution of insolvency proceedings is subject to the provisions set forth in the InsO, modified by section 46c KWG).

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

German regulatory banking law has undergone fundamental changes due to the implementation of the CRD IV reform package (see question 17), especially as the qualitative requirements for the capital adequacy were tightened up. As the capital adequacy rules are now European law, they are subject to European legislation, particularly level II legislation and amendments.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Control over an institution is always at hand if another entity or individual has to be considered its parent company or if another kind of hierarchical relationship (eg, owing to a majority of voting rights) exists between both.

Beyond that even owner of a 'substantial holding' are addresses by special regulatory requirements. Such a holding is given if the interest held, directly or indirectly, amounts to at least 10 per cent of the relevant institution's capital or voting rights or if there is another way to exercise significant influence on the institution's management.

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German regulatory law does not know any particular restrictions in connection with the holder of such a substantial holding. However, the European Central Bank (ECB) may prohibit the intended acquisition of a substantial holding if, for example, there is doubt with regard to the acquirer's reliability (see question 27).

23 Are there any restrictions on foreign ownership of banks?

There are no general restrictions in this case.

24 What are the legal and regulatory implications for entities that control banks?

Entities that control a German bank are subject to extensive transparency obligations. For example, BaFin may request the holders of a substantial holding to provide information regarding any and all business activities and submit the respective documentation. Moreover, it may carry out on-site inspections during normal business hours.

Under certain conditions, BaFin is even entitled to prohibit the holder of a substantial holding to exercise its voting rights and to order that the shares may only be used with the authority's consent.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The holder of a substantial holding must notify the supervisory authorities of any changes in such holding insofar as certain thresholds (for example, 20 per cent, 30 per cent or 50 per cent of the capital or the voting rights) are reached or exceeded. In addition, the supervisory authority must be notified of any pending penal procedures against the holder of a substantial holding.

In the ordinary course of business with the institution, the holder of a substantial holding has to comply with general fiduciary duties such as not to cause damage to the company and to keep confidential the company's business secrets. In addition, German regulatory law provides for particular requirements regarding lending activities in favour of persons, affiliated with the lending institutions either personally or under corporate law. Pursuant to section 15 KWG, loans to governing and related bodies (*Organkredite*) may be granted only by virtue of a unanimous decision by all of the institution's senior managers of the management board and the supervisory body only on market terms. For an institution in crisis such loans are recognised and treated as liable equity capital.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Depending on the corporate structure of the institution concerned, unit holders are mostly liable only in proportion to their stake.

In the event that an institution chooses to carry out a reorganisation procedure in accordance with KredReorgG (see question 13), the reorganisation provides for a possible intervention in the position of the stakeholders of the respective institution, subject to certain conditions even without their explicit consent.

Update and trends

On 19 December 2014 guidelines on common procedures and methodologies for the supervisory review and evaluation process – EBA/GL/2014/13 – were published by the European Banking Authority. These guidelines are addressed to competent authorities and are intended to promote common procedures and methodologies for the supervisory review and evaluation process and for assessing the organisation and treatment of risks. The SREP framework is built around business model analysis, assessment of internal governance and institution-wide control arrangements, assessment of risks to capital and adequacy of capital to cover these risks and assessment of risks to liquidity and adequacy of liquidity resources to cover these risks.

The national competent authorities should implement these guidelines by incorporating them in their supervisory processes and procedures by 1 January 2016.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

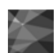
The acquisition of a so called 'substantial holding' in an institution requires a successful owner control process which may be burdensome. For example, the acquirer(s) must, however, notify BaFin of the proposed acquisition. The ECB may prohibit the proposed acquisition for example, if:

- the acquirer lacks reliability or does for other reasons not meet the demands required in the interest of ensuring a sound and prudent management of the institution;
- the institution is not or does not remain able to comply with regulatory requirements, or the acquisition of or increase in the substantial holding would integrate the institution into a corporate association with the holder of the substantial holding which could obstruct efficient supervision of the institution;
- the future managing directors are not reliable or professionally qualified;
- the acquisition either gives rise to money laundering or the financing of terrorism as a matter of fact or it gives reason to fear such development; or
- the acquirer lacks the required financial soundness.

See question 22 regarding the meaning of the terms 'control' and 'substantial holding'.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

According to our experience, this mostly depends on the relevant jurisdiction. In addition, the level of cooperation of the ultimate beneficiary behind the acquirer, particularly the willingness to provide information requested by BaFin, plays a major role. As regards certain jurisdictions, BaFin's concerns seem to be particularly serious. From a technical point of view, for example, for foreign non-EU acquirers (having no registered office in an EU member state) the period within which the supervisory authorities can



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review the submitted documents and prohibit the transaction amounts to a maximum of 90 days. For acquirers from an EU member state the maximum assessment period amounts to only 80 days.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The examination programme of the supervisory authority regularly confines itself to reviewing the documents submitted by the acquirer. The supervisory authority can, however, request additional information or documents and make further inquiries, if need be.

30 Describe the required filings for an acquisition of control of a bank.

Reporting duties are set forth in the Ownership Control Ordinance pursuant to which the acquirer has to provide, inter alia, the following information to BaFin:
- personal details of the acquirer in the case of legal entities, including, if relevant, their group structure and ownership or control;
- information regarding reliability of the acquirer (eg, whether the acquirer is subject to criminal proceedings or has been prosecuted and convicted for criminal or administrative offences in the past);
- shareholding structures in other companies;
- details on the acquirer's financial or economic situation and creditworthiness;
- a statement setting out the financial arrangements of the acquisition; and
- an outline of the acquirer's strategic objectives and plans.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Technically, the authorities can prohibit the transaction within 60 days (assessment period) after it has received all information necessary. The authorities have a wide discretion regarding defining what information is required. In practice, this can lead to the effect of there being no reliable time frame.

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Hungary

Zoltán Varga and Balázs Baranyai

Nagy és Trócsányi

Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The main elements of regulatory policies related to the Hungarian banking sector are:

- governmental control (including authorisation and supervision);
- financial and monetary stability;
- strict capital and risk-management requirements as well as organisational regulations;
- insurance of deposits; and
- regulation of information in the interest of the protection of bank secrecy, transparency and consumer protection.

2 Summarise the primary statutes and regulations that govern the banking industry.

The most important regulations regarding the banking sector are:

- Act XXXVII of 2014 on the further development of the system of institutions strengthening the security of the individual players of the financial intermediary system (the Resolution Act);
- Act CCXXXVII of 2013 on credit institutions and financial enterprises (the Banking Act);
- Act CXXXIX of 2013 on the Hungarian Central Bank (the Central Bank Act);
- Act LXXXV of 2009 on the Pursuit of the Business of Payment Services;
- Act CIV of 2008 on strengthening the stability of financial systems (the Stability Act);
- Act CLXII of 2009 on Consumer Credits;
- Act CXXII of 2011 on Central Credit Information System; and
- Act CXXXV of 2013 on the Integration of savings cooperatives and amendments to economic related acts.

Furthermore, in some aspects Act CXX of 2001 on Capital Markets, Act CXXXVI of 2007 on the Prevention of Financing Money Laundering and Terrorism, Act CXXXVIII of 2007 on Investment Service Providers also have significant effects on the banking sector, Act CCXXXV of 2013 on Certain Payment Providers and Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The financial markets are exclusively supervised by the Hungarian Central Bank (Central Bank). While the Hungarian Financial Supervisory Authority (HFSA) was almost exclusively responsible for their supervision and had the necessary instruments for this responsibility, in 2013 the HFSA was integrated into the Central Bank. This means that the Central Bank assumed all functions, duties and responsibilities of the HFSA and the latter ceased to exist on 1 October 2013. Even though the HFSA ceased to exist without a legal successor, continuity was preserved as, according to the Central Bank Act, the rights and obligations (including authority over certain state assets) transferred to the Central Bank, and the Central Bank took the place of the HFSA in ongoing procedures.

The reformed Central Bank is responsible for mitigating and managing risks potentially arising in the financial sector at system level (macroprudential policy) and for overseeing the safety and stability of individual financial institutions (microprudential policy). It has also assumed the functions of consumer protection, market supervision, as well as capital and insurance supervision, while keeping its 'old' duties and responsibilities such as, naturally, the fundamental function of being responsible for monetary policy.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

The Hungarian system for insuring deposits consists of two elements, one of which is deposit insurance. For this purpose the National Fund for Deposit Insurance (FDI) was established by Act CXII of 1996 on credit institutions and financial enterprises. This Act was recently replaced by the Banking Act, but the regulation has basically remained the same.

Each credit institution must be a member of the FDI (membership is a condition of foundation). According to the Banking Act, credit institutions shall, upon joining the FDI, pay a one-off affiliation fee at the rate of half per cent of its subscribed capital to the FDI within 30 days of receiving the authorisation.

In addition, credit institutions shall pay ordinary – and in some cases extraordinary – annual fees for the FDI. The amount of the annual fee to be paid shall not be higher than two thousandths of the aggregate total interest holdings indicated under accrued and deferred liabilities on deposits insured by the FDI and kept with the member institution on 31 December of the previous year and the deposits insured by the FDI.

In the case of deposits being frozen, the FDI undertakes to provide liquid assets to the credit institution according to general market conditions. The above undertaking may not be higher than the amount of deposits placed in the credit institution in question. Furthermore, only registered deposits will be insured by the FDI. The capital and interest amount of the deposits will only be reimbursed by the FDI up to €100,000 per person and per credit institution as compensation.

The other element, laid down in the Act CCVIII of 2011 on the Hungarian Central Bank, is the opportunity to receive extraordinary credit, which may be provided by the Central Bank for credit institutions and to the FDI in the event of emergency. For this purpose 'emergency' means that the insolvency of the credit institution endangers the stability of the entire monetary system. The Central Bank has discretionary power to provide such extraordinary credit.

The Hungarian government is determined to put the banking system into an ownership structure where 50 per cent of the ownership is Hungarian. The government wants the Hungarian banking system to be a firm base of financial stability and to regain its independence. Additional steps may be implemented by the government to further increase the state's ownership percentage within the Hungarian banking system.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

In accordance with the Banking Act, an 'affiliate' means any company over which a parent company effectively exercises a dominant influence. All

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affiliates of affiliate companies will also be considered affiliates of the parent company.

From the regulatory viewpoint a parent company or an affiliate will be considered a client; therefore, in cases of transactions between a parent company and an affiliate the general prudential rules of the Banking Act will apply, including the rules for limitation of exposure.

Furthermore, some indirect limitations also apply if the parent company qualifies as a credit institution and its affiliate is also a credit institution, financial enterprise or investment enterprise, or the parent company has a holding in such an institution, or if the credit institution's parent company is a financial holding company. In the above cases the companies are subject to supervision on a consolidated basis, which basically means that they must meet the prudential and exposure rules of the Banking Act both jointly and severally and this provision may influence the transactions between the companies concerned.

Members of groups that qualify as subject to the supplementary supervision – financial conglomerates – must also meet the prudential provisions both jointly and severally. Credit institutions subject to supervision on a consolidated basis and all other entities covered by supervision on a consolidated basis may enter into a group financial support agreement under which a party to the agreement is to provide financial support to any other party to the agreement affected by the measures, exceptional measures to be taken by the Central Bank upon the occurrence of events invoking such measures, exceptional measures.

Pursuant to the Banking Act financial institutions, in addition to financial services as determined by the Banking Act, are entitled to perform exclusively the following activities:

- activities auxiliary to financial services;
- insurance mediation services;
- securities lending or borrowing, acting as nominee for shareholders, pursuant to Act CXXXVIII of 2007 providing investment services, auxiliary services, intermediary activities and commodity exchange services;
- transactions in gold;
- keeping registers of shareholders;
- services related to electronic signatures;
- activities in support of the lending operations of the Student Loan Centre;
- recruiting new members for voluntary mutual insurance funds;
- activities relating to the management of collateral held in custody with a view to reducing or avoiding losses from financial services;
- use of assets subject to securities acquired for the purpose of abating deficit resulting from financial services;
- activities relating to management and enforcement claims as an agent;
- sale and purchase of information related to financial instruments; and
- conveyance of subsidies from the European Union.

Financial activities not listed above are prohibited activities with regard to financial institutions.

In addition, the provisions of the Banking Act limit certain market activities of financial institutions in the area of risk management in accordance with the relevant EU legislation. Such limitations include limitation of exposure related to the acquisition of ownership, and restrictions on investment activities, including real estate investment restrictions.

6 What are the principal regulatory challenges facing the banking industry?

Hungary is facing similar challenges to other EU countries. In line with the decision of the Basel Committee on Banking Supervision, the Central Bank will have a key role in facilitating and supervising that banks refill their liquid reserves and reach 60 per cent by 2015 and 100 per cent by 2019. The Central Bank is also expected to keep a close eye on internal audit systems and company-level management.

In terms of the purpose of the recent reform, the Central Bank will carry out more efficient macroprudential and microprudential supervision, thus it must take measures to prevent excessive lending, mitigate systematic liquidity risks, operate the countercyclical capital buffer and reduce the probability of default of systemically important financial institutions.

7 Are banks subject to consumer protection rules?

The CXXXIX Act of 2013 on the National Bank of Hungary states that it aims to protect the interests of parties using the services rendered by financial organisations and to strengthen the public confidence in the financial system. The main pillars of the consumer protection policy overseen and enforced by the Central Bank are the efficient supervision, efficient enforcement of sanctions and the protection of the defenceless groups of society.

The Central Bank upon request or of its own motion monitors compliance with consumer protection provisions of the Hungarian law and opens the proceeding. Proceedings for the protection of consumers' interests shall not be opened after a period of three years following the time of the infringement. The administrative time limit for these proceedings is three months. In this period the Central Bank has the power to carry out trial transactions and to conduct direct inquiries or thematic investigations. If the Central Bank finds any infringement it may impose sanctions such as:

- issue a warning for taking the measures necessary for compliance with the relevant legal provisions, and for eliminating the discrepancies detected;
- order the cessation of the infringement;
- prohibit any further infringement;
- order the infringer to terminate within the prescribed time limit the deficiencies and disparities exposed, and notify the Central Bank concerning the measures carried out to eliminate such deficiencies and disparities;
- ban or impose conditions regarding the pursuit of the activity or the supply of services involved in the infringement, until the infringement is eliminated; and
- impose a consumer protection fine.

The most common practices that have attracted the attention of the Central Bank are practices such as unilateral increment of fees and misinformation of the consumers.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

In Hungary the legal and regulatory policies regarding the banking sector correspond to related policies of western European countries and the European Union. The above regulations rest on three main principles: security (the main aspects of security are described in question 1), competition (securing equal conditions and fair competition) and consumer protection.

Future regulation, in correspondence with EU legislation , is likely to focus on enhanced liquidity and risk management of financial institutions and to expand regulatory control in the banking industry.

Also we should note, the European Bank Authority has issued its Single Rule Book which aims to provide a single set of harmonised prudential rules that institutions throughout the EU must respect. Moreover, it intends to ensure uniform application of Basel III in all member states. It aims to close regulatory loopholes and thus contribute to a more effective functioning of the Single Market.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The basis of supervisory control is regular disclosure of data and the supervisory procedure performed by the Central Bank. The banks and Hungarian branch offices of credit institutions established in other EU member states have to provide the Central Bank with a report at least once a year, and must report certain events (eg, an increase or decrease of capital; suspension, limitation and cancellation of certain financial services; and activities auxiliary to financial services). Furthermore, the Central Bank is entitled to compel the banks to supply data on certain issues. In the event that they are in danger of breaching the rules on prudence, banks are obliged to notify the Central Bank.

During the supervisory review, the Central Bank reviews the strategies, policies, processes and methods relating to the capital adequacy of credit institutions and evaluates their exposure in accordance with the Hungarian regulation and Regulation (EU) No. 575/2013. The frequency and extent of the review and evaluation are determined by the Central Bank, based on the size and the extent of the activity of the bank in question. It must, however, be updated on at least an annual basis.

The Central Bank may conduct comprehensive inspections and direct inquiry into financial organisations in connection with a specific problem or, if the same problem arises at several financial institutions, a general

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inquiry. It may also conduct post-inspections or may request information concerning compliance with its resolutions. Comprehensive inspections and direct inquiries may take no longer than six months; in the event of general inquiries the deadline is nine months, but these may be prolonged by six months, if there is a good cause.

The Central Bank conducts a market surveillance procedure if a suspicion of unlawfulness arises, inter alia, if operations or services are conducted by a bank without proper authorisation or notification. The Central Bank may also conduct enquiries, ex officio or upon an application, into breaches of the consumer protection laws.

Credit institutions (financial holding companies) that are supervised on a consolidated basis must comply with the provisions concerning prudent operation, risk exposure and capital adequacy not only separately but also collectively.

10 How do the regulatory authorities enforce banking laws and regulations?

On the one hand, laws are enforced during an authorisation procedure by the rejection of authorisation and the withdrawal of authorisation; on the other hand, the Central Bank may choose between measures determined in the Banking Act according to the seriousness of the violation.

In the event of a bank violating the laws concerning it, the Central Bank will consider taking measures (eg, calling upon the bank to take the necessary reparatory steps, requiring extraordinary supply of data, obliging the financial institution to draw up and execute an action plan, or adopting a resolution to declare the fact of infringement). In the event of considerable violations of the provisions and where the Banking Act orders it to do so, the Central Bank will take the necessary measures prescribed in the Banking Act. In the event of any serious infringement, and where the Banking Act orders it to do so, the Central Bank will take the necessary measures or extraordinary measures (eg, delegate a supervisory commissioner to the credit institution, or limit or prohibit certain transactions and payments).

The Central Bank may (simultaneously with a measure or extraordinary measure or by itself) impose fines and penalties. Penalties may be imposed both on banks and executive officers failing to fulfil the provisions on operation, breaching their own internal regulations or an obligation set out by the Central Bank in its Resolution or late compliance with said provisions. The basic penalty is between 100,000 and 2 billion forints. The penalty varies according to the nature and severity of the violation; it could amount to 200 per cent of the supervisory fee (basic fee and variable fee) if this exceeds 2 billion forints. The penalties imposed on an executive officer may be between 100,000 and 20 million forints that cannot be paid off by the bank itself.

An inquiry by the Central Bank may be initiated by a foreign financial supervisory authority.

If the Hungarian branch of a financial institution established in another EU member state or the cross-border financial services and activities in the territory of Hungary of a financial institution established in another member state violate the provisions of Hungarian law, the Central Bank first calls upon the branch or bank to rectify the situation. If it refuses to comply, the Central Bank will notify the supervisory authority of the other EU member state and request that the supervisory authority take appropriate action. If the supervisory authority fails to act, the Central Bank may address the issue to the European Banking Authority.

If the Central Bank considers that the continuance of the anomalous situation presents a serious threat to the stability of the financial system or the interests of customers, it is entitled to act directly. In that event, the Central Bank informs the supervisory authority of the concerned member state about the measures applied, as well as any extraordinary measures, and the reasons for them.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The primary supervisory issues facing the Central Bank concerning the banking sector in 2015 are ensuring (if they need enforcing) the prudent operation of the sector, in line with EU rules ensuring the stability and uninterrupted operation of the financial markets; providing a framework for safe and competitive growth; identifying risks threatening certain financial institutions and handling (eliminating) already known risks; proactively and consistently protecting consumers' rights and interests; providing a forum for resolving disputes; educating consumers; strengthening public trust in the financial system; and helping the European level supervision.

As for addressing the issues, the fundamental reform of supervision in 2013 (ie, consolidating the duties and functions (extended and strengthened in recent years) into one organisation) will help to more efficiently eliminate and prevent unnecessary risks in the financial system.

12 How has bank supervision changed in response to the 2008 financial crisis?

First, the activity, the status, and the structure of the HFSA were changed, and subsequently, by the dissolution of the HFSA, supervision became the exclusive responsibility of the Central Bank.

The Financial Stability Council was established, thereafter integrated into the Central Bank.

The HFSA acquired certain responsibilities with regard to consumer protection; since 2011 it could conduct consumer protection proceedings ex officio, impose consumer protection fines and other sanctions and had the right to initiate consumer protection lawsuits at civil courts on behalf of consumers. The Central Bank has assumed these duties.

The president of the Central Bank has a right to adopt decrees, and such decrees are now at the same level of the hierarchy of norms as the government's decrees.

Pursuant to the Stability Act and to the Resolution Act, the Central Bank is entitled and obliged to examine the status of Hungarian credit institutions from the point of view of the banking industry's stability and the minister responsible is authorised to request reports from the above authorities if the solvency of one or more credit institutions endangers the stability of the financial system. Such a report includes, in particular:

- an examination of the effects of such situation upon the financial markets and the financial infrastructure;
- analysis regarding short, medium and long-term liquidity; and
- analysis regarding the fulfilment of capital adequacy requirements.

As a result of the above evaluation, if they deem it to be necessary, the Central Bank may mutually propose the application of the measures provided by the Stability Act and Resolution Act .

Furthermore, the HFSA had been more active in respect of banking sector governance with soft-law instruments. This practice has been continued by the Central Bank. The most common soft-law instruments are authorisation guidelines, supervisory guidelines, recommendations, CEO letters and other guidelines.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

In order to maintain financial stability, ensure the continuous availability of the critical functions provided by the financial sector, efficiently manage any institutional crises and minimise the use of taxpayer funds for crisis management purposes and establish a framework for the administrative restructuring of distressed financial Institutions, the Parliament has adopted the Resolution Act, according to which the Central Bank shall, in the case of a systemic crisis, notify the minister in charge of the regulation of the money, capital and insurance market if the objective of resolution has not been accomplished by way of the resolution actions applied by the Central Bank. Based on the notification in his decision the minister in charge of the regulation of the money, capital and insurance market may resolve that the state financial stabilisation instrument is to be applied. A state financial stabilisation instrument may take the form of a capital increase or take the form of temporary nationalisation of the shareholdings. Upon temporary nationalisation in the context of the state financial stabilisation instrument the shareholdings in the institution, financial holding company, mixed financial holding company or mixed activity holding company under resolution, having its registered office in Hungary, shall be transferred to the state or a solely state owned enterprise. In the course recapitalisation by the state and temporary nationalisation it shall be ensured that the institution concerned or the financial undertaking keeps operating on a commercial basis and that on the basis of the principle of private investment in the market the role of the state as the owner of the equity elements is taken over by market players via a public auction.

In 2014, the Central Bank appointed supervisory commissioner in two cases. According to the Banking Act, the Central Bank may appoint a supervisory commissioner if the dissolution procedure opens after the date

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of the resolution – at the same time it passes the resolution of dissolution (if this has not happened earlier). The commissioner's assignment shall end at the time when the receiver takes over, and he shall have powers to stop all payments until the time of the opening of the dissolution procedure.

When taking the resolution actions and exercising the resolution powers, the shareholders of the institution under resolution bear losses first. No shareholder shall incur greater losses directly related to the application of the resolution actions than would have been incurred if the institution had been liquidated. After the execution of the resolution action it shall be assessed by the independent asset appraiser, whether the shareholders and the creditors would have been treated better by having the institution under resolution liquidated. That valuation shall be distinct from the independent valuation specified in the Resolution Act. If the assessment carried out determines that any shareholder or creditor has incurred greater losses than it would have incurred in the case of liquidation, it shall be entitled to indemnification.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

If a bank failure is caused by reasons set out in the Banking Act, the Central Bank may pass a resolution in which it appoints a supervisory commissioner. In certain cases the Central Bank does not have the right to decide and must appoint a commissioner. The board of directors and members of the supervisory board have the right to seek remedy against such resolution of the Central Bank.

During the period of the supervisory commissioner's appointment, members of the board of directors cannot perform their duties or exercise their signatory rights as described in the statutory provisions governing business associations and cooperatives. For the period of appointment, the supervisory commissioner exercises the rights of board members described by law and the charter documents.

Since January 2011, credit institutions must have written policies and procedures for the identification, measurement, management and monitoring of liquidity risk (costs and benefits, too) over an appropriate period of time. With the same amendment to the former Banking Act credit institutions were required to distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. They will take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account and their eligibility to be used as extra liquidity buffers; they will monitor how assets can be mobilised in a timely manner, and existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets among entities, both within member states of the European Union and in third countries.

15 Are managers or directors personally liable in the case of a bank failure?

The liability of the members of the board and the supervisory board is regulated by different acts. The Hungarian Civil Code sets out the general rules, according to which the board and supervisory board members will act with due care and diligence bearing in mind the best interest of the company. The board and supervisory board members are both personally and financially responsible towards the company for any damages they have caused by breaching the rules, the charter document or resolutions of the general meeting or by breaching their managerial duties.

Concerning liability, specific regulations are laid down in the Banking Act.

The executive officers, members of the board and the supervisory board of the financial institution are liable to ensure that the financial institution carries out the licensed activities in accordance with the provisions set out by the Banking Act and other laws.

The executive officers and employees of the financial institution will act at all times with due diligence and expertise consistent with the professional requirements applicable for their respective positions, also in view of the interests of the financial institution and its customers, and in compliance with the relevant regulations.

The notification obligations described in the answer to question 18 will be fulfilled by the executive officers of the credit institution.

The case is different from the foregoing if a manager or a director is an employee of the credit institution, because in that case the rules of the Labour Code will apply to his or her liability.

Since the Central Bank continuously monitors the operation of credit institutions, it should notice when a credit institution does not operate prudently. In those cases the Central Bank tries to enforce the prudent operation and, as mentioned in question 10, it can impose penalties, including fines, on executive officers who fail to fulfil provisions or who breach the law or the internal regulations of the bank.

If any actions of executive officers breach any section of Economic Crimes of the Criminal Code, the officers will also be held responsible for such actions.

16 How has bank resolution changed in response to the recent crisis?

Changes introduced in recent years concerning bank resolution have aimed to increase the risk-handling ability of the banking sector and lessen the possibility of crisis situations having an impact on the real economy and on the financial sector. The purpose of the measures adopted is to ensure a higher level of prudent and transparent operation of the financial organisations.

As part of the aforementioned changes, from 2013 credit institutions with a balance of over 500 billion forints qualify as credit institutions subject to the public's interest and, as such, they must set up and operate an audit committee.

The HFSA issued guidance, which is still applicable, for financial organisations on how to lessen the risk related to the real estate market. It has communicated to financial organisations its strict expectations regarding choosing commercial partners. The HFSA also drew attention to generating data on consolidated deposits, emphasised the importance of fulfilling 'know-your-customer' (KYC) obligations prudently before entering into a contract with a customer and established which clients can be accepted as professional clients. Financial organisations' information obligation towards its clients and professional clients is also a clear expectation. In order to maintain financial stability, ensure the continuous availability of the critical functions provided by the financial sector, efficiently manage any institutional crises, minimise the use of taxpayer funds for crisis management purposes and establish a framework for the administrative restructuring of distressed financial institutions, Parliament has adopted the Resolution Act which regulates the institution of resolution regarding the credit institutions and investment firms established in Hungary, the financial holding companies, mixed financial holding companies and mixed activity holding companies established in Hungary, the financial undertakings established in Hungary which are covered by the consolidated supervision, and the Hungarian branch of an institution incorporated in a third country.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Banks may be founded with a minimum subscribed capital of 2 billion forints. A branch office of a third-country credit institution may be established with a minimum of 2 billion forints in endowment capital.

The requirement of prudent operation as it relates to banks means that they have to manage the funds placed in their custody, as well as their own resources, so as to maintain liquidity and solvency at all times. Credit institutions shall have sufficient own funds at all times to cover the risks of its activities, covering at least the minimum capital requirement defined in article 92 of Regulation 575/2013/EU; the extra capital requirement prescribed in the framework of a supervisory review, but it may not be less than the minimum amount of subscribed capital prescribed as a precondition for authorisation.

The provisions concerning the equity capital, solvency margin, reserves, limitations of exposure (ie, limitations and restrictions on high exposure, investments, acquisitions, qualification of assets, risk reserves), collections of resources and the approximation of maturity and liquidity come within the requirement of prudent operation.

Banks must place 10 per cent of their annual after-tax profits into a general reserve to offset losses incurred during their activities. Upon request, a credit institution may be exempted by the Central Bank from the obligation to maintain general reserves. Credit institutions are allowed to use general reserves only to cover operating losses arising from their activities.

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As Regulation 575/2013/EU and Directive 2013/36/EU influenced the Banking Act, in accordance with the cited EU legislation, credit institutions also have the obligation to maintain a capital conservation buffer and an institution-specific countercyclical capital buffer. Special rules apply to the capital buffers of global and other systemically important institutions.

18 How are the capital adequacy guidelines enforced?

Banks have certain notification requirements and data disclosure requirements towards the Central Bank with the special aim that the banks correspond to the capital requirements. The board of directors of a credit institution must immediately notify the Central Bank in writing:
- if the danger of illiquidity is imminent;
- in case of insolvency;
- if the solvency margin has diminished by 25 per cent or more; or
- if the credit institution has suspended its payments or it has stopped its operations or financial service activities.

Furthermore, the board of directors of a credit institution must notify the Central Bank within two business days in writing if the subscribed capital is reduced. Credit institutions operating as a branch office have additional reporting obligations.

Through the supervisory review, the Central Bank reviews the strategies, policies, processes and methods relating to the capital adequacy of credit institutions and evaluates their exposure.

Measures and extraordinary measures will also be applied (besides fines) in the case of infringement of capital adequacy requirements.

19 What happens in the event that a bank becomes undercapitalised?

If the amount of equity capital of a bank falls below the minimum amount of subscribed capital prescribed by the Banking Act, the Central Bank may give the credit institution a maximum of 18 months to bring its equity capital to compliance level. If the amount of equity capital of a bank falls below the amount of the subscribed capital, the Central Bank may compel the financial institution's board of directors to convene a general meeting. In this case, the general meeting will decide whether the financial institution should reduce the subscribed capital or the owners who have a qualifying holding should provide for the financial institution's equity capital to be restored to at least the level of the prescribed subscribed capital.

Undercapitalisation is also a condition for the appliance of the measures provided by the Stability Act.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Banking Act does not explicitly define the concept of insolvency and does not specify which requirements must be violated or to what extent for a bank to be considered insolvent.

The Central Bank applies extraordinary measures in lieu of bankruptcy proceedings; for example, it may:
- prescribe the selling of certain assets of the credit institution;
- set a deadline for the financial institution to settle its capital structure;
- prohibit certain transactions and payments;
- compel the board of directors to convene the general meeting;
- delegate a supervisory commissioner; or
- call upon the owner of the financial institution to take the necessary measures.

If the board of directors fails to convene the general meeting, the Central Bank can convene the court of registry.

If the bank becomes insolvent, the board of directors must immediately notify the Central Bank in writing. In the event of insolvency, liquidation proceedings will ensue. The liquidation proceedings can be initiated either by the bank in question itself or the Central Bank at the Metropolitan Court.

The Central Bank initiates liquidation proceedings against the bank or the branch office of a third-country financial institution in the event that the Central Bank withdraws the credit institution's authorisation on the basis of it failing to pay any of its undisputed debts within five days of the date on which they are due, or it no longer possesses sufficient funds (assets) to satisfy the known claims of creditors. Furthermore, liquidation proceedings will commence if the person in charge of the dissolution procedure of a credit institution informs the Central Bank that the assets of the credit institution will not cover the claims of the creditors and the owners or members do not pay the outstanding amount, or, in the case of a branch office, if insolvency proceedings have been initiated against the foreign financial institution that is operating the branch office in Hungary. The Hungarian branch office of a credit institution established in another EU member state may not be liquidated under Hungarian law.

The court must decide on the request for liquidation within eight days of its submission.

During the liquidation of a financial institution, creditors shall present their claims within 60 days of the publication of the court ruling ordering liquidation.

The court appoints the liquidator in the order adopted on the liquidation. The Central Bank may, from the submission of the request for liquidation, order prohibition of all payments until the starting date of the procedure (the date of the promulgation of the order in the Official Gazette).

The court must then arrange a meeting to negotiate a composition at the request of the debtor bank. The court will confirm this composition by an order only if solvency of the debtor bank will be restored through the composition and the composition is in conformity with legal regulations. The permission of the Central Bank is also required for approval of the composition during the composition process if the further operation of the bank constitutes a condition of the composition. If no composition has been settled or the court refuses to confirm the composition, the court issues an order about, inter alia, the satisfaction of the creditors, the conclusion of the liquidation and the dissolution of the debtor and any subsidiary of it.

Special rules apply to credit institutions that operate branch offices in other EU member states or provide cross-border services. In their cases the Central Bank immediately informs the supervisory authorities of the EU member states where the credit institution under liquidation proceedings operates any branch offices or provides cross-border services. The effect of the order on liquidation applies to the entire EU territory.

The provisions of the Act on Bankruptcy and Liquidation Proceedings will apply in the case of issues not covered by the Banking Act.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The Banking Act has been amended in order to conform with Regulation (EU) No. 575/2013 and Directive 2013/36/EU; the first amendment is the Capital Requirements Regulation (CRR), the second is the Capital Requirements Directive (CRD). These legal acts comprise the new Capital Requirements Directives (CRD IV). The CRD is the legal framework for the supervision of credit institutions, investment firms and their parent companies in all member states of the European Union and the EEA. The CRR has been in force since 27 June 2013, while the supervised entities within its scope are subject to it as of 1 January 2014. The CRR is directly applicable to anyone in the European Union and is not transposed into national law, though the Banking Act makes references to it and complies with its provisions. Much of the CRR is derived from the Basel III standards issued by the Basel Committee on Banking. It includes most of the technical provisions governing the prudential supervision of institutions.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

According to the Banking Act, in the Hungarian regulation 'qualifying holding' has the same meaning as laid down by Regulation (EU) No. 575/2013. It means a direct or indirect holding in an undertaking that represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking.

In respective of the acquisition of a qualifying holding, the Banking Act does not discriminate between persons or types of entities. The acquirer must obtain the permission of the Central Bank.

According to the Banking Act, any person who wishes to acquire a qualifying holding in a credit institution must be independent of any influences that may endanger the institution's sound, diligent and reliable (collectively, 'prudent') operation, must have goodwill and the capacity to provide reliable and diligent guidance and control of the credit institution, and also its ownership structure as well as business connections must be transparent so as to allow the competent authority to exercise effective

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supervision over the credit institution. Moreover, the legitimate source of the remuneration paid for the qualifying holding must be proved.

If the credit institution is a public limited company the provisions of the Act on Capital Markets regarding acquisition of a qualifying holding will also apply.

23 Are there any restrictions on foreign ownership of banks?

There are no restrictions.

24 What are the legal and regulatory implications for entities that control banks?

Once the permission described in question 22 is obtained in accordance with the Banking Act, there are no further special implications for entities that acquired a qualifying holding. However, the requirements specified above will also be fulfilled during the course of the credit institution's operation.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The essential requirements against persons and entities with a qualifying holding are diligent and reliable operation, goodwill, transparency and guidance and control of the financial institution (see question 22).

For this purpose the main duty of acquirers is to provide the credit institution's capital. The amount of the credit institution's own funds may not be less than the minimum amount of initial capital prescribed by the Banking Act. The owners will, however, not be – directly – compelled to provide further capital contributions; the prudent operation is basically not the owners' responsibility. Therefore, if the amount of a credit institution's own funds falls below the minimum level of the initial capital, the Central Bank will give the credit institution (in essence, the owners) a maximum of 18 months to bring its own funds into compliance, or it may compel the financial institution's board of directors to convene a general meeting. In this case, the general meeting will decide whether the financial institution should reduce the subscribed capital or if the owners who have a qualifying holding should provide for the financial institution's own funds to be restored to at least the amount of prescribed initial capital.

Pursuant to the Banking Act, the Central Bank may also take certain measures and necessary exceptional measures if the owner of a financial institution violates the Banking Act itself, the legal provisions on effective, reliable and independent ownership and prudent operation, or obviously conducts its activities without due care. For example, the Central Bank must consider the need for such measures if the credit institution's own funds fail to reach the capital requirements described by the Banking Act, or the owners violate any of the regulations on exposures, on the determination, analysis, evaluation and definition of exposures, on the management of exposures, or on the management and reduction of risks. There are also certain circumstances when the Central Bank must take measures or exceptional measures against the credit institutions or the owners.

In the foregoing circumstances the Central Bank may, inter alia:

- stipulate an extraordinary supply of data;
- require the credit institution to take measures for reinforcement of the arrangements, processes, mechanisms and strategies relating to its internal control mechanism, corporate governance functions, risk-management procedures and internal models for the assessment of capital adequacy; or
- prohibit, limit or make subject to conditions payment of dividends, raising of loans by the owners of financial institutions, or rendering services to them by credit institutions that involve any exposure.

When applying exceptional measures, the Central Bank may limit or prohibit the credit institution concluding transactions between the owners and the credit institution. The Central Bank may also simultaneously call upon the owner of the financial institution that has a qualifying holding to take the necessary measures.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

For insolvency the regulations do not contain special implications for entities or individuals with a qualifying holding; therefore, the general regulations for the owners will apply.

In the event of insolvency, basically the same measures and exceptional measures described in question 25 may be taken by the Central Bank, such as the compelling of the financial institution's board of directors to convene the general meeting and the calling upon of the owner of the financial institution with 5 per cent or more holding to take the necessary measures.

Following the foregoing call upon the owners, the credit institution's board of directors must take immediate action to ensure that deposits and other receivables of the owners due from the credit institution are blocked, that lending to companies in the sphere of interests of the owners is suspended and that no financial services involving exposure of the owners are rendered.

The board of directors of the credit institution must keep these restrictions in effect until the owners terminate the cause for taking the measures or the liquidation of the credit institution is ordered by the court.

If the financial institution fails to comply with the supervisory measures, the Central Bank may initiate the convening of the financial institution's general meeting at the court of registry.

If the measures taken by the Central Bank were insufficient to prevent the insolvency, the Central Bank must initiate the liquidation of the credit institution pursuant to liquidation rules governed by the Act on Bankruptcy and Liquidation Proceedings (see also question 20).

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

For this purpose, 'control' is defined as in question 22.

According to the Banking Act, the Central Bank's permission must be obtained before executing a contract regarding the acquisition of a qualifying holding in a credit institution, as well as regarding the acquisition of additional qualifying holding by which 20, 33 or 50 per cent of ownership share or voting rights would be reached. Accordingly, the owner of a credit institution may only enter into contracts regarding ownership rights, voting rights or to secure advantages in excess of such rights with the Central Bank's permission.

Finally, the Central Bank's permission must be obtained before executing a contract for the acquisition of majority ownership in a company with a qualifying holding in a credit institution.

The permissions must be obtained in each case prior to the conclusion of the contract. Accordingly, following the conclusion of the contract the Central Bank must be informed within 30 days about the execution of the above transactions.

In cases specified in the Competition Act the acquirer must also obtain the approval of the Competition Authority.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The process basically corresponds to the general process prescribed for any acquirers. There are two supplementary rules, however, provided for foreign acquirers as follows.

If there is a foreign-registered financial institution, insurance company or investment company among the founders wishing to acquire a qualifying holding – in addition to the general requirements – a statement from the competent supervisory authority of the country of origin stating that the enterprise conducts its activities in compliance with prudential regulations must also be attached to the application for authorisation.

If the applicant is a financial institution, investment firm, insurance company, reinsurance company or a UCITS management company authorised in another EEA member state or is the parent of either of the companies; or controls any of these companies, the Central Bank shall forward the application without delay to the competent supervisory authority of the place where the financial institution, investment firm, insurance company, reinsurance company or the UCITS management company is established.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

While considering an application, the Central Bank must investigate whether the applicant's activity and its influence over the credit institution endangers the prudent guidance and control of the credit institution. The Central Bank will also investigate whether the applicant's transparency in business connections and ownership structure and the structure of its direct or indirect holding in other businesses allows the competent authority to exercise effective supervision over the financial institution. The Central Bank shall refuse to grant the authorisation if the applicants' or its members' or executive officers' activities, influence on the financial

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institution is considered harmful to the financial institutions independent, sound and prudent management; business activities or relations, or direct or indirect members' share or holdings in other companies is structured in a manner to obstruct supervisory activities, or good business reputation is lacking.

The Banking Act gives only examples of the circumstances when the applicant's or its owner's activity or its influence on the credit institution endangers its prudent operation.

According to the Banking Act, prudent operation is endangered particularly if:

- the applicant's or its owner's financial and economic standing is inconsistent with the extent of the acquisition of ownership share as proposed;
- the legitimacy of the origin of the funds used for acquisition of the ownership interest or the authenticity of the information the person specified as owner of the funds is not sufficiently evidenced;
- the applicant or its owner fails to meet the conditions determined for the credit institution by the Central Bank in the extraordinary action plan;
- the Central Bank has suspended its right to exercise voting rights within the five years before the notification; or
- in case of individuals, he or she:
  - has a criminal record;
  - has seriously or regularly breached the banking regulations, and it has been stated in a final decision less five years ago, does not have a satisfactory reputation; or
  - has been as established as having personal responsibility for the liquidation or a situation close to insolvency of a credit institution.

30 Describe the required filings for an acquisition of control of a bank.

When applying for authorisation for the acquisition the following filings are necessary:

- the application for authorisation, which will include details of any companies that have qualifying holdings in the credit institution, the percentage of shares owned by the applicant in the enterprise that holds a qualifying holding in a financial institution and the planned percentage of shares to be acquired;
- the contract proposal made for the acquisition of ownership or for an agreement to secure substantial advantages attached to voting rights, including the facts required to determine the grounds for disqualification and a statement regarding any criminal proceedings in respect of the executive officers of the applicant;
- the details of the applicant, a statement about its current and future obligations, proof that the applicant has no debts with the tax authorities and the details of the person or entity that has a qualifying holding in the applicant entity;
- a statement, with related probative documents, that the amount that is used for the acquisition originates from the applicant's lawful income;
- a description of the drafts for the organisational and ownership structure; and
- certain special filings required if the credit institution belongs or, following the acquisition, will belong to a body subject to supervision on a consolidated basis or supplementary supervision.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The applicant or the owner may exercise voting rights deriving from the qualifying holding or the rights deriving from the advantages secured by the agreement connected with acquisition of ownership or voting rights as of the 60th business day of the Central Bank's receipt of the application for authorisation, unless the Central Bank refuses to authorise the acquisition as of the 60th business day of the receipt of the application.

The Central Bank may, however, call the applicant for completion of documents. The duration for the completion is 20 business days – in the cases of companies seated in another EU member state it is 30 business days – and this period is not included in the aforementioned 60 business-day period.

Update and trends

The government recently communicated its plan to cut the tax rate regarding the bank sector to increase the lending activity of banks, thus attempting to stimulate the economy. However, these changes are not planned to enter into force until 2016.

The government also announced it purchased 15 per cent ownership in the Erste Bank Hungary, which owned a market share regarding retail credit approximately 15 per cent. Moreover, in 2014 the government also purchased the Hungarian subsidiaries of the GE Capital and the Bayerische Landesbank in accordance with its plan to increase the percentage of the bank sector owned by Hungarians.

In 2014 the Central Bank established an asset management agency – the Hungarian Reorganisation and Receivables Management Company – to handle non-performing commercial real-estate loans to help banks clean up their corporate loan portfolio and boost lending.

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Indonesia

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The banking sector in Indonesia is regulated on the basis of a range of prudential principles. In 2004, Bank Indonesia (BI) launched the Indonesian Banking Architecture (API), which set out a fundamental framework for the Indonesian banking system. API was comprehensive in nature and provided direction, form and order to the banking industry for up to 10 years. The policy direction for the banking industry under API was premised on the formation of a sound, strong and efficient banking industry, being a fundamental requirement for financial system stability in the interest of national economic growth.

The launch of API was integrally linked to Presidential Instruction No. 5 of 2003, in which API was identified as one of the keys for promoting national economic growth. API implemented the following six policy programmes (API Programs):

- banking structure strengthening;
- banking management quality enhancement;
- supervisory function improvement;
- management quality enhancement;
- banking infrastructure development; and
- customer protection improvement.

The API Programs were central to the Indonesian government's ability to regulate the banking sector from 2004 through to 2013.

From the commencement of 2014, the role of banking supervision in Indonesia was assigned from BI to the Financial Services Authority (OJK). The OJK's regulatory role is broader than just banking supervision, since the OJK is now the responsible authority for the integrated supervision of the entire financial services industry. As a result, BI is now responsible only for the monetary sector and has the single objective of achieving and maintaining stability of the rupiah, which comprises two main aspects: stability of the rupiah's value for the purchase of goods and services; and stability of the rupiah's exchange rate against other currencies.

Since commencing as financial services regulator, OJK has carried out a number of initiatives to implement its mandate, particularly by conducting integrated regulation and supervision over the financial services sector, and in raising the profile of consumer education and protection. The OJK is currently in the process of formulating a blueprint for the financial services sector, which will focus on achieving the following three main targets:

- optimising the role of the financial services sector to foster improvement in national economic growth;
- maintaining financial system stability as the basis for sustainable development; and
- realising society's financial independence and supporting efforts to enhance national development.

In November 2014, OJK released 20 policies comprising six OJK banking regulations, seven OJK capital market regulations and seven OJK regulations in the non-bank financial industry. The six banking regulations consist of:

- the Implementation of Integrated Governance for Financial Conglomerations;
- the Implementation of Integrated Risk Management for Financial Conglomerations;
- Financial Services Using Virtual Offices in the Framework of Inclusive Finance (*Laku Pandai*);
- Rural Banks (*Bank Perkreditan Rakyat*);
- the Obligation to Provide Minimum Capital for Sharia Banking; and
- Asset Quality of Sharia Commercial Banks and Sharia Business Units.

The 20 policies were issued as a part of the OJK's strategy to supervise the financial services sector, the deepening of the financial market, and the expansion of access to finance for those who have previously been unable to access such services (including populations in isolated rural areas). The expectation is that the OJK's policies will foster a strong financial services sector with sustainable economic growth.

In its capacity as a member of G-20 and other international forums (such as the Financial Stability Board and the Basel Committee on Banking Supervision (BCBS)), Indonesia is committed to adopting the recommendations generated by such forums. One of the recommendations issued by BCBS and implemented in the Indonesian banking sector by the OJK is a framework for standards of bank capitalisation.

2 Summarise the primary statutes and regulations that govern the banking industry.

The Indonesian banking sector is predominantly regulated by Law No. 7 of 1992 on Banking as amended by Law No. 10 of 1998 (together, the Banking Law). The Banking Law accommodates the existence of a dual banking system in Indonesia (shariah banking and conventional banking). The shariah banking system is specifically regulated by Law No. 21 of 2008 on Shariah Banking. BI regulations further stipulate detailed provisions regarding the banking industry, both for conventional and shariah banking, including regulations on rural banks.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The OJK is the primary regulatory authority responsible for overseeing and supervising financial services institutions including banks in Indonesia. For large and suspicious transactions OJK will work in coordination with the Financial Transaction Reporting and Analysis Centre (PPATK).

In carrying out its responsibilities, OJK will coordinate with BI in relation to the monetary sector, and will coordinate with the Indonesia Deposit Insurance Corporation (LPS) in relation to the guarantee of bank customer deposits and the management of failing banks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Protection of bank customers' deposits is provided by Law No. 24 of 2004 as amended by Law No. 7 of 2009, which regulates the LPS and its role in the banking industry (LPS Law). LPS is an independent institution that guarantees customer deposits and actively maintains the stability of the banking system. All banks in Indonesia are required to participate, including Rural Banks, but not including Rural Credit Agencies (Badan Kredit Desa). The maximum deposit that is guaranteed for each bank customer is a maximum of 2 billion rupiah. Deposits guaranteed by the LPS include giro and deposit accounts, deposit certificates, savings or their equivalents. The LPS collects premiums and participation fees from all participant banks.

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One of the objectives of LPS is to maintain stability in the banking system. Therefore, under the LPS Law, LPS is authorised to rescue a failing bank (that is, a bank that is facing financial difficulties) with the continuation of its business. However, a bank that is in danger of ceasing operations may no longer be restructured by the OJK. In such a case, subject to certain provisions under the LPS Law, LPS may take the following actions:

- supervise, manage and take ownership of the assets already owned, or which will be owned, by the bank or the obligations of the bank;
- temporarily invest capital;
- sell or transfer the assets of the bank without the approval of the debtor customers or the bank obligations without the approval of the creditor customers;
- assign the management of the bank to another party;
- merge or consolidate with other banks;
- assign the ownership of the bank to another party; and
- review, cancel, terminate or change any contract of the bank that is binding on the bank and any third party which, according to LPS, is detrimental to the bank.

Subject to certain requirements under the LPS Law, LPS must sell all the shares of the rescued bank within a period of no longer than two years (for a rescued bank that did not pose a systemic risk if it had not been rescued) or three years (for a rescued bank which would have posed a systemic risk had it not been rescued).

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Banking Law defines 'affiliated parties' as being:

- members of the board of commissioners (BoC), supervisors, board of directors (BoD) or their proxies, officers, or employees of a bank;
- members of the management, supervisors, managers or their proxies, officers or employees of a bank;
- parties providing their services to a bank, including public accountants, valuers, legal consultants and other consultants; or
- parties who are deemed by BI to have influence in the management of a bank, including shareholders and their families, families of members of the BoC, families of supervisors, families of members of the BoD, and the families of managers.

However, BI's Regulation No. 7/3/2005 as amended by BI Regulation No. 8/13/PBI/2006 on Legal Lending Limits for Commercial Banking (Legal Lending Regulation), uses the term 'related party' (instead of 'affiliated party' as defined above) in relation to certain limitations applied to banks in their provision of portfolio funding.

Under the Legal Lending Regulation, the maximum limit of the total funding portfolio of a bank to its related parties is 10 percent of its capital, which must be approved by the BoC of the relevant bank.

The Legal Lending Regulation specifically defines the related parties of a bank as, among others:

(i) an individual, company or legal entity controlling the bank;
(ii) a company or legal entity which is controlled by the bank;
(iii) an individual or company/legal entity controlling the company referred to in point (ii);
(iv) a company in which:
  - an individual, company or legal entity referred to in point (i) acts as controller;
  - an individual, company or legal entity referred to in point (iii) acts as controller;
(v) any members of the BoC or BoD and executive officials of the bank; and
(vi) parties who have family relations with a bank controller, members of the BoC or BoD and executive officials of the bank.

If the bank is a public company or issuer, it will also be subject to requirements under OJK Rule No. IX.E.1 on Affiliated Transactions and Conflicts of Interest in Certain Transactions.

The most recent OJK Regulation No. 29/POJK.05/2014 on the Implementation of Business Activities of Finance Companies (POJK No. 29/2014) regulates the business activities of finance companies in the following specific areas:

- investment finance, by way of:
  - finance lease;
  - sale and leaseback;
  - factoring with recourse;
  - purchase with payment by instalments;
  - project finance;
  - infrastructure finance; or
  - other finance activities under OJK approval;
- capital finance, by way of:
  - sale and leaseback;
  - factoring with recourse;
  - factoring without recourse;
  - capital facility; or
  - other finance activities under OJK approval;
- multipurpose finance, by way of:
  - finance lease;
  - purchase with payment by installments; and/or
  - other finance activities under OJK approval;
  - Other finance activities under OJK approval.

POJK No.29/2014 also prohibits financial institutions from carrying out any of the following activities:

- the withdrawal of funds directly from the public in the form of giro, deposit, savings and/or other equivalent form;
- the provision of any kind of guarantee relating to the fulfilment of obligations of another party;
- the issuance of promissory notes, except as security for loans to banks that become creditors;
- activities that cause or force other financial institutions under the supervision of the OJK to violate laws or regulations;or
- activities that cause or force other financial institutions under the supervision of the OJK to avoid the law or regulations.

6 What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenge facing the banking industry is the implementation of Basel III throughout the Indonesian banking system.

Basel III is a comprehensive set of reform measures developed by BCBS to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to:

- improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source;
- improve risk management and governance; and
- strengthen banks' transparency and level of disclosure.

Reform is aimed at two levels:

- individual bank-level, or micro-prudential regulation, which is intended to help raise the resilience of individual banking institutions, to help them through periods of stress; and
- macro-prudential regulation, which is intended to address system-wide risks that can build up across the banking sector over time.

The above two approaches to supervision are intended to be complementary, based on the proposition that greater resilience at the individual bank level will reduce the risk of system-wide shocks.

7 Are banks subject to consumer protection rules?

Bank customers are given protection under the general consumer protection law (Law No. 8 of 1999 on Consumer Protection). In addition, banks are subject to OJK Regulation No. 1 of 2013 on Consumer Protection in the Financial Services Sector (Regulation No. 1), which is administered by the OJK. In 2014, the OJK released a circular letter (Circular Letter of OJK No. 2 of 2014 on Services and Settlement of Consumer Complaints on Financial Services Business Actor) to implement Regulation No. 1 (collectively the Consumer Protection Regulations).

According to the Consumer Protection Regulations, Banks are required to resolve all complaints received from customers or representatives of customers, and must establish a special work unit or assign a particular employee (for example, a member of the BoD or an employee) who will be responsible for handling and resolving customer complaints.

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The Consumer Protection Regulations require that settlement of a customer complaint can be either in the form of a statement of apology or compensation.

The relevant bank must resolve customer complaints within 20 business days after the date of receipt of a written complaint. In certain limited circumstances, banks may extend the period by another 20 business days.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

It is anticipated that the OJK will issue a series of further regulations designed to achieve the following targets:
- optimising the role of the financial services sector to support national economic growth;
- maintaining financial system stability for sustainable development; and
- enhancing society's financial independence and supporting efforts to enhance development.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The OJK has authority to supervise banks by way of off-site supervision and on-site supervision.

Off-site supervision

Off-site supervision is supervision through regular reports delivered to the OJK by banks on their business activities. These reports include periodic reports (daily, weekly and monthly), corporate governance reports, annual reports, profit and loss statement reports and examination reports.

If it becomes necessary (in the determination of the OJK):
- banks are also required to give any kind of information requested by the OJK for the purpose of oversight;
- the OJK may conduct an examination of other parties, including parent companies, subsidiaries, connected parties, affiliated parties and bank debtors; and
- the OJK may assign another party to conduct an examination on its behalf.

On-site supervision

On-site supervision may take the form of general examination and special examination aimed at creating a picture of the financial condition of the bank, monitoring the level of compliance with prevailing regulations, and ascertaining whether the bank is involved in any unsound practices that may jeopardise the sustainability of bank operations.

There are three supervisory classifications based on the evaluation of a particular bank. The categories are as follows: routine supervision; intensive supervision; and special supervision.

All banks are subject to annual routine supervision. If there is a real or immediate threat to a bank's business activities, the bank will be placed under the OJK's intensive supervision. Certain measures will be taken by the OJK against a bank under intensive supervision, such as:
- instructing the bank to report on specific issues;
- increasing the frequency of the work plan assessment process and adjusting it to meet specific targets;
- instructing the bank to compile a work plan to overcome its current problems; and
- placing an on-site supervisor or assessor from the OJK (if necessary).

If the financial condition and management of the bank fails to improve, or the OJK finds that the bank's business activities are under threat while under intensive supervision, then the bank will be placed under special supervision. The intensity of direct examination may escalate, especially in terms of assessing performance, based on existing commitments and the work plan submitted by the bank's management to BI.

10 How do the regulatory authorities enforce banking laws and regulations?

The OJK has the right to impose sanctions in accordance with the law. Therefore, if a bank is not fully compliant with the relevant regulations, the OJK may impose different sanctions for each violation, including administrative sanctions ranging from fines, business suspension and ultimately, licence revocation.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Some of the most common enforcement issues in Indonesia arise out of the following matters: the lengthy process to validate banks' financial statements and other information after the banks have submitted their reports to the OJK; and standardisation of the operational procedures of OJK officials in their supervisory dealings with the banks.

The OJK will closely monitor banks and will penalise banks for breaches of the regulations, as necessary. Since the OJK took over the role of banking supervision in 2014 it has been expanding its number of officers and improving their training in order to address the above enforcement issues.

12 How has bank supervision changed in response to the 2008 financial crisis?

After the 2008 financial crisis, BI has strengthened its supervisory function of banks through a Memorandum of Understanding on Cross-Border Banking Supervision with a five Bank Supervisory Authority, re-organising the banking sector in Indonesia, improving the supervision infrastructure of banks, improving the implementation of supervision with a risk basis and increasing enforcement through close coordination with the police, prosecutors and PPATK.

In addition, BI has also issued several regulations in order to prevent the 2008 financial crisis from reoccurring, such as increasing the capital adequacy of banks, limiting ownership of banks and implementing fit and proper tests for executive boards and shareholders of banks.

Following the switch from BI to the OJK, the OJK has continued to strengthen banking supervision by issuing new regulations and streamlining existing regulations.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Banks may come under supervision of the LPS where a bank is determined to be a 'failing bank' with systemic or with non-systemic impact.

Based on the official LPS website, following the Bank Century case in 2008, there have been no systemic or non-systemic failing banks rescued by the LPS. However, 48 rural banks and one conventional bank were liquidated (or are in the process of liquidation). The interests of the various stakeholders (depositors, shareholders, creditors and employees) will be treated as follows:
- depositors' rights over their deposits will be guaranteed a maximum amount of 2 billion rupiah by the LPS;
- the rights, title, management or other interests of the bank's shareholders, directors and commissioners will be released;
- bank creditors will receive payment of the bank's liabilities from any disbursements and collection of creditors' receivables by the liquidation team; and
- the payment of employee salaries will be processed and made by the liquidation team or the LPS (as the case may be).

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Once a bank is under the supervision of the LPS as a systemic or non-systemic rescued bank, a specific shareholders' resolution of the failing bank is required to enable the LPS to supervise the bank's management. The bank's management and directors will then have no further role or authority, unless the BoC, BoD and employees of the failing bank are authorised by approval or assignment by the LPS to carry out specific legal actions relating to the bank's assets and obligations. The BoC, BoD and employees of the failing bank are obliged to provide any information required by the liquidation team.

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15 Are managers or directors personally liable in the case of a bank failure?

In the event of a bank failure owing to the fault or negligence of the BoD, each member of the BoD is jointly and personally responsible for all outstanding liability of the failed bank.

The bank's managers are not currently regulated under prevailing law.

16 How has bank resolution changed in response to the recent crisis?

Bank resolution has changed by way of the setting of new levels of capital adequacy for banks, new limitations on the ownership of banks, and fit and proper testing of executive boards and shareholders of banks by BI.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Under the minimum capital requirements for commercial banks under the relevant BI regulations, banks must comply with the following capital requirements:

- capital quality increase through a change of the capital instrument requirements in accordance with Basel III;
- minimum capital requirements in accordance with the relevant risk profile;
- the capital adequacy ratio which contains a main capital ratio of at least 6 per cent of risk weighted assets (ATMR) and a primary main capital ratio of at least 4.5 per cent of ATMR; and
- providing additional capital as a buffer to cover the obligation to provide capital adequacy according to the relevant risk profile. Further, the additional capital must consist of:
  - a capital conservation buffer of 2.5 per cent of the ATMR;
  - a countercyclical buffer of 0 per cent up to 2.5 per cent of the ATMR; or
  - capital surcharge for any domestic systemically important bank (D-SIB) of 1 per cent to 2.5 per cent of the ATMR.

18 How are the capital adequacy guidelines enforced?

The minimum capital requirements must comply with the following risk profile:

- 8 per cent of the ATMR for banks with risk profile in level 1;
- 9 per cent to less than 10 per cent of the ATMR for banks with risk profile in level 2;
- 10 per cent to less than 11 per cent of the ATMR for banks with risk profile in level 3; or
- 11 per cent to 14 per cent of the ATMR for banks with risk profile in levels 4 or 5.

If the bank is a foreign bank branch office in Indonesia, then it must comply with the Capital Equivalency Maintained Assets (CEMA). The minimum CEMA is 8 per cent of the total amount of a bank's liabilities for each month, with the minimum amount of 1 trillion rupiah. The minimum CEMA must be complied with and issued for the following six months.

19 What happens in the event that a bank becomes undercapitalised?

Under the Banking Law, if a bank becomes undercapitalised, then the OJK may force the bank's shareholders to carry out any of the following actions:

- inject capital;
- replace the bank's BoD and BoC;
- nullify the non-performing credit or financing and calculate the bank's losses of capital based on the sharia principles;
- merge or consolidate with other banks;
- sell the bank to a buyer who intends to acquire all liabilities;
- hand over the management of part or all the bank's activities to other parties; and
- sell part or all the bank's assets or liabilities to other banks or parties.

If the above actions are insufficient to overcome the bank's insolvency, then the OJK may revoke the relevant bank's business licence and instruct the BoD to convene a general meeting of shareholders (GMS) resolving the dissolution of the bank and the formation of a liquidation team.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Under Law No. 37 of 2004 on Bankruptcy and Suspension of Obligations for Payment of Debts (Bankruptcy Law), if a bank becomes insolvent, then the OJK may request a Suspension of Obligation for Payment of Debts for the relevant commercial court.

If the bank is categorised as a failing bank, the OJK may revoke its business licence. For a rescued or liquidated failing bank, refer to the response to question 13.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

See question 17.

The capital adequacy requirements are still being adjusted in accordance with Basel III and will not change in the near future.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

BI Regulation No. 14/24/PBI/2012 on Single Ownership of Indonesian Banks (Single Presence BI Regulation) provides that a controlling shareholder means a legal entity or individual or business group which owns:

- 25 per cent or more of the issued shares of a bank with voting rights; or
- less than 25 per cent of the issued shares of a bank with voting rights, but it can be proven that the shareholder concerned has control of the bank, either directly or indirectly.

The controlling party may only control one bank with exceptions for:

- the controlling party of two banks, each of which operates on different principles, that is, conventional and sharia principles; and
- the controlling party of two banks, one of which is a joint-venture bank.

In addition to the above, BI Regulation No. 12/23/PBI/2010 on Fit and Proper Testing (Fit and Proper Test BI Regulation) provides that control over a bank can be achieved by:

- holding 25 per cent or more of the shares of the bank, either individually or collectively;
- directly managing or influencing the policies of the bank;
- holding option rights in order to own shares which, if exercised, would allow the party concerned to own or control at least 25 per cent of the shares of the bank, either individually or collectively;
- cooperating or carrying out actions simultaneously to achieve a joint purpose to control the bank (acting in concert) with or without any written agreement with another party. That is, to collectively own or control 25 per cent or more of a bank's shares, directly or indirectly, with or without written agreement;
- cooperating or carrying out actions simultaneously to achieve a joint purpose to control the bank (acting in concert) with or without any written agreement with another party. Accordingly, to collectively have an option to own shares which, if exercised, would allow the party concerned to collectively own or control 25 per cent or more of the bank's shares;
- controlling one or more other companies that collectively owns or controls 25 per cent or more of the bank's shares;
- having the authority to approve or dismiss members of the BoC and BoD of the bank;
- indirectly influencing the bank's management or policies;
- controlling the bank's holding company; and
- controlling a party that has control as described in any of the above points.

23 Are there any restrictions on foreign ownership of banks?

The maximum foreign ownership in conventional commercial banks and commercial sharia banks is 99 per cent of the respective bank's paid up capital. Foreign entities or individuals are not allowed to become shareholders of conventional rural banks or sharia rural banks.

Foreign ownership is also subject to the OJK's approval and a foreign controlling shareholder (either an individual or a foreign legal entity) must satisfy the following requirements:

- it must support Indonesian economic development through the relevant bank;

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- if it is a financial institution legal entity, it must obtain a recommendation letter from the financial supervisory authority in its originating jurisdiction; and
- it must have an investment rating above a required level, depending on the investment vehicle.

Moreover, the general share ownership limitations described below are applicable to foreign ownership as well as domestic ownership.

Maximum share ownership for each shareholder in conventional commercial banks is as follows:
- 40 per cent of the bank's capital for a legal entity in the form of a bank financial institution and a non-bank financial institution;
- 30 per cent of the bank's capital for a non-financial institution legal entity; and
- 20 per cent of the bank's capital for individuals.

The definition of 'individual' includes Indonesian citizens and foreign citizens.

In addition, based on BI Regulation No. 14/8/PBI/2012 on Share Ownership in Commercial Banks (Share-Ownership Regulation), a legal entity in the form of a bank may own more than 40 per cent of the bank's capital provided that it is approved by the OJK, having satisfied the following requirements:
- financial health rating or other equivalent rating for a foreign bank;
- adequate minimum capital in accordance with its risk profile;
- maintaining a 6 per cent tier main capital;
- if domiciled overseas, having the recommendation of the relevant bank supervisory authority in its originating jurisdiction;
- being a public company bank;
- having a commitment to purchase equity bonds issued by the relevant bank and a commitment to own the bank for a certain minimum period; and
- having a commitment to support Indonesian economic development through the relevant bank.

24 What are the legal and regulatory implications for entities that control banks?

Once becoming a controlling party, the entity will be subject to general banking regulations applicable to bank controllers, including maintaining its commitment to develop healthy banking operations as required under the Fit and Proper Test BI Regulation.

In its holding company functions, the controlling party can also directly consolidate and control all activities of the relevant bank's subsidiaries.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Other than the requirements under the Fit and Proper Test BI Regulation, Indonesian banking law does not regulate specific duties and responsibilities of the controlling shareholder of a bank. Please see the response to question 22 for information on controlling shareholders.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

See the responses to questions 13 and 20.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Based on the BoD of BI Decree No. 32/51/KEP/DIR/1999 of 1999 on the Requirements and Procedures for Merger, Consolidation and Acquisition of Commercial Banks (BoD Decree No. 32/1999), in order to conduct a bank acquisition, the required approvals are both from the acquired bank, the acquirer and also the OJK. The required approvals for a bank acquisition include:
- approval from the BoC of both the acquired bank and the acquirer on the acquisition plan;
- approval from the GMS of the acquired bank;
- if the acquired bank is listed, then it must comply with the prevailing mandatory tender offer rules; and
- approval from OJK for the acquisition.

In addition to the above, the following issues need to be considered in any bank acquisition.

Fit and proper test

If the acquirer (either domestic or foreign) has 25 per cent or more of the issued shares with voting rights or less than 25 per cent of the issued shares with voting rights, but has control of the bank, either directly or indirectly, then the acquirer is classified as a controlling shareholder. According to the Fit and Proper Test BI Regulation, the potential or controlling shareholder of the bank must pass the fit and proper test held by the OJK. The test will assess the integrity and financial capability of the potential controlling shareholder. The test is carried out by way of administrative assessment or interview.

Anti-monopoly considerations

Another relevant consideration when conducting a bank acquisition is Law No. 5 of 1999 on the Prohibition of Monopoly and Unfair Business Competition Practices (Competition Law). The Competition Law prohibits mergers, consolidations and acquisitions of shares that may result in a monopoly or unfair business practices.

According to the Competition Law and relevant subordinate regulations, any acquisition of a company or bank by one or more companies, directly or indirectly, by way of a share transaction resulting in change or transfer of control comes under the jurisdiction of the Business Competition Supervisory Commission (KPPU).

The Competition Law sets out certain thresholds for any merger, consolidation or acquisition transaction that will trigger mandatory notification to the KPPU as follows:
- the transaction will result in a company with an asset value exceeding 2.5 trillion rupiah;
- (in relation to transactions involving banks) the transaction will result in a bank with an asset value exceeding 20 trillion rupiah; or
- the transaction will result in a company with a sales value (turnover) exceeding 5 trillion rupiah.

If two or more of the transaction parties are banks, then only the asset value test applies, so that mandatory notification must be made if the combined asset value exceeds 20 trillion rupiah. However if only one transaction party is a bank, the asset value decreases to a threshold of 2.5 trillion rupiah.

For the calculation of the assets and sales value, Government Regulation No. 57 of 2010 on the Mergers, Consolidations and Acquisitions of Shares that May Result in a Monopoly or Unfair Business Competition Practices (Competition Government Regulation) adopts the 'vertical line method' (that is, from the controlling shareholders to the controlled companies). This method sets out that the threshold is calculated as follows:
- for mergers or consolidations: the combined asset value or sales value of the (merged or consolidated) company and any company that directly or indirectly controls or is controlled by the (merged or consolidated) company; and
- for acquisitions: the combined asset value or sales value of the acquirer company and the target company as well as any company that directly or indirectly controls or is controlled by the acquirer and the target companies.

The Competition Government Regulation has adopted two systems for notification:
- mandatory post-merger notification, in which all mergers, consolidations and acquisitions, which meet the relevant threshold level must give mandatory notification to the KPPU within 30 working days after the completion; and
- voluntary pre-merger notification (also known as pre-merger consultation) in which a merger can be voluntarily notified to the KPPU before completion.

Although pre-merger notification is voluntary, the KPPU strongly encourages transaction parties to make pre-merger notification in order to minimise the risk of loss in case KPPU were to conclude that the merger violates the Competition Law.

KPPU Regulation No. 7 of 2011 on the Guidelines of article 27 of Indonesian Competition Law on Share Ownership (KPPU Regulation) stipulates that a shareholder could be deemed to be in control of a company if the shareholder has the ability to exercise control over management, or

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Update and trends

There are no recent updates to the Banking Regulations. However, based on recent media reports, the OJK has submitted six 'points of recommendation' on the Banking Regulations that refer to the following matters, and are likely to result in further legislation being issued in the near future:
- increasing bank support for the agriculture, fisheries and infrastructure sectors;
- further regulating foreign ownership in banks so that the existence of foreign parties in the national banking sector can provide increased economic benefits for Indonesia and added value;
- regulating banking conglomerations so that they will not have a systemic impact on the bank's subsidiaries in the future if the holding company suffers losses;
- further regulating consumer protection in the banking sector;
- further regulating the expansion of bank business activities; and
- constricting the central and regional disparity (for example, prioritising banks to open branch offices in certain areas of Indonesia).

has the ability to determine the direction, strategies and policies of the company, including but not limited to, the ability to:
- establish policies to take certain corporate actions;
- determine member of the BoD and/or the BoC;
- exercise the right of veto;
- access confidential information of the company;
- control the distribution of dividends; or
- implement any merger, consolidation or acquisition.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

As explained in the response to question No. 23, there is no difference between the criteria for share ownership and shareholding determination between local shareholders and foreign shareholders. However, foreign share ownership is also subject to the OJK's approval and a foreign financial institution controlling shareholder must satisfy the following requirements:
- if domiciled overseas, it must support Indonesian economic development through the relevant Indonesian bank;
- it must obtain a recommendation letter from the financial supervisory regulator in its originating jurisdiction; and
- it must have an investment rating above a required level, depending on the investment vehicle.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

Please see the responses to questions 22, 23 and 28 above.

30 Describe the required filings for an acquisition of control of a bank.

The filings required for an acquisition of control of a bank include:
- an acquisition plan must be submitted to BI in a notarial form; and
- an implementation report on the acquisition must be submitted to BI, together with a copy of the relevant deed of acquisition.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Based on BoD Decree No. 32/1999 and BoD of BI Decree No. 32/50/KEP/DIR/1999 on Requirements and Procedures for the Share Purchase of Commercial Banks, an acquisition will be approved (or rejected) within 30 days after the OJK receives 'complete and accurate' application documents. There is considerable flexibility for the OJK to satisfy itself that the submitted documents are 'complete and accurate', so the 30-day period is generally longer in practice. If the OJK fails to announce its decision within this time frame (after it has declared the application to be 'complete and accurate'), then it is deemed to have approved the acquisition.

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Italy

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Ughi e Nunziante – Studio Legale

Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The main principles of the Italian system aim to ensure the sound and prudent management of supervised entities, the stability of the entire banking and financial system as well as its efficiency and competitiveness.

The general structure of banking policy in Italy has, over the past three decades, been based on the obligation to comply with the principles and rules arising from Italy's membership of the European Union. As a consequence, the Italian banking system complies with the principle of the mutual recognition of banking authorisation granted in the EU home state.

The exercise of banking activities by authorised EU banks, both in relation to freedom of establishment and to freedom of service provision, must be preceded by a notice to the Bank of Italy from the competent supervisory authority in the bank's home state.

The structure of the Italian banking system is based on the presence of different kinds of institutions, which are entitled to conduct their business in relation to the following activities:

- banks: legally entitled, in principle, to carry out most types of banking activity (collecting savings from the general public, granting of loans and other forms of financing, payment services, issuing of e-money and, pursuant to specific rules, the exercising of investment services). Italian banks may be incorporated as companies limited by shares or as cooperative banks in the alternative form of banca popolare or banca di credito cooperativo;
- financial intermediaries: used to be entitled to provide financing, equity investments, brokerage on currencies and payment services (as reserved activities); however, after the reform of 2010, they are now entitled only to grant financing which is now the sole reserved activity;
- payment institutions: entitled to carry out only payment services or other ancillary activities; and
- e-money institutions: entitled to carry out business in the electronic money and payment services sectors.

2 Summarise the primary statutes and regulations that govern the banking industry.

The main principles governing the banking industry are contained in two main legislative Acts: Legislative Decree No. 385/1993 (the Italian Banking Act, TUB) and Legislative Decree No. 58/1998 (the Italian Financial Act, TUF). In the past two decades, the connections between the banking and the finance industries have considerably increased; therefore, the most recent legislative Acts affect both the banking and the finance sectors.

The TUB contains the principles regulating the carrying out of business by banks, other financial intermediaries, as well as by other entities operating in the banking sector. Moreover, the TUB is the principal legislative source for the framework of the powers and responsibilities of the regulatory authorities in Italy.

Both the TUB and the TUF have been significantly amended in the past few years.

The other principal legislative Acts and regulations governing banking and financing activities in Italy are the following:

- Bank of Italy Circular No. 285/2013, which contains the new supervisory instructions for banks;
- Bank of Italy Circular No. 263/2006, which contains the precautionary guidelines for banks;
- Law No. 262/2005 on the protection of savings, which has profoundly affected the TUB; in particular, this law has reorganised: the powers of the Bank of Italy and its governor-general; the relationships, responsibilities and mutual cooperation of the two main public authorities respectively responsible for the supervision of the banking system (Bank of Italy) and of the securities market (Consob); and corporate governance for listed entities (including banks);
- Legislative Decree No. 206/2005 (the Consumers Code), which contains provisions concerning the distance marketing of consumer financial services, including the distance marketing of banking products;
- Legislative Decree No. 11/2010, which implemented in Italy Directive 2007/64/EC (the Payment Services Directive). In particular, this decree introduced the rules for payment institutions in Italy. Therefore, at present, the rendering of payment services is reserved to banks, e-money institutions and payment institutions;
- Legislative Decree No. 231/2007, which implemented Directive 2005/60/EC on the prevention of the use of the banking and financial system for the purposes of money laundering and terrorist financing;
- Legislative Decree No. 141/2010, which implemented Directive 2008/48/EC on credit agreements for consumers. In particular, this decree introduced a set of provisions in the TUB regulating, inter alia, pre-contractual transparency duties, verification of the creditworthiness of consumers and the rights of consumers in case of withdrawal. This Decree has also had a considerable impact on financial intermediaries. Indeed, this decree has cancelled from the list of reserved activities (towards the general public) equity investment and currency exchange services.

In Italy an important regulatory role is provided by the Bank of Italy. In carrying out this role, the Bank of Italy has adopted several regulations setting the requirement for pre-contractual transparency, the organisation and effectiveness of the alternative dispute resolution system provided by the TUB, the authorisation and supervision procedures over all supervised entities, etc.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The activity of overseeing banks is mainly carried out by the Bank of Italy, together with other public bodies.

The Ministry of Economy and Finance is entitled to set out, in regulations enacted by the Ministry, the integrity requirements for shareholders and the experience requirements for persons responsible for administrative, management and supervisory functions in banks or financial intermediaries.

The Inter-ministerial Committee for Credit and Savings (CICR) also has certain powers, strictly coordinated with the Bank of Italy.

The Bank of Italy undertakes the main supervisory and regulatory duties, exercising them through a range of administrative, regulatory and control powers.

The Bank of Italy is also in charge of the supervision of:

- financial intermediaries that are entitled to provide financing;
- e-money institutions; and
- payment institutions.

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4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

According to the TUB, deposits are not insured by the government, but through a protection scheme originally set up on a voluntary and private basis, even though performing a public function.

The deposit protection schemes currently in force are the Inter-bank Fund for the Protection of Deposits, to which any Italian bank (and in some cases also Italian subsidiaries of banks operating outside the EU area) must adhere, and the Insurance Deposit Fund for Cooperative Savings, which operates for cooperative banks.

In case of insolvency of a banking institution holding deposits, a minimum compensation is provided, currently limited to €100,000. The Bank of Italy is entitled to modify such limit in order to adjust it to the variation to the rate of inflation.

Some depositors (territorial entities, top managers and directors of the same bank, banks and other credit institutions, etc) and some types of deposits and credits (credits resulting from bonds, promissory notes, share capital and reserves, etc) are excluded from the guarantee.

The refund in favour of the depositors shall be paid within 20 days from the commencement of the forced liquidation procedure of the relevant bank. This term may be extended by the Bank of Italy by a further 10 days, but only in exceptional circumstances.

There has been no recent intervention of the government in the ownership interest of insolvent banks.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Pursuant to Law No. 262/2005, the Bank of Italy, according to CICR Resolution 277/2008, provides the limits and conditions under which a bank may assume risks towards 'related parties'.

This concept includes both 'related entities' and 'entities connected to related entities'. 'Related entities' are:

- persons that carry out directive and control duties within the bank or the leading bank of the group;
- major shareholders who, under the TUB, needed prior authorisation for the acquisition of their share capital (see question 22);
- entities that may appoint, by virtue of agreements or of the articles of association, one or more members of the directing and controlling bodies;
- companies over which the bank or the banking group may directly or indirectly exercise a dominant influence; and
- other entities identified by the Bank of Italy by the application of the International Accounting Standards (IAS).

'Entities connected to related entities' are:

- companies directly or indirectly controlled by a related entity;
- entities that control directly or indirectly a related entity; and
- other entities identified by the Bank of Italy by the application of the IAS.

Pursuant to the provisions of the Bank of Italy, the full amount of the risk assets of a bank or of a banking group towards related parties cannot exceed certain diversified thresholds (in any case no more than 20 per cent) of its regulatory capital.

Furthermore, persons that carry out directive and controlling duties within the bank, as well as a company of the banking group, can enter into obligations with the bank only under the prior authorisation of the board of directors.

In December 2011 the Bank of Italy approved the rules implementing the CICR Resolution 277/2008. According to said implementation rules:

- in the approval of transactions with 'related entities' the role of the independent directors of the bank is particularly relevant since the bank shall constitute an executive committee (internal to the board of directors) exclusively composed of independent directors who are requested to communicate their prior opinion in respect of the relevant transaction by means of an express declaration in occasion of the vote in the board of directors called to resolve on the transaction; and
- the bank will set internal procedures aiming at regulating the transaction with related entities.

6 What are the principal regulatory challenges facing the banking industry?

As a consequence of the significant legislative and regulatory activity carried out in the past few years, the Italian banking industry has to take into account various legislative and regulatory requirements.

Based on the practical experience of entities operating in the banking system, the more frequent regulatory challenges, also in the light of the most recent business trends in Italy, relate to:

- the need to bring the contractual provisions relating to payment services in line with the recent transparency regulations adopted by the Bank of Italy;
- the new structural organisation which affects financial intermediaries (other than banks) already authorised to carry out payment services;
- the implementation of business plans featuring the integration between banks and payment institutions (such as for example through the use of ATM networks owned by the banks for the offering to the public of money transfer services by payment institutions);
- the recent introduction of a new set of rules adopted by the Bank of Italy in respect of the transparency and fairness duties for the entities carrying out consumer credit;
- the need for the financial intermediaries to adapt their business, their corporate structure as well as the internal compliance function to the new legal framework which has now substantially been implemented after the adoption, at the end of December 2014, of the secondary regulation of Legislative Decree No. 141/2010, even if the final entry into force is still subject to the publication of the secondary level regulation in the Official Gazette; and
- the duty to comply with the principles set out in the recent CICR Resolution 644/2012 which, by implementing the new article 117-bis TUB, adopted new rules for limits and criteria for fees applied by banks in financing contracts in case of overdraft and overrun by the client.

More generally, the most relevant challenge as regards regulation will be the gradual and organic implementation into the internal legal framework of the reforms that have been conceived and approved at EU level. Such process has already begun, and is expected to continue in the coming years until the new regulatory architecture is fully implemented.

7 Are banks subject to consumer protection rules?

Banks (as well as other financial intermediaries and e-money institutions) are subject to several consumer protection rules particularly under the profile of transparency.

This title includes specific rules for the sectors of consumer credit and payment services.

A specific section of TUB provides a general set of transparency and fairness rules applicable to all the customers of a bank.

The main protections offered to consumers are the following:

- written form is required for any banking contract;
- the banks shall comply with several pre-contractual requirements such as that to inform in writing the customer, inter alia, of the interest rates applicable to any financing contract to be entered into and the effective global interest rates applied in Italy; prices that will be applied and other economic terms; the customer's right of withdrawal;
- within certain terms from the signing of the contract or from the unilateral amendment by the bank of the conditions contained therein, the consumer may withdraw from the contract; and
- in case of non-compliance of the bank, consumers have the right to complain, without bearing any cost, to the Banking and Financial Arbitrator (ABF), the Italian institute established for the resolution of controversies on banking and finance matters.

In particular, more detailed rules for consumer protection are contained in the Bank of Italy's Resolution of 29 July 2009 which implemented the primary level provisions via a set of very detailed provisions aimed at ensuring that bank customers are informed in a fair, transparent and complete manner but, in particular, this Resolution focuses on the duty of the banks and intermediaries to comply with specific obligations in respect of consumer protection. Bank of Italy Resolution of 29 July 2009 requires banks

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to provide a set of pre-contractual documents containing the main terms and conditions of the contract.

Furthermore, banks and intermediaries are also obliged to comply with documentary standard forms relating to periodical communications; rules regulating unrequired marketing messages; disclosure duties in respect of the economic conditions of any kind of contract; implementation of internal procedures for receiving and managing the complaints of consumers, etc.

In addition to the above, further regulations are provided in a specific section of the Consumer Code (Legislative Decree No. 206/2005) where specific requirements are set forth in respect of distance marketing to consumers of bank and financial services.

The Bank of Italy is responsible for the enforcement of such consumer protection rules in the banking sector.

As mentioned above, complaints may also be filed with the ABF, even though the decisions of the latter have no direct binding effect on the banks.

In the recent past, particular attention has been focused on the non-compliance of certain financial intermediaries and e-money institutions which did not provide accurate pre-contractual information on the cost and interest rate to be applied to the service of revolving credit cards, and the consumers were found not to be aware of the very high costs generated by the service.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Over the next few years various legislative and regulatory interventions are expected to be implemented in Italy.

Generally, given the current trends, in the years to come a further focus on the strengthening and rationalisation of the framework of supervisory controls on banks, investment companies and hedge funds is expected. In particular, at the date of drafting of this contribution, Bank of Italy has adopted new rules regulating the supervision activities on asset management companies. The new Bank of Italy's resolution has been formally adopted, but it has not yet been published in the Official Gazette. Therefore, the implementation of this new set of rules is expected to bring about a change in regulatory policy in Italy in respect of this specific kind of entity.

In 2015 the Bank of Italy is also expected to continue its regulatory activity in view of the implementation of the new European Institutional Architecture based on the three European Supervision Authorities: the European Securities and Markets Agency, the European Banking Agency and the European Insurance and Occupational Pensions Authority.

It is worth noting that, several years since the beginning of the reform process (2010,) an important transitional scenario is still affecting the financial intermediaries sector (as opposed to banks). The first-level rules, adopted by Legislative Decree No. 141/2010, are not yet fully enforceable given that the entering into force of such new rules is subject to the gradual approval of the relevant implementing regulation.

At the time of writing, the Ministry of Economy and Finance and Bank of Italy have not yet adopted the respective rules by means of the Ministerial Decree (see the Update and trends) and Bank of Italy's new supervisory rules for financial intermediaries which ended the public consultation have not yet been formally published.

Although such provisions are not definitive, the general framework for the sector of the financial intermediaries will be characterised by:

- a new limit on the reserved activities allowed for financial intermediaries, since in the new scenario the only reserved business will be the granting of financing and the servicing activities under securitisation transactions;
- the introduction of a register for all the financial intermediaries (ie, the distinction between general enrolment in the register which is requested for all the intermediaries and a second type of enrolment in a special register provided only for those intermediaries with a business volume higher than a certain threshold will be cancelled);
- strengthening of the supervisory powers of the Bank of Italy on the new financial intermediaries. In this respect, the new supervisory policy will set forth more severe capital requirements and controls as well as in relation to the requirements prescribed to the shareholders and to the corporate bodies; and
- the introduction of a new supervisory regime on a consolidated basis also for groups composed of financial intermediaries.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banking supervision performed by the regulatory authorities, and in particular by the Bank of Italy, consists of three types:

- regulatory supervision: this covers the power to adopt provisions of a general nature;
- information supervision: this covers the acquisition, audit and assessment of periodical information provided by the entity supervised on a compulsory basis; and
- inspection supervision: this covers the Bank of Italy's power to carry out on-site inspections.

Regulatory supervision

The Bank of Italy's supervision aims at ensuring the sound and prudent financial management of supervised entities as well as the stability, efficiency and competitiveness of the banking and financial system as a whole. This aim is pursued through the enforcement of the rules and provisions regulating the credit sector.

Within the exercise of regulatory supervision, the Bank of Italy adopts provisions having as their purpose:

- capital adequacy;
- risk containment;
- ownership restrictions;
- permissible shareholdings;
- administrative and accounting organisation of the banks and internal audits; and
- public disclosure that supervised entities must provide with respect to the above points.

Inspection supervision

As far as inspection supervision is concerned, this authority is not only exercised over banks and other Italian supervised entities, but also over the branches of banks established in Italy by foreign banks.

Consolidated supervision

Banking supervision over a group of banks is defined as 'consolidated supervision' and implies a significant extension of the powers of the Bank of Italy also with respect to the following entities:

- companies in a banking group;
- banking and financial companies in which one of the companies of the group has an interest equal to at least 20 per cent of the capital;
- banking and financial companies which are not part of a banking group but which are controlled by the natural or legal person that controls a bank or a group of banks;
- companies that control at least one bank; and
- non-banking companies and non-financial companies directly controlled by a single bank.

As well as the supervisory activity over banks and groups of banks, the Bank of Italy exercises its powers over other relevant entities such as financial intermediaries, e-money institutions and payment institutions.

As a general remark, each of the above-mentioned categories (banks, financial intermediaries, etc) is regulated by specific supervisory rules adopted by the Bank of Italy.

A group of banks means a group composed of:

- a leading Italian bank that controls other banking, financial (or instrumental to the banking activity) companies;
- a leading Italian financial company that controls other banking, financial (or instrumental to the banking activity) companies; or
- a leading Italian financial company, that has at least one bank within the company group.

10 How do the regulatory authorities enforce banking laws and regulations?

The supervision exercised by the Bank of Italy over the correct performance of banking activity by supervised entities is quite pervasive and includes the duty to provide periodical information, as well as the inspection power of the authority.

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In cases of infringement of both laws and secondary level regulations by supervised entities, the Bank of Italy has a wide range of powers of intervention and sanction.

Supervision authorities, and in particular the Bank of Italy, mainly enforce laws and regulations by the following means (in rising order of seriousness):

- written warnings;
- notice of infringement by the Bank of Italy (upon receiving such notice a full hearing of the parties starts in which the entities involved may file with the Bank of Italy a written defence and potentially block the adoption of a sanctioning resolution); and
- administrative pecuniary fines on persons and banks, companies or other bodies involved, should the written defence not be accepted.

If a serious irregularity is found in the management of the supervised entities or in case of a serious breach of the law or of regulatory or statutory provisions, the Bank of Italy may propose that the Ministry of Economy and Finance withdraw the banking licence. If the Ministry considers the reasoning of the Bank of Italy well founded, it may order, by means of ministerial decree, the withdrawal of the licence and the commencement of the administrative forced liquidation procedure against the supervised entity.

In addition, with regard to credit institutions at risk of insolvency, the Bank of Italy may issue a number of extraordinary provisions in case of violation of legislative, administrative or statutory provisions which regulate their activities.

These extraordinary provisions include:

- the prohibition against starting up new operations; and
- the order to close branch offices, which may affect individual branches of an Italian bank, including those located abroad, or one or more branches located in Italy of a non-EU bank.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

For the following data we refer to the last available annual report on supervision issued by the Bank of Italy, which relates to 2013, but also contains references to data collected in the first few months of 2014.

In this period, the enforcement activity carried out by the supervisory authority was in line with 2012 and, indeed, the Bank of Italy carried out a great number of investigations into banks (171, compared with 183 in 2012), but while the number of generic controls decreased (from 140 in 2012 to 133 in 2013), that of specific investigations increased significantly (from 22 in 2012 to 36 in 2013). Such investigations mainly focused on verifying credit risk and capital adequacy, and their outcomes have been more often negative than positive for all kind of financial intermediaries.

In 2013, 84 sanction provisions were issued, for a total amount of €24.03 million (while in 2012 the total amount was of €18.3 million), mainly for non-compliance with organisational requirements or inadequacy of the risk policies applied.

Furthermore, the Bank of Italy has started several extraordinary administration procedures against banks and other non-banking entities (that is, financial intermediaries, investment management companies, and e-money institutions). As of 1 January 2014, with particular reference to banks, there were 11 extraordinary administration procedures and another two in the first three months of 2014.

12 How has bank supervision changed in response to the 2008 financial crisis?

The financial turmoil of 2007 had a strong impact upon banking supervisory activity. As a general remark, it is worth noting that the crisis did not affect the tripartite structure of the supervisory activity of the Bank of Italy (regulatory, information and inspection).

As a consequence of the financial turmoil, in the past years it was expressly clarified that in addition to the sound and prudent financial management of the supervised entities, the stability of the banking and financial system as a whole as well as the efficiency and the competitiveness of the financial system, the transparency of contractual terms and conditions is also to be considered as one of the key principles of banking supervision.

As a final remark, in view of the progressive alignment of the Italian banking system with the directives coming from the European Union, several reviews have been started, aimed at reshaping regulatory supervision by gradually implementing the new Basel III rules, which should eventually lead to the introduction of new sets of rules on corporate governance, aiming at regulating remuneration policies and at encouraging a more balanced assumption of risks.

It is worth noting that the new EU rules implemented by means of an amendment of Circular No. 263 of the Bank of Italy have also led to a partial revision of the provisions regulating the authorisation to carry out banking activities. The new rules aim to guarantee the stability and the prudent and sound management of banks from the beginning of operations and, at the same time, also aim to prevent barriers to the entrance of new players into the banking market. In compliance with the new European standards, the new rules increased the former minimum initial capital requirement, strengthened the requirements relating to the governance models and introduced higher qualitative standards to be fulfilled by those participating in the capital. The new regulation mainly deals with weaknesses identified by the inspections on the new banks and through the long-distance controls and inspections carried out on newly incorporated banks (eg, strategic risks, flaws in the governance models and excessive costs).

Moreover, in order to strengthen a system aiming to face and prevent further crises, Bank of Italy has set out standards for the internal controls of banks. The revision of the rules on internal controls aims to strengthen the power of intermediaries to manage corporate risk. The new framework defines an organic set of general principles on which internal controls standards will be based. The most relevant changes are:

- the obligation of the strategic supervisory body to define the generally acceptable level of risk;
- the adoption of an integrated approach to risk management aimed at providing opinions on the coherence between relevant operations and the internal risk policies;
- the introduction of specific policies on the outsourcing of corporate functions; and
- the upgrade and adjustment to international standards of the rules relating to the information system and to the business continuity.

A more recent intervention aimed at containing the systemic risk through capital adequacy requirements is Law No. 174 of 7 October 2014, which included provision for the full implementation of EU Directive CRD IV. In Italy, as in the other EU countries, the execution of Basel III and of the new legislative package known as CRD IV has been granted mainly by the direct effect recognised to Directive 2013/36/EU (Directive CRD IV) and by Regulation 2013/57/EU (CRR), which outline an organic set of rules and controls on banks and investment firms. The above-mentioned legislative package increases the level of prudential regulations and harmonises the rules applicable to the financial intermediaries within the single European market.

As a consequence, the contribution of the Italian legislator, which at the time being is still in process, has been mainly directed to secondary legislation and included profiles such as the sanction system adjustment in order to avoid duplications of roles between the Bank of Italy and Consob in relation to their sanctioning powers in case of non-compliance with the CRDIV and CRR rules.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Further to the privatisation of the Italian banking sector, which took place in the 1990s, the system as a whole tended to prevent state-owned capital from flowing into the bank's capital. Even in this period of crisis, public control (both in terms of governance and participation in the capital of the bank) is relatively limited.

Starting from February 2009 (up to 31 December 2009), pursuant to article 12 of Legislative Decree 18/2008 then implemented by means of Law No. 2/2009, the 'Tremonti bonds' were introduced, which are in essence convertible bonds issued by banks and subscribed by the state which, in certain circumstances, might lead to the participation of the latter in the capital of the relevant bank.

A bank in distress that has taken advantage of the issuance of such bonds shall than reimburse the bond loan before 29 January 2019 (that is, 10 years from the entrance into force of Law No. 2/2009). The loan can be converted into common shares by way of a capital increase, the subscription of which is reserved to the state.

The Tremonti bonds provide an indirect type of protection of the interests of certain categories of stakeholders. For instance, dividend coupons

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connected to the Tremonti bonds are paid by the bank only if there are actual gains to share. Hence, a bank suffering losses shall not pay the coupons so that the interests of shareholders, account holders, other creditors and stakeholders are protected.

Moreover, should the capital of the bank be reduced, the face value of the bonds will be reduced accordingly in order to prevent the shareholders from being damaged by the dilutive effect.

Other types of protection are also granted in case of distress events affecting the bank issuing the Tremonti bonds. More precisely, the bank may:

- keep on granting credit to small and medium-sized enterprises;
- stop collecting mortgage instalments from individuals that are unemployed or that are benefiting from the unemployment pay;
- lend to the enterprises the cash necessary to pay the unemployment pay; and
- limit the salaries of the top management and of the market operators, including traders.

The use of the Tremonti bonds is not, though, particularly significant. In 2009 only four banks issued Tremonti bonds for an aggregate amount of about €4 billion: Monte dei Paschi di Siena SpA (MPS) (€1.9 billion); Banco Popolare Soc Coop (€1.45 billion); Banca Popolare di Milano Soc Coop arl (€500 million); and Credito Valtellinese Soc Coop (€200 million).

More recent is the introduction, by means of Law No. 135/2012 and Law No. 228/2012, of 'Monti bonds'. The aim of these bonds is the capital reinforcement of the Banca Monte dei Paschi di Siena. In February 2013, MPS issued Monti bonds for an aggregate amount of €4.07 billion, which were subsequently subscribed by the Ministry of Economy and Finance.

At the present time, it appears that Monte dei Paschi di Siena may not be able to fully repay the interests accrued in relation to the Monti Bonds subscribed in the past. If this were the case, the Ministry of Economics may acquire a participation in Monte dei Paschi di Siena between 5 and 10 per cent. Indeed, that would be the first time in Italian banking system recent history that the government – after privatisation of the banking sector – gets back into the capital of an important Italian bank. Nevertheless, it has to be said that, while this editorial contribution is being printed, the chances of a significant capital increase by Monte dei Paschi, which may prevent the Monti bonds from being converted into common shares reserved to the state, cannot be excluded yet.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

It is provided that, in case of crisis, banks can be subject to a specific extraordinary administration procedure (see question 19), which may be followed, in case of insolvency, by the special bankruptcy procedure provided for banks.

In respect of the bank's management and directors, we should point out that from the date that the decree starting insolvency proceedings is issued, the governing body, controlling body and any other bodies are relieved of their duties.

The relieved bodies are replaced with specific insolvency proceeding bodies. The Bank of Italy appoints one or more liquidator commissioners (extraordinary commissioners) who, while carrying out their functions, are supported by a monitoring committee, which also supervises the liquidators' activity, provides opinions when required by the law and gives instructions on behalf of the Bank of Italy.

In Italy, banks are not currently required to adopt either resolutions or a contingency plan or similar (such as a living will).

15 Are managers or directors personally liable in the case of a bank failure?

According to the general principle of the liability of directors (pursuant to the provisions set out in the Italian Civil Code) and under rules provided by the Italian Bankruptcy Law, managers and directors may be personally liable under both civil and criminal law in case of a bank failure.

From a civil point of view, liability action can be addressed to the directors for violations relating to their duty to preserve the integrity of corporate capital and, more generally, in case of breaches of the duties provided by the law and the by-laws, should those breaches cause damage to the bank or to the creditors of the same. The directors shall be also bound to compensate the damages caused as a consequence of the abovementioned breaches.

If the bank is placed under extraordinary administration (see question 19) liability action against the former members of the disbanded governing bodies (including the managing director) may be proposed by the extraordinary commissioners, who will first be authorised to do so by the creditors' monitoring committee and the Bank of Italy.

16 How has bank resolution changed in response to the recent crisis?

To cope with the consequences of the crisis and to support the banking market, the Ministry of Economy and Finance as well as the Bank of Italy and the Italian government have tailored some specific legislative instruments.

New legislation provided for the issuance of hybrid equity instruments – Tremonti bonds, introduced in 2009, and Monti bonds introduced in 2012 – to be subscribed by the Ministry of Economy and Finance (see question 13) which can be calculated in Tier I regulatory capital.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The legal and regulatory capital adequacy requirements are of two types:

- requirements to be fulfilled in order to obtain a licence for banking activities; and
- requirements to be fulfilled during the course of business (the regulatory capital).

As for capital requirements for access to banking activities, banks must be incorporated with a minimum capital of €10 million for banks incorporated as companies limited by shares, and with a minimum capital of €5 million for banks incorporated as cooperative or mutual banks. This minimum capital must be fully paid in.

With respect to regulatory capital requirements during the course of business, Italian legislation complies with the standards and criteria set out in Basel II and Basel III. These requirements are based on the general criteria according to which banks must have a capital at least equal to the minimum capital required for access to the banking activity (ie, the incorporation capital).

Furthermore, banks must also align their regulatory capital and the availability of liquidity with the structure of their risk allocation.

Regulatory capital is structured on three different levels (tiers). Tier I (defined as 'basic assets') and Tier II ('additional assets') are calculated on the basis of the sum of positive and negative financial items. Italian regulation also allows banks to use Tier III assets, which are constituted by medium to long-term subordinate loans, but only to cover certain kinds of market risk.

18 How are the capital adequacy guidelines enforced?

The enforcement of capital adequacy guidelines is based on the banks' obligation to calculate their regulatory capital on a quarterly basis with respect to individual banks and on a six-monthly basis with respect to banking groups, while the consolidated data of the end of the financial period are calculated according to the criteria of reporting for the financial statements for the relevant accounting period.

The adequacy of the regulatory capital is also based on an ongoing enforcement based on the supervisory review process (SRP), which comprises two levels:

- internal capital adequacy assessment process (ICAAP), which relates to banks that internally assess their current and prospective capital adequacy; and
- supervisory review and evaluation process (SREP), carried out by the Bank of Italy, which examines the ICAAP and gives an overall assessment on the bank and its activity and may, if necessary, issue corrective measures.

By means of SREP the Bank of Italy not only verifies a bank's compliance with the capital adequacy requirements, but makes an evaluation of the corporate governance system and of the functionality of its internal bodies as well of the effectiveness of its internal supervisory capacity.

Should SREP reveal anomalies, the Bank of Italy orders the bank to adopt corrective measures.

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19 What happens in the event that a bank becomes undercapitalised?

Should a bank become undercapitalised and, in general, when it finds itself in a situation of non-compliance with the regulatory provisions on capital adequacy, it may be subject to several potential interventions from the supervisory authorities (with different responsibilities between the Bank of Italy and the Ministry of Economy and Finance), which may vary depending on the seriousness of the infringement ascertained.

First the Bank of Italy may prohibit, by means of an extraordinary provision, the commencement of new operations. This is aimed at preventing capital inadequacy from spiralling out of control.

If an irregularity ascertained under the capital adequacy profile is particularly serious or when such inadequacy involves the risk of degenerating into a significant financial loss, the Ministry, upon proposal of the Bank of Italy, may order the dissolution of the administrative and directive bodies of the bank and directly appoint an extraordinary commissioner (see also question 14).

Finally, if the capital adequacy infringement is exceptionally serious, the Ministry, upon proposal of the Bank of Italy, may even adopt an order for administrative forced liquidation.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

A distinction must be made between situations of financial difficulty that are not yet serious enough to be likely to cause the irreversible insolvency of a bank, and cases of actual irreversible insolvency.

If the Bank of Italy deems, after a prudent assessment, that the financial crisis of a bank does not yet constitute insolvency, the extraordinary administration procedure may be started.

This procedure contemplates that the Ministry of Economy and Finance, upon proposal of the Bank of Italy, shall adopt a decree by means of which it orders the dissolution of the directive boards and the appointment of extraordinary commissioners. Nevertheless, in case of extreme urgency, the Bank of Italy is entitled to temporarily assign the management of the bank to one or more commissioners, even before the adoption of the ministerial decree.

Should a bank's crisis degenerate into an actual situation of insolvency, pursuant to Italian law, the only possible remedy is the insolvency procedure.

With respect to a banking group, the extraordinary administration of the lead company is provided also when a company of the banking group is subjected to an insolvency procedure and that circumstance may significantly alter the financial and business balance of the group.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As mentioned in question 6, sustainable solutions decided at EU level in response to the ongoing financial crisis to avoid the bankruptcy of banks have been implemented and more are expected in the near future. In fact, further to the implementation of the recent EU regulations aimed, inter alia, at restraining financial pro-cyclicality, as of 1 January 2014, the banks will improve the quality of their capital up to the common equity Tier 1, equal to 7 per cent of the risk-weighted asset, 4.5 per cent of which should serve as a minimum requirement and 2.5 per cent as a capital conservation buffer. Banks that fail to fulfil the capital buffer requirement will not be able to allocate dividends, variable remunerations and other elements used in the calculation of the required capital and must implement the measures necessary to re-guarantee the amount of regulatory capital.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

As a general rule, there are no longer any particular limitations regarding the types of entities and individuals that may acquire a controlling interest in a bank.

Nevertheless, prior authorisation by the Bank of Italy is required in the following cases:

- acquisition of at least 10 per cent of the capital or of the voting rights (even by means of several subsequent acquisitions);
- acquisition of shares that causes one to exceed the thresholds of 20, 30 and 50 per cent of the capital or of the voting rights; and
- acquisition of control of a company which already holds a controlling interest or which exerts a dominant influence on a bank and in any case when it provides at least 10 per cent of the voting rights;
- the interest exceeds 10 per cent of the consolidated own funds of the acquiring entity; and
- the interest implies the acquisition of the majority of the corporate capital (control) or of a dominant influence on a bank located in a country outside the European Union, which is not Japan, Switzerland, Canada or the United States.

Other specific quantitative restrictions are in force with respect to mutual and cooperative banks. According to these, in such banks the maximum stake, which can be owned by a single entity is such that the existence of a controlling shareholder is not permitted.

23 Are there any restrictions on foreign ownership of banks?

In Italy there is no specific restriction on foreign ownership of banks.

However, if the acquisition for which the Bank of Italy's prior authorisation is required (see question 22) is carried out by an entity (natural or legal person) resident in a non-EU state that does not ensure reciprocity in favour of Italian citizens, the Bank of Italy must transmit the authorisation request to the Ministry of Economy and Finance. The ministry, upon proposal of the prime minister, may prohibit and stop the relevant acquisition.

24 What are the legal and regulatory implications for entities that control banks?

See question 25.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

A natural person who controls a bank (see question 27) shall comply with the requirements of integrity provided by the Ministry of Economy and Finance.

Should a legal entity control a bank, the persons that carry out administrative, directive and controlling duties within the controlling entity, shall comply, on a continuing basis, with integrity, professionalism and independence requirements. Should the controlling entity be a bank or a financial company (see question 9 for the concept of banking group), it will draft the consolidated financial statements of the group and adopt internal procedures to ensure correct observation of the instructions of the Bank of Italy.

Furthermore, for banking groups, the non-fulfilment of the obligations mentioned above implies the risk that the controlling entity may be subject to the extraordinary administration procedure.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

If one of the companies of the banking group (see question 23) becomes insolvent, the Bank of Italy can also start the extraordinary administration procedure for the leading bank.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

As mentioned in question 22, the acquisition of control of a bank must be previously authorised by the Bank of Italy. The Bank of Italy identifies the entities that are required to file the request for authorisation when the rights resulting from the interest are attributed to an entity other than the owner of the interest.

The issuing of the authorisation also depends on the classification of the applicant in terms of transparency of its assets, quality of the governance, soundness and fairness in business conduct and its relationship with other entities that may affect the effectiveness of the supervision.

For this purpose, the notion of 'control' is met when:

- an entity has the majority of the voting rights exercisable in the shareholders' meeting;
- an entity has sufficient voting rights to exercise a dominant influence on the shareholders' meeting; or
- an entity can exercise its dominant influence on the bank by virtue of a particular contract with the bank.

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Update and trends

In November 2014, the Italian Council of State provided its positive opinion on the draft Ministerial Decree for the execution of the new rules for financial intermediaries enacted in 2010 (see question 6) whose entry into force is now subject only to the publication of the mentioned implementing provisions set forth by the Ministry of Economy and Finance.

The reform of 2010 intends to redefine and simplify the category of the financial intermediaries, which are entities different from banks that carry out their business in the field of financings and loans in favour of the public.

As of today, such activity is reserved for banks and to two different categories of financial intermediaries: the 'intermediaries 107', whose enrolment in the relevant register is subject to more selective criteria and whose activity must comply with stricter organisational, administrative and capital requirements; and the so called 'intermediaries 106' whose enrolment in the relevant register is simplified and whose activity is subject to less severe requirements.

These two types of subjects, after the final implementation of the reform started in 2010, will be unified into a sole category of financial intermediaries.

As a result, with the publication in the Official Gazette of the final versions of the Ministerial Decree and the Bank of Italy's new supervisory rules on intermediaries, the multi-phases process aimed at ensuring the compliance of the intermediaries with the new rules will start.

In particular:

- within 90 days from the publication, the existing financial intermediaries, enrolled in the Special Registry of Financial Intermediaries 107 to that date, shall be automatically enrolled in the new sole Register of Financial Intermediaries;
- within 180 days from the publication, intermediaries that are enrolled in the General Register of Intermediaries 106 to that date shall request their cancellation; or
- within 12 months of publication, they may request their enrolment in the new sole Register of Financial Intermediaries provided that they comply with the new rules.

The enrolment in the new sole Register of Financial Intermediaries will be subject to the authorisation of the Bank of Italy. Such authorisation will be granted only to those subjects that meet the new and much more pervasive organisational, administrative and capital requirements set forth by the law.

Therefore it is likely that the year 2015 will be characterised by intense activity of financial intermediaries aiming at ensuring compliance with the new rules.

The 'control' exercised through the dominant influence is presumed on the basis of the following (non-binding) legal presumptions:

- the entity owning the shares, on the basis of existing agreements, has the right to nominate or revoke the majority of the board of directors or of the board of statutory auditors or has the majority of the votes necessary to decide on the approval of the financial statement and on the appointment of directors;
- the entity owns an interest which entitles it to appoint the majority of members of the board of directors and of the board of statutory auditors;
- the existence of economic relations between the shareholders of the controlled entity which cause alternatively:
- the transmission of profits and losses; or
- the coordination of management of the business activity with those of other business entities for a common purpose; or
- the attribution of more powers than those directly deriving from the interest; or
- the attribution of the power to choose the directors or the members of the supervisory board to entities other than the owner of the interest; and
- subjection to a common management.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The only difference between an Italian and a foreign acquirer is based on the need for the country of a non-EU acquirer that intends to acquire a capital participation in a bank higher than 10 per cent to ensure reciprocity in favour of Italian citizens.

In 2005 and 2006, two important Italian banks were acquired by foreign banks (BNL, acquired by BNP Paribas, and Antonveneta, acquired by ABN Amro).

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The Bank of Italy would consider, on the one hand, the structure of the acquisition operation and the acquirer's business strategy as well as the impact of the transaction on the prudential ratios of all the entities involved.

On the other hand, the assessment would focus on the relevant experience of the incoming management and the integrity of those who, in case of acquisition, would be entrusted with management and control duties in the bank.

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30 Describe the required filings for an acquisition of control of a bank.

In evaluating whether to authorise a major shareholder of a bank or a bank holding company, as described in question 27, the Bank of Italy will consider the information contained, inter alia, in the following documentation:
- For physical persons:
- self-declaration certifying the absence of criminal convictions;
- anti-Mafia certificate from the competent prefecture or from the business registry of the relevant chamber of commerce (if applicable);
- outline of the business activity performed; and
- list of interests directly or indirectly held.

For legal entities:
- minutes of a meeting of the board of directors certifying the absence of criminal convictions against the directors and compliance with anti-Mafia requirements;
- list of shareholders with more than 5 per cent of the capital;
- declaration of the directors with indication of the controlling entities; and
- list of interests directly or indirectly held.

In addition, the acquirer must provide information about its economic equity situation (and, if appropriate, those of the other companies of the group), its business relations with the bank to be acquired and on the source of the financial funding available for the transaction.

Finally the acquirer must provide the business plan for the transaction in order to allow the Bank of Italy to assess its stability and soundness.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The time frame for the approval of an acquisition of a relevant shareholding subject to the Bank of Italy's authorisation (see question 22) is the same for both a domestic and a foreign acquirer.

This time frame is defined in a regulation adopted by the Bank of Italy, which distinguishes between:
- acquisitions that are also subject to competition law, for which a time frame of 60 days for completion of the procedure is set; and
- acquisitions that are not subject to competition law, for which a time frame of 90 days for completion of the procedure is set.

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Japan

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The Financial Services Agency of Japan (FSA) says financial regulation and supervision has three major policy objectives: 'establishment of a stable financial system', 'protection of depositors, investors and insurance policyholders' and 'establishment of fair and transparent financial markets'.

2 Summarise the primary statutes and regulations that govern the banking industry.

The Banking Law (Law No. 59 of 1981)

The primary statutes and regulations that govern the banking industry are the Banking Law and the regulations enacted under the Banking Law. The Banking Law covers the scope of businesses, capital adequacy requirements, accounting, licensing, loan limits, limitations concerning subsidiaries, major shareholders and bank holding companies, branches of foreign banks, and so on.

The Law Concerning Concurrent Business, etc, of Trust Business by Financial Institutions (Law No. 43 of 1943)

The Law Concerning Concurrent Business, etc, of Trust Business by Financial Institutions sets out regulations for banks that conduct trust business concurrently with their banking business.

The Deposit Insurance Law (Law No. 34 of 1971)

The Deposit Insurance Law governs the deposit insurance system and includes provisions regarding purchasing of deposits and treatments of failed banks.

The Financial Instruments and Exchange Law (Law No. 25 of 1948)

The Financial Instruments and Exchange Law applies to financial institutions, including banks, that conduct securities business.

The Insurance Business Law (Law No. 105 of 1995)

The Insurance Business Law applies to financial institutions, including banks, that act as insurance agents.

The Foreign Exchange and Trade Law (Law No. 228 of 1949)

The Foreign Exchange and Trade Law applies to financial institutions, including banks, that conduct foreign exchange transactions and engage in international transactions.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The FSA is an affiliated agency of the Cabinet Office. The primary responsibility of the FSA is to inspect and supervise banks. Among others, the Inspection Bureau of the FSA conducts on-site inspections of banks to protect the best interests of consumers. The Supervisory Bureau of the FSA supervises banks by monitoring the soundness and appropriate management of the banks' business to prevent problems related to their financial intermediation functions, payment and settlement functions, and so on.

The Bank of Japan (BOJ), the central bank of Japan, is responsible for overseeing payment systems and supervising banks through on-site examinations for the purpose of understanding the business operations and the asset status of the banks. The BOJ executes its responsibilities pursuant to the contracts it has with the banks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are protected by the Deposit Insurance System (DIS), operated by the Deposit Insurance Corporation of Japan (DICJ), which is a semi-governmental corporation established in line with the Deposit Insurance Law. Under the DIS, current deposits and other payment or settlement deposits are protected in full, and principal amounts and interests of deposits other than the above are protected if the principal amounts for such deposits are no more than ¥10 million per depositor at each financial institution. Any portion of such deposits in excess of that amount may be repaid based on the asset status of the failed financial institution (some amount may be cut off).

In capital injection operations under the Early Strengthening Act, the Financial Functions Stabilisation Act (abolished in October 1998) and certain other laws, the DICJ entrusted subscriptions for preferred shares issued by banks to the Resolution and Collection Corporation. As to capital injection operations implemented under the Deposit Insurance Law (financial crisis management), the DICJ directly subscribed for preferred shares issued by banks. When the soundness of the banks that received capital injections had improved, the DICJ disposed of the preferred shares that they owned because it is not the intention of either the DICJ or the FSA to maintain ownership interests in the banking sector.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Banking Law provides for certain limitations on transactions between banks and their affiliates. Under the Banking Law, a bank and its affiliate (which is defined under the Banking Law as 'specified related person', described below) are prohibited from engaging in a transaction based on terms that are disadvantageous to either party, in light of the ordinary terms and conditions of a similar transaction with an unaffiliated company. This arm's-length rule also applies to a bank's transaction with a customer of its specified related person.

The 'specified related person' includes, without limitation:
- a subsidiary company of a bank;
- a major shareholder of a bank (as explained in question 24);
- a bank holding company (as explained in question 24);
- a subsidiary company of a bank holding company; and
- a bank agent for a bank.

6 What are the principal regulatory challenges facing the banking industry?

The Cabinet Decision, 'Japan Revitalisation Strategy (Revised 2014)', was announced on 24 June 2014. It states it will take the following actions in

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order to promote lending by financial institutions based on customer's business potential:

- appropriately implement the supervisory policies and the financial monitoring policy to ensure that financial institutions make efforts to provide financing taking well into consideration the growth potential of debtor's business, and that related stakeholders cooperate with each other to improve the performance, productivity, and sustainability of businesses.
- encourage regional financial institutions to make use of the 'Guideline for Personal Guarantee Provided by Business Owners', which was developed by a study group jointly established by the Japanese Bankers Association and Japan Chamber of Commerce and Industry;
- promote regional financial institutions to make use of specialist personnel in the management of regional companies via the Regional Economy Vitalisation Corporation of Japan (REVIC), which was an incorporation reorganised from 'Enterprise Turnaround Initiative Corporation of Japan' under the Act on Regional Economy Vitalization Corporation of Japan to vitalise regional economy; and
- encourage REVIC to establish funds and supply money to support core regional companies in achieving management improvements without delay.

7 Are banks subject to consumer protection rules?

Banks that sell financial instruments to consumers are subject to the Act on Sales, etc of Financial Instruments (ASFI). The ASFI obliges the financial instrument providers to explain to the customer important matters such as risk for loss of principal at the time of the sales of a wide range of financial instruments including savings deposits, trusts, insurance, securities, securities derivatives, etc. Further, it stipulates an obligation to the financial instrument providers to set out and disclose its solicitation policy, etc. In the event that the financial instrument provider violates the duty of explanation and its customer incurs damages, the financial instrument provider bears liability for damages to the customer regardless of its negligence.

In addition, the banks will be required to provide proper explanation or information under the Banking Law and the Financial Instruments and Exchange Law (FIEL). The inducement of customers by unjustifiable means is prohibited under the Act against Unjustifiable Premiums and Misleading Presentations. The FSA is the competent authority of the Banking Law, FIEL and ASFI.

The Consumer Protection Act will be also applicable to the banking business. Pursuant to this Act, consumers may cancel any contract resulting from unjust solicitation, and if a contract contains any unjust contractual clause, that contractual clause itself will be invalidated.

As regards financial inspections on banks, the FSA conducts examinations on the development and establishment of customer protection management systems by bank management. The compilation of problem cases in financial inspections includes cases of inadequate customer protection when banks sell risky products, such as investment trusts or variable pension insurances to customers.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Legal and regulatory policy over the next few years is expected to follow the cabinet decision, 'Japan Revitalisation Strategy (Revised 2014)', dated 24 June 2014, as explained in question 6, to overcome deflation and achieve sustainable economic growth under Abenomics. For example, the FSA says that it will review whether financial institutions provide credits and other services based on appropriate appraisal of their customers' business potentials, without depending excessively on customers' financial data and guarantees.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The FSA supervises banks by both off-site monitoring and on-site inspections in accordance with the Banking Law, supervisory policies and inspection manuals.

Under the Banking Law, a bank must prepare and submit to the FSA an interim business report and an annual business report for each business year which describe the status of the bank's business and property. If a bank has subsidiaries, etc, such bank must also prepare and submit the interim business report and annual business report on a consolidated basis. When the FSA deems it necessary to ensure sound and appropriate management of a bank's business, the FSA may require the bank (and if necessary, its subsidiaries or a person to whom its business is entrusted) to submit other reports or material.

When the FSA deems it necessary, the FSA may conduct an on-site inspection by having its officials enter the bank's premises, interview relevant personnel and inspect books, documents or other records. When necessary, the FSA officials may conduct a similar on-site inspection of the bank's subsidiaries, etc or a person to whom the bank's business is entrusted.

The FSA is publishing the yearly Financial Monitoring Policy for supervision and inspection explaining the priority issues, in addition to the general guidelines for supervision and inspection manual.

The BOJ's on-site examination is conducted by sending its staff to the banks' premises and obtaining financial reports from the banks that have current accounts with the BOJ. The examination involves confirming the quality of loans and other assets, the management of risks associated with borrowers' credit standing, fluctuations in interest rates, foreign exchange rates and stock prices, and the reliability and accuracy of operations.

10 How do the regulatory authorities enforce banking laws and regulations?

If the FSA deems it necessary to ensure the sound and appropriate management of a bank's business in light of the status of the business or property of such bank or the property of such bank and its subsidiaries, etc, it may instruct the bank to submit (or amend) a business improvement plan and, if and to the extent necessary, it may order the suspension of the whole or part of the bank's operations for a specified period of time or may order the bank to deposit the bank's property or to take other actions.

In relation to the capital adequacy requirements, certain actions may be taken as described in question 19. In addition, if a bank violates any laws or regulations, its articles of incorporation, administrative measures or disposition, or if a bank has committed an act that harms public interests, the FSA may order the suspension of the whole or part of the bank's operations or order the removal of its management, or may revoke its banking business licence. The bank that violates certain laws or certain enforcement procedures of the FSA may be subject to criminal sanctions.

After conducting an on-site examination, the BOJ provides guidance and advice based on the findings of the financial and management conditions to ensure the soundness of the banks.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In the financial year 2009, the FSA's financial inspections focused on examination of the financial intermediary functions performed by banks as well as the development of risk management systems in response to the recent crisis. In the financial year 2010, the FSA's financial inspections aimed to examine procedures and arrangements that allow banks to play a role in smooth and appropriate financing to borrowers, and a robust and comprehensive risk-management system supported with a sufficient financial base, as announced by the FSA in August 2010. As part of the supervisory policy for the financial year 2010, the FSA also places priority on improvement of customer protection and convenience for users. The FSA achieves such ends by requiring information security and utilising an enhanced system for processing complaints, among other things. The above policies were published in August 2010 to be applied starting from financial year 2010.

12 How has bank supervision changed in response to the 2008 financial crisis?

The FSA has taken the following actions regarding supervision following the crisis in the banking industry from 2007 to 2008:

- the FSA revised its supervisory guidelines and inspection manuals. The revisions expanded the scope of rescheduled loans advanced to SMEs that are not classified as non-performing loans because, due to the inherent nature of SMEs, SMEs have limited opportunities for restructuring, and it takes time for SMEs to recover profitability and return to solvency; and
- the FSA clarified and enhanced the checkpoints for supervision of financial institutions in the area of risk management and disclosure with respect to their exposure to the securitisation market.

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Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

If the Prime Minister recognises that, unless certain measures are taken in respect of a failed bank that is unable to pay its debts using its assets, there may be extreme adverse effect on the preservation of credit orders in Japan or in the area where the bank operates its business, then measures will be taken for DICJ to acquire all shares in such bank.

Although the applicable laws have changed and the relevant provision has been amended several times, measures' predecessor was applied to the Long-Term Credit Bank of Japan and the Nippon Credit Bank in 1998 and to the Ashikaga Bank in 2003 pursuant to the provisions and laws applicable at that time.

Since the shareholders of a company (bank) with excessive debt have already lost their economic interests, the shares of stock of such shareholders may become void. The DICJ is able to fund the bank thereby protecting the whole amount of deposits. The DICJ must, at the earliest opportunity, merge the bank with another financial institution, transfer its business to another financial institution or transfer the shares to another financial institution.

In March 2014, an additional measurement has been introduced for the purpose of overhauling the framework of orderly treatment of assets and liabilities of financial institutions, etc, to stabilise the financial system, where in the event that the Prime Minister gives specific approval that the prescribed measures should be taken, acknowledging the fact that otherwise it would bring considerable disruption to the financial market or other financial system. Under certain circumstances, the Prime Minister may order that the operation and the property of the financial institutions, etc, be managed by the DICJ when specific approval for type 2 measures has been given in respect of a financial institution, etc, with excessive debt or a suspension of payments (including threats thereof).

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

When a bank is taken over by the DICJ, the FSA may request that the bank submit reports or materials regarding its business and financial status, and order the bank to prepare and submit a business plan and take such other measures as are necessary.

15 Are managers or directors personally liable in the case of a bank failure?

A bank taken over by the DICJ is required to file lawsuits and conduct other action to pursue the civil liability of directors, officers, and auditors of the bank under their official responsibilities. In addition, if a director, officer, or auditor of such bank believes that a crime was committed while they were fulfilling their duties, they must take necessary measures to initiate an accusation as regards such crime. Managers and directors will be personally liable for their failure (if any) to perform their duties as managers or directors.

16 How has bank resolution changed in response to the recent crisis?

The amendment to the Deposit Insurance Act came into force to take into account the agreement at the G20 and others. Part of this amendment is explained above, in order to prevent financial crises that would critically influence the real economy.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The new legal and regulatory capital adequacy requirements applicable to banks in Japan are generally prescribed parallel to the Basel III framework. The capital of a bank is classified into three tiers: common equity Tier I capital, other Tier I capital, and Tier II capital.

The new capital adequacy requirements started to apply from the year ending March 2013, with gradual application planned to be completed by 2019. The target minimum standard capital adequacy ratio is set at 8 per cent, the minimum ratio for the Tier I capital ratio is set at 6 per cent, and common equity Tier I capital ratio at 4.5 per cent; however, transitional measures have been provided whereby until 30 March 2014, the standard ratio will be 4.5 per cent for the Tier I capital, and 3.5 per cent for common equity Tier I capital and until 30 March 2015, the standard ratio will be 5.5 per cent for the Tier I capital, and 4 per cent for common equity Tier I capital.

Common equity Tier I capital primarily consists of ordinary shares and warrants of ordinary shares; retained earnings; and other accumulated comprehensive income and other public reserve. Other Tier I capital primarily consists of preferred shares other than the above, and preferred securities without step-ups (under certain conditions).

Tier II capital primarily consists of subordinated bonds and loans, etc (where there are five years or more until the first call date).

Banks are not obliged to make contingent capital arrangements in Japan.

18 How are the capital adequacy guidelines enforced?

The capital adequacy requirements are enforced through off-site monitoring of the FSA. The FSA biannually confirms the status of capital enhancement through interviews with the banks.

Further, even before a bank actually becomes undercapitalised, the FSA may take preventive and comprehensive measures in order to further enhance the soundness of the bank. If the FSA finds it necessary to improve operation of the bank on profitability, credit risk, market risk or financing of the bank, the FSA may conduct hearings regarding cause and improvement plan and request the bank to submit reports. In addition, if the FSA finds that it is necessary to ensure the execution of the improvement plan, the FSA may issue a business improvement order.

In case the capital adequacy ratio of a bank actually becomes less than a target minimum standard capital adequacy ratio, then the FSA may take actions as set out in question 19.

19 What happens in the event that a bank becomes undercapitalised?

The level of undercapitalisation of a bank is classified into four categories and the actions to be taken by the FSA are stipulated for each level of undercapitalisation.

For a bank with international operations, the stipulated categories and actions that may be taken by the FSA are as follows:

- capital adequacy ratio of Tier I capital from ordinary shares, etc, ranging from 2.25 per cent to less than 4.5 per cent, Tier I capital adequacy ratio ranging from 3 per cent to less than 6 per cent, and the total capital adequacy ratio ranging from 4 per cent to less than 8 per cent would fall under category 1, in which case the FSA may order the bank to submit a business improvement plan including the measures for recapitalisation and order the bank to execute such plan;
- capital adequacy ratio of Tier I capital from ordinary shares, etc ranging from 1.13 per cent to less than 2.25 per cent, Tier I capital adequacy ratio ranging from 1.5 per cent to less than 3 per cent, and total capital adequacy ratio ranging from 2 per cent to less than 4 per cent would fall under category 2, in which case the FSA may order the following:
  - submission of a reasonable recapitalisation plan and execution thereof;
  - prohibiting or limiting the amount of dividend distribution or bonus payments to officers;
  - ordering compression of total assets or ordering suppression of growth of total assets;
  - prohibiting or limiting acceptance of deposits under terms that are less favourable to the bank determined on an arm's-length basis;
  - ordering downsizing of business operations in certain offices;
  - ordering the closure of certain offices except for the head office; or
  - ordering the taking of certain other necessary measures;
- capital adequacy ratio of Tier I capital from ordinary shares, etc ranging from zero to less than 1.13 per cent, Tier I capital adequacy ratio ranging from zero to less than 1.5 per cent, and total capital adequacy ratio ranging from zero to less than 2 per cent would fall under category 2-2, in which case the FSA may order the bank to execute measures for one of the following purposes:
  - strengthening of its capital;
  - substantial downsizing of its business operations; or

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  - merger with another bank or abolition of its business operations; and
- capital adequacy ratio of Tier I capital from ordinary shares, etc, less than zero, Tier I capital adequacy ratio less than zero, and total capital adequacy ratio less than zero would fall under category 3, in which case the FSA may order the bank to suspend all or part of its business operations.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

If the FSA determines that the bank is unable to repay all of its financial debts with its assets or that there is a possibility that the bank may suspend refunding deposits considering the conditions of its business or assets, then the FSA may order the bank to have its business and assets managed by a financial reorganisation administrator who will be appointed by the FSA concurrently with the issuance of order under the Deposit Insurance Law. The financial reorganisation administrator has the sole power to represent the bank, operate its business and manage and dispose its assets. The DICJ may be appointed as financial reorganisation administrator. In principle, the financial reorganisation administrator is expected to end its duties within one year from the order by transferring the business of the bank to another bank, by merging the bank with another bank or by taking other measures as appropriate. This period may be exceptionally extended by one year with the approval of the FSA if a compelling reason exists. Upon purchasing of business or merging with the bank, a financial institution that seeks the merger with the bank may apply for financial assistance from the DICJ. Such application is subject to prior approval of the FSA. The FSA grants the approval only if the merger contributes to protection of depositors, the financial assistance by the DICJ is essential for implementation of the merger and the dissolution of the bank would be significantly detrimental to the smooth supply of funds and to the benefits of users in the region or the field that the bank operates its business. If necessary, the DICJ may decide to establish an acquiring bank to temporarily succeed the business of the bank.

Furthermore, if there is a possibility that failure of a bank causes an extreme adverse effect on the preservation of credit orders in Japan or in the area where the bank operates its business, public money may be injected in order to recapitalise the capital of the bank, provide financial assistance to protect the full amount of deposits as an exceptional treatment to the deposit insurance cap, or have the DICJ acquire all shares of the bank. If the DICJ acquires all the shares of the bank, the DICJ must, at the earliest opportunity, merge the bank with another financial institution, transfer its business to another financial institution, or transfer the shares to another financial institution where, as a consequence, the bank will no longer be a subsidiary of the DICJ.

Insolvency procedures such as bankruptcy, civil rehabilitation, corporate reorganisation or special liquidation proceedings are also available.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

In line with Basel III, implementation of a gradual change of the capital adequacy guidelines is planned by 2019.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

In general, both entities and individuals may own a controlling interest in a bank. However, if it is a company established under Japanese law, only a stock corporation with a board of directors, a board or a committee of auditors and an accounting auditor may become a bank holding company, which is one of the categories of controlling shareholders of a bank.

Under the Banking Law, there are two categories of controlling shareholders of a bank: a major shareholder of a bank and a bank holding company.

A major shareholder of a bank is an entity or an individual that holds 20 per cent (or 15 per cent, if the shareholder is expected to have a material influence on the bank's decisions regarding financial and business policies) or more of the voting rights held by all shareholders of such bank. For the purpose of calculating the holding ratio of such entity or individual, the number of voting rights of the bank held by the entity or individual includes the voting rights of the bank held by certain relevant entities or individuals of the entity or the individual. The relevant entities or individuals include consolidated subsidiaries and affiliates and joint holders (meaning other entities or individuals that hold the voting rights of such bank and have agreed with such entity or individual to jointly acquire or transfer the bank's shares or to jointly exercise their voting rights, etc as shareholders of the bank).

A bank holding company is a company that holds more than 50 per cent of the bank's voting rights held by all shareholders, and the aggregate amount paid by such company to acquire all of its Japanese subsidiaries, including the bank (or other amounts recorded in its latest balance sheet), exceeds 50 per cent of the total assets of such company, meaning the company is a holding company. For the purpose of calculating the holding ratio of such company, the number of voting rights of the bank held by certain relevant entities or individuals of such company is included in the number of voting rights held by such company.

23 Are there any restrictions on foreign ownership of banks?

There is no restriction on foreign ownership of banks under the Banking Law.

24 What are the legal and regulatory implications for entities that control banks?

The Banking Law prescribes the FSA's supervision of major shareholders of banks.

When it is necessary to ensure the sound and appropriate management of a bank's business, the FSA may conduct off-site monitoring (including requesting a major shareholder of a bank to submit reports and material concerning the operation and financial conditions of the bank) and an on-site inspection (including interviewing the major shareholder of the bank on the operation and financial conditions of the bank as well as the major shareholder and inspecting books, records and other items of such major shareholder) that are helpful for understanding the status of the business or property of the bank.

When and to the extent necessary, the FSA may order such major shareholder to submit (or amend) and execute an improvement plan and to take other necessary measures.

Further, when the major shareholder no longer satisfies any of the requirements set out in question 29, the FSA may order such major shareholder to take necessary measures to satisfy the requirements within a designated time frame.

Similar to major shareholders of banks, bank holding companies are also subject to the supervision by the FSA under the Banking Law. Furthermore, the Banking Law limits the activities of bank holding companies to managing and controlling banks and other subsidiaries, which they are authorised to hold under the Banking Law, and activities incidental thereto. Bank holding companies are limited to hold, as subsidiaries, banks, securities companies, insurance companies and companies that are engaged in certain other financial business, certain business related to finance or certain other business relating to businesses and operations of banks. The purpose of this restriction is to ensure the soundness of operations of banks by eliminating risks that may arise from being involved in activities of non-financial industries. A bank holding company will be required to obtain prior authorisation from the FSA before acquiring a new subsidiary company, or when its existing subsidiary company changes its business. In addition, unless such Japanese company becomes the subsidiary of the bank holding company, the bank holding company or any of its subsidiaries may not acquire or hold shares of a Japanese company if their aggregate interests in the company exceed 15 per cent of the voting rights of such company, with certain exceptions.

Bank holding companies are required to satisfy the capital adequacy requirements and maintain adequate capital on a consolidated basis. Such requirements are in line with the capital adequacy requirements for a bank.

Bank holding companies must comply with the rule on a credit limit granted to an individual or entity. The credit limit rule is in line with those applicable to banks. Under this credit limit rule, the grant of credit extended by a bank holding company or any of its subsidiaries, etc is capped at 25 per cent if the credit is extended to an individual or entity or at 40 per cent if the credit is extended to an individual or entity as well as its parent companies or subsidiaries. The bank holding company is required to establish a proper system for appropriately handling the business-related information and controlling conflicts of interest among its group financial institutions and appropriately monitoring their business operations in order to protect the interests of customers of the banking business and certain other

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businesses of such institutions. This requirement is in line with those applicable to banks.

Directors and statutory executive officers engaging in the ordinary business of a bank holding company may not engage in the ordinary business of any other company except where it is authorised by the FSA.

Bank holding companies must prepare and submit to the FSA annual and semi-annual reports that contain consolidated statements on the status of business and property of such bank holding companies and their subsidiaries, and so on.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

For the primary duties and responsibilities of a controlling entity or individual, please refer to question 24, and for the primary filing obligations, please refer to question 30.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

There is no criminal or administrative sanction set out under the Banking Law that would be imposed on an entity or individual that controls a bank in the particular event that it becomes insolvent.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

If and when an entity or individual intends to become a major shareholder of a bank or a company intends to become a bank holding company, the relevant prior authorisation of the FSA must be obtained, except in certain cases such as where shares of such bank are acquired upon enforcement of a security interest or upon payment in kind. The definition of 'control' for this purpose is the same as the definition in question 22.

Documents required upon application for the prior authorisation of the FSA would include, in the case of a major shareholder of a bank, a document showing a framework for holding voting rights of the bank, prospective cash inflows, and net present value of cash inflow for the next five years generated from holding of such voting rights, a document showing results of stress tests and relationships that the major shareholder plans to have. In the case of a bank holding company, a document showing prospective income and expenditure and consolidated capital ratio of the company and the bank for next three fiscal years would be necessary, among other documents.

Update and trends

The Japanese Financial Services Agency published the Financial Monitoring Policy for 2014–2015 in September 2014. The basic purpose or concept of the policy is to overcome deflation and build a positive economy, and its focus includes responsiveness to the customers' real needs and lending based on customers' potentials, macro prudence, enterprise risk management, sustainability of a business model and corporate governance, and also acceleration of recovery from the Great East Japan Earthquake. Major banks are especially expected to support small and medium-sized enterprises by providing effective solutions for various challenges they face, and to support customers' overseas business as well as project finance. In 2014, the Japan's Stewardship Code was published for the purpose of promoting sustainable growth of companies through investment and dialogue, and in 2015, the Corporate Governance Policy is expected to be published to strengthen corporate governance, which will affect Japanese banks' businesses in general aspects. Additionally, this year, major changes to the Japanese basic Civil Code are scheduled, which will also affect the banks' business. Japanese banks will be required to comply with the enhanced anti-money laundering regulations as well as the international anti-tax avoidance measures this year, among other things.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The FSA is generally receptive to foreign acquirers, provided that such foreign acquirers satisfy the prescribed requirements for major shareholders of banks or for bank holding companies (for such prescribed requirements, please refer to question 29). The regulatory process for foreign acquirers under the Banking Law is not materially different from that for Japanese acquirers.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

When an application for authorisation of a major shareholder is filed, the FSA examines the following factors:

- whether there is any risk that the applicant would impair the sound and appropriate management of the bank's business in light of the source of acquisition funds and the purpose of the acquisition and other matters relevant to its holding of voting rights;
- whether there is any risk that the applicant would impair the sound and appropriate management of the bank's business in light of the status of property, income and expenditure of the applicant and its subsidiaries; and

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- whether the applicant sufficiently understands the public nature of the banking business, and has a sufficient social reputation.

When an application for authorisation of a bank holding company is filed, the FSA examines the following factors:

- whether the applicant and its subsidiaries have a prospect of achieving a good balance of income and expenditure;
- whether the applicant and its subsidiaries have the adequate capital in light of the assets owned by them; and
- whether the applicant has sufficient knowledge and experience that will enable it to carry out the management and operation of a subsidiary bank appropriately and fairly in light of its human resources structure, and has a sufficient social reputation.

30 Describe the required filings for an acquisition of control of a bank.

When an entity or individual intends to become a major shareholder of a bank, or a company intends to become a bank holding company, an application for authorisation thereof must be filed with the FSA.

When it acquires the prior authorisation of the FSA, both a major shareholder and a bank holding company must file a simplified notice with the FSA without delay, stating that it has become a major shareholder or a bank holding company.

In addition, the following events, for example, will trigger filing obligations of a major shareholder or a bank holding company:

- In the case of a major shareholder:
  - it has acquired more than 50 per cent of the voting rights of the bank;
  - it no longer holds the threshold percentage of becoming a major shareholder of a bank (20 per cent or 15 per cent, as applicable);
  - it has been dissolved; or
  - its majority of voting rights has been acquired by one shareholder.
- In the case of a bank holding company:
  - it has ceased to be a holding company;
  - it intends to hold a subsidiary;
  - its subsidiary is no longer its subsidiary;
  - it has been dissolved;
  - it intends to change the capital amount; or
  - more than 5 per cent of its voting rights has been acquired by one shareholder.

Although not directly connected with the 'control' issue, any entity or individual that has become a holder of more than 5 per cent of the voting rights held by all shareholders of a bank or a bank holding company is required to submit written notice to the FSA within five business days. The extended deadline of one month is applicable for a foreign acquirer. Also, written notice must be submitted if the holding ratio subsequently increases or decreases by 1 per cent or more, or if there is any change in the information included in previously submitted notice.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The ministerial ordinance under the Banking Law provides that the FSA must endeavour to evaluate and determine whether it should grant authorisation for a major shareholder of a bank or a bank holding company within one month (or two months for certain banks designated by the FSA) after the formal filing of an application for such authorisation. This time frame does not include a preliminary evaluation upon request of the applicant (if any) or the time spent for correction, amendment or supplementation of the application or application documents. Despite this provision setting out a standard time frame, the actual period required for such authorisation may differ significantly from case to case.

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Lebanon

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The following governmental and regulatory policies constitute the underlying principles of the banking sector in Lebanon:

- ensuring that banking activities in Lebanon are regulated and supervised by the Banque du Liban (BDL), the Lebanese central bank;
- protecting the banking sector from systemic risks by preserving the solvency of Lebanese banks; the governor (the Governor) and central council (the Central Council) of the BDL, along with the banking control commission (BCC) are vested with the greatest regulatory powers to such effect;
- upholding banking secrecy instituted by the Banking Secrecy Law of 3 September 1956 (the Banking Secrecy Law), which is at the core of the Lebanese banking system and plays a key role in attracting funds to Lebanon;
- applying anti-money laundering (AML) best practices, procedures and regulations;
- encouraging Lebanese banks to broaden their regional and international presence through fiscal incentives and other measures; and
- adhering to various sets of internationally recognised treaties and conventions, and maintaining a harmonious balance between the preservation of the banking system and the progressive implementation of international regulations and standards (such as Basel III).

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary laws and regulations governing the banking sector in Lebanon are:

- the Code of Obligations and Contracts enacted on 9 March 1932;
- the Code of Commerce enacted on 24 December 1942, which governs the corporate aspects of banks and prescribes certain formalities applicable to them (the Code of Commerce);
- the Code of Money and Credit enacted on 1 August 1963 (the CMC) which establishes the BDL and sets the general rules governing the banking industry;
- the Banking Secrecy Law, which compels all financial entities regulated by the BDL to absolute secrecy with respect to their clients' personal and account-related information and provides that banking secrecy can only be lifted in very limited circumstances;
- Law No. 318 of 20 April 2001 on Fighting Money Laundering (the AML Law), which provides for increased reporting obligations and the establishment of the special investigation commission (SIC), whose mandate includes investigating suspected money laundering offences and deciding to lift banking secrecy;
- other specific laws pertaining to the banking industry, such as Law No. 520 of 6 June 1996 on Developing the Financial Market and the Fiduciary Contracts Regulations, and Law No. 308 of 3 April 2001 on Banks' Shares;
- regulations (in the form of circulars) issued primarily by the BDL, but also by the BCC and the Ministry of Finance; and
- international banking rules and standards, namely those resulting from the Basel Committee on Banking Supervision and the Financial Action Task Force (regarding AML) to the extent that such rules are adopted by the BDL and mirrored in the circulars issued by the latter.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The BDL is the watchdog of the banking sector and is the entity principally responsible for overseeing banks in Lebanon. Its mission encompasses ensuring the solvency of banks, protecting the stability of the economy and the Lebanese currency, developing the monetary and financial markets, and structuring and organising means of payment.

The BDL's core prerogatives are vested in its governor and central council (which includes the governor, his four deputy-governors, and the general directors of the Ministries of Finance and the Economy).

The Central Council is in charge of defining the monetary and credit policy of the BDL, setting the regulations implementing the provisions of the CMC, determining the discount and interest rates of bank deposits with the BDL and issuing supervisory and regulatory measures applicable to banks' activities. The Central Council is also in charge of issuing banking licences.

The BCC was established by Law No. 28/67 of 16 January 1967 (Law 28/67) as an independent regulatory body not subject to the BDL's supervisory authority. The BCC monitors the regulatory compliance of banks, and may request information from the banks or from BDL accordingly.

The AML Law established the SIC, which operates under the umbrella of the BDL and is presided over by the governor. The SIC's main mission is to investigate and combat suspicious matters and acts involving money laundering. The SIC may impose sanctions, including imprisonment and hefty fines, on the indicted persons or entities.

Law 28/67 also instituted the higher banking instance (the HBI). The HBI is a judicial body within the BDL hierarchy. It is in charge of delivering administrative sanctions against the banks that do not comply with the applicable laws and regulations, ranging from simple warnings to removal from the BDL's official list of authorised banks.

In addition to the above-mentioned regulatory authorities, the Association of Lebanese Banks (ALB) is a professional association formed of representatives of the banks licensed by the BDL. It is in charge of efficiently coordinating the activities of banks in areas of common interests, optimising the quality of banking activity and, above all, protecting and defending the banks and their interests. The ALB makes decisions relating to the structuring of banking operations and transactions related to the banking business on a microeconomic level. The ALB also supervises the relationship between its members and settles disputes through an arbitral body composed of experts appointed by its board. The ALB may also initiate lawsuits in order to defend the interest of the profession or intervene in ongoing litigations for the same purpose.

Law 161 dated 17 August 2011 established a Capital Markets Authority (CMA) to ensure the protection of savings invested in financial instruments, encourage the capital markets in Lebanon, and coordinate between the various concerned sectors. Its functions namely include setting the framework and organising professional activities of the persons who perform operations on financial instruments, while monitoring their compliance with professional ethics, and supervising licensed stock exchanges and the persons who provide deposit, clearing or settlement services. In addition to setting the general regulatory framework for listing financial instruments and approving their trading on stock markets, the CMA is empowered with a sanctioning power with regard to violations of the provisions of the law on capital markets.

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4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

BDL is a public entity that has administrative and financial independence. Its initial capital was allocated by the Lebanese state. The capital can be increased through allocations by the state or by adding reserves to the capital by virtue of a decree of the council of ministers taken upon the request of BDL and proposal by the Minister of Finance.

The national institute for the guarantee of deposits (NIGD), established by virtue of Law 28/67 acts as the insurer of deposits. Its capital is composed of nominal shares owned by the Lebanese state and all Lebanese banks. All banks are required to contribute to the NIGD by paying an annual fee and the state contributes an annual fee equivalent to the sum of the fees paid by the banks. The NIGD indemnifies depositors for up to 5 million Lebanese pounds per depositor. The NIGD is managed by a board of seven members designated by decree.

The Lebanese state owns 20 per cent of the shareholding of the Housing Bank, which was established by virtue of Law No. 14 of 17 January 1977 as amended by Law No. 283 of 30 December 1993. The private sector owns the remaining 80 per cent of the bank's shareholding. The main purpose of the Housing Bank is to grant loans to Lebanese citizens wanting to purchasing, constructing, renovating, completing, or revamping real estate property in Lebanon.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

There is no unified legal definition of an 'affiliate' in the Lebanese banking laws and regulations. The meaning of 'affiliate' is addressed differently in various circulars depending on the purpose of the circular in question.

For example, BDL Circular 34 of 24 April 1997 distinguishes between three types of control exercised by banks over their affiliates and provides for a different accounting treatment for each type, as follows:

- exclusive control: effective control by the parent company of the financial and operational policy of the affiliate (ie, when the parent company directly or indirectly holds the majority of the voting rights in the affiliate and is entitled to appoint or revoke the majority of the affiliate's board members);
- joint control: joint control of the affiliate by the parent company and other partners by virtue of a joint venture agreement related to the management of the company, without any partner having any majority stake in the affiliate; and
- participation interest: the parent company directly or indirectly holds at least 20 per cent of the voting rights in the affiliate.

Moreover, BDL Circular 141 of 16 August 2007 governs the relationship between Lebanese banks and their affiliates abroad, and provides for a set of reporting obligations applicable in relation to banks and financial institutions established abroad, in which the parent company holds, directly or indirectly, at least 40 per cent of the voting rights, or whose management is effectively controlled by the parent company regardless of the latter's equity stake.

There are no limitations applicable to transactions between a bank and its affiliates other than the usual conflict-of-interest limitations set out in the CMC and the Code of Commerce, namely that granting loans to or conducting other transactions with board members, major shareholders or their family members is subject to the prior approval of the bank's general assembly and to the provision of sufficient collateral if applicable.

Law 50/83 of 15 July 1983 established a summa division between commercial banks and specialised banks (investment banks). On 11 February 2004, Law No. 575 introduced Islamic banks in Lebanon as a new category.

Article 121 of the CMC defines a bank as 'an institution whose main purpose is the usage of funds it receives from the public for its own account in lending operations'. This definition applies to commercial banks, often described as 'conventional banks'. Generally speaking, commercial banks are entitled to carry out the broadest set of activities related to commercial banking.

Law No. 50/83 of 15 July 1983 establishes 'specialised banks', more commonly known as investment banks. The purpose of specialised banks is limited to using their resources in medium- and long-term loans, direct investment, participations, purchase and sale of financial instruments for their account or for the account of third parties and the issuance of guarantees for medium or long-term operations against adequate collateral. Specialised banks are in principle prohibited from receiving deposits from the public for a term shorter than six months. Investment banks may also manage collective investment funds and carry out fiduciary activities in accordance with applicable laws.

Law 575 institutes Islamic banks, which are defined as 'banks whose articles of association comprise an undertaking not to contravene, in the operations they carry out, the provisions of Islamic law (shariah), particularly with the prohibition to pay or receive interest'. It is worth noting that shariah law prohibits fixed or floating payment or acceptance of specific interest or fees (known as riba, or usury) for loans. Unless otherwise specified in Law 575, Islamic banks are governed by all legal and regulatory provisions in force in Lebanon, particularly those related to banks, including without limitation, the CMC, the Code of Commerce and the Banking Secrecy Law. Islamic banks are specialised in shariah-compliant operations such as Mudarabah, Musharakah, Ijara and so on, which are tailor-made financial operations structured to be shariah compliant. A shariah board often issues a scholarly opinion to evidence compliance of a particular instrument or product with shariah precepts.

6 What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenges facing the banking industry are twofold:

- regulating an increasingly complex banking industry, taking into account growing supra-national regulations (Basel, FATCA, etc), while preserving the specificities of the Lebanese banking sector (including, without limitation, banking secrecy which is a principle inherent to the country's history); and
- safeguarding the immunity of the Lebanese banking system from and the resilience of its economy against the recent global financial crisis, the risks of overspill from the conflict in neighbouring Syria and domestic security challenges.

7 Are banks subject to consumer protection rules?

Consumer Protection Law No. 659 dated 4 February 2005 includes banks within its scope of application. However, the provisions of the Consumer Protection Law on treatment of contracts concluded between banks and consumers are enforced without any prejudice to the provisions of the specific laws and regulations applicable to the banking sector, especially circulars issued by the BDL.

It is in that sense that the BDL remains the most important safeguard for consumer rights in the banking sector. Over the past few years, the BDL issued several consumer-oriented circulars, the latest of which is Circular 134 dated 12 February 2015, which sets communication guidelines for products and services offered by banks and financial institutions to their clients, and imposes information obligations to raise the awareness of clients and clarify their rights regarding the products and services in which they are interested.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The policies and guidelines that have secured the resilience of the Lebanese banking sector to the global financial turmoil of 2008 are likely to be pursued by the BDL, in order to ensure the limitation of systemic risk, the increase of the Lebanese banking system's competitiveness, and the progressive implementation of international banking standards.

The existing framework will be strengthened to give supervising authorities new powers to monitor banks, namely in an effort to comply with international AML standards while preserving the principle of banking secrecy, so that the required actions, decisions and sanctions are taken in a timely fashion and that banks abide by their regulatory obligations.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Pursuant to Law 28/67, the BCC plays a major role in overseeing banks in Lebanon and assists the BDL in its mission of overseeing the banking

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sector. The BCC is vested with the authority to conduct investigations ex officio and to require any information directly from the banks or from the BDL.

The BDL and the BCC are vested with the necessary authority to:
- control the monetary and financial policies of the banks;
- control the compliance of the banks with the applicable rules and regulations;
- require any information, including but not limited to the financial statements of banks; and
- carry out off-site and on-site monitoring.

The BCC is entrusted with the task of monitoring banks on a recurring basis and has extensive powers when performing its tasks. Such powers may even go beyond the monitoring powers granted to the BDL under the CMC and which include, without limitation, reviewing documentation, requesting information and clarifications, performance of an audit, etc.

In practice, the BCC's controllers carry out off-site and on-site monitoring and communicate to the banks any corrective actions that should be implemented. The BCC often solicits the governor's opinion and intervention as may be required.

10 How do the regulatory authorities enforce banking laws and regulations?

The BDL uses the broad powers granted to it by the CMC to ensure compliance by the banks with banking laws and regulations.

The BDL issues instructions, notes and circulars destined to clarify the requirements imposed on banks. Following off-site monitoring and on-site inspections, the BDL regularly sends follow-up letters to banks, outlining the main flaws and discrepancies and the corrective actions that should be taken. The BDL may opt for any of the following actions:
- sending a cautionary notice to the bank's management requiring an explanation for the failure to observe an applicable regulation;
- providing the bank with a recommendation as to the necessary measures that must be taken to ensure compliance with the applicable rules and regulations; and
- issuing an order to the bank requiring that certain measures be taken within a designated time frame.

The BDL is entitled to impose a wide range of sanctions on banks. These sanctions range from a simple warning or a prohibition to engage in certain operations or activities, to the removal of the infringing bank from the list of authorised banks and its subsequent liquidation.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The most common enforcement issues relate to transparency in business dealings, suitability and efficiency of information systems and compliance of the banks with the BDL's circulars, especially those related to the limitation of systemic risk, AML or CFT procedures and corporate governance practices.

The BDL and the BCC ensure that adequate measures are taken in a timely manner to sanction violations and to ensure compliance with the regulatory framework and best practices.

12 How has bank supervision changed in response to the 2008 financial crisis?

The principles governing supervision have not changed per se. The BDL and the BCC are practising their supervisory role more aggressively to ensure compliance with the stricter set of checks and balances, prohibitions and control mechanisms introduced by the BDL.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Law No. 2/67 of 16 January 1967, Law No. 1,663 of 17 January 1979 and Law No. 110 of 7 November 1991 address different aspects of the regime applicable to insolvent banks.

Pursuant to the CMC and the laws referred to above, a bank may be seized and thereafter liquidated if it ceases to pay its debts as they fall due.

The introduction of these measures was triggered by the financial difficulties faced by Bank Intra in the 1960s. Since then, the effective application of Law 2/67 to a bank facing difficulties has occurred only once (Al Madina Bank in 2004). This is partly because of the stringent preventive control exercised by the BDL and its tendency to encourage alternative solutions, such as merger with or absorption by another bank in case a bank suffers difficulties, with the ultimate aim of preserving the reputation of the Lebanese banking sector.

Law No. 110 of 7 November 1991 entitled 'Reform of the banking sector' instituted a special banking court whose competence extends to all cases of bank insolvency. In the event a bank is officially declared insolvent, it is deemed 'seized' and all its assets and rights are automatically transferred to the NIGD.

The bank's employees enjoy first privilege on the bank's assets and take precedence over, respectively, the creditors and the shareholders.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Before the bank is seized, the court appoints a management committee (see question 20) which is vested with the powers of the board of directors and, if need be, those of the general assembly.

After the bank is seized, the NIGD will be in charge of establishing the liquidation's final inventory. At the end of this process, the NIGD will transfer the ownership of any remaining assets to BDL.

Banks are not required by law to have a resolution plan.

15 Are managers or directors personally liable in the case of a bank failure?

The assets of the chairman or general manager, board members, auditors and all persons having signatory authority on behalf of the bank during the 18 months before the bank's failure shall de jure be put under precautionary seizure until their respective liability is determined by virtue of a final judicial order.

The managers and directors are hence personally and civilly liable. They are also prohibited from partaking in boards or in any other positions in banks in the future. Their criminal liability may also be invoked in the event they have committed fraudulent or collusive acts.

16 How has bank resolution changed in response to the recent crisis?

Bank resolution has not changed in response to the recent crisis. Instead, the supervision mechanisms were enhanced, as outlined in question 12.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Given the importance of maintaining a highly solvent and well-capitalised banking sector, BDL has adopted several regulatory measures to ensure that banks preserve a sound capital adequacy level.

BDL Circular 6,939 of 25 March 1998 defines the total capital ratio as the aggregate of Tier I capital (composed of common equity Tier I and additional Tier I capital) and Tier II capital.

In December 2011, the BDL set an agenda for the implementation of Pillar I of Basel III, with more conservative rules, such as raising total capital ratio to eventually reach 12 per cent in 2015 (compared with the 8 per cent required by Basel II). The guidelines provide that, after the prescribed deductions are made in compliance with the applicable regulations, the minimum solvency ratios for 2012, 2013, 2014 and 2015 should be, respectively, as follows:
- common equity Tier I ratio: 5, 6, 7 and 8 per cent;
- Tier I ratio: 8, 8.5, 9.5 and 10 per cent; and
- total capital ratio: 10, 10.5, 11.5 and 12 per cent.

It is worth noting that at the end of 2013, the Lebanese banks' consolidated Basel II capital adequacy ratio reported 11.8 per cent, exceeding the regulatory requirement of 10.5 per cent.

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18 How are the capital adequacy guidelines enforced?

Pursuant to the BDL Circular 43 of 25 March 1998, banks operating in Lebanon are required at the end of June and December to report their solvency ratios to the BCC and to the Statistic and Economic Research Department at the BDL.

BDL Circular 104 of 1 April 2006, the purpose of which is the implementation of the Basel II Capital Adequacy Accord, provides that all banks operating in Lebanon must, inter alia:

- implement the Basel II Accord in a diligent and progressive manner, in order to compute the solvency ratio on an individual or consolidated basis, starting 1 January 2008;
- implement the standardised approach to compute credit risks and the basic indicator spproach to compute operational risks;
- compute market risks, as of 31 August 2007, and include in the solvency-ratio calculation capital requirements to cover market risks, as of 1 January 2008;
- obtain the approval of the BDL to switch from the implementation of both aforementioned approaches to more advanced approaches; and
- prepare an action plan for the implementation of the foregoing to be discussed with and approved by the BCC.

The BCC requires banks operating in Lebanon to initiate an internal capital adequacy assessment process in accordance with the second pillar of Basel II. Lebanese branches of foreign banks registered in countries that implement the Basel II Accord must submit to the BCC the annual reports issued by their foreign head office on capital adequacy, irrespective of the approach applied by the head office to the said branches in Lebanon.

BDL Circular 118 of 21 July 2008 provides that the BCC shall periodically ascertain the banks' capital adequacy, and shall review and evaluate the qualitative and quantitative components of the capital adequacy assessment process, in accordance with the requirements specified in such Circular and the regulations and implementation rules issued, or to be issued by the BCC and BDL.

The qualitative components include the review of and assessment of the banking governance system, the risk-management system and the internal audit and control systems, while the quantitative elements include the calculation of required capital level.

19 What happens in the event that a bank becomes undercapitalised?

Pursuant to BDL Circular 118 of 21 July 2008, the BCC may request the bank to increase its own funds, in case it detects weaknesses or deficiencies in the qualitative or quantitative components. However, such increase does not relieve the bank from the obligation to address these weaknesses.

Pursuant to article 134 of the CMC, Lebanese banks must ensure that their assets exceed their total liabilities by at least the value of their capital. If a bank suffers a loss, it must recapitalise within a period of one year. This time frame may be extended by the BDL for additional periods not exceeding one year on aggregate, provided the bank offers sufficient guarantees as to its ability to reconstitute its capital.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Law 2/67 provides for specific provisions applicable to defaulting banks operating in Lebanon.

In case a bank ceases to pay its debts as they fall due, the governor shall promptly request the competent court to start applying the provisions of Law 2/67 and inform the minister of justice and the minister of finance of the insolvency. Defaulting banks as well as their creditors may also request the application of the provisions of Law 2/67 by the court.

Within 48 hours of the date of the request, the court must temporarily appoint a director having banking and financial expertise to manage the ordinary operations of the bank, and whose role ends upon the appointment of a managing committee, composed of six to 10 members and a president (the management committee).

Following deliberation and after consulting with the governor and hearing the defaulting bank's representative, the court delivers its decision confirming the payment cessation. As a result of such decision, the board members of the defaulting banks are dismissed. The same applies to the local management of defaulting foreign banks operating in Lebanon.

As long as the bank is not seized, the management committee represents the creditors of the defaulting bank and takes the necessary measure to safeguard the interests of the rightholders.

The role of the management committee encompasses the management of the bank's branches in Lebanon and abroad. Within six months, if the management committee deems that the bank is able to continue its activities, it notifies the competent court, which delivers a decision to convene the general assembly of the shareholders to elect a new board of directors thus ending the role of the management committee. If on the contrary it appears that the bank is unable to resume its activities, the court may decide, upon the request of the management committee, to liquidate the bank.

Law 1,663 of 17 January 1979 considerably enhanced the prerogatives vested in the NIGD after a bank is seized. Such prerogatives comprise the automatic transfer of the banks' seized assets and rights to the NIGD.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As indicated in question 17, the BDL is aiming at strengthening the banks' capital funds in order to attain a capital adequacy ratio of 12 per cent by 2015. The BDL is attempting to increase this ratio as a prudential measure to exercise better control and protect the banking sector through positive signals to the international community.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The set of documents to be presented to the BDL as part of the application for a new bank licence comprise signed declarations by the founders which include their CVs (degrees, experience and other relevant information), as well as an overview of their financial standing.

Law 308 of 3 April 2001 grants the Central Council the authority to ascertain the financial and moral aptitude of the bank's founders, as well as the subscribers to the bank's shares and is entitled to object to any transfer of a Lebanese bank's shares that may cause, directly or indirectly, the loss of effective control by any shareholder or economic group over the management of the bank or the voting rights. The Central Council enjoys broad discretionary powers in this regard, for the purpose of upholding public interest.

There is no legal definition of 'control' per se. BDL Circular 47 of 4 June 1998 provides for specific obligations on 'holding companies', defined as companies that own more than 5 per cent of the shares of a bank. Pursuant to Law 308 of 3 April 2001, subscribing to and trading in the shares of Lebanese banks is subject to the prior authorisation of the Central Council (see question 27).

23 Are there any restrictions on foreign ownership of banks?

There are no restrictions on foreign ownership of banks in Lebanon. Law 308 of 3 April 2001 abolishes previous restrictions regarding the ceiling on the ownership of shares by foreign nationals. However, the Lebanese Code of Commerce requires the majority of the board of directors of joint-stock companies (which is the form under which all banks in Lebanon are incorporated) to be Lebanese nationals, and said requirement should hence be reflected in the composition of a bank's board of directors. All the bank's shares must be in the nominative form.

24 What are the legal and regulatory implications for entities that control banks?

A direct implication for such entities is an increased exposure to the scrutiny of the regulatory authorities overseeing the banking sector and the obligation to abide by certain duties and responsibilities as detailed in question 25.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

BDL Circular 47 requires holding companies registered in Lebanon to comply with the following obligations:

- preparing non-consolidated detailed annual financial statements according to the forms issued by the BDL and organised in accordance with International Accounting Standards (IAS) that do not contradict the regulations in force in Lebanon;
- preparing annual consolidated financial statements of the companies within its group (including banks and financial and non-financial

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Update and trends

New capital markets and insider trading laws

On 4 August 2011, the Lebanese parliament enacted the long-awaited Capital Markets and Insider Trading Laws that set the legal organisational framework of the Lebanese financial markets in line with international norms.

The Capital Markets Law provides for the formation of the National Council for Financial Markets as a watchdog entrusted with organising, regulating and controlling the capital markets and its participants. The Council's functions are similar to those of the SEC with a considerable autonomy in setting its policies.

The Council has now been formed, but no other steps have been taken yet. Only time will tell whether these laws will bring about the renaissance of capital markets in Lebanon or remain shelved owing to the country's political stalemate.

Anti-Money Laundering (AML)/Combating the Financing of Terrorism (CFT) compliance departments and branch officers

BDL Intermediate Circular 371 dated 11 September 2014 requires banks to assign a qualified and independent AML/CFT branch officer at each of their branches. The branch officer should verify that the branch's staff complies with all AML/CTF procedures, properly fills out know your customer forms, monitors cash and transfer transactions, submits periodic reports and informs the compliance departments of any suspicious operation.

The banks' compliance departments should be divided into two sections before 31 March 2015: one section would supervise the operations of the bank's head office and branches in Beirut, and the other section would oversee the operations of all other branches across Lebanon.

FATCA and banking secrecy

The US Foreign Account Tax Compliance Act (FATCA) is a US endeavour to combat perceived tax abuse by US persons through the use of offshore accounts. At its heart, FATCA is about disclosure. Under FATCA, foreign financial institutions (FFIs) around the world are required to provide the Internal Revenue Service (IRS) with information on certain US persons invested in accounts outside of the US.

The BDL and the Association of Banks in Lebanon seem inclined to adopt a constructive approach towards a well-orchestrated implementation of FATCA beginning 2014 in accordance with Lebanese law, without compromising on banking secrecy. This includes the elaboration of an Anti-Money Laundering and FATCA Manual, internal policies, the appointment of a FATCA responsible officer and the preparation of two documents addressed to the banks' customers, namely the FATCA acknowledgment letter and the FATCA banking secrecy waiver.

The main speculation surrounding FATCA's enactment was that it seemed to outline a path towards an end to banking secrecy.

The implementation of FATCA will require Lebanese FFIs to set up costly infrastructures for screening, implementation and compliance processes in order to identify and report information about their US clients to the IRS. Banks are considering having all clients with US citizenship sign special waivers allowing the bank to report on their accounts to the IRS. If a client refuses, the bank will alert the IRS of such refusal in line with FATCA stipulations.

As such and from a legal standpoint, Lebanon's banking secrecy law does not have to be amended for banks to comply with FATCA, which leads many to believe that FATCA will not wither the Lebanese banking system nor affect the flow of remittances to Lebanon.

Despite increasing regulations, including FATCA, aimed at combating money laundering, banking secrecy remains the core principle of the banking system and plays a key role in attracting funds to Lebanon.

BDL stimulus packages

The BDL has always acted as a driver for investments in Lebanon namely by announcing several economic stimulus packages in the past three years. The BDL issued Intermediate Circular 382 on 10 December 2014, which details the mechanism of the 2015 stimulus package. The circular stipulates that BDL will roll over the unutilised amount of the US$1.47 billion in financial facilities that it provided to banks in 2013, as well as the unutilised sums of US$928.7 million in facilities that it granted to banks in 2014. It will add US$995 million as part of the 2015 stimulus package and extend the loans to domestic banks on a first-come first-served basis at an interest rate of 1 per cent per year. The financial facilities will allow banks operating in Lebanon to extend loans to clients at reduced interest rates. The 2013 and 2014 stimulus packages contributed up to 50 per cent of the economic growth in the country, and it is expected that the 2015 package will yield a real GDP growth rate of 2 per cent in 2015.

The BDL also issued Circular 331 in August 2013 with the main objective of stimulating the creation of startups and facilitating finance to companies at their earliest stages. This move was hailed by Lebanese private equity investors and venture capital firms as a great success for the Lebanese ecosystem in general. The BDL, which cannot directly invest in equities according to Lebanese law, implemented a creative mechanism to advance US$400 million to Lebanese commercial banks that would then be invested directly in startups or indirectly in startup funds under a 75 per cent guarantee: simultaneously, the bank receives an interest-free loan from the BDL, then uses this loan to buy treasury bills, and finally sells the latter to the BDL at a discounted rate, thus increasing the current value from which the bank derives a profit amounting to 75 per cent of its investment in startups. Nonetheless, Circular 331 stipulates that a bank's total participation cannot exceed 3 per cent of its capital, and that it must pay the BDL 50 per cent of the profits accrued through the startups' distribution of dividends or share sale.

To incentivise the investments under Circular 331 even more, the BDL ambitiously launched in November 2014 the 'Accelerate 2014' programme and organised Lebanon's first international startup conference bringing together over 500 top entrepreneurs, investors, and knowledge-economy stakeholders from around the world to lay the foundation for establishing Lebanon as a premier international startup hub, and for providing startup support activities and relevant startup investment opportunities to a high-calibre international audience.

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institutions related to it and registered in Lebanon or abroad), in accordance with the consolidation guidelines set by the BDL;
- using the templates for the balance sheet and the profit and loss accounts adopted by the BDL for the preparation of annual consolidated financial statements;
- organising its internal accounting in compliance with IAS regulations that do not contradict the regulations in force in Lebanon;
- establishing an internal control unit which operates in accordance with the regulations applicable to Lebanese banks;
- providing the BDL and the BCC on annual basis and within the timetables applicable to Lebanese banks, with the detailed personal and consolidated financial statements, yearly bulletin, auditors' report, and the yearly minutes of meetings of the general assembly and the board of directors;
- using IAS 14 as a guideline for the disclosure of financial and non-financial information related to the group companies;
- publishing consolidated and non-consolidated financial statements on a yearly basis (in accordance with the rules applicable to Lebanese banks) and provide the BDL and the BCC with evidence of such publication;
- appointing the same auditors as for its related banks and financial institutions; and
- providing the BCC, before the end of July and December of each year with a detailed statement of all its shareholders, identifying their nationalities, share proportions and the class of shares they own (if existing), along with information regarding the companies participating in the holding companies and any amendment to such statement and a detailed statement of about the shares held by the holding companies in companies located in Lebanon and abroad.

All the shares of the holding companies registered in Lebanon must be in the nominative form.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Laws 2/67 and 110/91 do not expressly refer to the controlling entities or individuals. However, it is very common in Lebanon that board members are themselves owners of equity stakes in the capital of the bank (controlling or non-controlling), and therefore suffer the same consequences referred to above applicable to board members of an insolvent bank.

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Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

There is no legal definition of 'control' per se.

Pursuant to Law 308 of 3 April 2001, subscribing to and trading in the shares of Lebanese banks is unrestricted in principle, subject to the prior authorisation of the Central Council:

- if the subscriber or the transferee acquires directly or indirectly more than 5 per cent of the shares or the voting rights of the bank, whichever is higher;
- if at the time of the transfer of shares, the transferor holds 5 per cent or more of the shares or the voting rights of the bank, whichever is higher; and
- if the transferor or the transferee is a board member of the bank, irrespective of the number of shares held or transferred.

Any legal action that aims at enabling an assignee to acquire shares of a Lebanese bank in violation of Law 308 of 3 April 2001 as amended shall be null and void.

The governor has the authority to suspend the trading in such shares and the exercise of the voting rights related thereto. His decision shall be notified to Midclear, the central custodian and clearing centre of the banks' shares, with a request to sell the said shares, by auction or through the organised financial market.

Specific requirements apply to the transfer of the shares of a bank listed on the financial market, namely, the prior authorisation of the BDL should be sought in case the purchaser or the seller is an employee who is part of the 'upper management' as such term shall be defined in the circulars issued by the BDL, or already has or acquires in aggregate more than 1 per cent of the bank's total shares.

The content of the BDL authorisation and the details of the contemplated operations should be immediately communicated to the body overseeing the financial market.

More generally, Law 308 provides that the Central Council may object to any transfer of shares of a Lebanese bank which may directly or indirectly lead to the loss by a shareholder or an economic group of 'effective control' (even if such loss of control is relative), with respect to the administration of the bank or the voting rights related thereto. Control is not defined in this particular context and its determination is left to the discretion of the Central Council on a case-by-case basis.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The regulatory authorities are generally receptive to foreign acquirers. The regulatory process for a foreign acquirer is not substantively different, but may take longer in instances where the approval of the Central Council is required considering the assessment to be made by the latter of the prospective foreign acquirer. It remains that Law 308 did not comprise restrictive or specific provisions applicable to foreign acquirers.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

Law 308 provides that, in all cases where the approval of BDL is required, the Central Council shall ascertain the financial and moral aptitude of the founders, subscribers and transferees of a bank's shares.

The Central Council will take into account other informal criteria in order to ascertain that the relevant persons possess the necessary experience and track record in the banking industry, as well as sufficient financial capabilities to take part in the bank's activities.

30 Describe the required filings for an acquisition of control of a bank.

An application should be filed before the Central Council describing in detail all elements of the acquisition operation for which the approval of the Central Council is sought. This application must comprise the contractual documents corresponding to the proposed share transfer. The Central Council may request clarifications, additional information or amendments.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The length of the process depends on the level of scrutiny required to give comfort to the Central Council and approval of applications by foreign acquirers are likely to take a longer time frame.

In practice, informal preliminary discussions are held with the BDL to evaluate the feasibility of the transaction prior to filing an application. The effective filing usually takes place after an informal favourable opinion is granted, which explains why rejected applications are rare and result mostly from adverse developments originating after the filing.

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Luxembourg

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The Luxembourg government is strongly committed to further strengthening the competitiveness of the Luxembourg economy by sustaining the long-term stability and development of its financial centre.

The EU regulatory context heavily influences domestic legislation, which has to comply with new legislative developments at EU level either in terms of supervision or liquidity.

The governmental programme emphasises the importance of the financial services sector to the Luxembourg economy, of which the banking sector represents more than 60 per cent of the workforce. Luxembourg is also committed to contributing to more financial transparency, inter alia, in the context of the US Foreign Account Tax Compliance Act (or FATCA), or the automatic and mutual exchange of information under the Common Reporting System, and is moving to offer the required reporting for international banking clients with cross-border interests. Bank secrecy rules have now been eased and automatic exchange of information is in place since 1 January 2015 with also more stringent reporting, transparency and monitoring requirements for banking activities.

A further trend is the continued diversification of activities into new markets in the financial sector. The government is also keen to strengthen the organisational rules of the depositary regime for Undertakings for Collective Investment in Transferable Securities and other investment funds, and ensure an adequate risk management policy at the level of the whole banking and financial sector.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary statute governing the banking sector is the law of 5 April 1993, as amended, on the financial sector (the Financial Sector Law). This law governs the Luxembourg financial services sector as a whole, and the banking sector in particular, regulating access to professional activities, the duties and rules of conduct of the financial sector, organising the prudential supervision of the financial sector or the deposit guarantee schemes, and indemnification systems in respect of credit institutions.

The Financial Sector Law incorporates the European banking directives of 14 June 2006 (2006/48/EC), which address the taking up and pursuit of business of credit institutions, and the Markets in Financial Instruments Directive of 24 April 2004 (2004/39/EC)(MiFID).

Other relevant regulations include:

- Law of 17 June 1992, as amended, relating to the accounts of credit institutions;
- Law of 23 December 1998, as amended, establishing a supervisory commission of the financial sector (the 1998 Law);
- Law of 12 November 2004, as amended, on the fight against money laundering and terrorist financing;
- Law of 16 March 2006 relating to the introduction of the international accounting standards for credit institutions (the 2006 Law);
- Law of 9 May 2006 on market abuse transposing the Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 into Luxembourg law, as amended by the law of 26 July 2010 on market abuse;
- Law of 13 July 2007 on markets in financial instruments (the 2007 Law);
- Grand-Ducal Regulation of 13 July 2007 relating to organisational requirements and rules of conduct in the financial sector;
- Law of 10 November 2009 on payment services;
- Law of 27 October 2010 on the strengthening of the legal framework on the fight against money laundering and terrorist financing;
- Law of 28 April 2011 on capital requirements, transposing the Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 into Luxembourg law;
- Law of 21 July 2012 on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public;
- Law of 21 December 2012 relating to family office activity;
- Law of 21 December 2012 implementing Directive 2010/78/EU of the European Parliament and the Council dated 24 November 2010 (the 2012 Law);
- Law of 6 April 2013 on dematerialised securities;
- Law of 27 June 2013 on mortgage banks amending the Financial Sector Law dated 5 April 1993;
- Law of 12 July 2013 regarding EU short-selling regulation; and
- Law of 12 July 2013 relating to alternative investment funds managers.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The Financial Sector Supervisory Committee (CSSF) is responsible for the prudential supervision of Luxembourg-based credit institutions. Its supervision also extends to professionals in the financial sector ((PFS) including investment firms, specialised PFSs and support PFSs), alternative investment fund managers, undertakings for collective investment, pension funds, SICARs, securitisation undertakings issuing securities to the public on a continuous basis, regulated markets and their operators, multilateral trading facilities, payment institutions and electronic money institutions. The CSSF also supervises the securities markets, including their operators.

The Banque centrale du Luxembourg (BcL) is in charge of all monetary and financial competences pertaining to a national central bank within the scope of the European System of Central Banks (ESCB). The main tasks assigned to the ESCB include the promotion of the financial stability, the definition and implementation of the monetary policy at EU level, the conduct of foreign exchange operations, the holding and management of official foreign reserves and the smooth operation of the payment systems. The BcL provides services to the financial sector (information collection, including statistical figures for preparing European monetary policy) and opens account only with monetary and financial institutions.

At EU level, the new European Banking Authority (EBA) was established on 1 January 2011 as part of the European System of Financial Supervision (ESFS) and took over all existing responsibilities and tasks from the former Committee of European Banking Supervisors (CEBS). These regulatory competences were formally accepted by Luxembourg by means of the Law of 21 December 2012 implementing Directive 2010/78/EU dated 24 November 2010 (Omnibus I Directive).

At the EU level, a two-pillar mechanism known as European banking union has been implemented under the form of a single supervisory mechanism (SSM) and a single resolution mechanism (SRM).

The SSM is detailed in the European Central Bank Regulation EU No. 468/2014 of 16 April 2014 and entrusts power over 'significant' eurozone banks to the European Central Bank (ECB). The three most significant banks in each participating member state will qualify as 'significant' as well

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as other banks meeting certain criteria, both in quantitative and qualitative terms. As from 4 November 2014, the ECB became the direct supervisor of 120 significant banks of the eurozone. In Luxembourg, six entities are qualified significant and are therefore supervised directly by ECB. The CSSF is in charge of assessing, at least once a year, whether a bank satisfies any of the 'significant' criteria. From 4 November 2014, the CSSF is responsible for the supervision of less significant institutions under the oversight of the ECB.

The SRM was adopted in July 2014 and ensures, where a bank subject to the SSM faces severe financial difficulties, that its resolution will be managed efficiently, with minimal costs to taxpayers and the real economy. The SRM applies as from 2015 together with the Bank Recovery and Resolution Directive.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Any credit institution established in the Grand Duchy is required to adhere to the Luxembourg deposit guarantee and investor compensation scheme: the Association for the Guarantee of Deposits (AGDL), established in accordance with the Laws of 11 June 1997 and 27 July 2000 implementing EU Directives 94/19/EC and 97/9/EC.

The AGDL covers the aggregate deposits of each bank client of up to a value of €100,000 (or equivalent if denominated in foreign currency). In the event of the bankruptcy of a member bank the AGDL ensures reimbursement of all deposits of up to €100,000 held with the bank, covering both natural persons and small and medium companies complying with the following conditions: employing fewer than 50 employees; and, having an annual turnover of less than €8.8 million and a balance sheet total below €4.4 million. Besides this deposit guarantee, claims arising out of investment transactions of a maximum of €20,000 are also protected under the deposit guarantee provided by the AGDL. The circular issued by the CSSF (Circular 13/555) requires banks to implement a 'single customer view' process, allowing banks to obtain a complete view of the total balances due per customer, by 31 December 2013. The management of the banks is required to confirm its compliance with these requirements on an annual basis. On 12 June 2014, Directive 2014/49/EU on deposit guarantee schemes (the DGS Directive) was published in the Official Journal of the European Union. It forms part of the measures adopted in the aftermath of the financial crisis in an effort to establish a banking union and aims to further strengthen the protection of depositors. This simplification and harmonisation will contribute to more transparency for depositors, faster verification of claims by the deposit guarantee schemes and speedier reimbursement in the event of a bank failure. The DGS Directive should, for the most part, be implemented and effective from 3 July 2015.

The Luxembourg state is the sole shareholder of the Banque et Caisse d'Epargne de l'Etat (BCEE), which is ranked among the safest banks in the world. The state also holds a stake interest of 10 per cent in the Banque Internationale à Luxembourg (BIL), along with Precision Capital, a holding company held by the state of Qatar. During the 2008 financial crisis, the Luxembourg government was not required to recapitalise any Luxembourg banks. During that period, only three banks (Glitnir, Landsbanki and Khaupting banks) were declared bankrupt and their liquidations did not call for government intervention. Beyond its anchor interest in the BCEE, the state has not expressed a wish to expand its interests in the banking sector and is not expected to do so imminently.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Financial Sector Law does not provide for any restrictions, requirements or preconditions for intra-group transactions among Luxembourg-regulated credit institutions and related subsidiaries. Such intra-group transactions remain, however, subject to the scrutiny from the CSSF with a view to managing and preventing liquidity risks (Circular CSSF 09/403). In particular, the CSSF exercises a prudential supervision on a consolidated basis on any Luxembourg parent company which holds directly or indirectly 20 per cent or more of the capital or voting rights of another credit or financial institution.

6 What are the principal regulatory challenges facing the banking industry?

The banking industry has to face the new wave of regulatory and reporting obligations resulting from the 2008 financial crisis, mainly imposed by the EU regulations. This will impose new organisational and technical constraints on financial institutions, which will be subject to a whole set of new regulatory requirements, in particular following the implementation of the Capital Requirement Directive IV (CRD IV) package. Unlike in other EU member states, stringent requirements for transparency and exchange of banking information is expected to reshape private banking activity in Luxembourg, which will be adversely affected and will certainly decrease its activities in coming years.

On 17 July 2013 the CRD IV package was transposed – via a regulation and a directive, and the new global standards on bank capital (Basel III) – into EU law and entered into force. The new rules apply from 1 January 2014 and address some of the vulnerabilities shown by banking institutions during the financial crisis back in 2008: the insufficient level of capital (both in quantity and in quality) resulting in the need for unprecedented support from national authorities, by setting stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. Furthermore, the CRD IV package unifies capital requirement standards throughout the EU, thereby creating a common ground for comparison. On 27 October 2014, the CSSF released a new circular No. 14/593, replacing several previous circulars, detailing the reporting requirements applicable to credit institutions as from 2014 following the implementation of the CRR/CRD IV and SSM.

The European legislative framework on short selling and certain aspects of credit default swaps (CDSs) fully applies as from 1 November 2012. It is binding in its entirety and directly applicable in Luxembourg. The provisions governing short selling and certain aspects of credit default swaps in Europe are set out in a variety of EU Regulations (eg, Regulation No. 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps, Regulation (EU) No 826/2012 of 29 June 2012 supplementing Regulation (EU) No 236/2012 and Regulation (EU) No 827/2012 of 29 June 2012 laying down implementing technical standards).

The European Market Infrastructure Regulation 648/2012 on over-the-counter (OTC) derivatives, central counterparties and trade repositories has been phased in for implementation until 2015 (EMIR). The purpose of EMIR is to introduce new requirements to improve transparency and reduce the risks associated with the derivatives market. EMIR also establishes common organisational, conduct of business and prudential standards for central counterparties and for trade repositories and applies to all financial and non-financial counterparties established in the EU that enter into derivative contracts.

The Law dated 12 July 2013 on Alternative Investment Fund Managers (the AIFM Law) transposed EU Directive 2011/61/EU on Alternative Investment Fund Managers into Luxembourg law. The AIFM Law, introducing a new supervisory regime for the responsible managers of alternative investment entities, also affects the banking and financial services sector, insofar as the depository in charge of the safekeeping of the AIF and qualifying as a credit institution, investment firm or – under certain conditions – the newly created 'PSF' category of 'depositary' under the Financial Sector Law has to be appointed for each alternative investment fund. In this context it is noteworthy that the AIFM Law introduced a new type of PSF (professionals of the financial sector), defined as a 'professional depository for assets others than financial instruments'.

As from 12 February 2014 EMIR also requires that all financial and non-financial counterparties report details of their derivative contracts – regardless of whether traded OTC – to a trade repository. This reporting obligation applies to derivative contracts that were entered into before 16 August 2012 and remain outstanding on that date, and those entered into on or after 16 August 2012.

A summary of the EMIR obligations applicable to banks has been detailed in CSSF circular 13/557, with additional information provided in a CSSF Press release 14/11. In addition, as from 2014 new supervisory requirements entered into force pursuant to regulation EU 575/2013 on prudential requirements for credit institutions and investment firms (CRR). The technical standards to be implemented are further detailed in the Circular CSSF 14/593 implementing Commission Regulation 680/2014 of 16 April 2014.

7 Are banks subject to consumer protection rules?

Banks are subject to consumer protection both enacted at the level of the European Union and at the Luxembourg national level. The adoption of

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the consumption code on 8 April 2011 (*code de la consommation*) has transposed in the Luxembourg internal regulation the EU Directive 2008/48/CE on credit agreements for consumers. This Directive aims to harmonise the laws, regulations and administrative provisions of the member states covering credit for consumers, in order to facilitate cross-border services. It increases the transparency of contractual conditions and improves the level of consumer protection. During the pre-contractual phase, the credit institutions must supply clear information on the main features of the credit offered in due course. Apart from an obligation to supply comprehensive pre-contractual information, creditors must supply consumers with adequate explanations so that the latter may choose a contract which corresponds to their needs and to their financial situation. In addition creditors must evaluate the solvency of their clients before concluding an agreement, while also respecting the right of consumers to be informed when their request for credit is rejected.

The contract must restate the main information relating to the credit offer chosen. Consumers may exercise their right to withdraw by notifying the creditor of their intention, without having to justify their decision. This must take place within fourteen days from the conclusion of the agreement. Consumers also have the right to make early repayment of their debt.

Consumers investing in financial products are protected by the MiFID Directive, the Markets in Financial Instruments Directive (Directive 2014/65/EC (MiFID II), which is aimed at substituting and repealing the MiFID I (Directive 2004/39/EC) still in force. Building on the rules already in place, the revised MiFID, which will be applicable in 2017 will strengthen the existing protection of investors by introducing robust organisational and conduct requirements or by strengthening the role of management bodies.

Luxembourg courts remain competent to know any litigation in respect of consumer protection. However, the CSSF is competent to receive complaints by customers of entities subject to its supervision and to act as an intermediary with them in order to seek an amicable settlement to these complaints. The opening of the procedure is subject to the condition that the complaint has been previously dealt with by the relevant professional. Therefore, the complaint must have been previously sent in writing to the management of the professional. If within one month after having sent the complaint to the management, no satisfactory response is received or at least an acknowledgement of receipt, a request for out-of-court complaint resolution with the CSSF can be filed. CSSF Regulation 13-02 sets out the proceeding for out-of court complaints.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

There is a clear trend towards further tightening and enhancing the existing regulatory framework for banking business in the EU. By way of example, the current MiFID regime will be updated, extended and strengthened via MiFID II and MiFIR, and the upcoming 'Packaged retail investment products (PRIPS)' regulation also imposes more documentary tasks and stricter formalities by introducing a mandatory 'key information document', currently required for investment funds qualifying as UCITS, for a broad range of investment products offered and distributed also by credit institutions. The PRIPS regulation, which will be applicable as from 16 December 2016 and was published in the Official Journal of the EU on 9 December 2014, goes to show that EU regulatory initiatives address legal loopholes and inconsistencies among sector regulations with a view to achieving a level playing field within the financial sector in its entirety, covering insurances, asset management, financial intermediaries and banking.

In line with the US Volcker Rule, stricter rules will be introduced in the EU for the largest banks, banning proprietary trading in financial instruments and commodities as from 2017. According to the draft regulation on structural measures improving the resilience of EU credit institutions EU financial regulators will have the power to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) to separate legal trading entities within a banking group. Along with this proposal, the European Commission will adopt accompanying measures aimed at increasing transparency of certain transactions in the shadow banking sector.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The supervision of banks by the CSSF aims to ensure the security of public savings by monitoring the solvency and prudent management of banks, ensuring financial stability and proper functioning of the banking system as a whole, and protecting the reputation of the financial sector by censuring unacceptable conduct. The CSSF monitors the application of laws and regulations with respect to quantitative standards that pertain to minimum equity capital, the ratio between own funds and risk exposure, limitations of risk concentration on a single debtor or maximum groups of associated debtors, liquidity ratio, limitation of qualified participation interest, and qualitative standards that relate to structure, organisation, risk exposure, and internal control or management of the banks.

With regard to the means of supervision and ongoing surveillance of the banks, the CSSF relies heavily on reporting provided by the external auditors of the credit institutions. Reporting made in the form of management letters or a long-form report provides a broad range of operational information that the CSSF could not otherwise obtain.

The CSSF also implements a regime of both onsite and off-site supervision and created in 2013 a specific 'onsite' department with the view to increase its control. It may make any request it deems necessary to carry out its supervisory duties, including inspection of the books and records of the banking entities. Although the CSSF used to conduct relatively few onsite supervisory visits, their numbers have increased drastically in recent years. Occasionally, the CSSF organises inspections to address specific concerns detected in a bank. The CSSF also relies on qualitative and quantitative reports prepared by the banks' internal auditors. The reports are drafted according to guidelines and methodologies that it has issued via specific circulars.

10 How do the regulatory authorities enforce banking laws and regulations?

When the CSSF identifies deficiencies, it may limit its action to simple monitoring, addressing a letter emphasising the inventoried deficiencies and shortcomings in the management, convening the bank's management, or undertaking onsite inspections. It also may use its powers of injunction and suspension. To ensure compliance with the laws and regulations of the financial sector, the CSSF has at its disposal various means of intervention, including:

- injunction to remedy identified deficiencies;
- suspension of persons, suspension of the voting rights of certain shareholders, or suspension of activities of the entity;
- imposition of administrative fines on persons in charge of administration or management;
- requesting that the courts order that payments be suspended and that the entity be placed under controlled management; and
- requesting that the courts order the winding up and liquidation of an undertaking.

Furthermore, the CSSF may report any infringement of the Financial Sector Law to the public prosecutor subject to criminal sanctions, including:

- persons or entities carrying out activities in the financial sector without a licence;
- persons or entities carrying out the activities of company domiciliation without being so entitled; or
- persons attempting fraud.

In addition, credit institutions and their management, either natural or legal persons, can be sanctioned or fined when they:

- fail to comply with applicable laws, regulation, statutory provisions, or instructions;
- refuse to supply the CSSF with the information requested or when the supplied information is revealed to be incomplete, inaccurate or false;
- prevent or hinder inspections carried out by the CSSF;
- do not meet the rules regarding the publications of financial statements;
- fail to act in response to CSSF injunctions; or
- act in a manner to jeopardise the sound and prudent management of the credit institution.

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Each of these events may entail the CSSF imposing fines ranging from €250 to €250,000 or prohibiting them from participating in the profession.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In its annual report for 2013 (the 2014 report was not yet available at the time of writing) the CSSF disclosed what regulatory interventions it had carried out during the course of that year.

In 2013 the CSSF reiterated its emphasis on carrying out more onsite inspections. Consequently, the number of people involved in such inspections has substantially increased, allowing the CSSF to carry out 152 onsite inspections at the premises of financial players in 2013. Generally, all onsite inspections are followed by observation letters sent to the controlled banks. In the event of more serious flaws, the CSSF analyses whether there is a need for an injunction procedure or a non-litigious administrative procedure in order to impose administrative sanctions pursuant to article 63 of the Financial Sector Law.

Ad hoc control missions are onsite inspections intended to investigate a specific – or even worrying – situation relating to the professional itself. The particular situation will have, in principle, already been documented during the off-site prudential supervision. Such missions may either be planned in advance or occur unexpectedly. The nature and scale of ad hoc missions may vary significantly and subsequently determine the composition of the onsite teams. In 2013, the CSSF carried out 32 ad hoc missions, of which 16 concerned banks on different topics including contract for difference, business plan or recovery model. The other missions concerned specific risk analyses (eg, market rate risk or interest rate risk).

The total amount of administrative fines imposed in 2013 reached €667,650 against €562,375 in 2012. The CSSF imposed three administrative fines pursuant to article 63 of the Financial Sector Law and relating to credit institutions, each amounting to €60,000 and 20,000 in respect of default of compliance regarding the AML/CFT (the fight against money laundering and terrorist financing).

12 How has bank supervision changed in response to the 2008 financial crisis?

A strong tendency to build up and strengthen central control mechanisms at EU level, set to replace or supplement to a large extent the supervision by national regulators, has been seen. Following the crisis, the European Banking Union has been overhauled and has been rebuilt on two main pillars: the SSM and the SRM.

On 4 November 2014 the SSM became fully operative. It was established by the EU SSM Regulation (1024/2013), which conferred specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, and complemented by the EU SSM Framework Regulation (468/2014), which established the framework for SSM cooperation between the ECB and national competent authorities and national designated authorities. Pursuant to the SSM, the ECB becomes the central prudential supervisor of financial institutions in the eurozone (including approximately 6,000 banks), with the possibility to extend the scope of its activity to cover EU member states outside the eurozone which choose to join the SSM.

On 30 July 2014 the EU SRM Regulation (806/2014), which established the SRM for the banking union, was published in the EU Official Journal. The SRM Regulation is completed by an intergovernmental agreement, which to date has been signed by 26 member states. The SRM will complement the SSM in order to provide a single European mechanism for the resolution of credit institutions. Where a credit institution fails, the mechanism will allow the resolution to be managed effectively through the Single Resolution Board and the Single Resolution Fund. The fund will initially be segregated into national compartments, which will gradually be merged as of 1 January 2016 during an eight-year transitional period. As of 1 January 2015, the Single Resolution Fund is funded by contributions from the banking industry, with the objective of reaching, within eight years, at least 1 per cent of the amount of covered deposits of all of the eurozone credit institutions. The actual amount of credit institutions' contributions to the Single Resolution Fund will be determined by the Single Resolution Board each year, based on criteria set out by the SSM Regulation, delegated acts of the European Commission and the Council Implementing Act adopted by the European Commission on 21 October 2014, taking into account the risk profile of the given credit institution.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Luxembourg law does not provide for specific rules or statutory provisions on the nationalisation of credit institutions and other PSFs. For the time being the legal framework for situations of financial distress (see question 20), along with the temporary lending or the availability of changes in control in distressed banks (eg, the takeover of Dexia BIL by the Qatari sovereign fund) have so far been sufficient to tackle cases of imminent or occurred bank insolvencies.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Currently, Luxembourg regulations do not provide for a specific resolution regime akin to the 'living will' rules under US legislation. This may well change in the foreseeable future, as the upcoming Basel III regulations and the future EU directive on recovery and resolution of credit institutions and investment firms foresee the introduction of such resolution regimes in the European Union (see question 3).

EU Directive 2014/59 of 15 May 2014 on the recovery and resolution of credit institutions and investment firms aims at establishing an effective recovery and resolution framework across the European Union and at equipping the relevant authorities of the member states with common and effective tools and powers to address further banking crises. According to this Directive EU banks are required to produce a detailed recovery plans on entity and group basis. National regulatory authorities will also have broad powers to remove impediments to the implementation of recovery plans, will draw up resolution plans at bank or group level and may require banks to take appropriate action to ensure that impediments be removed. Banks will be required to hold capital equal to a percentage, to be set by the national resolution authority on an institution-by-institution basis, of the total of their liabilities, and creditors and counterparties may be subject to temporary moratoria and other restrictions on enforcing security and exercising contractual termination rights.

With regard to Luxembourg bank management guidelines, reference is made to CSSF Circular 12/552 on central administration, governance and risk management requirements for Luxembourg credit institutions and investment firms (see question 7).

The Luxembourg government intends to reform the current legal framework (draft bill 6539) by providing conservatory measures and legal instruments to prevent financially distressed companies from being declared bankrupt should their financial problems be detected at an early stage.

15 Are managers or directors personally liable in the case of a bank failure?

Luxembourg law does not provide for a specific liability or responsibility regime for managers or directors of failed credit institutions; hence, the general liability rules under the Law of 10 August 1915 on commercial companies (Commercial Companies Law) apply in cases of bankruptcy or insolvency of credit institutions. The Commercial Companies Law stipulates the liability of managers and directors with regard to the company for the execution of their mandates and any related wrongdoing or misconduct. This general liability regime applies to any corporate company established as a public limited company.

16 How has bank resolution changed in response to the recent crisis?

The implementation of the EU legislation on the SSM and the SRM was proposed as a reaction to the banking turmoil back in 2008. In addition, the EU regulation applicable to banking institutions is therefore included in the single rulebook aiming at providing a single set of harmonised prudential rules, which institutions throughout the EU must respect. As part of this single rulebook, the Directive 2014/59 of 15 May 2014 is aimed at establishing a framework for the recovery and resolution of credit institutions and investment firms. It provides for a complete framework for crisis management of banks, ensuring the early intervention of national supervisors to manage the banks financial difficulties and that appropriate management tools be in place with the view to manage future crisis (see

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question 14). The SRM was established by EU Regulation 806/2014 of 15 July 2014 and applies to bank falling within the scope of the SRM (see question 12). At the national level, no bank resolution mechanism has been set up to complement the EU resolution mechanism.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Since January 2014, credit institutions have been subject to CRD IV and the capital requirement regulation. Banks are therefore required to comply with the prescribed liquidity coverage ratio (LCR) and report it to the Luxembourg authorities on a monthly basis. The LCR compares the stock of high-quality liquid assets held by the banks with the total net cash outflows expected over the next 30 days. This requirements aims to ensure that banks maintain enough liquid assets to survive for 30 days in a stress scenario, as specified by the CSSF. Until the LCR becomes binding in 2015, the old liquidity ratio of at least 30 per cent still applies. The Luxembourg parliament has now prepared the bill 6660 aiming at transposing the capital requirements of Directive 2013/36/EU (CRD IV) into Luxembourg law and is anticipating a rapid adoption.

Owing to the CRD IV package the current capital adequacy requirements in place will undergo certain changes. Currently, banks must have total capital of at least 8 per cent of risk-weighted assets (RWAs). Whereas this percentage does not change under CRD IV, the minimum requirement for Tier 1 capital is, however, increased from 4 per cent to 6 per cent, and the minimum requirement for common equity Tier 1 (CET 1) is increased from 2 per cent to 4.5 per cent. CRD IV also tightens the definition of common equity, and the definition of what amounts to Tier 2 capital is simplified with all subcategories (such as upper Tier 2 and lower Tier 2) removed; the concept of Tier 3 capital is abolished. In line with Basel III, CRD IV creates five new capital buffers: the capital conservation buffer, the countercyclical buffer, the systemic risk buffer, the global systemic institutions buffer and the other systemic institutions buffer. The capital conservation buffer is designed to ensure that firms build up capital buffers outside periods of stress that can be drawn down as losses are incurred. A capital conservation buffer of 2.5 per cent, comprising CET 1, is established above the regulatory minimum capital requirement The bank-specific countercyclical capital buffer will require banks to build up a buffer of capital during periods of excessive credit growth. The countercyclical capital buffer rate to be set by the CSSF must be between 0 per cent and 2.5 per cent of the RWAs of firms that have credit exposure in Luxembourg, unless the CSSF considers, in the light of its economic conditions, that the countercyclical capital buffer rate should exceed 2.5 per cent. Banks that fail to meet the capital conservation buffer or the countercyclical capital buffer will be subject to constraints on discretionary distributions of earnings. Luxembourg is able to apply systemic risk buffers of 1 per cent to 3 per cent for all exposures and up to 5 per cent for domestic and third-country exposures without having to seek prior approval from the Commission – it will be able to impose even higher buffers with prior approval from the Commission. If Luxembourg decides to impose a buffer of up to 3 per cent for all exposures, the buffer has to be set equally on all exposures located within the EU.

In 2014, credit institutions started reporting elements of the net stable funding ratio (NSFR), which aims to ensure that banks maintain stable sources of funding for more than one year relative to illiquid assets and off-balance sheet contingent calls. Although not binding until 2018, the NSFR is likely to be modified or altered during the course of the coming years. The CSSF published in its circular 14/582 the European Bank Authority (EBA) guidelines on retail deposits.

In addition to the liquidity ratio, banks are also required to meet strict criteria regarding risk management in general. Banks must implement processes to identify, measure, manage and report liquidity risks to which they are exposed and adopt internal guidelines to plan and manage their liquidity requirements, including liquidity buffers.

18 How are the capital adequacy guidelines enforced?

According to article 53 of the Financial Sector Law, the CSSF has full supervisory and investigatory powers to ensure the enforcement of the capital adequacy provisions including access to all relevant documents, questioning of any person and onsite inspections or investigations. The CSSF may also enjoin institutions to cease any practices that it considers contrary to the capital adequacy provisions and it can request the freezing or confiscation of assets. In addition, the CSSF may request approved external auditors to provide information on a financial institution or require them or suitable experts to carry out onsite verifications or investigations on a financial institution. It may even request temporary banning of professional activity against persons subject to its prudential supervision, as well as restricting or limiting the business, operations or network of banks. Furthermore, in the event of non-compliance with the capital adequacy requirements, the fines mentioned above (see question 10) can be imposed by the CSSF on the administrators of the bank or any other persons subject to its supervision.

19 What happens in the event that a bank becomes undercapitalised?

According to article 59 of the Financial Sector Law, the CSSF, when noting that the bank does not meet its capital adequacy commitments, must charge the bank, by registered letter, to remedy the capitalisation deficiency within such period as its sets out. If, at the end of the time limit imposed by the CSSF, the required level of capitalisation is not reached, the CSSF may, inter alia, suspend the board members or managers of the bank, suspend the exercise of voting rights of shareholders whose functions or influence may be detrimental to the restoration of the capital adequacy requirements, or both. Such decisions adopted by the CSSF take effect with regard to the person in question from the date on which they are notified by registered letter or served by a bailiff as a writ. Where, as a result of a suspension order by the CSSF the administrative, executive or management body of the bank no longer has the minimum number of members prescribed by law or by its articles of incorporation, the CSSF must fix the period by registered letter within which the institution concerned must replace the suspended persons and fill the vacancies. The CSSF may disclose to the public any suspensive measure unless such disclosure would disrupt the financial markets or to be disproportionately detrimental to the parties involved.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Financial Sector Law provides for a suspension of payments procedure in the event that a bank becomes insolvent. Pursuant to article 60-2 of the Financial Sector Law a bank (or the CSSF) may apply for a suspension of payments declaration to the Luxembourg District Court in the event of an acute shortfall in liquidity or a similar insolvency situation (eg, creditworthiness is undermined or the bank's ability to meet its commitments in full is compromised). This procedure brings about a temporary suspension of all payments by the distressed bank and prohibits all acts and decisions unless authorised by the administrators. The judgment ordering suspension of payments lays down the conditions and procedures applicable to the suspension of payments, applicable for a maximum of six months.

The Financial Sector Law further provides that a bank may be dissolved and wound up if it has become apparent that the previously ordered suspension of payments has not been sufficient to rectify the situation or the establishment's financial position has been undermined to such an extent that it can no longer meet its commitments to creditors and stakeholders. Only the CSSF or the public prosecutor may apply to the competent district court for an order to dissolve and wind up a bank. When ordering the winding up, the district court must appoint an official receiver and one or more liquidators. It will also determine the manner in which the winding up is to be carried out.

One or more administrators are appointed by the district court to control the management of the bank's assets. The judgment granting the suspension of payments is published in the Luxembourg Official Gazette and in two national newspapers and one foreign newspaper with a sufficiently large circulation. Additional publications and a notification by the CSSF to the relevant national regulatory authority are required for banks with branches abroad.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The capital adequacy guidelines for credit institutions governed by Luxembourg are about to undergo ground-breaking changes owing to the CDR IV package. The CRD IV package provides new rules on capital requirements for credit institutions and investment firms and aims to put in place a comprehensive and risk-sensitive framework and to foster enhanced risk management among financial institutions (see question 17). Full implementation of the reform package is foreseen by 1 January

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2019. Luxembourg has already drafted a bill in this respect with the view to allow quick enactment of the CRD IV. In addition to provisions addressed at national authorities, such as authorisation, shareholder control and supervisory measures and sanctions, the directive also covers qualitative provisions on the Internal Capital Adequacy Assessment Process and the Supervisory Review and Evaluation Process. As well as disclosure obligations, the Regulation on prudential requirements for credit institutions and investment firms contains quantitative requirements, including own funds and capital, liquidity and leverage ratio requirements. The CRD IV package will be supplemented by more than 100 technical regulatory standards, technical implementation standards and guidelines, the development of which will be overseen by the EBA.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Natural and legal persons are acceptable as shareholders in a bank. The authorisation of a new shareholder acquiring a qualifying interest in the bank is subject to the prior communication to the CSSF of the identity of the shareholders and of the amounts of those holdings. 'Qualifying holding' means any direct or indirect holding in the bank that represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the bank in which the participation is taken.

Authorisation is subject to the condition that the shareholders with a qualifying holding fulfil the required conditions to ensure sound and prudent management. The concept of sound and prudent management must be assessed in light of five criteria listed in article 6 of the Financial Sector Law: the professional standing of the shareholders, the professional standing and experience of any person who will direct the business of the bank after obtaining authorisation, the financial soundness of the shareholders, the compliance with the prudential and supervisory requirements at group level, and the risk of money laundering and terrorist financing. Moreover, the authorisation of the new shareholder is subject to the condition that the structure of its direct or indirect stakeholders be transparent and organised in such manner that the CSSF, as responsible authority for the prudential supervision of the bank and, where applicable, of the group to which it belongs, be clearly identifiable. This transparency requirement will allow the prudential supervision of the CSSF and any other competent regulatory authorities to be exercised without hindrance and in the most efficient way. The CSSF requires that the group structure of the shareholder-to-be allow the exercise of effective supervision, as well as the effective exchange of information and a clear allocation of responsibilities among the competent regulatory authorities.

In order to obtain approval as a shareholder with a qualifying participation in the bank natural persons and, in the case of legal persons, the members of the administrative, management and supervisory bodies and the shareholders or members with a qualifying holding must produce evidence of their professional standing. Professional standing is assessed on the basis of police records and of any evidence showing that the persons concerned have a good reputation and offer every guarantee of irreproachable conduct.

In order to assess the professional standing of the persons indicated above, the natural and legal persons concerned must fill in, sign and send to the CSSF the 'Declaration of honour' document, available for download from the CSSF website. Moreover, a natural person must transmit a copy of his or her identity documents, a curriculum vitae and an extract of his or her police record to the CSSF. Legal persons must also transmit a copy of their coordinated articles of association, an extract from the trade and companies registry and the annual reports (balance sheet and profit and loss account) for the past three years.

23 Are there any restrictions on foreign ownership of banks?

Participations in Luxembourg banks may be held by foreign residents or nationals. Whereas no legal or regulatory restrictions in this regard exist under Luxembourg law, the direct and indirect shareholding structure of the bank must nevertheless stay transparent and at all times be organised in such a way that the CSSF is not compromised in the exercise of its regulatory supervision. Hence, if the laws, regulations or administrative provisions of a third country governing one or more natural or legal persons with which the bank has close links prevent the CSSF from effectively exercising its supervisory functions, the acquisition by the respective foreign investors will be denied. Likewise, an authorisation is refused if difficulties involved in the enforcement of these provisions prevent the CSSF from effectively exercising its supervisory functions.

24 What are the legal and regulatory implications for entities that control banks?

There are no specific regulatory implications for controlling entities of Luxembourg-regulated banks. The obligations to report annually the identity of the shareholders of the bank to the CSSF are incumbent on the CSSF-regulated bank itself – no action is required from the shareholders themselves in this regard. As communicated by CSSF Circular 12/553 of 24 December 2012 the respective reporting table (B4.5 'Analysis of shareholdings') was updated. The identity of the shareholders must be communicated to the CSSF when these persons hold, directly or indirectly, at least 10 per cent of the capital or the voting rights attached to the shares of the bank (no longer 5 per cent).

Direct action is, however, required when shareholders intend to augment their participations in Luxembourg-regulated credit institutions. As stated in article 6 of the Financial Sector Law, shareholders further increasing, directly or indirectly, their qualifying holdings, as a result of which the proportion of the voting rights or of the capital held would reach or exceed 20 per cent, 33.33 per cent or 50 per cent, or so that the bank would become their subsidiary, are required to first notify such decision to the CSSF in writing indicating the size of the intended (increased) holding and relevant supporting information.

Likewise, natural or legal persons must inform the CSSF if it has taken the decision to reduce its qualifying holding so that the proportion of voting rights or capital held would fall below 20, 33.33 or 50 per cent, or so that the credit institution would cease to be its subsidiary.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

See question 24.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

In the normal course of events the bankruptcy of a bank does not affect the shareholders, apart from the financial consequences (devaluation) for the participation held in the bank's capital. In the event of an insolvency, however, shareholders that control and influence the bank in undue manner – acting, in other words, as de facto managers – may be deemed personally accountable for the bankruptcy and consequently be held responsible for the debts of the bank if the conditions set out in article 495 of the Luxembourg Commercial Code are met. In particular, a controlling entity may be declared specifically liable if it, under the protection of the bank, acted in its own interests, disposed of the bank's property as its own or improperly pursued, for its own benefit, an operating deficit when it was clear that this would lead to a suspension of payments. Moreover, the court may order such controlling entity to bear all or part of the debts of the bank if its gross negligence contributed to the bank's insolvency (article 495-1 of the Commercial Code).

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The authorisation of a new shareholder acquiring a controlling interest in the bank follows the rules set out for the acquisition of a qualifying interest (see question 22).

Where the shares of bank are admitted to trading on a regulated market, acquisitions are also regulated by the general provisions on takeover bids and changes of control pursuant to the Law on Takeover Bids dated 19 May 2006, implementing the EU Directive 2004/25/EC as amended. In this case, additional conditions must be met (eg, due and timely information concerning the bid and disclosure to the CSSF).

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The majority of Luxembourg banks are part of international banking groups or otherwise held by foreign entities. The acquisition of BIL, as well as KBL European Private Bankers SA by an investment group owned by the state of

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Qatar, may be cited as more recent examples of foreign investment in the Luxembourg financial sector. Other examples involve the Chinese banking sector, which has also dramatically grown its activity in Luxembourg over recent years. At the end of 2014, China's Bank of Communications was the country's sixth bank to establish a presence in the Grand Duchy.

Provided the conditions set out under question 22 are met, in particular when the seamless regulatory supervision by the CSSF is ensured, there are no legal impediments or regulatory entry barriers for foreign acquirers.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

Please refer to the preconditions and requirements of the CSSF authorisation process described in detail in question 22. Further guidance to the approval of a change in control in a Luxembourg bank is given in the Appendix II of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector.

Please see question 30 for further details on these guidelines.

30 Describe the required filings for an acquisition of control of a bank.

According to article 6, paragraph 6 of the Financial Sector Law, the CSSF is obliged to make publicly available a list specifying the information that is necessary to carry out an assessment of the planned acquisition and which must be provided to it at the time of notification. The CSSF complied with this statutory obligation by referring to the requirements list attached as Appendix II to the Guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC, as published by CEBS, the European Securities and Markets Authority and the Committee of European Insurance and Occupational Pensions on 11 July 2008.

According to this requirements list, the following pieces of information and documentary proof must be provided to the CSSF for the approval of an intended acquisition of control in a Luxembourg-regulated credit institution. Natural persons planning to acquire a Luxembourg regulated bank are obliged to provide the following:

- name, date, place of birth and address;
- a complete and detailed curriculum vitae;
- information on any relevant criminal records, investigations or proceedings, relevant civil or administrative cases and disciplinary actions, investigations, enforcement proceedings or sanctions by a supervisory authority with respect to the acquirer or any company he or she has ever controlled or directed;
- information on any previous assessment of reputation conducted by a supervisory authority;
- details of sources of revenue, assets and liabilities of the proposed acquirer and pledges and guarantees he has granted;
- a description of his or her professional activities;
- ratings and public reports on the companies controlled or directed by the acquirer and if available, on the acquirer him or herself; and
- a description of the financial and other interests or relationships of the acquirer with current shareholders of the bank, its board members, etc.

For legal persons acting as acquirers the following is required:

- evidence of business and the registered name and address of the head office;
- registration of legal form;
- an up-to-date overview of entrepreneurial activities;
- detailed shareholding structure of the acquirer or organisational chart of the group the acquirer may be part of and information on any shareholder agreements and group companies that are supervised by a supervisory authority;
- complete and audited financial statements for the three most recent financial periods; and
- information about the acquirer's credit rating and its group's rating.

In addition, information has to be provided on the target bank, the aim of the acquisition and the shareholding in the bank's capital already owned by the proposed acquirer.

Furthermore, the CSSF must be informed about the funding of the share purchase (on any private resources financing the acquisition, the transfer of funds, access to capital sources and financial markets, borrowed funds, etc).

Finally, the guidelines also contain a list of information to be provided to the CSSF in the event of a change of control of a bank or the acquisition of qualifying holdings by acquirers.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Pursuant to article 6, paragraph 7 et seq of the Financial Sector Law, the CSSF must promptly and, in any event, within two working days of receipt of the notification, acknowledgement receipt thereof in writing to the proposed acquirer. The CSSF has a maximum of 60 working days from the date of sending the acknowledgement of receipt of the notification and all the documents required to be attached to the notification to carry out the assessment; the CSSF must indicate the date of expiry of this assessment period in the acknowledgement of receipt it sends to the proposed acquirer. The CSSF may request any further information that is necessary to complete the assessment during the assessment period if necessary, but no later than the 50th working day of such period. The request must be made in writing and must specify the additional information needed. For the period between the date of request for further information by the CSSF and the receipt of a response thereto by the proposed acquirer, the assessment period must be interrupted, but the interruption may not exceed 20 working days. Any further requests by the CSSF for completion or clarification of the

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Update and trends

As described further above, a number of legislative changes will come into effect in 2015 directly affecting the banking sector (the Bank Recovery and Resolution Directive, the Omnibus II directive, the EMIR regulation, etc). Among those changes, the main hot topics are likely to be the Central Bank supervision and the SSM, which will involve a complete shift in banking supervision in Luxembourg and within the EU, and the Common Reporting Standard (the mutual and automatic exchange of information) establishing a new reporting paradigm for reporting and identifying reportable accounts. The exchange of information will be further enhanced in 2017, requiring new adaptations from the banking sector. The CRS will put an end to Luxembourg bank secrecy. This will significantly impact the client, the relationship manager and the private bankers. Finally, the MiFID2/MiFIR repealing and recasting the MiFID directive shall impose new markets requirements including those relating to position limits, algorithmic trading and transparency but also new conduct of business requirements that entail significant changes for banking institutions. In the tax sector, more stringent application of the transfer pricing rules and increase of the VAT rate from 15 per cent to 17 per cent may have the effect of slightly reshaping the profit margins of Luxembourg-based institutions.

information will be at its discretion but may not result in further interruption of the assessment period. The CSSF may extend the interruption to 30 working days if the proposed acquirer is situated or regulated in a third country or is not subject to regulatory supervision according to the applicable EU Directives (ie, Directives 2006/48/EC, 92/49/EEC, 2002/83/EC, 2004/39/EC, 2005/68/EC and 85/611/EEC). If the CSSF, upon completion of the assessment, decides to oppose the acquisition, it must inform the proposed acquirer in writing within two working days and not outside the assessment period, and provide the reasons for that decision. If the CSSF does not oppose the acquisition within the assessment period in writing, it will be deemed approved.

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Mexico

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The oversight of the Mexican banking system is primarily the responsibility of the Ministry of Finance and Public Credit, the Bank of Mexico, the National Banking and Securities Commission, the Institute for the Protections of Bank Savings and the National Commission for the Protection and Defence of Users of Financial Services.

In 2014, a major financial reform was approved, with four main objectives: expanding credit through credit performance evaluations for banks; protecting and strengthening the stability of the banking sector by improving the legal framework of bank's bankruptcy; increasing competition with dispositions that promote transparency in the market and consumer protection; and strengthening governmental banking.

2 Summarise the primary statutes and regulations that govern the banking industry.

In Mexico credit institutions are governed primarily by the Credit Institutions Law, the Law for the Transparency and Order of the Financial Services, Law for the Transparency and Promotion of the Guaranteed Real Estate Credit, the general regulations applicable to credit institutions issued by the National Banking and Securities Commission, by the circulars issued by the Bank of Mexico, by the general regulations issued by the National Commission for the Protection and Defence of Users of Financial Services, the Law Regulating Financial Groups, Banks Savings Protection Law and in the case of development bank institutions (governmental banking institutions), also by their own organisational laws.

- Credit Institutions Law: Regulates the incorporation, operation, supervision, liquidation and resolutions of banking institutions.
- Law to regulate banking groups: Regulates the functioning of banking groups and the liability of the holding controlling entity.
- Law for the Protection and Defence of Users of the Financial Services Creates the National Commission for the Protection and Defence of users of the Financial Services and a decentralised entity for the protection of consumers, setting forth procedures that can be brought against banking institutions and prohibiting abusive clauses.
- Law for the Transparency and Order of the Financial Services: Regulates transparency of commissions, interest rates and other banking prices, adhesion agreements and payment systems of low transactions payment systems (debit and credit ATMs).
- Law for the Transparency and Promotion of the Guaranteed Real Estate Credit: Regulates credits guaranteed by real estate mortgages and transfer of mortgages.
- Regulations issued by the National Commission for the Protection and Defence of Users of Financial Services: Regulates transparency of financial services and abusive clauses.
- Banks Savings Protection Law: Creates a system to guarantee deposits in case of bankruptcy of financial institutions.

3 Which regulatory authorities are primarily responsible for overseeing banks?

In Mexico, the National Banking and Securities Commission, a decentralised body of the Ministry of Finance and Public Credit, is the primary authority responsible for the oversight and supervision of the credit institutions together with the Institute for the Protection of Bank Savings, in order to ensure that they following the applicable rules and healthy practices in the area.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

In Mexico, the Institute for the Protection of Bank Savings guarantees the payment of principal and financial charges of the full service banking institutions derived from bank deposits, up to an amount equivalent to 400,000 investment units (approximately 2 million pesos), per person, individual or entity, in the same full service banking institution.

Furthermore, regarding the participation of the state in the Mexican banking system, the Credit Institutions Law establishes the existence of development bank institutions, which form part of the federal public administration, in which the federal government has at least a 66 per cent share of the capital stock, and the fundamental purpose of which is to facilitate access to credit and financial services for individuals and entities, and to provide them technical assistance and training in order to promote economic development.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Full-service banking institutions require the agreement of at least three-quarters of the board members present at the board of directors meetings in order to approve engaging in operations with related persons, in which the latter are or may become debtors to the full-service banking institutions.

According to article 67 of the Law Regulating Financial Groups, the affiliates will be governed by corresponding international treaties or agreements, the provisions contained in the above-mentioned Law and those emanating from it, as well as the opinion of the Bank of Mexico and of the Commissions for National Banking and Securities, Insurance and Bonds and Retirement Savings System.

An affiliate is the Mexican company authorised to organise and operate like any of the financial entities that may form a financial group under the Law Regulating Financial Groups. It regulates operations carried out by foreign financial institutions, which are the financial entities incorporated in a country with which Mexico has signed an international treaty or agreement by virtue of which the establishment of affiliates in Mexico is permitted.

The affiliates may carry out the same acts as the bank holding company of full service banking institutions and they will have the same restrictions, unless the applicable international treaty or agreement establishes some restriction. The affiliates may acquire shares from financial entities in order to be incorporated into a financial group or for a foreign financial institution to acquire the shares of a bank holding company.

6 What are the principal regulatory challenges facing the banking industry?

As a result of the so-called 'financial reform' (published on 10 January 2014 in the Official Federal Gazette), the obligations of credit institutions have increased, which may be reflected in increases in the operating expenses

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of such institutions. In Mexico, financial matters are regulated by the Federal Congress, by a decentralised body of the Ministry of Finance and Public Credit, which is the National Banking and Securities Commission, by a constitutionally autonomous body, which is the Bank of Mexico, and by the National Commission for the Protection and Defence of Users of Financial Services, which increases the charges of the credit institutions, such charges being established in different regulatory bodies.

7 Are banks subject to consumer protection rules?

The Law for the Protection and Defence of Users of Financial Services created the National Commission for the Protection and Defence of Users of Financial Services, the purpose of which is to protect and defend the rights and interests of public users of financial services. The Institute for the Protection of Bank Savings was also created to protect the resources of the public.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The reforms made in 2014 allow the leaders of the financial institutions to confront and regulate the greatest risks that the financial entities currently face, such as business risks, business development and strategies for managing them to prevent future financial crises.

The recent reforms follow the same trend in the sense of encouraging the review, verification, substantiation and evaluation of the operations, organisation, functioning, processes, internal control, risk management and information systems, and the assets, the adjustment of capital to the risks, the quality of the assets and, in general, everything that can affect the financial and legal position, so that the credit institutions follow industry best practice and thereby avoid systemic risks and future financial crises.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The supervision of the credit institutions is the responsibility of the National Banking and Securities Commission, which may carry out inspections of the credit institutions, in order to review, verify, substantiate and evaluate the operations, organisation, functioning, processes, systems of internal control, of risk management and of information, as well as the assets, the adjustment of capital to the risks, the quality of the assets and, in general, everything that can affect the financial and legal position, keeping records, in order to ensure that the credit institutions are in compliance with the provisions that govern them and the healthy practices in the industry.

In addition, the National Commission for the Protection and Defence of the Users of Financial Services will be responsible for the supervision of the entities regulated by the Credit Institutions Law, which may request the National Banking and Securities Commission to inspect the credit institutions in order to review, verify, substantiate and evaluate that the credit institutions are in compliance with the provisions referred to in this paragraph.

The oversight by the National Banking and Securities Commission will be done through the analysis of accounting, legal, economic, financial, administrative, process and procedures information obtained by such Commission under the applicable law, in order to evaluate the compliance with the regulations governing the credit institutions, as well as their stability and proper functioning.

Notwithstanding the information and documentation that the credit institutions must provide it periodically, the National Banking and Securities Commission may, within the scope of the applicable provisions, request from them the information and documentation it needs to fulfil its oversight duties.

10 How do the regulatory authorities enforce banking laws and regulations?

The National Banking and Securities Commission, as a result of its oversight powers, may make observations and order the adoption of measures to correct the irregular acts or omissions it has detected through its activities.

The National Banking and Securities Commission, in order to enforce its decisions, may make use of the following measures: advice with warning; fine from 2,000 to 5,000 days of minimum wage; additional fine of 100 days of minimum wage for each day the infringement persists; and the assistance of police force. If the warning is insufficient, it may request the competent authority to proceed against the infringer for disobedience of a legitimate order of a competent authority.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The measures adopted by the National Banking and Securities Commission to correct the irregular acts or omissions will be preventative with the purpose of preserving the stability and solvency of the credit institutions, and regulatory in order to define criteria and establish rules and procedures that their operations must abide by.

12 How has bank supervision changed in response to the 2008 financial crisis?

As a result of the financial crisis of 2008 the law applicable to credit institutions in Mexico has been reformed in order to ensure the stability of the Mexican financial system through the adoption of prudent measures, evaluation periods of the full service banking institutions, sanctions and the establishment of obligations for them to comply with capitalisation indexes that permit them to cover their obligations, even in adverse situations and thus protect the rights of the public and creditors of the credit institutions.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The National Banking and Securities Commission, with a resolution of its governing board, in protection of the interests of the public and creditors of a full service banking institution, may declare as a precautionary measure the intervention in the full service banking institution and order the closing of its offices and branches when any of the following situations occurs:

- in the space of one month, the capitalisation index of the full service banking institution diminishes to a level equal or inferior to the minimum capital requirements;
- it does not comply with the minimum required capitalisation index; or
- one of the premises of non-compliance established in section VI of article 28 of the Credit Institutions Law is present and, in the judgment of the Banking Stability Committee, it could generate, directly or indirectly, serious negative effects on other full-service banking institutions or other financial entities, such that it threatens their stability or solvency, provided that it could affect the stability or solvency of the financial system or could put at risk the functioning of the system of payments necessary for the development of economic activity.

In addition, the National Banking and Securities Commission may declare the intervention of a full service banking institution when in its judgment there are irregularities of any kind that could affect its stability and solvency, and put at risk the interests of the public or of the creditors of the institution in question.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

The intervention of a full service banking institution will imply that the person that the governing board of the Institute for the Protection of Bank Savings designates will become a provisional administrator of the institution, who must prepare an opinion on the overall situation of the full service banking institution, which must include at least a detailed description of the financial situation of the full service banking institution, an inventory of assets and debts and, in addition, the identification of the obligations pending payment of the institution and it must have a legal and accounting opinion that the independent external auditors have prepared.

The designated provisional administrator will become the sole administrator of the institution, substituting the board of directors as well as the general shareholders meeting and for that he will have, among other things, the powers that corresponded to the board of directors and the general director, enjoying general powers for acts of dominion, of administration, of litigation and collections, with powers that require a special clause under the law, and to subscribe negotiable instruments, carry out credit transactions, present denouncements and complaints, withdraw from them, grant pardon and commit to arbitral proceedings. In no case

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will the provisional administrator be restrained in his actions by any resolutions that the board of directors may have adopted.

15 Are managers or directors personally liable in the case of a bank failure?

The credit institutions will be liable directly and without limitation for the acts carried out by their officers and employees in the performance of their duties, as well as for the acts carried out by those who claim to hold some position, agency, commission or any other legal title that such institutions had granted to carry out its operations. This will be applicable notwithstanding the civil or criminal liabilities such person may incur individually.

16 How has bank resolution changed in response to the recent crisis?

Under Mexican law, the resolution of a full service banking institution now is appropriate when the National Banking and Securities Commission has revoked the authorisation that it had been granted to incorporate and operate as such, or when the Financial Stability Committee determines that: serious negative effects can be generated on other full service banking institution(s) or other financial entities, such that it threatens their stability or solvency, provided that it may affect the stability or solvency of the financial system; or the functioning of the payments system is put at risk.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

According to the general regulations applicable to credit institutions, issued by the National Banking and Securities Commission, the minimum subscribed and paid in capital applicable to the full service banking institutions will be established in function of the operations they engage in. Their minimum capital will be the equivalent in Mexican currency to the value of 36, 54 or 90 million investment units (180, 270 or 450 million pesos, respectively), in function of the operations included in their corporate purpose.

In addition, the full service banking institutions must evaluate, at least once a year, whether the capital they have would be sufficient to cover possible losses derived from the risks such institutions could incur in different scenarios, including those in which adverse economic conditions prevail.

18 How are the capital adequacy guidelines enforced?

The capital requirements will be determined based on balances on the last day of the month. The institutions will make such calculation once a month and will provide that information to the Bank of Mexico. Notwithstanding the above, the Bank of Mexico will verify the calculation and may resolve that an institution make the calculation in order to determine compliance with the capitalisation requirements at any time when in the judgment of the Banking and Securities Commission it is considered that between the days when the calculation is made, the institution is assuming risks significantly greater than those shown with the figures of the close of the month.

19 What happens in the event that a bank becomes undercapitalised?

If the full service banking institution does not comply with the minimum capitalisation index required, the National Banking and Securities Commission, with approval of its governing board, after hearing from the banking institution affected, as well as the opinion of the Bank of Mexico and of the Institute for the Protection of Bank Savings, may declare the revocation of the authorisation that it has granted to it to incorporate and operate as such.

When the full-service banking institutions do not comply with the capitalisation index or with the basic part of the net capital, the National Banking and Securities Commission must order the application of minimum corrective measures such as:

- inform its board of directors of its classification based on its capitalisation index;
- present to the Commission a capital restoration plan that will result in an increase in its capitalisation index, which must be approved by its board of directors before being presented to the Commission;
- suspend, totally or partially, the payment to its shareholders of dividends;
- suspend, totally or partially, the stock buyback programmes;
- defer or cancel, totally or partially, the payment of interest and, if necessary, the payment of principal or convert into shares the subordinated obligations; and
- suspend the payment of the extraordinary compensation and bonuses additional to the salary of the general director and of the officers of the two levels below that.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The laws regulating the bank bankruptcy processes through the amendment published in the Official Federal Gazette on 10 January 2014 are: the Credit Institutions Law, the Commercial Bankruptcy Law, the Law for Protection of Bank Savings and the Securities Market Law. The process in the case of bank insolvency is governed by the Decree published in the Official Federal Gazette on 10 January 2014 and is the following:

When there is bank insolvency, extinction of its capital or the assets of the banking institutions are not sufficient to cover their debts, the judicial liquidation process will be initiated by the National Banking and Securities Commission or the Institute for the Protection of Bank Savings which will act as liquidator. The purpose of judicial bank liquidation includes the following among its essential elements:

- cause of revocation and initiation of the process: which involves the recognition of creditors and ranking of claims, the sale of assets, priority of payment, challenges without suspension of the process and reserves are established in case of pending lawsuits;
- modifications to the bank resolutions scheme;
- liquidity index and treatment of bank systems with liquidity problems;
- adoption of prudential measures;
- periodic evaluation of the full service banking institutions; and
- imposition of sanctions.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

Recently the rules issued in Basel III were adopted and incorporated into Mexican law, with which minimum capitalisation indexes required for credit institutions were established in order to ensure financial stability and the liquidity of the institutions that make up the Mexican financial system.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The persons who acquire or transfer common stock that represents more than two percent of the capital stock of a full-service banking institution, must give notice to the National Banking and Securities Commission within the three business days following the acquisition or transfer.

Additionally, when it is intended to acquire directly or indirectly more than 5 per cent of the common paid in capital stock, the authorisation of the National Banking and Securities Commission must first be obtained, which authorisation may be granted discretionally, for which purpose it will entertain the opinion of the Bank of Mexico.

In the event that a person or group of persons, whether or not shareholders, intends to acquire 20 per cent or more of the common stock or obtain control of the institutions, it must request in advance the authorisation of the National Banking and Securities Commission, which it may grant discretionally, entertaining the opinion of the Bank of Mexico.

The Credit Institutions Law defines control as:

- the capacity to impose, directly or indirectly, decisions on the general shareholders meetings;
- to maintain title to the rights that permit, directly or indirectly, the exercise of the vote with respect to more than 50 per cent of the capital stock; or
- to direct, directly or indirectly, the administration, the strategy or the principal policies of the institution, whether through the ownership of securities or by virtue of any other legal act.

23 Are there any restrictions on foreign ownership of banks?

Foreign governments may not participate in, directly or indirectly, the capital stock of the full-service banking institutions, unless:

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- they do so as temporary prudential measures such as financial support or rescue;
- the foreign government has control through official entities such as funds, governmental development entities, among others, with the prior discretional authorisation of the National Banking and Securities Commission, with a resolution of its governing board; or
- the participation is indirect and the foreign government does not have control.

24 What are the legal and regulatory implications for entities that control banks?

According to the Law Regulating Financial Groups, a company intended to control a banking institution is created for the acquisition and administration of its stock.

The National Banking and Securities Commission supervises bank holding companies, the predominant entity of which is also supervised by the Commission, according to the applicable legal provisions. They must be fixed capital stock corporations, organised in accordance with the General Business Organisations Law, taking the following into account:

- their purpose will be to provide banking and credit services, in terms of this Law;
- the duration of the company will be indefinite;
- they must have the corresponding capital stock and the minimum capital established in this Law; and
- they must have their corporate domicile in Mexico.

The corporate by-laws, as well as any modification thereof, must be submitted to the approval of the National Banking and Securities Commission. Once the corporate bylaws or its amendments are approved, the public instrument recording them must be registered in the Public Registry of Commerce.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Articles 119 and 120 of the Law Regulating Financial Groups provide that a bank holding company will sign an agreement establishing that it will be secondarily liable without limitation for compliance with the obligations of the financial entity and will also be liable without limitation for the losses of the full-service banking institutions.

The responsibilities of a bank holding company are regulated by the Institute for the Protection of Bank Savings, which must estimate and notify the bank holding company of the preliminary amount of the losses on the business day following their determination.

The bank holding company must create a reserve from its capital for an amount equivalent to the preliminary amount of the losses and it must establish a guarantee, within a term that will not exceed 15 calendar days from the date on which it receives the said notification.

The bank holding company will be subject to a special oversight programme of the Commission which supervises the entity the Ministry determines as predominant. Additionally, the bank holding company will receive inspection visits from the responsible authorities. Another of the restrictions on the bank holding company is that it cannot pay dividends to the shareholders or carry out any mechanism or act that involves a transfer of economic benefits to the shareholders, as of the date on which the governing board of the Institute for the Protection of Bank Savings determines the method of resolution applicable to the full-service banking institution that suffered the losses.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

It is liable secondarily and without limitation for compliance with the obligations and losses of the banking institution, whether acquired prior or subsequent to its state of insolvency. The bank holding company will be obligated to create a reserve and provide a guarantee for the payment of the amount of the losses.

The person or persons who have powers to administer the company must deliver the administration to the liquidator or the representative the latter designates, in terms of article 167 of the Credit Institutions Law. The delivery referred to in this article will include all the assets, books and documents of the insolvent full service banking institution.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The Credit Institutions Law defines control as the capacity to impose, directly or indirectly, decisions on the general shareholders meetings; to maintain title to the rights that permit, directly or indirectly, the exercise of the vote with respect to more than 50 per cent of the capital stock; to direct, directly or indirectly, the administration, the strategy or the principal policies of the institution, whether through the ownership of securities or by virtue of any other legal act.

Persons that acquire or transfer common stock representing more than 2 per cent of the capital stock of a full service banking institution must give notice to the National Banking and Securities Commission, within three business days from the acquisition or transfer.

Additionally, when it is intended to directly or indirectly acquire more than 5 per cent of the common paid in capital stock, the authorisation of the National Banking and Securities Commission must be obtained first, which it may grant discretionally, for which it must entertain the opinion of the Bank of Mexico.

In the event that a person or group of persons, whether or not shareholders, intends to acquire 20 per cent or more of the common stock or to obtain control of the institution, it must request the prior authorisation of the National Banking and Securities Commission, which may grant it discretionally, with the prior opinion of the Bank of Mexico.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The Credit Institutions Law establishes a restriction on foreign government which may not participate, directly or indirectly, in the capital stock of the full-service banking institutions, unless:

- they do so as temporary prudential measures such as financial support or rescue;
- the foreign government has control through official entities such as funds, governmental development entities, among others, with the

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prior discretional authorisation of the National Banking and Securities Commission, with a resolution of its governing board; or
- the participation is indirect and the foreign government does not have control.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

According to Mexican law, the authority will determine if a person or group of persons has control of a credit institution based on the capacity it has to impose, directly or indirectly, decisions on the general shareholders meetings of the institution; to maintain title over the rights that permit it, directly or indirectly, to exercise the vote with respect to more than 50 per cent of the capital stock of the institution; or to direct, directly or indirectly, the administration, strategy or principal policies of the institution, whether through ownership of securities or by virtue of any other legal act.

30 Describe the required filings for an acquisition of control of a bank.

The request presented to the National Banking and Securities Commission to obtain its authorisation must contain:
- the list or information on the person or persons who intend to obtain control of the institution;
- the list of the board members and directors who would be appointed;
- a general operating plan; and
- a strategic programme for the organisation, administration and internal control of the institution.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

By provision of articles 8 and 9 of the Law Regulating Financial Groups, the term for the administrative authorities to hear the opinion of other authorities, and those related to the authorisations regarding the organisation, merger, spin-off and liquidation of the bank holding company will have a maximum term of 180 days for the administrative authorities to issue their ruling.

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Norway

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The banking sector is regulated by the Financial Supervisory Authority of Norway (Finanstilsynet, FSAN), which is Norway's combined prudential and market conduct regulator for the finance sector. Furthermore, the Financial Stability Department (FSD) of the Central Bank of Norway acts as a macro prudential regulator. The banking sector legislation and regulatory framework is within the responsibility of the Norwegian Ministry of Finance.

The FSAN is an independent governmental agency governed by the Financial Supervisory Authority Act of 1956. The main objective of the FSAN is to promote financial stability and well-functioning markets, while its expressed intermediate goals are to stimulate:

- financially sound and liquid financial institutions;
- robust infrastructure ensuring satisfactory payments, trade and settlement;
- investor protection;
- consumer protection through good information and advice; and
- efficient crisis management.

The objective of the FSAN's supervision of the banking sector is to promote solid financial institutions with sound risk awareness, management and control.

The FSD is part of the Central Bank of Norway, which is governed by the Central Bank Act of 1985. The FSD's objective is to promote a robust financial system by:

- monitoring financial stability;
- advising on measures to prevent systemic risk;
- contributing to developing a sound regulatory framework for the financial system;
- acting as the licensing authority for interbank systems and monitoring payment systems; and
- conducting research and analysis to support the department in the performance of its duties.

Norway is not part of the European Union (EU), but is a member state of the European Economic Area (EEA) and hence a part of the Internal Market. The EEA unites the EU member states and the three EFTA states Iceland, Liechtenstein and Norway, through the EEA Agreement.

The FSAN has a permanent observer role to the European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority). Norway also participates as an observer to the European Systemic Risk Board on an ad hoc basis.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary statutes currently governing the banking industry in Norway are:

- the Financial Services Act of 1988;
- the Commercial Bank Act of 1961;
- the Savings Bank Act of 1961; and
- the Financial Contracts Act of 1999.

Other important banking sector statutes are:

- the Financial Supervisory Authority Act of 1956;
- the Anti-Money Laundering and Counter Terrorist Financing Act of 2009;
- the Central Bank Act of 1985;
- the Guarantee Schemes Act of 1996; and
- the Securities Trading Act of 2007.

The above statutes are all complemented by regulations.

An important note is that the Savings Bank Act, Commercial Bank Act, Financial Services Act and Guarantee Schemes Act (plus large parts of the Insurance Services Act) are in the process of being consolidated and substituted by a new Act on Financial Enterprises and Financial Groups (the Financial Enterprises Act). At the time of writing, the new Financial Enterprises Act has just been handed over by the Finance Committee to the Parliament (Stortinget) for passing.

The new Financial Enterprises Act introduces a number of amendments and will consist of over 280 sections (which is a lot by Norwegian legislative standards) and comprehensive secondary law regulations. That said, the Act will not imply larger material changes of the current law.

The substantial changes compared with current law relate to, inter alia, new capital requirements for insurance companies incorporating Basel III/CRD IV, new regulations on cooperation agreements out of group relations, regulations on holding companies as parent companies in financial groups, exchange of customer information between group entities, removal of banks' obligation to have control committees and boards of representatives, abandoning of regulations on securitisation, and changes in banks' cash-handling requirements.

For the avoidance of doubt, our responses to the questions in this chapter are based on the current legislation if not stated otherwise.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The FSAN is the regulatory authority primarily responsible for overseeing banks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

The governmental Norwegian Banks' Guarantee Fund guarantees deposits of up to 2,000,000 krone per depositor per bank, that is, more than twice as much as the €100,000 deposit guarantee applicable in the EU.

Pursuant to the Guarantee Schemes Act of 1996, all banks headquartered in Norway are required to maintain membership in the Banks' Guarantee Fund. Branches of non-Norwegian banks operating in Norway has the right, but is not required, to seek membership. The right to be admitted as a member is conditional and subject to approval by the FSAN. Currently admitted branches of non-Norwegian banks are the Norwegian branches of Danske Bank, Swedbank, Nordnet Bank, Handelsbanken, Skandiabanken, Bluestep Finans and Skandinaviska Enskilda Banken.

Regarding government ownership, the Norwegian state owns 34 per cent of the shares of DNB ASA, which controls DNB Bank ASA – Norway's largest bank. The objective of this ownership is to ensure that DNB stays headquartered in Norway, which is secured by the state's negative control. Hence, the government intends to maintain this interest. The government

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has not expressed any intention to increase its ownership in the banking sector.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Transactions between a bank and its 'affiliates' (ie, transactions between financial enterprises within the same group, a financial institution and a subsidiary or other affiliated enterprise with a capital interest in or shared management with the financial institution, and a financial institution and its parent company or other affiliated enterprise with a capital interest in or shared management with the financial institution) shall be carried out on arms'-length basis. A financial group is obligated to secure that revenues, costs, losses and profits are distributed as accurate as possible between the enterprises of and areas of operations of the group.

Group contributions and dividend combined may not exceed the threshold 'justifiable dividend' based on the operations of the relevant year, unless the Ministry of Finance – to secure the solvency of the group or an enterprise of the group – allows larger distributions. A subsidiary of the group may not provide group contributions to another subsidiary. Furthermore, as a main rule pursuant to the Financial Services Act, a group enterprise may not provide loans or guarantees for another group enterprise. This does however not apply to receivables and debt incurred as a result of ordinary market terms transactions between the enterprises of the group.

In the new Financial Enterprises Act, the provision regarding intragroup loans and guarantees are specified to only prohibit loans and guarantees which are not justifiable based on the capital and risk exposure of the enterprise providing such loans and guarantees. An enterprise providing loans or guarantees exceeding 5 per cent of that enterprise's liable capital shall be required to notify the FSAN.

6 What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenges facing the banking industry in Norway are the same as in the EU (ie more stringent, complex and frequent regulations owing to the EU's ambitions on establishing an internal market with common regulations and harmonised supervision). Norwegian authorities, in this context being the FSAN, the Ministry of Finance and the Central Bank, also worry about a potential housing bubble in Norway and keep suggesting counter cyclical measures for local banks.

7 Are banks subject to consumer protection rules?

Banks are subject to consumer protection rules. The Financial Contracts Act, which inter alia implements EU Directive 2008/48/EC on credit agreements for consumers, is invariable in consumer relations and contains a number of mandatory consumer protection provisions applicable to financial contracts between banks and consumers. These provisions concern, inter alia, the banks' disclosure duties and other obligations in relation to agreements on deposits and payment services, credit, guarantees and security. The Financial Services Act also contains consumer protection rules, inter alia regulating loan agreements with consumers.

The FSAN is responsible for maintaining the consumer protection rules through inspections and supervision. Furthermore, the FSAN regularly publishes circular letters and guidelines regarding consumer protection, including guidelines provided by the European Banking Authority.

As allowed for in the Financial Contracts Act, an extrajudicial complaints committee for consumers is established for the purposes of resolution of disputes relating to financial contracts. Most Norwegian banks are affiliated members of the complaints committee through interest groups. Interest groups of consumers, insurance companies and securities funds are also represented. The complaints committee regularly handles disputes regarding financial contracts brought to them by consumers. The committee's decisions are precatory, but most banks (and other non-consumer parties) choose to comply with its decisions.

Disputes regarding financial contracts may of course also be brought before the court. In recent years, particularly cases relating to leveraged investments (often in complex structured financial products) marketed and arranged by banks for consumers, have received a great deal of attention.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The Norwegian regulatory policy is to a very large extent harmonised with that of the EU. The direct consequences for Norway of EU's ambitions will be the continuous need for evaluation and harmonisation of relevant EU regulations in Norway through the EEA Agreement, which probably will require larger and more dominant regulatory bodies, even more coordinated with the equivalent EU bodies.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are supervised by the FSAN by way of:
- on-site inspections (based on international supervisory standards) involving the banks' management team and board of directors;
- off-site supervision on the basis of reporting to the FSAN (ie, regular reporting regulated by law and ad-hoc reporting pursuant to the FSAN's instructions);
- risk-based supervision (cf. Pillar II of the Capital Requirements Directive);
- ICAAP – all banks are required to conduct the annual Internal Capital Adequacy Assessment Process to determine their actual need for capital; and
- supervisory collaboration – Norway has signed the EU's Memorandum of Understanding (MoU) on Cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union on cross-border financial stability, and a similar MoU between the Nordic and Baltic countries.

The supervision of banks is already comprehensive and coordinated with EU supervision, but as indicated under question 8, the strengthening of the cooperation between the supervisory bodies of the EU/EEA will presumably cause more frequent and coordinated supervision.

Pursuant to the FSAN's public register, there are 19 commercial banks, 105 savings banks and 40 Norwegian branches of foreign credit institutions operating as licensed banks in Norway. Banks of all these categories are regularly subject to on-site inspections. As also noted under question 12, the FSAN prioritised on-site inspections of Norway's largest banks for supervisory review of capital and risk assessments after the 2007–2010 financial crisis, as a preventive measure. In general, supervision with focus on capital adequacy and (systemic) risk prevention has increased significantly in response to the financial crisis. The FSAN also carries out on-site inspections based on specific suspicion. Such inspections may be limited to a certain area of the bank's operations or cover larger parts of the bank's business. The FSAN also initiates inspections with the purposes of controlling the banks' compliance with new legislation or regulations.

10 How do the regulatory authorities enforce banking laws and regulations?

The FSAN has all regulatory powers to enforce banking laws and, including issuing injunctions and orders (including orders to cease operations) and fining.

Representatives of banks wilfully or negligently violating the Financial Supervisory Authority Act or an order issued by the FSAN may be subject to fines or prison of up to three years.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The FSAN rarely issues fines against banks operating in Norway. The most common misconduct issues involving Norwegian banks relate to misleading investment advice and (mis-)selling of unsuitable complex financial products to consumers, management and control failures in relation to anti-money laundering procedures and bank system deficiencies.

12 How has bank supervision changed in response to the 2008 financial crisis?

In its strategy document for 2010–2014, the FSAN stated the following:

> *The years ahead will bear the imprint of the severest financial crisis the world has seen since the 1930s. Rules and supervision need much*

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improvement in many countries. New international obligations will make demands on Finanstilsynet in terms of regulatory development, reporting, operational supervision and cooperation with other countries' supervisory bodies. In addition to complying with its new obligations, Finanstilsynet will need to assure the necessary risk monitoring and risk prevention in markets and individual institutions.

Following the financial crisis, the FSAN prioritised on-site inspection of Norway's largest banks for supervisory review of capital and risk assessments. In general, supervision with focus on capital adequacy and (systemic) risk prevention has increased significantly in quality and diligence in response to the financial crisis. More frequent and comprehensive regulations, more stringent reporting requirements, more focus on risk monitoring and prevention, as well as a more harmonised and coordinated supervision in the EU and EEA, are all changes in response to the financial crisis. The FSAN has also stated that its experiences from the 2007–2010 financial crisis have shown that focusing on macroeconomic stability versus a narrow focus on one-one supervision and inspections is vital for the prevention of new financial crises.

We note that no Norwegian banks were in immediate danger of becoming insolvent during the 2007–2010 crisis, but relatively extreme measures were implemented by the regulatory authorities to prevent capital inadequacy. The Norwegian government established a finance fund in 2009 which offered (emergency) capital to banks from May 2009 to November 2009. The objective was to stimulate the banks to maintain their lending activity, and a total of 28 Norwegian banks received funding.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Pursuant to the Guarantee Schemes Act, the following circumstances trigger an obligation for the FSAN to inform the Central Bank and the Bank Guarantee Fund about a capital inadequacy incidence:

- a bank is unable to meet its liabilities as they fall due;
- a bank is unable to meet the existing capital adequacy requirements in accordance with a directive from the FSAN; or
- a bank's assets and incomes combined are not sufficient to meet the bank's liabilities in full.

An assessment on whether the bank may be secured a sufficient financial basis for continued satisfactory operations will then be made. If the FSAN concludes that such sufficient financial basis may not be secured, the Ministry of Finance will be notified. The notification shall include the FSAN's assessment on whether the bank should be subject to public administration.

Public administration orders are, however, extremely rare. A public administration order towards a Norwegian bank has only happened once, against Norion Bank in 1989. During the financial crisis in Norway in 1991/92, the Norwegian state however became the owner of 100 per cent of the shares in three of the largest Norwegian commercial banks (Kredittkassen, Fokus Bank and DNB), through forced write-offs of the said banks' share capital as a requirement from the state to re-fund the banks. No Norwegian banks were subject to public administration during the financial crisis in 2007–2010, but an administration order was passed in relation to Kaupthing Bank Hf's branch in Norway in 2008. Two other fallen Icelandic banks, Glitnir and Landsbanki, were administered without the involvement from the Norwegian government.

Once a public administration order has been made against a bank, the following effects, among others, come into play:

- the bank's former governing bodies become inoperative. The appointed administration board assumes the authority vested in these bodies. The last serving board of directors shall nonetheless decide matters which cannot be deferred until the administration board has taken up its duties;
- the members of the board, the control committee and the auditor shall provide the administration board with full information on the bank's status and activities;
- the bank may not receive deposits, assume new financial obligations or expand previous financial obligations without the FSAN's approval;
- payments to depositors and other creditors may not take place without the FSAN's approval; and
- creditors holding claims established prior to the public administration order may not distrain on, or by other means secure payment by recourse to, assets belonging to the bank.

The administration board shall as soon as possible determine whether the bank may be able to continue its operations, should be subject to merger or takeover, or should be subject to wind-up. The position of shareholders and employees will hence vary accordingly.

The new Financial Enterprises Act proposes no material changes to public administration regulations.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

As noted under question 13 above – the bank's former governing bodies become inoperative once the public administration order is effective. The last serving board of directors shall nonetheless decide matters which cannot be deferred until the administration board has taken up its duties. The directors, the control committee and the auditor shall provide the administration board with full information on the bank's status and activities.

Norwegian banks are for the time being not required by law to have resolution plans or recovery plans, but the EU's Bank Recovery and Resolution Directive (BRRD) – which requires recovery plans for banks – is considered as EEA relevant and will hence be implemented in Norwegian law.

15 Are managers or directors personally liable in the case of a bank failure?

The CEO and the directors may be held personally liable in the case of a bank failure if such failure has been caused by their negligence or wilful misconduct.

16 How has bank resolution changed in response to the recent crisis?

Important changes to bank resolution were made during the 2007–2010 crisis as a response to the specific challenges which then arose. Among other changes, certain 'emergency' regulations were passed in 2008 to handle the Kaupthing situation (see question 13) in Norway – namely, where Kaupthing ceased its operations in Norway but continued its operations in Iceland. Regulations were then passed to enable public administration of branches of foreign banks in Norway even though the foreign bank continues to operate.

No new regulations on resolution have been passed since then. We do, however, note that the EU's BRRD is considered as EEA relevant and will be implemented in Norwegian law, see our response to question 14.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The Norwegian capital adequacy requirements for banks are established in accordance with the EU Capital Requirements Directive (2013/36 (CRD IV)) and the Capital Requirements Regulation (575/2013 (CRR)). Neither of CRD IV or the CRR has been implemented in the EEA agreement yet, but Norwegian legislation has been adapted to comply with these requirements.

CRD IV is the legal framework for the supervision of credit institutions, investment firms and their parent companies in all member states of the European Union and the EEA, and will be the basis of the single supervisory framework throughout the EU and the EEA when that will be formally introduced.

CRD IV partly builds on several standards issued by the Basel Committee on Banking Supervision, most notably Basel III regarding capital buffer and its buffer components, which include the capital conservation buffer, the countercyclical buffer, the global systemically important institutions buffer, the other systemically important institutions buffer, and the systemic risk buffer components. CRD IV also includes several more general provisions, concerning competence of the regulatory authorities, market entry, sanctions in case of breach of the CRD/CRR, governance and remuneration, among others.

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18 How are the capital adequacy guidelines enforced?

The capital adequacy guidelines are enforced through period reporting from the banks and a combination of theme-based inspections and on-site inspections from the FSAN.

19 What happens in the event that a bank becomes undercapitalised?

If a bank becomes undercapitalised, the CEO and the board of directors of the bank are, independently of each other, required to notify the FSAN. Together with the bank itself, the FSAN will consider what measures are required. The FSAN has wide powers to ensure that appropriate measures are taken, for example, to call for a general meeting or to replace the board of directors.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

If a bank becomes insolvent, the FSAN shall notify the Central Bank and the Banks' Guarantee Fund. If it must be assumed that the bank cannot pay its dues on time, and that further funding of the ongoing operations are not available, the Ministry of Finance can decide to put the bank under public administration. Rather than taking a bank under public administration, Norwegian authorities will probably repeat the way they handled the financial crisis in 1991/92, which is considered as highly successful. See question 13.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

See question 17 above.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

There are no express legal or regulatory limitations regarding types of entities and individuals who may own a controlling interest in a Norwegian bank. A 'controlling' interest for the purposes of the ownership regulations constitutes more than 10 per cent of the capital or voting rights, or other interest which provides material influence, in the bank. Such interest is referred to as a 'qualified interest'.

Any entity or individual who acquires such controlling interest will however be subject to approval by the Ministry of Finance, or the FSAN in cases which are not considered important. The applicable entity will, based on the acquirer's mandatory notification, consider the acquirer's qualification as owner and whether the acquisition is fit and proper as owner in relation to the bank's activities. The factors considered by the Ministry of Finance or the FSAN in such approval are explained under question 27.

23 Are there any restrictions on foreign ownership of banks?

There are no regulatory restrictions on foreign ownership of banks in Norway, apart from the general rules outlined in this section.

24 What are the legal and regulatory implications for entities that control banks?

An entity that owns a 'qualified interest' in a bank, see question 22, is responsible for complying with the terms of the authorisation issued by the Ministry of Finance for such ownership. The Ministry of Finance may revoke such authorisation at any time if the terms of the authorisation are no longer met. Special regulatory requirements relevant for the shareholders apply upon the occurrence of insolvency or capital inadequacy of the bank, see question 26.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

In addition to being responsible for complying with the terms of the ownership authorisation issued by the Ministry of Finance or the FSAN, an entity with a qualified interest in a bank is required to notify the FSAN of changes to the entity's board of directors, management and shareholders. The FSAN may require additional information if it considers it necessary for their ownership control.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Upon the occurrence of insolvency or capital inadequacy, the board of directors and the managing director of the bank are required to notify the FSAN. The FSAN will subsequently consider alternative measures together with the bank, and the Central Bank of Norway will be notified. The FSAN will also be authorised to call for a general meeting to be held, involving all shareholders of the bank. If the assessment of the bank's solidity implies that a significant share of the bank's equity capital is lost, the board is required to call for a general meeting immediately. This requirement also applies if 25 per cent of the bank's share capital, or 25 per cent of the bank's primary capital and basic capital combined if the bank is not organised as a private or public limited company, is lost. In these events, the general meeting must resolve, inter alia, whether the bank has sufficient capital to adequately continue its operations. The general meeting's resolution is subject to approval by the FSAN. The general meeting may also resolve to transfer the bank's operations to other financial institutions or resolve winding-up.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Any entity or individual who acquires a 'qualified interest' in a bank (ie, controlling more than 10 per cent of the capital or voting rights of the bank), or other interest which provides material influence, is required to notify the FSAN of such acquisition. Such notification is subject to a number of information requirements laid down in the Financial Services Act and appurtenant regulations.

The acquisition is then subject to regulatory approval by the Ministry of Finance/the FSAN, which will consider the acquirer's qualification as owner, and if the acquisition is financially adequate in relation to the bank's activities. Pursuant to the Financial Services Act, the Ministry of Finance or the FSAN shall consider, inter alia:

- the acquirer's general reputation, professional competence, experience and previous conduct in business relationships;
- the general reputation, professional competence, experience and previous conduct in business relationships of persons who will form part of the board of directors or management of the bank's activities;
- whether the acquirer will be able to use the influence conferred by the acquisition to obtain advantages for its own or associated activities, or indirectly exert influence on other business activity, and to whether the acquisition could result in impairment of the bank's independence in relation to other business interests;
- whether the acquirer's financial situation and available financial resources are adequate, especially in relation to the types of activities in which the institution are or will be engaged, and whether the acquirer and its activities are subject to financial supervision;
- whether the bank is and will continue to be in a position to meet the solvency and prudential requirements and other supervisory requirements that follow from the financial legislation;
- whether the ownership structure of the bank after the acquisition or particular ties between the acquirer and a third party will impede effective supervision of the bank, in particular whether the group of which the bank will form part after the acquisition is organised in a manner that does not impede effective supervision; and
- whether there are grounds for assuming that money laundering or financing of terrorism, or any attempt to commit such act, is taking place in connection with the acquisition, or that the acquisition will increase the risk of such act.

Increases in ownership reaching 20 per cent, 30 per cent or 50 per cent of the capital or voting rights in the bank, or any ownership share providing dominant influence pursuant to the provisions of the Public and Private Companies Acts, also require notification and approval by the regulatory authorities.

As a main rule, the decision to authorise the acquirer or not shall be made within 60 business days from the time the FSAN received the acquirer's notification.

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28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

As noted under question 23, there are no regulatory restrictions on foreign ownership of banks in Norway. The authorisation process is not different for a foreign acquirer, but it may be more challenging, especially if the acquirer is incorporated in a country outside the EU or EEA.

If the acquirer is a credit institution, insurance company, investment firm or holding company for a securities fund authorised to operate in another EEA member state, the FSAN shall consult the regulatory authorities of that member state before making a decision.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The factors considered by the Ministry of Finance or FSAN in an acquisition of control of a bank are listed under question 27.

30 Describe the required filings for an acquisition of control of a bank.

The required filing for an acquisition of control of a bank is limited to the notification described under question 27. Pursuant to current law, the notification shall as a minimum include information regarding:
- the size of the acquired holding;
- the size of the overall holding in the bank after the acquisition;
- complete information about the acquirer (if the acquirer is an entity; information about the entity's board of directors, management, owners and beneficial or ultimate owners);
- information about the target bank;
- the acquirer's evaluation of the bank's financial position and activities;
- the acquirer's business operations and available financial resources;
- the acquirer's ownership interests in other financial institutions;
- other owners with which the acquirer shall be consolidated; and
- the purpose of the acquisition.

Furthermore, the notification shall include responses to, inter alia:
- whether the acquirer has been filed for bankruptcy in Norway or abroad during the past 10 years;
- whether the acquirer during the past 10 years has been convicted for a criminal offence in Norway or abroad;
- whether the acquirer is indicted or charged for a criminal offence in Norway or abroad;
- whether the acquirer during the past 10 years has been subject to tax estimation or surtax or equivalent in Norway or abroad;
- whether the acquirer during the past 10 years has been subject to fines or penalties pursuant to the Norwegian Financial Supervisory Authority Act, the Securities Trading Act, the Accounting Act or securities legislation, or equivalent statutes abroad;
- whether the acquirer during the past 10 years has had board positions, management positions or qualified ownership interest in entities involved in the above; and
- whether the acquirer previously has been assessed for authorisation as acquirer of a qualified ownership interest in a financial institution in Norway or abroad.

The FSAN may also require additional information.

It is not expected that the above requirements will change materially under the regulations to the new Financial Enterprises Act.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Irrespective of the acquirer being domestic or foreign, the regulatory authorities in Norway are bound by the Financial Services Act to make a decision regarding the authorisation, as a main rule, within 60 business days from the time the FSAN received the acquirer's notification about the acquisition.

If, however, the Ministry of Finance or the FSAN – before 50 business days have lapsed since the notification – requires additional information in writing, the time limit will be extended. Pursuant to current law, the maximum extension is 20 business days in cases where the acquirer is subject to supervision or resident in the EEA, 30 business days if not. In the new Financial Enterprises Act, the latter time limit does not apply.

The typical time frame for regulatory approval is hence notification +60 (+20) business days for EEA acquirers, and notification +60 (+30 or more) business days for non-EEA acquirers.

Update and trends

The need for new and consolidated Financial Enterprises Act has been highlighted and discussed in Norway for over 20 years, as many of the statutes forming the Norwegian finance legislation have been in force for over 50 years.

A new Financial Enterprises Act, consolidating and replacing the Savings Bank Act, the Commercial Bank Act, the Financial Services Act, the Guarantee Schemes Act, and large parts of the Insurance Services Act, is now finally in place and will be adopted very soon, but certain interest groups are not fully satisfied with it. The new Act is very comprehensive (by Norwegian standards), and many have claimed that it is not particularly user friendly.

The material amendments compared with current law relate to, inter alia, new regulations on cooperation agreements out of group relations, regulations on holding companies as parent companies in financial groups, exchange of customer information between group enterprises, removal of banks' obligation to have control committees and boards of representatives, abandoning of regulations on securitisation and changes in banks' cash-handling requirements.

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Peru

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The current Peruvian banking legal framework is in compliance with the Basel Core Principles for Effective Banking Supervision published by the Basel Committee on Banking Supervision in 1988. It has also been in compliance with the standards set by Basel II since 2009.

The Superintendency of Banks, Insurance Companies and Private Pension Fund Managers (SBS) is currently evaluating the impact of the changes proposed in Basel III and its implementation into the Peruvian financial system.

The Peruvian financial system operates under the following general principles.

Equal treatment for foreign investments

Foreign investors in Peruvian financial companies will have the same treatment as that afforded to local investors.

Prohibition of discriminatory treatment

The general provisions issued by the Peruvian Central Bank (the Central Bank) or SBS in the exercise of its powers may not include special treatment that will discriminate between:

- companies of similar nature;
- companies of a different nature, concerning the same type of transaction;
- companies established in Peru against similar foreign companies; and
- foreign individuals and companies domiciled in Peru against Peruvian individuals and companies, with respect to the granting of loans.

Non-participation of the state in the financial system

The Peruvian state may not participate (compete) in the financial system, except for its full equity holdings in Banco de la Nación (the bank in charge of administering the sub-accounts of the National Treasury and providing the government with the financial services it requires to manage public funds, and which generally operates in marginal territories where there are no private banks); Banco Agropecuario (a bank created for granting credits to small and medium-sized agricultural producers); Corporación Financiera de Desarrollo and Fondo MiVivienda (institutions that serve as channels for governmental promotional credits). In addition, the Central Bank performs the traditional tasks of a central bank, including the issuance of banknotes, implementation of the government's monetary policies, regulation of money supply, management of official gold and foreign exchange reserves and running the interbank clearance system.

Authorisation for financial intermediation

Only entities that are licensed by the SBS may enter into the banking business in Peru. More specifically, only licensed entities can receive deposits from the public for purposes of granting loans. Illegal banking is deemed a criminal offence.

Free-market interest rates, fees and charges

Companies in the financial system may freely set interest rates, fees and charges that they charge or pay their clients.

Freedom to hold and dispose of foreign currency

Individuals and companies may execute transactions in foreign currencies and may even agree for mandatory payments in any foreign currency. US dollars are still widely used in Peru, although the current tendency is to transact in nuevos soles, the Peruvian currency, because of the current appreciation. Euros are also used in some local transactions. Inbound and outbound wire transfers into and out of Peruvian territory occur directly from and into bank accounts without participation of the Central Bank or any foreign currency control whatsoever. Money-laundering regulations are applicable, however.

It should be noted that the Peruvian Congress has enacted a Banking Services Consumer Protection Act, through which certain protections have been stressed in favour of bank customers, from the perspective of consumer protection.

2 Summarise the primary statutes and regulations that govern the banking industry.

Constitutional economic framework

From an economic perspective, the Peruvian Constitution enacted in 1993 has established a favourable legal framework for the purposes of attracting national and foreign investments into the country in order to boost necessary development.

Accordingly, the Peruvian Constitution recognises the following guarantees:

- prohibition of discriminatory treatment against foreign investors;
- free and open market orientation;
- private property rights protection;
- freedom to hold and dispose of foreign currency;
- consumer protection; and
- safety and soundness of banking system as effective means for protecting depositors.

Foreign investors, and the local target companies in which they invest 'new money', may execute legal stability agreements with the government (through the Peruvian Investment Promotion Agency (ProInversión)) for a 10-year period. Stability agreements are only available when foreign investment exceeds US$10 million.

The following guarantees are granted by the state through a stability agreement:

- to the foreign investors, legal stability regarding:
  - the income tax system;
  - the free availability of foreign currency;
  - the right to remit profits or dividends out of the country;
  - the right to use the most favourable exchange rate existing in the market for any currency exchange operation; and
  - the right to receive non-discriminatory treatment in relation to national investors; and
- to the company receiving the investment, legal stability regarding:
  - the income tax regime; and
  - the hiring of workers under special employment contracts.

Legal framework of the Peruvian financial system

The regulatory banking legal framework in Peru is set out in Law No. 26,702 (the Banking Law), as amended, which contains the main guidelines for banking regulation in Peru. Also, both the SBS and Central Bank regularly issue regulations governing banking activity.

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3 Which regulatory authorities are primarily responsible for overseeing banks?

Peruvian banking and financial institutions are primarily overseen by the SBS, which is constitutionally charged with protecting depositors. Banks are also overseen by the Central Bank, mainly for monetary policies and more specifically for regulating the level of mandatory reserve requirements.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Bank deposits are protected by the Deposit Insurance Fund (the FSD) against bank failure. Specifically, savings deposit accounts maintained by individuals, savings deposit accounts maintained by non-profit entities and current accounts in general are covered in full up to the equivalent, at the current level of coverage and exchange rate, of around US$35,000 per person per bank.

The financial resources available to the FSD pursuant to the Banking Law include the original contribution from the Central Bank, insurance premiums paid by banks, unclaimed bank deposits (10 years), fines imposed by the SBS for non-compliance with the Banking Law and extraordinary contributions from the treasury.

As Peru was not severely affected by the financial crisis, the Peruvian government generally remained on the sidelines and, therefore, did not take any ownership interest in the banking sector.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Notwithstanding other applicable legal lending limits established in the Banking Law, the total amount of credits (whether direct or contingent), financial leases and investments that a Peruvian bank may enter into with related parties may not be higher than 30 per cent of its regulatory capital. All transactions with related parties must be on an arm's-length basis.

As for the effects of the aforementioned limitation, 'related party' means any person or company holding, whether directly or indirectly, more than 4 per cent of the ownership of a bank, or that may have a 'significant influence' in a bank's management. The following persons will be deemed to have significant influence in a bank's management:

- persons belonging to the same economic group; and
- unless the contrary has been duly demonstrated, a person or company that maintains management relations with the bank, arising from any of the following situations:
- when a person or company is the final borrower of a credit granted to the other person or company;
- when a person or company is represented by the other person or company;
- between companies that have the same directors, managers, counsels or principal officers;
- when the resources for the activities of a company come, directly or indirectly, from another company;
- between companies with the same shareholders that have the ability to designate or remove at least one member of the board of directors (or equivalent board) of such companies;
- between a person and a company when such person is a director, manager, counsel or principal officer of said company, or has been one of them at any time during the past 12 months; or
- between a person and an economic group when such person is director or manager of a company belonging to such economic group, or has been one of them at any time during the past 12 months.

A bank may not grant to, or to the account of, a person or company (which includes all of its affiliates), whether directly or indirectly, credits, investments or contingent funds in excess of 10 per cent of its regulatory capital. This limit may be raised to 15, 20 or 30 per cent, depending on the type of collateral securing the excess over such limit, as established in articles 207, 208 or 209 of the Banking Law.

Permissible and prohibited activities

Under article 221 of the Banking Law, banks and financial institutions may carry out the following operations and services:

- receive both demand and time deposits;
- grant advances or overdrafts on current accounts and give secured or unsecured direct loans;
- discount and grant advances on bills of exchange, promissory notes and other documentary evidence of debt;
- grant mortgage and security loans and, in connection therewith, issue negotiable instruments, mortgage and pledge instruments, both in domestic and foreign currency;
- grant guarantees, bonds and other guarantees in favour of other financial institutions;
- issue, confirm and negotiate letters of credit, in line with international practice;
- grant syndicated loans;
- acquire and negotiate certificates of deposit issued by a company, mortgage instruments, warrants and bills of exchange from trading;
- carry out factoring transactions;
- conduct credit operations with companies in the country and place deposits with them;
- conduct credit operations with banks and foreign financial institutions, as well as placing deposits with each other;
- buy, hold and sell shares of banks or foreign institutions operating in financial intermediation or in the stock market, or ancillary to one or the other, in order to give international scope to their activities;
- issue and place bonds, domestic or foreign, including regular, convertible, leasing and subordinated bonds of various types and in various currencies, as well as promissory notes, negotiable or non-negotiable certificates of deposit and other instruments representing obligations, provided they are of its own issuance;
- accept bills of exchange term, originating in business transactions;
- carry out transactions in commodities and financial derivatives such as forwards, futures, swaps, options, credit derivatives or other derivative instruments or contracts, according to the standards issued by the SBS;
- acquire, hold and sell equity securities that are traded in a centralised mechanism for negotiation and private debt instruments, according to the rules issued by the SBS;
- acquire, hold and sell shares of companies providing complementary or auxiliary services to the bank or its subsidiaries;
- acquire, hold and sell, as investors, quotas in mutual funds and investment funds;
- buy, hold and sell securities in public debt, internal and external, as well as obligations of the Central Bank;
- buy, hold and sell bonds and other securities issued by multilateral lending agencies of which Peru is a member;
- serve as agent for the placement and investment in the country of external resources;
- buy, hold and sell securities for government debt, according to the standards issued by the SBS;
- trade in foreign currency;
- issue foreign currency bank certificates;
- purchase or sell portfolios;
- perform structured finance operations and participate in securitisation transactions, subject to the provisions of the Securities Market Law;
- acquire property, plans and equipment;
- make payments, receipts and transference of funds and issue drafts against their own offices or correspondent banks;
- issue cashier's cheques, travellers' cheques and issue payment orders;
- carry out agency and trust services;
- receive securities, documents and objects in custody as well as renting out safe deposit boxes;
- issue and manage credit cards and debit cards;
- carry out leasing operations;
- promote foreign trade operations and provide comprehensive advice in this area;
- carry out securities underwriting activities;
- provide financial advisory services without handling clients' money or investment portfolios on their behalf;
- act as trustees;
- buy, hold and sell gold;
- provide pawn loans;

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- act as originators in securitisation processes through the transfer of property, real estate, credit or money, being empowered to establish special purpose companies; and
- all other operations and services, provided they meet the requirements established by the SBS, with prior opinion of the Central Bank.

Notwithstanding other prohibitions contained in the Banking Law and its implementing regulations, banks and financial institutions may not:
- give credit to guarantee their own shares;
- grant credits with the purpose, directly or indirectly, of acquiring shares of the company;
- give credit to finance political activities;
- give guarantees, or otherwise support obligations of third parties, for an undetermined amount or term;
- guarantee mutual money operations to be concluded between third parties, unless one of them is another company in the financial system, or a bank or foreign financial entity;
- guarantee the assets of their fixed assets, excluding those that are affected in support of leasing, and mortgage companies to issue property capitalisation;
- accept endorsements, guarantees or warranties issued by their directors and employees in support of operations of credit to related persons;
- acquire shares in companies outside the financial system, which, directly or indirectly, are shareholders of the company, unless they are traded in the stock market;
- negotiate certificates of deposit with their subsidiaries and commitments that give rise to the obligation to repurchase such certificates;
- accept deposits on behalf of financial institutions authorised to operate in the country; or
- use information not disclosed to the market, natural or juridical persons, whether or not customers, in order to foster self-dealing or third parties to apply the provisions of the Securities Exchange Act.

6 What are the principal regulatory challenges facing the banking industry?

Peru still has very low penetration of banking services set against a consistently rising GDP, so Peru's banking industry stands to grow strongly in the next few years. In order to maintain healthy capital ratios, Peruvian banks will need to continue increasing their capital base through profit capitalisation and through innovative hybrid subordinated instruments.

Since 2009, when the Peruvian regulatory framework adapted to Basel II standards, Peruvian banks are now subject to greater capital requirements. Moreover, if Basel III standards are implemented in Peru, Peruvian banks will be subject to greater liquidity coverage requirements.

Finally, Peruvian banks will have to be prepared to expand internationally – not necessarily opening foreign offices but doing cross-border lending (especially to go along increasingly expanding ventures of Peruvian companies) and raising capital or issuing debt on the international securities markets. This would probably require a thorough revision of the applicable legal tax framework.

7 Are banks subject to consumer protection rules?

Peruvian consumer protection laws are applicable to: consumer relationships concluded in Peruvian territory; or, consumer relationships with effects in Peruvian territory.

The place of celebration of the consumer contract (which originates the consumer relationship) shall be determined according to the law applicable to the contract chosen by the parties. According to the Peruvian Civil Code (the Civil Code), a contract is concluded, in the place and moment, where and when the acceptance is known by the party who made the offer to conclude such contract. In consequence, if the contract was concluded through remote means out of Switzerland and the acceptance was received in Peru, such contract, according to the Peruvian legal framework, would be concluded in Peru. It must be also noted that, in Peru, there are no clear guidelines or judicial precedents that would conclusively assert in what circumstances an acceptance made by electronic means would be considered as being received in Peru.

Although the consumer relationship is not concluded in Peru, Peruvian consumer protection laws will be applicable if such relationship has effects on Peruvian territory. In consequence, for example, if the consumer contract (which originates the consumer relationship) was concluded on Swiss territory, but some services are rendered on Peruvian territory, the Peruvian consumer protection laws would apply. With regard to this, it must be noted that the Consumer Code does not indicate whether it will only apply if the consumer relationship 'main effects' reach Peruvian territory. In consequence, if the consumer relationship has any effect on Peruvian soil, Peruvian consumer protection laws will apply.

Formerly, in Peru, the definition of 'consumer' was only applicable to individuals and micro-enterprises. Upon the issuance of the Consumer Protection and Defense Code, by means of Law No. 29571 (the Consumer Code), the definition of 'consumer' applies to natural or legal persons acting in an area out of a business or professional activity and micro-enterprises entering into transactions out of the scope of their ordinary business activities. Pursuant to the Consumer Code, a 'consumer relationship' is considered a relationship by means of which a consumer acquires a product or service from a provider in exchange for an economic benefit.

According to this, the consumer protection laws will not apply to a natural or legal person that does not qualify as a consumer when the consumer relationship is not concluded on Peruvian territory; or, when the consumer relationship has no effects on Peruvian territory.

It must be noted that there are special provisions applicable to the financial services provided by entities under the supervision of the SBS. Said specific legal framework is basically composed of: special provisions in the Consumer Code; Law No. 28587, Complementary Law to the Consumer Code in financial services matters (the Complementary Law); and SBS Regulation No. 8181-2012, Transparency Regulation and provisions for contracting with users of the financial system.

It must be also noted that the Consumer Code establishes special provisions applicable to the credit services provided, under any modality, by entities that are not under the supervision of the SBS, considering that some provisions of the Complementary Law are also applicable. (These provisions related to the modification of contracts, interests, commissions and expenses.)

With respect to the regulation of commercial publicity of products and services, the applicable legal framework basically compises: the Consumer Code; and Legislative Decree No. 1044, the Unfair Competition Law, which is applicable to acts with real or potential effects on Peruvian territory.

The Consumer Code approves a wide range of rules intended to protect consumers in all the sectors of the economy. In that sense, it has established different dispositions to reduce the situation of asymmetric information between the consumers and the providers of products and services. For that purpose, the dispositions in the Consumer Code aim to assure that the consumers can take informed decisions about the services and products that are offered to them. In that vein, the Consumer Code has established, among others, the following rights in favour of the consumers: the right to access to adequate, truthful and complete information, the right to not being discriminated, the right to reparation and compensation of damages and the right to associate.

With respect to the financial services provided by entities under the supervision of the SBS, the Consumer Code, the Complementary Law and the Transparency Regulation establish specifics dispositions in order to assure the provision of adequate and precise information to the financial consumers about, among others, interest rates, commissions, expenses and modifications of contracts.

The Banking Law, regulates bank secrecy and states, as a general rule, that the Peruvian Financial System entities may not provide to third parties any information regarding the liability operations without having the client´s express and written authorisation. In addition, Law No. 29733, the Data Protection Law, limits the sharing and transference of 'personal data' ('defined as any individual's information that identifies it or makes it identifiable through means that can be reasonably used) to third parties by considering as mandatory the attainment of the previous, informed, express and unambiguous consent of the owner of such data. It also establishes that, in the case of 'sensitive data' (which includes, among others, personal data related to economic income), such approval shall also be in writing.

Finally, the Unfair Competition Law regulates the legal framework applicable to commercial publicity of products and services in Peru. In that sense, the Unfair Competition Law states that advertising is governed by the principles of authenticity, legality, social adequacy and accuracy.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The introduction of Basel II standards is very recent. Basel III is, however, already being implemented in the local regulation; measures such

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as countercyclical reserves and limits on liquidity risk were implemented during 2013 and it is expected that during 2014 and 2015 the SBS will continue to implement additional Basel III standards.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are required to provide the SBS, on an ongoing basis, with all relevant information that is necessary to allow for off-site evaluation of its financial performance, including annual audited and interim financial statements on a consolidated basis, board of directors' reports, auditor's reports and other reports that reflect the operations of the banks' businesses. Under current practice, such reporting is required on a daily, weekly, monthly, quarterly, semi-annual and annual basis, depending on the nature of the information to be reported.

The SBS is also responsible for conducting on-site examinations of banks once a year. During these inspections, the SBS examines all operations and analyses the relationships between assets, liabilities, net worth, profit and loss accounts and all other factors affecting the banks' financial and capital structure, in order to verify compliance of the bank with Peruvian banking regulations.

10 How do the regulatory authorities enforce banking laws and regulations?

The SBS has the power to impose administrative sanctions on banks and their directors, officers and employees upon infringement of the rules that govern the activities of the Peruvian financial system. Sanctions may vary from monetary fines to licence cancellation, depending on the gravity of the breach.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

There is a good level of communication and close coordination between banks and the SBS. Most issues arise when other government agencies, such as the Consumer Protection Agency (Indecopi) or the National Congress, intend to regulate the banking business. Complaints over high interest rate loans refresh the debate on free market policies. It is also not uncommon to hear voices from Congress complaining about collection methods used by banks against defaulting debtors, especially in the agricultural sector. During the past few years, the SBS has successfully forced banks to be more transparent in publishing the terms and conditions of their products and in drafting standard contracts that contain reasonable protection for consumers.

New players are now entering the banking industry due to good macroeconomic indicators and current credit expansion. These new players will place stress on current credit valuation standards, as their plans involve obtain market share by attracting those who do not use banks from the poorer sectors of the population, and this will also challenge SBS's capacity to oversee a larger banking industry.

12 How has bank supervision changed in response to the 2008 financial crisis?

Banking supervision did not undergo any significant changes in response to the global financial crisis. The SBS was, however, in close contact with all banks, checking that their liquidity ratios were not deteriorating and that credit and market risks were under control. One important regulation that was issued in the context of the international crisis was the one implementing pro-cyclical reserve requirements.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

As it is further explained in question 19, banks in Peru may be subject to an intervention regime by the SBS upon breaching certain regulatory obligations, including failing to meet capital requirements and incurring a certain level of losses. This situation is strictly regulated (see question 19).

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

As explained in questions 19 and 20, if a bank enters into a surveillance regime, a recovery plan must be drafted by the bank and approved by the SBS. Said plan is drafted after the notice of surveillance regime is communicated to the bank, and must contain the measures to be taken by the bank in order to overcome the failure. In addition, a recovery agreement must be made between the bank and the SBS, containing several commitments by the bank including new capital contributions.

If the situation does not improve over the course of the surveillance regime, the SBS will commence an intervention regime after which the bank is dissolved by resolution of the SBS.

If this were to happen, the obligations of the bank undergoing liquidation will be paid in the following order: first, labour obligations; second, obligations originating from financial intermediation such as deposits or other modalities, not covered by deposit insurance (see question 4); third, tax obligations; and fourth, other obligations.

This order is established by the Banking Law and therefore, mandatory. In this context, the bank's management and directors must act according to the instructions of the SBS, following the directives it may dictate during the surveillance regime as well as during the intervention regime, which may include the appointment of a new board of directors, further capital contributions, among others.

15 Are managers or directors personally liable in the case of a bank failure?

Managers and directors of a bank could be subject to administrative, patrimonial and criminal liability, if they approve credit transactions knowing deliberately that such approval is in violation of the applicable legal lending limits. The sanctions are stricter if any such credit transaction is granted in favour of a manager or director of the bank or in favour of an affiliate of the bank, and moreover if as a consequence of approving such transactions the bank enters into a resolution situation.

16 How has bank resolution changed in response to the recent crisis?

The recent financial crisis did not much affect the Peruvian financial system, and bank resolution has not undergone any significant change in response.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Under article 199 of the Banking Law, the regulatory capital of a bank may be no lower than 10 per cent of its total weighted assets, which is equivalent to:

- 10 times the regulatory capital allocated to cover market risks;
- 10 times the regulatory capital allocated to cover operational risks; and
- the total amount of credit risk-weighted assets.

18 How are the capital adequacy guidelines enforced?

Banks are required to prepare and submit to the SBS, on a monthly basis, several reports regarding compliance of capital adequacy regulations.

Furthermore, banks are required to send reports to the SBS regarding consolidated capital adequacy and consolidated regulatory capital on a quarterly and annual basis.

Under current regulations, Peruvian banks are not required to make contingent capital arrangements.

19 What happens in the event that a bank becomes undercapitalised?

Surveillance

When a bank fails to meet the capital requirements established by the SBS, it is subject to a surveillance regime by the SBS. The surveillance regime will last for 45 days and may be extended for an additional 45 days.

During the surveillance regime, the competence and authority of the governing bodies of the bank are maintained without any limitations other than those imposed by the SBS, but a recovery plan or agreement must be

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reached in order to overcome the crisis. Such agreement is notified to the Central Bank, which is kept informed of its implementation.

The effects of a surveillance regime on a bank are the following:
- permanent inspection of the bank by the SBS, as per the powers conferred upon it by the Banking Law;
- prohibition from establishing or accepting trusts;
- suspension of voting rights that would otherwise be exercised in a shareholders' meeting or other meetings of equivalent bodies, with respect to any shareholders who may have acted as directors or managers at the time the bank was submitted to the surveillance regime;
- the SBS must immediately convene a general shareholders' meeting for the implementation of the necessary agreements to overcome the causes of the submission to the surveillance regime and especially for the implementation of the capital contribution that may be required by the SBS to the shareholders of the bank, as established by article 99 of the Banking Law; and
- other measures deemed necessary by the SBS.

Intervention

If, among other reasons, the recovery agreement referred to above or the particular provisions of the SBS are not complied with during the surveillance regime, positions subject to credit risk or market risk represent 25 times more than the total regulatory capital of the bank, or there is a loss or reduction of more than 50 per cent of the regulatory capital of a bank, such bank will be the subject of intervention by the SBS.

The effects of the intervention are the following:
- powers and authority of the shareholders' meeting will be limited exclusively to the issues related to the intervention, as established by law;
- suspension of the bank's business;
- application of the necessary portion of the bank's subordinated debt, if applicable, to absorb losses;
- application of the following prohibitions:
  - (i) initiating any judicial or administrative processes with respect to collections from the bank;
  - (ii) pursuing the execution of any court orders issued against the bank;
  - (iii) granting liens over any of the bank's assets as a guarantee against any existing obligations;
  - (iv) making payments or advances or providing compensation or assuming obligations on the bank's behalf, with any funds or assets it owns and that are in the possession of third parties, except for compensation to be made between companies of the financial and insurance system and compensation of reciprocal obligations arising from repo and derivative transactions executed with local or foreign financial and insurance institutions; and
  - (v) other provisions that the SBS may deem necessary; and
- others that the SBS may deem relevant.

The intervention will last for 45 days, extendable once for an identical period. Once this period has expired, the corresponding resolution will be issued, ordering the dissolution of the company and the commencement of the relevant liquidation process.

The intervention procedure may finish before the end of the aforementioned term, whenever the SBS deems it convenient. The corresponding resolution must be previously notified to the Central Bank.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

In addition to the intervention events referred to in question 19, a moratorium on payment of the obligations of the company may result in intervention by the SBS, with the effects detailed above.

Once the intervention period has expired, the process of dissolution – and liquidation – of the company will begin.

Other causes for liquidation of a bank are the grounds cited in the relevant articles of the Peruvian Corporations Law approved by Law No. 26,887, as applicable.

It must be taken into consideration that the resolution for dissolution does not end the legal existence of the bank, which will remain until the liquidation process is completed and, as a result thereof, the extinction is recorded before the corresponding Public Registry. Notwithstanding the above, upon the publication of the resolution for dissolution, the bank may not be a subject of credit in the Peruvian financial market, will be exempted from any taxes and may not be subject to the obligations prescribed by the Banking Law for active banks. Furthermore, the prohibitions (i) to (v) listed in question 19 will also be applicable as of the date of the publication of the SBS resolution for the dissolution of the bank.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

No. As discussed previously, the Peruvian legal framework was revisited and amended in 2009 in order to conform to Basel II standards. If Basel III standards are adopted in Peru, then Peruvian banks may be required to significantly adjust their regulatory capital requirements in order to arrive at an appropriate level and quality of regulatory capital.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

According to article 50 of the Banking Law:

> *Any individual or legal entity directly or indirectly purchasing stock of a company equivalent to 1 per cent of the capital stock throughout a period of 12 months, or which with the said companies attain a share equal to or greater than 3 per cent, shall be under the obligation of supplying the SBS any information it may request in order to identify their main economic activities and the structure of their assets. This includes revealing the names of shareholders in the case of companies issuing bearer shares.*

Among others, the following persons may not be shareholders of a bank:
- those convicted for illegal drug-trafficking, terrorism, attempting to commit a crime against national security, treason and other crimes;
- those declared bankrupt or those who are currently following an insolvency proceeding;
- those who, as directors or managers of a company, have been found to be administratively responsible for acts deserving sanctions in the previous 10 years;
- those who, in the previous 10 years, were majority shareholders, directors, managers or main executives of companies or private fund managers that were intervened by the SBS; and
- those who, according to the SBS evaluation, do not meet the solvency or moral integrity requirements.

Moreover, according to article 54 of the Banking Law, public officials and employees, as well as their spouses, may not hold shares of a company of the financial system in excess of 5 per cent of the company's capital stock.

Likewise, the chairman of the Securities Market Superintendency (the securities market regulator or SMV), the superintendent of the SBS, employees of any of those institutions, as well as their spouses, may not hold shares of a company of the financial system at all. Such limitation shall not apply in the case of shares acquired prior to their assuming the position or function, provided this is included in the corresponding sworn declaration of assets and income. Also exempted are shares that, without altering the pre-existing percentage, may be subscribed in the cases of capital increases.

Finally, according to article 55 of the Banking Law, any person who is, directly or indirectly, a majority shareholder of a bank or of the insurance system may not, directly or indirectly, be a holder of more than 5 per cent of the stock of another company of the same nature.

Regarding the definition of 'control', article 9 of SBS Resolution No. 445-2000 establishes that control is the preponderant and continuous influence in the decision-making process of a company. Control may be direct or indirect. A person is deemed to have direct control on a bank if such person exercises more than half of the voting rights of the general shareholders' meeting, through direct or indirect property, liens, trust, syndication or any other means. On the other hand, a person is deemed to have indirect control on a bank if such person has the ability to designate or remove most of the members of the board of directors (or equivalent corporate body), in order to exercise the majority of the voting rights on a board of directors' meeting (or equivalent assembly), or for the purposes of governing the operating or financial policies of the bank, even if such person does not have the majority of voting rights in the shareholders' meeting.

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23 Are there any restrictions on foreign ownership of banks?

No. The Peruvian Constitution has established an attractive legal framework for foreign investment. Pursuant to article 5 of the Banking Law, foreign investors are to be provided with the same treatment afforded to local capital.

Moreover, any discriminatory treatment from the regulators to either local or foreign entities is expressly prohibited.

24 What are the legal and regulatory implications for entities that control banks?

As mentioned in question 22, any person who is directly or indirectly a major shareholder of a bank or of an insurance company may not directly or indirectly be a holder of more than 5 per cent of the stock of another company of the same nature. Other than that, there are no express limitations to the business activities that entities that control banks may carry out.

Banks that belong to a financial (or mixed) conglomerate that performs its activities mainly in Peru will be subject to consolidated supervision by the SBS. They must comply with capital requirements for all activities being carried out by the companies comprising the conglomerate. Failure to comply with these requirements may result in restrictions or the suspension of activities of the bank.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The SBS is empowered to request from supervised banking and financial institutions financial statements and other relevant financial information on an individual or consolidated basis. The main purpose of the consolidated supervision is to carry out preventive measures aimed at lessening any possible risks with regards to transactions with other entities comprising the conglomerate or their common clients.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

As mentioned in question 19, controlling and other shareholders may be required by the SBS to work on and approve a recovery plan or agreement and perform capital increases, as necessary.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Article 57 of the Banking Law establishes that prior authorisation from the SBS must be obtained in order to acquire shares in excess of 10 per cent of the capital stock of a bank.

If a legal entity domiciled in Peru is a shareholder of a bank with a percentage greater than 10 per cent, its shareholders must have prior SBS authorisation in order to assign any rights or shares of the aforementioned legal entity in a proportion higher than 10 per cent. If the shareholder is a non-domiciled legal entity, it is obliged to inform the SBS in the event of any changes in its ownership in the proportion of the excess of the aforementioned percentage, indicating the name of the shareholders of such non-domiciled legal entity.

As the bank acknowledges such situation, it must inform the SBS about the purchase of any part of its stock by a non-domiciled legal entity, indicating the names of the shareholders of the latter.

Furthermore, banks have to register their shares with the SMV and list them on the Lima Stock Exchange before starting business in Peru. In the event an existing shareholder or other investor increases its participation to a 'significant participation' or acquires a 'significant participation' in voting shares issued by a bank, said shareholder or investor must comply with the rules and regulations set for public tender offers (OPAs) (OPA Regulations) as approved by the SMV, in addition to the requirements established by the SBS.

In that regard, the current OPA Regulations state that the acquisition of a 'significant participation' in a company listed in Peru triggers the obligation of the acquirer to launch a post-acquisition OPA. The OPA Regulations consider the following situations as acquiring 'significant participation' in a listed company:

- having, directly or indirectly, a voting interest equal or higher to the following thresholds: 25, 50 or 60 per cent of the capital stock;
- the power of a person or a group of persons, without having direct or indirect participation, to exercise voting rights for 25 per cent or more of the capital stock; or
- having, directly or indirectly, voting rights in a percentage that will allow the acquirer to remove or appoint the majority of the target company's directors or amend the target company's by-laws.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The regulatory process is the same for local and foreign investors.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

In addition to the requirements in question 27, investors seeking to acquire control of a bank must be recognised for their moral integrity and financial capacity.

30 Describe the required filings for an acquisition of control of a bank.

Authorisation for acquiring more than 10 per cent of a bank stock must be requested from the SBS, by filing the relevant application together with a sworn statement declaring that the investor has no impediments to becoming a shareholder, in accordance with the relevant provisions of the Banking Law.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The SBS must resolve the authorisation request described above within 30 calendar days of filing.

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The government recognises the vital role of banks in providing an environment conducive to the sustained development of the country's economy. Accordingly, it is the government's policy to promote and maintain a stable and efficient banking system that is globally competitive, dynamic and responsive to the demands of a developing economy.

2 Summarise the primary statutes and regulations that govern the banking industry.

The General Banking Law governs not only universal banks but also commercial banks; section 71 provides that the organisation, ownership, capitalisation and powers of thrift banks (savings and mortgage banks, stock savings and loan associations, and private development banks), rural banks, cooperative banks, and Islamic banks, as well as the general conduct of their businesses are governed by the Thrift Banks Act, the Rural Banks Act, the Philippine Cooperative Code and the Charter of Al-Amanah Islamic Investment Bank of the Philippines respectively. The General Banking Law applies, however, to thrift banks and rural banks insofar as it is not in conflict with the provisions of the special laws governing such banks. On the other hand, the Philippine Cooperative Code recognises the primacy of the General Banking Law in the regulation of cooperative banks.

The rules implementing the above statutes are embodied in the Manual of Regulations for Banks issued by the Bangko Sentral ng Pilipinas (BSP), the Philippine central bank. From time to time, additional circulars and other issuances are promulgated by the BSP to cover new matters, if not to amend, repeal, supplement, or otherwise modify existing rules.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The BSP, through its Monetary Board, is primarily responsible for overseeing banks. The Philippine Deposit Insurance Corporation (PDIC) can also conduct examination of banks, with the prior approval of the Monetary Board, provided that no examination can be conducted by the PDIC within 12 months of the previous examination date.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Banks must insure their deposit liabilities with the PDIC. Each depositor is a beneficiary of the insurance for a maximum amount of 500,000 Philippine pesos or its foreign currency equivalent.

There are very few remaining government-owned or controlled banks, owing to the government's privatisation programme.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The grant of loans and other credit accommodations by a bank to its DOSRI (directors, officers, stockholders and their related interests) is regulated. Corporations in which the lending bank owns at least 20 per cent equity are considered as affiliates, which are deemed 'related interests' of such bank. DOSRI loans must be approved by the board of directors of the lending bank and granted upon terms not less favourable to the bank than those offered to non-DOSRI borrowers. Core banking consists of deposit taking and lending. In particular, commercial banking includes:

- accepting drafts;
- issuing letters of credit;
- discounting and negotiating promissory notes, drafts, bills of exchange, and other evidence of debt;
- accepting or creating demand deposits;
- receiving other types of deposits, as well as deposit substitutes;
- buying and selling foreign exchange, as well as gold or silver bullion;
- acquiring marketable bonds and other debt securities; and
- extending credit – all subject to pertinent rules promulgated by the Monetary Board.

Universal banking includes the above functions and two additional powers, namely the capacity to invest in enterprises not allied to banking and to underwrite securities. However, no bank in the Philippines can engage in insurance business as insurer.

6 What are the principal regulatory challenges facing the banking industry?

Apart from the regulatory challenge posed by the Basel II and III-based capital adequacy requirements, the constant challenge to the banking industry is to be more dedicated in providing loans and other credit accommodations (including microfinancing) that will foster national development and eradicate poverty.

7 Are banks subject to consumer protection rules?

Banks are subject to the recently promulgated BSP Regulations on Consumer Protection, which sets out the minimum standards of consumer protection in the areas of disclosure and transparency, protection of client information, fair treatment, effective recourse and financial education. The BSP is responsible for enforcing these rules in the banking sector.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Over the next few years, the BSP will reinforce its policy of encouraging mergers or consolidations between and among banks. The BSP will increasingly align its regulatory policy with applicable internationally accepted standards, including those of the Bank for International Settlements and the Basel Committee on Banking Supervision. Enhanced compliance by banks with prudential measures prescribed by the BSP will be uppermost in the agenda of the BSP, to promote safer and more sound banking practices.

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Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The BSP examines the books of every bank once every 12 months, and at such other times as the Monetary Board may deem expedient. An interval of at least 12 months is required between annual examinations.

The BSP examiners are authorised to administer oaths to any director, officer or employee of any bank and to compel the presentation of all books, documents, papers or records necessary to ascertain the facts relative to the true condition of such bank.

The PDIC may also examine banks, with the prior approval of the Monetary Board, to determine whether they are engaging in unsafe and unsound banking practices. No examination can be conducted by the PDIC within 12 months of the last examination date. To avoid overlapping of efforts, the PDIC examination considers the relevant reports and findings of the BSP pertaining to the bank under examination.

10 How do the regulatory authorities enforce banking laws and regulations?

Violations of any of the provisions of the General Banking Law are subject to the penalties and other sanctions under the New Central Bank Act.

Any owner, director, officer or agent of a bank who, being required in writing by the Monetary Board or by the head of the supervising and examining department of the BSP, wilfully refuses to file the required report or refuses to permit a lawful examination into the affairs of such bank, will be punished by a fine of between 50,000 and 100,000 Philippine pesos or by imprisonment of not less than one year or no more than five years, or both, at the discretion of the court.

On the other hand, the wilful making of a false or misleading statement on a material fact to the Monetary Board or to the BSP examiners will be punished by a fine of between 100,000 and 200,000 Philippine pesos or by imprisonment of not more than five years, or both, at the court's discretion.

In turn, any person who is responsible for wilful violation of the General Banking Law or any order, instruction, rule, or regulation issued by the Monetary Board will, at the court's discretion, be punished by a fine of between 50,000 and 200,000 Philippine pesos or by imprisonment of not less than two years or no more than 10 years, or both. Whenever a bank persists in carrying on its business in an unlawful or unsafe manner, the Monetary Board may take action for the receivership and liquidation of such bank, without prejudice to the penalties provided in the first sentence of this paragraph and the administrative sanctions provided in the next paragraph.

Without prejudice to the foregoing criminal sanctions against culpable persons, the Monetary Board may impose administrative sanctions for any of the above violations, wilful violation of the charter or by-laws of the bank, any commission of irregularities, or conducting business in an unsafe or unsafe manner as determined by the Monetary Board. These administrative sanctions are as follows:

- fines in amounts as may be determined by the Monetary Board to be appropriate, but in no case to exceed 30,000 Philippine pesos a day for each violation, taking into consideration the attendant circumstances, such as the nature and gravity of the violation or irregularity and the size of the bank;
- suspension of rediscounting privileges or access to the BSP credit facilities;
- suspension of lending or foreign exchange operations or authority to accept new deposits or make new investments;
- suspension of interbank clearing privileges; and
- revocation of quasi-banking licence.

In addition, the Monetary Board can suspend or remove the offending director or officer of a bank. In this respect, the termination (or even the resignation) from office of such director or officer will not exempt him from administrative or criminal sanctions.

Moreover, the erring corporation may be dissolved by quo warranto proceedings instituted by the solicitor general. In this connection, an original quo warranto proceeding may be commenced with the Supreme Court of the Philippines.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Enforcement issues mostly relate to compliance by banks with BSP regulations on safe and sound banking practices in connection with the offering and provision of bank services and products.

12 How has bank supervision changed in response to the 2008 financial crisis?

See question 8. The BSP has further strengthened its supervision of the banking sector. PDIC deposit insurance coverage was increased from 250,000 to 500,000 Philippine pesos per depositor.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

As noted in question 20, the Monetary Board may appoint a conservator for a bank that is in a 'state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors'. The conservator will have such powers as the Monetary Board deems necessary to take charge of the assets and liabilities of the bank, manage it or reorganise its management, collect all monies and debts due it and restore its viability. If, based on the report of the conservator or its own findings, the Monetary Board determines that the continuance in business of the bank would involve probable loss to the depositors and other creditors of the bank, the bank would be placed under receivership and eventually liquidated. The PDIC is usually the designated receiver. If the bank notifies the BSP or publicly announces a bank holiday, or in any manner suspends the payment of its deposit liabilities continuously for more than 30 days, the Monetary Board may, summarily and without prior hearing, close the bank and place it under receivership of the PDIC.

The assets of a bank under liquidation are held in trust for the equal benefit of all creditors. The receiver must first pay the costs of the proceedings, before paying the debts of the bank, in accordance with the rules on concurrence and preference of credit under the Civil Code of the Philippines. The shareholders last to receive payment, if any funds remain. The depositors can claim from the PDIC the amount of their insured deposits (see question 12).

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

The directors and officers of a failing bank must cooperate with the regulators, including the conservator and receiver. The following acts of a director or an officer of such bank are subject to criminal penalties:

- refusal to turn over bank records and assets to the designated receiver;
- tampering with bank records;
- appropriating bank assets for himself or another party;
- causing the misappropriation and destruction of bank assets;
- receiving or permitting or causing to be received in the bank any deposit, collection of loans, or receivables;
- paying out or permitting or causing to be paid out any fund of the bank; and
- transferring or causing to be transferred securities or property of the bank.

In addition, erring directors and officers will be included in the list of persons disqualified by the Monetary Board from holding any position in any bank or financial institution.

No voluntary dissolution and liquidation of a bank can be undertaken without the prior approval of the Monetary Board. For this purpose, a request for Monetary Board approval must be accompanied by a liquidation plan.

15 Are managers or directors personally liable in the case of a bank failure?

The bank's directors and officers who knowingly assent to patently unlawful acts of the bank or who are guilty of gross negligence or bad faith in directing the affairs of the bank or acquire any personal or pecuniary interest in conflict with their duties as such directors or officers, will be liable

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jointly and severally for all resulting damages suffered by the bank and its shareholders.

16 How has bank resolution changed in response to the recent crisis?

Bank resolution has not changed in response to the recent crisis. There is a legislative bill that seeks to amend the BSP charter by giving the BSP more flexibility in dealing with banking crises, but it is still pending in the Philippine congress.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The BSP prescribes the minimum level of capitalisation for banks. For instance, a universal bank with more than 100 branches must have a minimum capital of 20 billion Philippine pesos while that of a commercial bank with similar number of branches is 15 billion Philippine pesos.

In addition, the BSP adopted Basel III-based capital adequacy requirements for universal banks and commercial banks. Thrift banks and rural banks that are not subsidiaries of universal banks or commercial banks continue to be subject to Basel II-based guidelines. In any case, the daily risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, must not be less than 10 per cent for both a solo basis (ie, head office plus branches) and a consolidated basis (ie, parent bank plus subsidiary financial allied enterprises, excluding an insurance company). The qualifying capital is the sum of Tier I (core) capital and Tier II (supplementary) capital, less required deductions. In turn, Tier II capital is the sum of upper Tier II capital and lower Tier II capital, net of required deductions.

Universal and commercial banks have their respective internal capital adequacy assessment process that supplements the BSP's risk-based capital adequacy framework. These banks are responsible for setting internal capital targets consistent with their risk profile, operating environment and strategic plans.

18 How are the capital adequacy guidelines enforced?

In the event of non-compliance by a bank with the prescribed minimum ratio, the Monetary Board may, until that ratio is met or restored by such bank:

- limit or prohibit the distribution of net profits by such bank, and require that such profits be used, in full or in part, to increase the capital accounts of such bank;
- restrict or prohibit the acquisition of major assets by such bank; and
- restrict or prohibit the making of new investments by such bank, with the exception of purchases of readily marketable evidence of indebtedness of the Philippines and the BSP, and other evidence of indebtedness or obligation to the servicing and the repayment of which are fully guaranteed by the Philippines.

19 What happens in the event that a bank becomes undercapitalised?

If a bank becomes undercapitalised, it may be placed under conservatorship by the BSP, with a view to rectifying the capital deficiency. It may be possible to correct this condition, and the threatened insolvency of the bank may be averted by effective management reforms and infusion of additional capital.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Monetary Board may first appoint a conservator for a bank that is in a 'state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors'. If conservatorship is not successful or not deemed proper by the Monetary Board, the Monetary Board may summarily forbid the bank from doing business and designate the PDIC as its receiver. If the receiver determines that the bank cannot be rehabilitated or permitted to resume business, the Monetary Board may instruct the receiver to liquidate the bank.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

See question 17. The capital adequacy requirements are based on Basel III guidelines for universal and commercial banks. Eventually, thrift and rural banks must observe those guidelines.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Control is defined as ownership of more than 50 per cent of the voting stock of a bank.

Foreign individuals and non-bank corporations controlled by foreign nationals can collectively own up to 40 per cent of the voting stock of a universal or commercial bank. However, Philippine citizens and non-bank corporations controlled by Philippine citizens can collectively own up to 100 per cent of the voting stock of such bank. Under Republic Act No. 10641, a qualified foreign bank can be authorised by the BSP to acquire up to 100 per cent of the voting stock of an existing domestic bank, form a 100 per cent-owned banking subsidiary, or establish a Philippine branch with full banking licence.

23 Are there any restrictions on foreign ownership of banks?

See question 22.

24 What are the legal and regulatory implications for entities that control banks?

Apart from being subject to DOSRI rules, entities controlling a bank are expected to see to it that such bank observes the BSP rules on corporate governance, which are anchored on the principle of transparency, accountability and fairness or equity.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

See question 24. In respect of transparency, the controlling entity or individual, as a 'principal stockholder' of a bank classified as a 'public company', must disclose the changes in its or his stockholding in such bank, under the Securities Regulation Code.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The controlling entity or individual will not be liable to the creditors of the insolvent bank beyond the amount of its or his equity contribution to such bank.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Any sale or transfer, or series of sales or transfers, which will result in the ownership or control of more than 20 per cent of the voting stock of a bank by any person, whether natural or juridical, will require the prior approval of the Monetary Board.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The regulatory process is no different for a foreign acquirer.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The BSP will want to know the organisational and financial profile of the acquirer. For instance, a foreign bank acquiring a local bank must be widely owned or publicly listed, if not owned or controlled by the government of its country of origin. The Monetary Board may also:

- ensure geographical representation and coverage;
- consider strategic trade and investment relationships between the Philippines and the country of incorporation of the foreign bank;
- study the demonstrated capacity, global reputation for financial innovations and stability in a competitive environment of the applicant;

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Update and trends

The most significant development in the banking sector is the passage of Republic Act No. 10641, which allows full entry of qualified foreign banks into the Philippines via a wholly owned banking subsidiary, if not a branch with full banking authority.

- see to it that reciprocity rights are enjoyed by Philippine banks in the applicant's country; and
- consider the willingness of the applicant to fully share its technology.

30 Describe the required filings for an acquisition of control of a bank.

A written application (together with supporting documents) is to be filed with the BSP for the purpose of acquisition of control of a bank.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The approval process can be completed within one month.

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Portugal

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The Portuguese banking sector is governed by policies aimed at ensuring the stability, transparency and efficiency of the financial system, its agents and their interaction. Supervised entities must undergo licensing processes that ensure their capability to pursue their activity in the financial system and, during their activity, they must comply with strict policies on capital requirements, corporate governance, auditing and information duties.

In spite of the different entities that are allowed to operate in the Portuguese banking system (such as credit institutions, investment companies, financial institutions and financial companies), only credit institutions are legally allowed to take deposits and other repayable funds for their own use, carry out credit operations and payment services. Furthermore, banks are, by definition, allowed to, inter alia:

- issue and manage other payment methods;
- carry out transactions on money and exchange market instruments, financial futures, options, operations on currencies, interest rates, commodities and securities;
- participate in issues and placement of securities;
- operate in interbank markets;
- advise on and manage security portfolios;
- carry out insurance mediation activities; and
- issue electronic money.

2 Summarise the primary statutes and regulations that govern the banking industry.

The Portuguese banking sector is primarily governed, on a national level, by the following statutes:

- the General Legal Framework for Credit Institutions and Financial Companies (RGICSF) which governs the access and pursuit of the banking activity, enacted by Decree-Law No. 298/92, of 31 December, as amended;
- the Portuguese Securities Code which sets forth the legal framework applicable to securities and tender offers over securities, money market instruments, derivative instruments for the transfer of credit risk, differential agreements, options, futures, swaps and other derivatives, organised forms of security trading, enacted by Decree-Law No. 486/99, of 13 November, as amended;
- the General Legal Framework for payment services, enacted by Decree-Law No. 317/2009, of 30 October, as amended, which implemented Directive 2007/64/CE, of the European Parliament and of the Council, of 13 November;
- the General Framework for undertakings for collective investment, enacted by Decree-Law No. 63-A/2013, of 10 May;
- the Anti-Money Laundering and Terrorist Financing Framework, enacted by Law No. 25/2008, of 5 June, as amended;
- the legal framework applicable to consumer loans, enacted by Decree-Law No. 133/2009, of 2 June, as amended, which implemented Directive 2008/48/EC of the European Parliament and of the Council, of 23 April 2008 on credit agreements for consumers;
- the Portuguese Civil Code, enacted by Law No. 47,344, of 25 November 1966, as amended, which sets forth the general rules on contractual obligations;
- legal framework applicable to commercial paper, enacted by Decree-Law No. 69/2004, of 25 March, as amended; and
- regulations, notices, instructions, circulars recommendations and other statements issued by the Bank of Portugal (Banco de Portugal or BdP), and by the Portuguese Securities Market Commission (CMVM).

Other laws and regulations on, inter alia, consumer protection, distance marketing, transparency and calculation of interest rates shall apply to the banking industry.

3 Which regulatory authorities are primarily responsible for overseeing banks?

As a consequence of the implementation of the Single Supervisory Mechanism (SSM), the European Central Bank (ECB) is currently the main supervisory authority of banking activity alongside the national competent authorities. As planned, the ECB has commenced to enact its supervisory powers by carrying out a comprehensive assessment over three Portuguese banks in 2014.

At a national level, the BdP is responsible for the regulation and supervision of credit institutions, such as banks, and other entities which carry out any of the regulated activities foreseen in the RGICSF. In addition, credit institutions may also be subject to the CMVM's supervision under certain circumstances (as detailed below).

The BdP is responsible for carrying out the 'prudential' supervision of credit institutions, such as banks, financial companies and payment institutions. Moreover, it is responsible for the 'behavioural' supervision of the entities mentioned regarding their interaction with their clients making sure that they act according to the principles of diligence, neutrality, loyalty, discretion and respect and also release information.

Additionally, other attributions of the BdP include:

- ensuring the compliance with the anti-money laundering requirements of financial entities;
- maintaining price stability;
- the management of own investment assets as well as management of ECB's exchange reserves;
- guidance and monitoring of currency and exchange markets;
- monitoring and promoting a sound functioning of payment systems;
- the issuance of money under the authorisation of the ECB;
- promoting international cooperation; and
- to act as intermediary of the Portuguese international monetary relationships.

The BdP is entrusted with the competences to license, supervise, monitor and impose sanctions on banks which do not comply with certain requirements as well as imposing resolution measures over banks.

On the other hand, the CMVM is responsible for the supervision of the securities market and its agents, particularly the licensing to carry out such supervised activities and monitoring institutions in Portugal. Therefore, the CMVM enacts supervision powers over banks whenever they are listed entities, issuers of financial instruments or financial intermediaries.

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4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are insured by the Deposit Guarantee Fund, which is in line with the Deposit Guarantee Schemes Directive (Directive 2014/49/EU of the European Parliament and of the Council, of 16 April 2014 on deposit guarantee schemes) and not by the Portuguese government. Banks with registered office in Portugal are mandatorily participants of the Deposit Guarantee Fund, as well as banks with registered offices in non-EU countries in relation to deposits taken in Portugal (except if the BdP considers the fund guarantee system in the country of origin of the banks to be equivalent to the Portuguese regime).

In case of winding up of a bank, the Deposit Guarantee Fund ensures the reimbursement of deposits set up in banks which are participants of the Fund up to a limit of €100,000 per depositor and bank.

The Portuguese State has a direct ownership interest in Caixa Geral de Depósitos, SA, a bank which is entirely owned by the state. The Portuguese State also has granted a significant loan to the Resolution Fund which, in turn, capitalised Novo Banco (a bridge bank incorporated as a result of the resolution measures enforced by the BdP over Banco Espírito Santo in August 2014).

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Certain transactions must be notified to the supervisory authorities, such as the ones related to owners of qualifying holdings in credit institutions (for the acquisition or disposal of qualifying holdings see question 27), and transactions with managers.

An 'affiliate' is deemed as a legal person which is in a control or dominance relationship with another legal person, whenever one of the following occurs:

- one entity holds the majority of voting rights in a company;
- an entity is a shareholder of a company and has the right to appoint or remove more than half of the directors or members of the auditing committee;
- an entity is able to exercise a dominant influence over a company;
- an entity is a shareholder of a company and solely controls, by means of shareholders agreements, the majority of the voting rights;
- an entity can and effectively exercises a dominant influence over the company; and
- a legal person manages the company as if they were the same entity.

The granting of loans, including the granting of collateral, to any person who directly or indirectly owns a qualifying holding in a bank or to a company controlled directly or indirectly by said person or which is in a group relationship with said person, cannot exceed, at any given moment and jointly, 10 per cent of the own funds of the bank. Moreover, the total amount of loans granted under the above-mentioned circumstances cannot exceed, at any given moment, 30 per cent of the own funds of the bank.

Additionally, the CMVM must be notified of any transactions carried out by managers of a listed bank or with a company which dominates the bank, relating to shares or securities of such bank. For these purposes, any members of corporate and audit bodies of the bank shall be deemed as managers.

Moreover, in relation to equity issuers, any relevant transactions with related parties that have affected the financial situation or the stability of the bank in the first semester of a financial year must be disclosed in the annual report and accounts.

6 What are the principal regulatory challenges facing the banking industry?

The main challenge that the banking industry currently faces is to balance a vigilant and strict regulation of banks which does not, however, impair these entities with excessive bureaucracy and strict capital requirements and force them to constrict their activities and potentially bring harmful consequences to the Portuguese financial system and all of its agents.

The Portuguese banking supervisory entities are particularly strict on compliance with capital requirements and account presentation of supervised entities, especially in light of recent developments which led the BdP to enforce a resolution measure over a main bank in Portugal in August 2014.

7 Are banks subject to consumer protection rules?

According to Portuguese law, consumer protection rules are applicable to banks in what concerns information duties, marketing requirements, pricings and interest rates.

Banks are required to provide detailed pre-contractual information, assess the creditworthiness of the consumer before granting the loan, provide specific information throughout the duration of the loan agreement, grant a mandatory 14-day cooling-off period, and allow for an early repayment of the loan, provided that the consumer gives a 30-day prior notice.

Any marketing carried out by banks in Portugal must also comply with certain transparency and accuracy requirements. There are also specific rules applicable to housing loans, consumer credit, deposits and complex financial products.

Banks must inform the BdP about pricings applicable to their services, which are publicly available at the supervisor's website.

Lastly, maximum interest rates on loan agreements entered into by banks and consumers are determined by the BdP and regularly updated.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Bearing in mind that the Single Supervision Mechanism has been fully operational since 4 November 2014 and that the European Union heads for a more aligned regulation of the banking industry, legal and regulatory policies shall inevitably be European sourced.

Nevertheless, in light of the current European and global context, Portuguese supervisory entities shall continue to focus on regulation and supervision of banks acting in Portugal with particular emphasis on the capital and corporate governance requirements (such as appointment of corporate bodies and remuneration) as well as ring-fencing mechanisms applicable to banks.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Four groups of Portuguese banks are supervised by the SSM, which were considered 'significant' to this effect. The core activity of the 'less significant' (for the purposes of the SSM) Portuguese banks is subject to the supervision of BdP and the CMVM, as detailed in question 3.

The main means of supervision by the BdP are the following:

- issue of notices and recommendations regarding the conduct rules for the management of banks;
- establishment of rules of conduct for banks ensuring transparency of information during the pre-contractual and contractual stages;
- assessment of the complaints presented by banks' clients;
- analysis of the information regularly reported by the banks;
- assessment of the banks' exposure to risks and of the adequacy of the banks' strategies, mechanisms and procedures to mitigate those risks;
- analysis of the result of the stress tests imposed to banks;
- evaluation of the systemic risks; and
- on-site inspections.

10 How do the regulatory authorities enforce banking laws and regulations?

The BdP has the power to carry out such enforcement through:

- fines and ancillary penalties;
- injunctions for the fulfilment of certain duties;
- seizure of documents and valuables;
- special audits through on-site inspections; and
- withdrawal of the bank's authorisation.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The BdP carried out 419 inspections to 81 credit institutions. Most of these were carried out by means of mystery-client visits and credentialed inspections. Besides the inspections carried out on the price lists, the services and

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means of payment and the complaints books, other matters related to legal and regulatory amendments were inspected.

Following these inspections, in the first semester of 2014 the BdP issued 357 recommendations and specific determinations ordering the correction of the detected irregularities and situations of non-compliance. The BdP opened 25 administrative offence procedures against 14 institutions.

12 How has bank supervision changed in response to the 2008 financial crisis?

Following the 2008 financial crisis, Portuguese banks were required to increase their own funds and restructure their capital to meet the new requirements on minimum capital, information on complex financial instruments, depositors' protection, with a highlight on the rules applicable to the recovery and resolution of credit institutions.

Permanent onsite inspections became a normal practice.

Portuguese law regarding recovery and resolution of banks was amended before the relevant European Directive being approved, in order to ensure a more effective answer in case of a crisis in a bank, and creating a resolution fund, to be used in case such a measure was to be applied, to maintain the confidence of the public in Portuguese banks.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The BdP may apply certain resolution measures in case a bank is in a situation where it may need to cease to be duly authorised for the pursuit of the banking activity (or presents a 'serious risk' of non-compliance), which may consist of either the disposal, in part or in whole, of the business of the credit institution to other credit institution or the transfer, in part or in whole, of its business to one or more transition banks, to be funded by the Resolution Fund, which shall be supported by contributions by Portuguese banks.

Such resolution measure must be 'adequate' and 'proportional' concerning the possible (or expectable) consequences of such measure to the financial soundness of the institution, the interests of its depositors and, generally, the effects of the resolution on the stability of the financial system.

Among others, the RGICSF establishes three situations deemed as a 'serious risk' of non-compliance: the bank's losses surpass its share capital; its assets are lower than its obligations or the bank is unable to fulfil its obligations.

We have witnessed the resolution of two banks: Banco Privado Português and Banco Português de Negócios. Moreover, we are currently in the middle of the Banco Espírito Santo resolution process, which has resulted in the creation of a bridge bank – Novo Banco.

Portuguese law establishes a priority regarding the liability for the losses of the institution: firstly, the shareholders are held liable for the losses and only after the creditors are held liable. No creditor could be put in a worse situation resulting the resolution measure than it would be in a standard winding-up procedure.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Whenever a resolution measure is applied, the management and supervisory bodies of the bank are suspended.

The BdP must then appoint new directors, who may veto the decisions approved by other corporate bodies of the bank or directly execute BdP's decisions without the consent of shareholders.

Each deposit-taking institution must have in place a recovery and a resolution plan. These plans must be submitted to the BdP and must drafted in accordance with the applicable legal requirements. The recovery plan is intended to identify the measures that must be applied when such institution is in a financially precarious situation (or, at least, when there is a risk of slipping into such situation). However, the resolution plan must ensure that all the relevant information is provided to the BdP, allowing for an orderly resolution of the bank through the application of resolutions measures.

15 Are managers or directors personally liable in the case of a bank failure?

Managers or directors may be held personally liable in case of a bank failure for the damages caused to the bank in case of breach of their legal and statutory duties, except if they prove they acted without fault or under the 'business judgment' rule.

In case of a winding-up procedure of the bank, managers or directors may also be held liable if the winding-up is considered culpable (ie, if such situation was created or exacerbated by the actions or omissions of the bank or if its directors carried out their activities with wrongful intent or serious fault, in the previous three years). In such scenario, the court may, among others:

- prohibit the exercise of managing duties from two to ten years;
- prohibit the pursuit of any commercial activity from two to 10 years, including holding a position in any statutory body;
- determine the loss of any claims held by the manager or director over the bank, or direct the person to return any assets or rights received as payment of such claims; or
- order the person to compensate the bank's creditors.

Managers or directors may also be criminally prosecuted as a result of the insolvency of the debtor, with penalties ranging from fines to incarceration, as well as being held personally liable for the tax debts of the bank.

16 How has bank resolution changed in response to the recent crisis?

In recent years, the BdP was granted with additional powers in the context of its corrective intervention in order to ensure the financial soundness of credit institutions and the financial system as a whole, as well safeguard depositors' interest.

As an example, the BdP may now separate the assets and obligations of the relevant bank in order to sell them in parts and to different buyers by means of a bridge bank.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Portuguese law establishes minimum share capital requirements for each type of credit institution – including banks – and financial company. For instance, banks are required to have a minimum share capital of €17.5 million and investment firms are in general required to have a minimum share capital of €7.5 million.

In addition, since 1 January 2014, the rules on regulatory capital adequacy requirements are harmonised throughout the European Union. Banks and other credit institutions and investment firms must meet the rules on regulatory capital and liquidity established by the CRD IV package.

Under the Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), institutions must maintain a CET 1 capital of at least 4.5 per cent of their risk-weighted assets (RWAs), a tier 1 capital of at least 6 per cent of their RWAs and a total capital of at least 8 per cent of their RWAs.

However, and as agreed with the European Central Bank, the European Commission and the International Monetary Fund in the context of a bail-out package provided to the Republic of Portugal in 2011, the BdP determined that Portuguese credit institutions and investment firms must have a CET 1 ratio not below 7 per cent. This obligation is to last until the adoption in full by these entities of the rules applicable under the CRD IV package.

18 How are the capital adequacy guidelines enforced?

The BdP is entitled to demand credit institutions and financial companies to promptly adopt the measures or take the actions that are necessary to overcome any non-compliance by them with the rules regulating their business, including capital adequacy guidelines.

Among the powers granted to the BdP for this purpose is the power of suspending or substituting one or more members of the management and supervisory bodies of a credit institution and the power to appoint both a provisional board of directors and a supervisory committee or a sole supervisor.

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19 What happens in the event that a bank becomes undercapitalised?

The BdP may apply corrective measures over a credit institution in distress, which may consist of, notably:

- the presentation by the credit institution of a restructuring plan, setting out measures such as a share capital increase, a reduction thereof or the disposal of shareholdings or other assets;
- the suspension or substitution of one or more members of its management and supervisory bodies; or
- the subjection of certain acts or transactions to the prior approval of the BdP.

Where the corrective measures applied do not suffice in recovering a credit institution or would be deemed to be insufficient to that end, the BdP may also elect to appoint a provisional board of directors; in specific cases, apply a resolution measure, as mentioned in question 13; or even repeal the authorisation of the credit institution in Portugal, causing its dissolution and winding-up.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Some of the circumstances that may trigger the imposition of the resolution measures mentioned in question 13 include a credit institution having (or being at risk of having) losses that in the short-term may consume its share capital, its assets becoming lower than its liabilities or it becoming unable to fulfil its obligations.

In cases where the distress situation affecting a credit institution may not be resolved by the BdP by exercising the powers granted to it under the RGISCF to intervene, including by means of the imposition of a resolution measures, or even after resolution measures have been imposed upon a credit institution, the BdP may revoke the authorisation of the credit institution in Portugal, causing its dissolution and winding-up (which shall be governed by Decree-Law No. 199/2006, of 25 October, which implemented Directive 2001/24/EC of the European Parliament and of the Council of 4 April, and the Portuguese Insolvency Code).

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The rules on capital adequacy requirements have undergone a deep reform, with the entry into force of the CRD IV package, which created a single rulebook throughout the European Union in this domain. Further changes are expected, most notably those resulting from the adoption of implementing acts of the CRD IV and the CRR, which are to be enacted in coming years.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Portuguese law does not establish any legal or regulatory limitation regarding the types of entities and individuals that may own a controlling interest in a bank, other than the typical assessment by the BdP on the identity and suitability of its direct and indirect qualified shareholders, in order to ensure a sound and prudent management of the bank (see question 27).

An entity is under control if another entity (regardless of its legal form or domicile):

- is considered to be a parent company;
- owns or is able to exercise the majority of the voting rights of that entity;
- is a shareholder of that entity and is entitled to appoint or remove the majority of the members of the management body or supervisory body;
- is able to exercise a dominant influence on that entity by contract or pursuant to its articles of association; or
- is able to manage that entity as if they are a single entity.

Control is also defined by reference to the accounting rules to which that entity is subject pursuant to Regulation (EC) No. 1606/2002 of the European Parliament and of the Council, of 19 July 2002, on the application of international accounting standards.

23 Are there any restrictions on foreign ownership of banks?

Portuguese law does not establish any specific restriction on foreign ownership of banks. However, the BdP may oppose the acquisition or increase of a direct or indirect qualifying shareholding in a Portuguese bank if it would become part of a group that does not have a structure in place that allows for an effective supervision, or where the supervisory body of the relevant parent company will not cooperate sufficiently with the BdP.

24 What are the legal and regulatory implications for entities that control banks?

The acquirer of a controlling interest in a Portuguese bank may – depending on its form of organisation – become subject to a consolidated group supervision by the BdP, namely, intra-group reporting duties and group financial statement regulations.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Portuguese law does not establish any express obligation on a shareholder to inject additional capital in the event that a bank becomes undercapitalised. However, the BdP may recommend that shareholders give financial support to a bank. Also, shareholders (current or new) may have to take part in a share capital increase pursuant to a restructuring plan (to be approved by the BdP) whenever the bank is or may be in default of its legal obligations in the pursuit of its activity.

In addition, an entity or individual that controls a bank must notify the BdP of its intention to increase or reduce a qualifying shareholding whenever such change exceeds or falls below certain percentages of the bank's share capital or voting rights.

Loans or security granted in favour of qualified shareholders of a bank may only be granted up to certain percentages. At least two-thirds of the members of the board must approve the granting of such loans or security. A favourable opinion by the supervisory board is also required.

The general liability provisions set out in the Portuguese Companies Code regarding the liability of a controlling entity or individual shall also apply. Depending on whether the controlling entity or individual is domiciled in Portugal or not, the controlling entity or individual may be held liable for the obligations of the bank (even if such obligations were incurred by the bank prior to the relevant entity or individual having become a controlling entity or individual).

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

In case the BdP adopts a resolution measure towards the bank, the bank's shareholders may be subject to certain burden-sharing measures as provided by law (including the reduction of the bank's share capital or suppression of the par value of its shares) upon a specific decision by the Minister of Finance.

In addition to the general corporate liability of the controlling entity or individual (see question 25), if the bank is declared insolvent and it is fully controlled by the controlling entity or individual or the management of its activity is subordinated, by contract, to the management of another entity or individual, the BdP may also request the declaration of insolvency of the controlling entity or individual, if it concludes, with a justified reason, that, on the basis of the net financial situation of the insolvent bank, the assets of the controlling entity or individual are not enough to make good its own liabilities in addition to the unpaid liabilities of the insolvent bank.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The intention or project to acquire, directly or indirectly, a qualifying shareholding (ie, a shareholding that is equal to or exceeds any of the thresholds of 10 per cent, 20 per cent, 33 per cent or 50 per cent of the share capital or voting rights) in a bank shall be notified previously to the BdP.

The BdP may oppose to said acquisition if it considers that the acquirer does not meet the necessary conditions to guarantee a sound and prudent management, or if the information provided is not sufficient. In order to evaluate the aforementioned conditions, the BdP takes into account the acquirer's adequacy, its influence in the bank and the financial soundness of the acquisition project.

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In case any competition issue derives from the transaction, a report from the Portuguese Competition Authority shall also be required, which may oppose to the transaction or accept it but only with the fulfilment of certain conditions or remedies. Furthermore, if the bank is listed, the acquirer is subject to several disclosure information duties and, as the case may be (if the threshold of one-third of the voting rights corresponding to the share capital is exceeded), it can be required to launch a tender offer over all the shares issued by the bank.

For a definition of 'control', see question 22.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The Portuguese regulatory authorities are receptive to foreign acquirers as there are no significant differences in the treatment granted to domestic and foreign acquirers, as the several relevant acquisitions of qualifying shareholdings or controlling interests in important Portuguese banks by foreign acquirers so attest.

The acquisition process for foreign acquirers is subject to tighter scrutiny by the BdP (in particular, in case of non-EU member states acquirers).

Among others, the BdP shall inform the European Commission and the other EU member states' competent authorities of any qualifying shareholdings' acquisitions over a credit institution, when the acquirer is based in a non-EU country.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

In the assessment of a bank's acquisition project, the BdP shall take into consideration the following factors:

- the reputation of the acquirer;
- the reputation, professional qualification, independence and availability of the management body's members of the credit institution, who will be appointed after the acquisition;
- the financial soundness of the acquirer, namely according to the type of activity exercised;
- the bank's capacity to comply continuously with the applicable prudential requirements. As mentioned in the question 23, if the referred institution becomes part of a group structure, the BdP shall take in consideration whether the group has a structure in place that allows for an effective supervision, with an efficient exchange of information among the competent authorities which enables the allocation of responsibilities among the referred authorities; and
- the existence of reasonable grounds to suspect that, in connection with the proposed acquisition, certain acts of money laundering and terrorist financing, within the meaning of article 1 of the Directive 2005/60/EC of the European Parliament and the Council, of 26 October 2005, are being or have been committed or attempted.

Update and trends

The Portuguese Companies Code was recently amended with the aim of providing Portuguese companies with alternative financing mechanisms, in order to relieve the excessive dependence on bank financing, by implementing a more favourable framework to companies' restructuring, long-term financing for production activity and the issue of hybrid capitalisation securities. It remains to be seen how this new trend will be received by Portuguese companies.

Moreover, the draft law implementing the AIFM Directive was recently published, which will make a significant impact in the entire financial sector.

Lastly, another new development is the implementation of the SSM and achieving a harmonious articulation between the ECB and the national authorities will be a challenging task.

30 Describe the required filings for an acquisition of control of a bank.

The application for the acquisition of a qualifying holding in a bank shall be accompanied by the following documentation:

- general documents regarding the identity of the acquirer, as well as the identity of the entities which have the control of the acquirer;
- documents and statements attesting the reliability of the acquirer, its management body's members and affiliates;
- information regarding the acquisition's financing;
- a business plan with information about the strategic development plan, regarding the acquisition, projections and details related to the key modifications to be introduced in the bank;
- financial documents, including the forward accounts of the bank (eg, balance sheet, income statement and prudential ratios); and
- information regarding the impact of the acquisition in the corporate governance and group structure of the bank.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The BdP has 60 working days to inform the prospective acquirer of the decision to accept or oppose to the acquisition. This time frame may be extended to 80 or 90 working days, in case additional information is requested.

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

In general, governmental and regulatory policy dictates that the objectives of securing systemic stability in the economy, ensuring institutional safety and soundness, and promoting consumer protection, are obtained. The South African Reserve Bank (SARB) is the central bank of South Africa and its focus is on stability, which includes price stability, financial stability and the stability of the banking system. The SARB recognises, in the performance of its duties, the need to pursue balanced economic development and growth based on the principles of a market system, private and social initiative, effective competition, and social fairness.

The SARB also has the responsibility for promoting the safety and soundness of the domestic banking system through the effective and efficient application of international regulatory and supervisory standards and to minimise systemic risk.

2 Summarise the primary statutes and regulations that govern the banking industry.

The following primary statutes and regulations govern the banking industry:

- the Banks Act 1990 (the Banks Act) and regulations published in terms thereof, providing for the regulation and supervision of the taking of deposits from the public;
- the South African Reserve Bank Act 1989, specifically regulating the SARB and the monetary system;
- the National Payment Systems Act 1998 (the NPS Act), providing for the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in South Africa;
- the Inspection of Financial Institutions Act 1998, providing for the inspection of the affairs of financial institutions (such as banks) and for the inspection of the affairs of unregistered entities conducting the business of financial institutions;
- the Currency and Exchanges Act 1933, regulating legal tender, currency, exchanges and banking. Exchange Control Regulations issued in terms of that Act impose exchange control that restricts the export of capital from South Africa;
- the Financial Intelligence Centre Act 2001 (FICA), establishing a Financial Intelligence Centre and a Money Laundering Advisory Council to combat money-laundering activities and the financing of terrorist and related activities, and imposing certain duties on institutions and other persons who might be used for such;
- the Financial Advisory and Intermediary Services Act 2002 (FAIS) regulates the rendering of certain financial advisory and intermediary services to clients;
- the Mutual Banks Act 1993 provides for the regulation and supervision of the activities of mutual banks;
- the Co-operative Banks Act 2007 provides for the regulation and supervision of cooperative banks. The legislation acknowledges member-based financial services cooperatives as a different tier of the official banking sector. Note, however, that rules to be implemented in terms of this Act are still in draft form;
- the National Credit Act 2005 (NCA) regulates consumer credit and improved standards of consumer information, prohibits certain unfair credit and credit-marketing practices as well as reckless credit granting, provides for debt reorganisation in cases of overindebtedness, regulates credit information and provides for registration of credit bureaux, credit providers and debt-counselling services;
- the Consumer Protection Act, 2008 (CPA), which is intended to protect certain fundamental consumer rights, and which also applies to the provision of banking services to consumers, unless exempted, except to the extent that any such service constitutes advice or intermediary services regulated by FAIS, or is regulated in terms of the Long-term Insurance Act 1988 or the Short-term Insurance Act 1988;
- the Financial Markets Act 19 of 2012, which provides (inter alia) for the regulation of financial markets, the custody and administration of securities and to prohibit insider trading; and
- the Protection of Personal Information Act 4 of 2013 (POPI), which will, once fully effective, regulate the manner in which personal information may be processed by establishing the conditions, in harmony with international standards, that prescribe the minimum threshold requirements for its lawful processing.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The following regulatory authorities are responsible for overseeing banks:

- the SARB, as the central bank and, more particularly, the registrar of banks (registrar), who is an officer of the SARB, are primarily responsible for overseeing banks. The SARB also, in terms of the NPS Act, recognises the Payment Association of South Africa as a payment system management body with the object of organising, managing and regulating the participation of its members (ie, banks) in the payment system;
- the Financial Intelligence Centre, which monitors and gives banks guidance as accountable institutions regarding the performance by them of their duties and their compliance with FICA;
- the Financial Services Board (FSB), established in terms of the Financial Services Board Act 1990, which provides for the establishment of a board to supervise compliance with laws regulating financial institutions and the provision of financial services;
- the National Credit Regulator, established in terms of the NCA, whose responsibilities include the registration of credit providers and monitoring the consumer credit market and industry to ensure prohibited conduct is prevented or detected and prosecuted;
- the National Consumer Commission, established in terms of the CPA, whose responsibilities include enforcement of the CPA; and
- the Information Regulator, which is to be established once POPI becomes effective and whose responsibilities will include monitoring and enforcing compliance with the provisions of POPI.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

A deposit insurance scheme has not yet been introduced in South Africa. The government also has no ownership interest in the banking sector.

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5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

A bank requires the prior written approval of the registrar to:
- establish or acquire a subsidiary within or outside South Africa;
- invest in a joint venture within or outside South Africa if the investment exceeds certain thresholds;
- establish, open or acquire a branch office or representative office outside South Africa;
- create, establish or acquire a trust outside South Africa of which the bank is a major beneficiary or any financial or business undertaking outside South Africa under the bank's direct or indirect control;
- acquire an interest in any undertaking with a registered office or principal place of business outside South Africa; or
- create a division within or outside South African where another person conducts his or her business through that division.

Banks are also required to furnish the registrar with particulars relating to its shareholding or other interest in its subsidiaries. Furthermore, no reconstruction of companies within a group of which a bank or a controlling company or subsidiary of a bank is a member may be effected without the prior written approval of the registrar.

There is no statutory or other definition of 'affiliate', but generally speaking 'affiliate' would include:
- subsidiaries of a bank (companies in which the bank holds or controls majority voting rights at either shareholder or board level either through itself or through one or more other subsidiaries);
- controlling companies of a bank (companies of which the bank is a subsidiary as referred to above or companies that otherwise control a bank by meeting certain requirements in the Banks Act referred to in question 22); and
- joint ventures, divisions and branch offices of the bank referred to in question 5.

A bank is not permitted to:
- hold shares in any company of which such bank is a subsidiary;
- lend money to any person against security of its own shares or of shares of its controlling company;
- grant unsecured loans or loans against security which in the opinion of the registrar is inadequate for the purpose of furthering the sale of its own shares;
- show bad debts, losses or certain costs as assets in its financial statements or returns;
- pay out dividends on its shares or open any branch or agency before provision has been made out of profits for such bad debts, losses and certain costs;
- act as agent for the purpose of a money-lending transaction between a lender and a borrower, except in terms of a written contract of agency which confirms that the bank acts as the agent of the lender, that the lender assumes all risks and related responsibilities and that payment is not guaranteed by the bank;
- record in its accounting records any asset at a value increased by the amount of a loss incurred upon the realisation of another;
- conclude a repurchase agreement in respect of a fictitious asset or an asset created by means of a simulated transaction;
- purport to have concluded a repurchase agreement without the agreement being substantiated by a written document signed by the other party, and the details of the agreement being recorded in the accounts of the bank as well as in the accounts which may be kept by the bank in the name of the other party; and
- pay out dividends from its share capital, without the prior written approval of the registrar.

A bank must hold all its assets in its own name, excluding any asset:
- bona fide hypothecated to secure an actual or potential liability;
- in respect of which the registrar has approved in writing that the asset may be held in the name of another person; or
- falling within a category of assets designated by the registrar as assets that may be held in the name of another person.

There have been no changes as to how the above-mentioned activities are classified.

6 What are the principal regulatory challenges facing the banking industry?

Currently, the principal regulatory challenges for the banking industry are posed by ongoing compliance with Basel III and the shift towards the twin peaks model of financial regulation.

Full compliance with the Basel III framework is still being phased in. The transitional arrangements has been made to afford the banks sufficient time to meet the higher standards set by Basel III. A 'Financial System Stability Assessment' for South Africa, compiled by the International Monetary Fund, reports that a domestic systematically important bank capital requirement, conservation buffer, and countercyclical capital buffer will be phased in from 2016 when the current 1 per cent systemic risk charge is phased out. The liquidity coverage ratio (LCR) will be introduced in 2015. The SARB has approved a committed liquidity facility to assist banks in meeting the LCR.

A second revised draft of the Financial Sector Regulation Bill (FSR Bill) has been published for public comment. The intention is to establish a twin peaks model of financial sector regulation for South Africa. In terms thereof two regulators will be established, namely a Prudential Authority (PA) that operates within the administration of the SARB and a new Financial Sector Conduct Authority (FSCA), which is intended to replace the FSB.

The FSR Bill also sets out the functions of the SARB in relation to financial stability and managing systemic risks and systemic events. The intention is that the PA will supervise the safety and soundness of banks, insurance companies and other financial institutions, while the FSCA will supervise how financial services firms conduct their business and treat customers.

The twin peaks system of regulation will (when fully phased in) focus on a more harmonised system of licensing, supervision, enforcement, customer complaints (including ombuds), appeal mechanism (tribunal) and consumer advice and education.

Full implementation of the Twin Peaks system of regulation will inevitably require further legislative and operational changes.

7 Are banks subject to consumer protection rules?

The CPA protects certain fundamental consumer rights, and applies to the provision of banking services to consumers, except to the extent that any such service constitutes advice or intermediary services regulated by FAIS, or is regulated in terms of the Long-term Insurance Act 1988 or the Short-term Insurance Act 1988. The fundamental consumer rights include the following rights to:
- protection against discriminatory marketing;
- restrict unwanted direct marketing;
- choose;
- disclosure and information;
- fair and responsible marketing;
- fair and honest dealing;
- fair, just and reasonable terms and conditions; and
- fair value, good quality and safety.

The National Consumer Commission is responsible to enforce the CPA . We are not aware of any practices that have drawn particular scrutiny.

Banks are also subject to the Code of Banking Practice (Code) which provides the platform for the Ombudsman for Banking Services to adjudicate disputes between banks and their customers. The Code sets out the commitments banks make to their customers, and provides information on the respective rights and obligations of both parties. As such, the intention of the Code is to supplement the regulatory and contractual requirements that govern relationships between banks and their customers.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

No major changes are expected other than compliance with any amendments to the Basel Capital Accord and harmonising domestic regulatory standards with minimum international standards.

See also question 6 on the shift to a twin peaks system of financial regulation.

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Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are subject to inspections by the regulatory authorities. Official inspection can take various forms. Banks are requested and required by various pieces of legislation to submit, at regular intervals, specific financial and other reports, which are then analysed by the regulatory authorities with a view to spotting undesirable developments, such as potential default trends.

In addition, banks are subjected to on-site inspections in which case the authorities undertake a type of external audit of the bank, but with specific reference to the prudential and conduct-of-business requirements. Regulatory bodies may also conduct inspections when complaints are received by the public. Informally, supervisors may also engage in presentations to and meetings with the board of directors of banks.

10 How do the regulatory authorities enforce banking laws and regulations?

Laws and regulations are enforced by virtue of powers granted in terms of applicable legislation, which may include requiring the bank to hold more capital and even the imposition of fines. In extreme circumstances, banking licences may be revoked.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Enforcement of legislation is addressed in terms of powers granted by the different Acts. In addition, regulators may have the statutory power to issue guidelines (in the form of circulars as to how the provisions of the Acts are to be applied and interpreted) and directives based on the provisions of the Acts for certain more detailed activities and how these are to be conducted.

The most common enforcement issues were introduced when the NCA became effective. It forms part of a new wave of measures aimed at protecting consumers and making credit and banking services more accessible. The NCA changed the legal landscape regarding consumer credit comprehensively and apart from the cost of compliance that was prohibitive, numerous problems of interpretation have also given rise to a spate of litigation.

12 How has bank supervision changed in response to the 2008 financial crisis?

See question 6.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

South African legislation does not allow for banks to be taken over by government or regulatory authorities. See question 20 for the legal and regulatory processes in the event that a bank becomes insolvent.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

The SARB has issued Directive 1 of 2015, which specifies the minimum requirements for the recovery plans of banks, controlling companies and branches of foreign institutions. The level of detail and range of recovery options are required to be commensurate with the risk profile of the relevant bank or institution. These requirements are in line with the international standard for resolution planning set by the Financial Stability Board in its 'Key attributes of effective resolution regimes for financial institutions' released on 4 November 2011.

The Directive sets out the following governance requirements:

- The development, maintenance, approval and annual review of the recovery plan should be subject to an appropriate governance process with clearly assigned roles and responsibilities for operational staff, senior management and the board of directors (or committee of similar standing in the case of a locally registered branch of a foreign bank).
- The board of directors should express its view on the recoverability of the bank from severe financial stress based on the recovery options identified in the recovery plan.
- An overview of any material changes or updates made since the previous version of the bank's recovery plan needs to be included in the recovery plan.

15 Are managers or directors personally liable in the case of a bank failure?

In terms of the Banks Act, the registrar may institute action under section 77 of the Companies Act 71 of 2008 or section 424 of the Companies Act 61 of 1973 (repealed by the Companies Act 71 of 2008) against any director, chief executive officer or executive of the bank who was knowingly a party to the carrying out of the business of the bank in the manner envisaged in those sections. Any amount recovered as a result of proceedings instituted by the registrar must be used:

- first to reimburse all expenses reasonably incurred by the registrar in bringing such proceedings;
- thereafter to set off against any amount paid to depositors by the registrar, a deposit insurance scheme, or any governmental body, as part or full compensation for the losses suffered by depositors as a result of the bank being unable to repay their deposits; and
- thereafter for the pro rata repayment of the losses of depositors.

16 How has bank resolution changed in response to the recent crisis?

See question 14.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

A bank the business of which does not include trading in financial instruments must manage its affairs in such a way that the total of its common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital and its common equity Tier 1 unimpaired reserve funds, additional Tier 1 unimpaired reserve funds and Tier 2 unimpaired reserve funds in the Republic is at no time less than the greater of:

- 250 million rand or, in the case of a bank that, immediately prior to the date of commencement of the Banks Act, was registered as a banking institution or a building society under a law repealed by this Act, 1 million rand; or
- an amount that represents a prescribed percentage of the sum of amounts relating to the different categories of assets and other risk exposures and calculated in such a manner as is prescribed in the regulations.

A bank must furthermore hold in South Africa level-one high-quality liquid assets of a value that equals at least the sum of the amounts calculated as prescribed percentages of – but that in no circumstances may exceed 20 per cent of – such different categories of its liabilities as may be specified by regulation in relation to a time when such liabilities fall due or to any other aspect pertaining to such liabilities. A bank may not pledge or otherwise encumber any portion of the level-one high-quality liquid assets it holds. The registrar may exempt the bank from this prohibition on such conditions and to such an extent and for such a period as he may determine.

Although a bank is obliged to furnish the registrar with returns regarding the nature and amounts of the bank's assets, liabilities and contingent liabilities and returns relating to the extent and management of risk exposures in the conduct of its business, no contingent capital arrangements are required.

18 How are the capital adequacy guidelines enforced?

If a bank fails or is unable to comply with prudential requirements, it must forthwith report in writing its failure or inability to the registrar, stating the reasons therefor. The registrar may summarily take action against the bank, or if he deems fit, condone its failure or inability and afford it an opportunity to comply. The registrar may by written notice impose a fine on the bank. If the bank fails to pay the fine within the time specified in the notice, the registrar may recover the amount by way of civil action.

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19 What happens in the event that a bank becomes undercapitalised?

See question 18.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

If the registrar is of the opinion that any bank will be unable to repay deposits made with it or will probably be unable to meet any other of its obligations, the Minister of Finance may, if he or she deems it desirable in the public interest, by notifying the CEO or chairperson of the board of directors of that bank in writing, appoint a curator to the bank. On the appointment of a curator the management of the bank vests in such curator, subject to the supervision of the registrar, and those who until then were vested with its management are divested of it. The curator must recover and take possession of all the assets of the bank. The appointment of a curator does not amount to the bank being wound up or liquidated.

Subject to the supervision of the registrar, the curator must conduct the management of the bank in such a manner as the registrar may deem to best promote the interests of the creditors of the bank concerned and of the banking sector as a whole, and the rights of employees in accordance with relevant labour legislation. If, at any time, the curator is of the opinion that there is no reasonable prospect that the continuation of the curatorship will enable the bank to pay its debts or meet its obligations and become a going concern, the curator must inform the registrar in writing forthwith.

Notwithstanding the foregoing, the registrar has the right to apply to a court for the winding up of any bank under the Companies Act, and the registrar also has the right to oppose any such application made by any other party. No person other than a person recommended by the registrar may be appointed as provisional liquidator or liquidator of a bank. The Master of the High Court will also appoint a person, who must, in the opinion of the registrar, have wide experience of and be knowledgeable about the latest developments in the banking industry to assist the provisional liquidator or liquidator in the performance of his or her functions in respect of the bank in question. A liquidator is appointed to conduct the winding-up of a bank, and a provisional liquidator holds office until the appointment of a liquidator.

The Banks Amendment Bill 17 of 2014 seeks to provide an alternative to the recovery of a bank within the existing corporate entity, to facilitate the transfer of all or part of a bank's business to a successor entity pursuant to a transfer under section 54 of the Banks Act and to facilitate the implementation of the said measures by the curator. It is explained in the draft memorandum to this Bill that it is proposed that the Banks Act is amended to enable the curator to enter into transactions in which the business of the bank is, in whole or part, transferred in circumstances where a reasonable probability exists that the transferee entity will be able to meet the transferred liabilities and that as a result of the transfer the bank's creditors will not incur greater losses as a result of such transfer than would have been incurred if the bank had been wound up under the Banks Act on the date of the proposed transfer. This will enable the transfer of assets of a bank under curatorship in terms of a prudent and responsible framework without the unnecessarily restrictive provision that the transfer would enable such a bank to 'become a successful concern'. The draft memorandum further explains that the Bill proposes to empower the minister to enable the curator to raise funds and provide security over the assets in respect of such funding. In addition it is also proposed that the institution of claims against the bank be allowed for damages in respect of any loss sustained by, or damages caused to any person as a result of the security after the expiry of a period of one year from the date of the provision of the security.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The Regulations Relating to Banks, issued under the Banks Act, has been amended to give effect to Basel III. The implementation of the Basel III framework is based on a phased-in approach commencing on 1 January 2013 and continuing up to 2018, in line with the timelines determined by the Basel Committee. In particular, the capital framework for banks has been replaced by an amended capital framework as set out in the Regulations.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

No entity other than a bank or institution that has been approved by the registrar and that conducts business similar to the business of a bank in a country other than the Republic may exercise control over a bank, unless such person is a public company and is registered as a controlling company in respect of such bank. A person is deemed to exercise control over a bank if:

- the bank is a subsidiary of the controlling company; or
- that person alone or together with his or her associates:
- holds shares in the bank of which the total nominal value represents more than 50 per cent of the nominal value of all the issued shares of the bank, unless he or they are unable to influence decisively the outcome of the voting at a general meeting due to limitations on the voting rights attached to the shares;
- is entitled to exercise more than 50 per cent of the voting rights in respect of the issued shares of the bank; or
- is entitled or has the power to determine the appointment of the majority of the directors of that bank.

23 Are there any restrictions on foreign ownership of banks?

There is no specific restriction of foreign ownership of banks, but there are restrictions on shareholding. In general, a shareholder may not acquire or hold more than 15 per cent of the shares of a bank or controlling company without the permission of the minister of finance or the registrar. In considering the requisite permission, the registrar or minister may consult the Competition Commission. The registrar or the minister must be satisfied that the proposed acquisition of shares will not be contrary to the public interest and to the interests of the bank or its depositors or of the controlling company. Note that exchange control approval will also be required.

24 What are the legal and regulatory implications for entities that control banks?

Apart from the fact that controlling companies must be registered and approved, investments made by a controlling company or loans and advances made, other than in the banking sector and in fixed property intended for use in the conducting of the business of a bank, may not exceed a prescribed percentage of a prescribed amount.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

A controlling company must manage its affairs in such a way that the total of its common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital, and its common equity Tier 1 unimpaired reserve funds, additional Tier 1 unimpaired reserve funds and Tier 2 unimpaired reserve funds does not at any time amount to less than an amount that represents a prescribed percentage of the sum of the amounts relating to the different categories of assets and other risk exposures and calculated in such a manner is prescribed.

In addition, the capital and reserve funds of any regulated entity included in the banking group and structured under the controlling company must not at any time amount to less than the required amount of capital and reserve funds determined in respect of the relevant regulated entity, in accordance with the relevant regulator responsible for the supervision of the relevant regulated entity.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

None.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Application for registration as a controlling company must be made to the registrar on the prescribed form. The registrar may grant or refuse the application or make the granting thereof conditional.

Please refer to the definition of 'control' in question 22.

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28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Foreign institutions have acquired shareholding in South African banks. Although the regulatory process is no different for a foreign acquirer in terms of the Banks Act, exchange control approval will nevertheless be required.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The registrar shall not grant an application for registration as a controlling company unless he is satisfied that:

- the registration of the applicant as a controlling company will not be contrary to the public interest;
- in the case of an applicant intending to control any bank, the applicant will be able to establish control;
- no provision of the memorandum of incorporation of the applicant and no interest which any person has in the applicant is inconsistent with the Banks Act;
- every director or executive officer of the applicant is a fit and proper person and has sufficient knowledge and experience; and
- the applicant is in a financially sound condition.

30 Describe the required filings for an acquisition of control of a bank.

See question 27.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The time frame is not regulated and it is not possible to estimate.

Update and trends

Last year saw the successful implementation of the Southern African Development Community (SADC) Integrated Regional Settlement System (SIRESS). SIRESS allows SADC member states to settle regional transactions among banks within the SADC countries on a gross basis and in real time. This replaced paper-based instruments and facilitates electronic fund transfers within member states. The member states of the SADC are Angola, Botswana, Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

According to Guidance Note 2/2015 issued by the SARB, meetings to be held by the SARB during 2015 with the boards of directors of banks and controlling companies will consist of a discussion of the following topics:

IFRS 9
IFRS 9, published by the International Accounting Standards Board, includes a new standard for impairment accounting. The SARB intends to cover the implementation and impact assessment of the new standard over the next two years, with a key focus on practical implementation and readiness during 2015.

Shadow banking
The SARB wishes to obtain a better understanding of banks' strategic perspective regarding intermediating credit through non-bank channels and the extent of their involvement in and facilitation of these activities, or alternatively the impact of shadow banking on their own operations and preparing therefor.

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Spain

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

Governmental and regulatory policies related to the Spanish banking sector are designed mainly to ensure the stability of the Spanish financial system. The financial system is stable when credit entities are dedicated to the business of credit intermediation, namely, receiving funds from the public and granting credit. Banking policies promote credit intermediation activities in two ways:

- by developing rules to guarantee the correct functioning of financial institutions, their capacity to deal with adverse events and to align the interests of all parties involved in the credit chain (banks, deposit-holders and investors) with general interests; and
- by implementing a supervisory system designed to ensure the solvency of financial institutions and compliance with their specific regulations.

The Spanish banking sector is also subject to European Union (EU) governmental and regulatory policies. These policies have a macro-prudential approach and are intended to avoid system risk and achieve the stability of the financial system of the EU as a whole. EU regulations aim to ensure the safety and soundness of the EU banking sector and consistent supervision in all EU member states. Since the beginning of the financial crisis, the purpose of EU policies and regulations has been to restore financial stability within the EU. As a result, the roadmap of the Spanish banking sector has been, and in the near future, will continue to be, determined by EU initiatives.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary statute governing credit entities in Spain is Law 10/2014 on the organisation, supervision and solvency of credit entities (Law 10/2014). Law 10/2014 was recently enacted to adapt the Spanish legal system to Directive 2013/36/EU (CRD IV) and Regulation (EU) No. 575/2013 (CRR). Law 10/2014 was also a major achievement in that it repealed, and in a single law combined, some of the numerous and rather archaic rules governing the organisation and discipline of credit entities.

Law 10/2014 establishes that accepting deposits from the public is an activity that is legally reserved to credit entities. Furthermore, it sets out the general lines of the legal regime of credit entities, such as their authorisation process, the provision of cross-border services within the EU, significant holdings, corporate governance, solvency and penalty regime. Matters related to savings banks and cooperative banks are regulated by specific legislation.

The recently approved Royal Decree 84/2015 of 13 February on the organisation, supervision and solvency of credit entities (Royal Decree 84/2015) develops the provisions of Law 10/2014 related to, among others, corporate governance, internal capital adequacy assessment, capital buffers and the Bank of Spain's supervisory duties regarding credit entities.

Law 9/2012 on the restructuring and resolution of credit entities (Law 9/2012) is also a key piece of banking legislation. Law 9/2012 was enacted to fulfil the Spanish government's commitments under the Memorandum of Understanding signed with the Eurogroup in 2012. However, it was also a means for advance incorporation of some of the provisions of the draft European directive establishing a framework for the recovery and resolution of credit entities and investment firms. The most significant measures adopted by Law 9/2012 were: regulating the intervention measures that could be adopted with respect to a credit entity depending on its financial situation, namely, early intervention, restructuring and orderly resolution; and reinforcing the powers of the Fund for Orderly Bank Restructuring (FROB), this being the authority in charge of providing public financial assistance to credit entities in distress and responsible for managing their restructuring.

As the aforementioned European directive was passed on 15 May 2014, a new law governing the resolution of credit entities and investment firms is currently being drafted with the intention of repealing Law 9/2012. The new law will follow the principles of Law 9/2012, but will incorporate the full EU framework on: recovery plans, which must be drafted by all entities, not just those in distress; resolution measures, which must include a bail-in tool; and the establishment of a National Restructuring Fund financed by contributions of credit entities and investment firms.

3 Which regulatory authorities are primarily responsible for overseeing banks?

Until the establishment of the Single Supervisory Mechanism (SSM), the Bank of Spain was the sole authority responsible for overseeing banks. However, as will be further explained in question 9, the supervision of Spanish banks is now shared between the Bank of Spain and the European Central Bank (ECB).

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Insurance of deposits

Deposits are not insured by the Spanish government, but by the Deposit Guarantee Fund of Credit Institutions (the Fund). The Fund operates under private law, has its own legal personality and full capacity to carry out its functions. It is intended to guarantee deposit-holders the reimbursement of their cash and security deposits with credit entities up to the limit of €100,000. For this purpose, the Fund may also adopt measures to support the resolution of credit entities.

All Spanish credit entities must be members of the Fund. Branches of non-EU credit entities are required to be members of the Fund only if the deposits held are not covered by a guarantee scheme in their home country or the coverage is lower than that of the Fund (in which case they will be members of the Fund only for the amount not guaranteed in their home country). Branches of EU credit entities are not required to be members, although they may become members if they wish. Each member credit entity must contribute the equivalent of 2 per thousand of its guaranteed deposits to the Fund. However, under certain circumstances, member credit entities may be required to contribute additional amounts.

The Fund will pay deposit holders the guaranteed amounts of their deposits in the following circumstances:

- when the credit entity has been declared insolvent or has filed a declaration of insolvency; or
- unless the entity is subject to a resolution measure, when deposits due and payable have not been paid and the Bank of Spain determines that the credit entity will be unable to restore them and has no prospects of doing so in the near future owing to its financial situation.

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Government recapitalisation of the banking sector

The Spanish government may hold ownership interests in credit entities by means of the FROB. The FROB is a public entity, fully owned by the state, and is responsible for managing the restructuring and resolution of the Spanish banking sector to ensure the stability of the Spanish financial system.

The FROB has held ownership interests in many credit entities since the beginning of the financial crisis in 2009. However, due to sales, divestments and repayment of financial assistance, the FROB currently only holds the following ownership interests in Spanish credit entities:

- 62.01 per cent of Bankia-BFA (BFA Tenedora de Acciones, SAU is the 100 per cent owner of Bankia SA). The FROB's holding is expected to be sold by the end of 2017; and
- 65 per cent of Banco Mare Nostrum, SA. The FROB's holding is expected to be sold by February 2018.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

No specific legal regime governs the transactions entered into by a bank and its affiliates. There are, however, certain provisions that may affect transactions with group entities, such as: those regulating restrictions to large exposures; those regulating qualified holdings in non-financial entities, where a qualified holding is defined as a holding which amounts to at least 10 per cent or which enables the holder to influence the management significantly; and those relating to listed credit entities.

There is no statutory list of the activities that can or cannot be performed by financial institutions. Furthermore, the concept of financial institution comprises a variety of entities (credit entities, investment firms, payment entities, e-money entities, etc) that hold different statutory licences which, in some cases, enable them to perform only a certain type of services. For instance, investment firms may only provide investment services. E-money entities may only engage in the business of issuing e-money. Payment institutions may only provide payment services

Spanish credit entities are, however, full-service entities. They operate under the principle of 'universal banking' and are therefore authorised to perform a very broad range of activities. In addition to taking deposits from the public, they can provide most financial services, for instance, payment services, investment services, issuance of e-money and activities relating to the financial markets and can also act as insurance mediators. This notwithstanding, they are not authorised to manage collective investment schemes, carry out insurance business other than mediation or generally engage in retail trading activities.

6 What are the principal regulatory challenges facing the banking industry?

In general, the biggest challenges in banking regulation in the near future will arise from the implementation into Spanish law of the European regulatory measures approved over the past few years to overcome the financial crisis and achieve a true European banking union. Although some of these measures were implemented by Law 10/2014, Royal Decree 84/2015 and Law 9/2012, significant legislative work is pending completion to incorporate the full European framework on credit entities. As indicated in question 2, a draft law to repeal Law 9/2012 and fully implement the EU regime on resolution of credit entities is currently under way.

7 Are banks subject to consumer protection rules?

Like any other entity which does business with consumers, banks are subject to the General Law for the Defence of Consumers and Users (the Consumer Law). The Consumer Law regulates the relationship between businesses and consumers, in particular the conditions that must be met throughout the contracting process. General matters regulated by the Consumer Law relate to:

- pre-contractual information;
- the consumers' right to withdraw from the contract after it has been concluded;
- certain conditions within a contract that are considered abusive;
- distance contracting; and
- product guarantee and after-sale services.

In addition to the Consumer Law, banks are subject to specific rules when granting credit to consumers. These rules are set out in Law 16/2011 on credit agreements for consumers (the Consumer Credit Law). The Consumer Credit Law regulates agreements whereby a creditor (not necessarily a bank) grants or promises to grant credit to a consumer in the form of a deferred payment, loan or similar financial accommodation. However, certain agreements fall outside the scope of the Consumer Credit Law, for instance, those secured by a mortgage on immoveable property, those intended for the purchase of property rights in land or in a building, those falling below or exceeding a certain threshold or those free from interest and charges.

The most significant provisions of the Consumer Credit Law relate to:

- Credit agreements advertisements that indicate the interest rate or cost of the credit. Among other requirements, these must include the annual percentage rate (APR).
- Pre-contractual information requirements, that is, the information the creditor must provide the consumer before the consumer is bound by the agreement. This enables the consumer to compare offers and make an informed decision as to whether to conclude a credit agreement. This obligation may be fulfilled by the provision of a standard consumer credit information form.
- The obligation to provide assistance to the consumer prior to the conclusion of the credit agreement. Banks are required to provide proper and personalised information to enable the consumer to assess whether the credit agreement is in line with their interests, needs and financial situation.
- Obligation to assess the consumer's creditworthiness on the basis of sufficient information. This may be obtained from the consumer or from a credit database.
- Information to be included in the credit agreement.
- The consumer's right to withdraw from the contract in the 14 calendar days following its conclusion without giving a reason or being charged a cancellation fee.
- The calculation of the APR.
- The procedure to amend the total cost of the credit. The cost of the credit cannot be modified to the consumer's detriment unless this is expressly set out in the credit agreement. If this is the case, an unbiased index or reference rate must be used in the calculations. Furthermore, the credit agreement must include the procedure for the change in the total cost, the rights of the parties in relation thereto and the index or reference rate applicable.
- Open-end credit agreements and, in particular, their termination by the parties. The consumer is entitled to terminate the agreement free of charge and at any time unless the parties have agreed a period of notice. The notice period may not exceed one month. The bank may also terminate the credit agreement, although in this case it must give the consumer two months' notice.
- The consumer's right of early repayment of the credit and the limits on the compensation the bank may receive. The maximum compensation will be 1 per cent of the credit repaid, if the period that remains until the credit's expiry exceeds one year. If not, the maximum will be 0.5 per cent.

There are also certain rules aimed to protect borrowers of mortgage loans such as those contained in Royal Decree-Law 6/2012 on urgent measures to protect mortgage debtors with no resources, Royal Decree-Law 6/2013 on the protection of holders of certain investment and saving products and other financial measures and Law 1/2013 on measures to reinforce the protection of mortgage debtors, debt restructuring and social lease.

Finally, banks are subject to strict transparency rules when providing banking services, regardless of whether or not the client is a consumer (although in the latter case, the parties may waive their application). The rules are contained in Order EHA/2899/2011 on transparency and protection of banking services for clients and Circular 5/2012 of the Bank of Spain for credit entities and payment service providers on the transparency of banking services and responsibility in granting credit (the Transparency Rules).

The Transparency Rules focus on:

- the information on interest rate and charges that credit entities must publish;
- the pre-contractual information requirements for each type of banking service;

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- contract contents and information that must be provided after the contract has been concluded;
- communications with clients; and
- responsible lending practices.

The transparency of the banking system has been a major concern over recent years. It is essential to restore public confidence in the banking sector. However, while the financial crisis has resulted in the production of an incredible amount of EU legislation aimed at restoring the solvency of credit entities, no EU legislation has been approved to regulate the relationship between banks and their clients. Transparency and client protection are, for the moment, subject to national initiatives. In the case of Spain, the loss of public confidence in the banking system led to the Transparency Rules being approved. The Transparency Rules were intended to correct practices that came to light during the crisis, such as the failure to assess debtors' creditworthiness and the marketing of high-risk products to clients. They were also a means to update the rules governing matters no longer aligned with the business and marketing practices of the banking industry.

The Bank of Spain is entrusted with the enforcement of the Transparency Rules.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

We anticipate that the next years will be dedicated to implementing and developing the existing EU regulatory framework and the legislation still in progress. For instance, CRD IV and CRR provide for the adoption of a large number of delegated and implementing acts, some of which are expected to be submitted by the end of 2017.

Although the SSM and the Single Resolution Mechanism are already in force, the Spanish authorities must make significant efforts to adapt over the next few years. In particular, the SSM entails a major change in the Bank of Spain's current supervisory approach and practice, given that it must now follow the standards set by the ECB.

There are still several matters being discussed at a European level, such as the possible adoption of a banking structural reform to avoid proprietary trading or the regulation of shadow banking. We expect these issues to be resolved and formalised in specific EU provisions over the next few years, thus requiring further implementation work in Spain.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Supervision of banks under the SSM

The SSM has been operative since 4 November 2014 and it is responsible for overseeing all banks within the eurozone. The ECB now has the exclusive competence to carry out certain tasks for prudential supervisory purposes. For instance, it is responsible for authorising and withdrawing the authorisation of credit entities in the eurozone, assessing notifications for the acquisition and disposal of qualifying holdings, performing stress tests, carrying out supervision on a consolidated basis and ensuring banks' compliance with EU prudential requirements, such as own funds' requirements, liquidity, leverage or corporate governance.

However, for the sake of efficiency, supervisory tasks and responsibilities are allocated to the ECB and the national central authorities (NCA) depending on the bank's significance. The ECB is entrusted with the direct supervision of banks qualifying as significant in accordance with the criteria established in Council Regulation (EU) No. 1024/2013 (the SSM Regulation). Under Regulation (EU) No. 468/2014 (the SSM Framework Regulation), significant banks are supervised by a joint team composed of staff members from the ECB and the NCA and coordinated by an ECB staff member.

The less significant banks continue to be supervised by NCA staff members, unless the ECB decides to take over their direct supervision at any time (except for the SSM Framework's 'common procedures', such as bank authorisation and the assessment of the acquisition and disposal of qualifying holdings in banks; these are the joint responsibility of the ECB and the NCA).

The list of significant and non-significant banks is published by the ECB and the Bank of Spain. As of 4 August 2014, the Spanish banks which qualified as significant and, therefore, subject to the direct supervision of the ECB were:

- Banco Bilbao Vizcaya Argentaria, SA;
- Banco de Sabadell, SA;
- Banco Financiero y de Ahorros, SA;
- Banco Mare Nostrum, SA;
- Banco Popular Español, SA;
- Banco Santander, SA;
- Bankinter, SA;
- Caja de Ahorros y MP de Zaragoza, Aragón y Rioja;
- Caja de Ahorros y Pensiones de Barcelona, SA;
- Banco de Crédito Social Cooperativo;
- Catalunya Banc;
- Kutxabank, SA;
- Liberbank, SA;
- Banesco Holding Hispania; and
- Unicaja Banco, SA.

The rest (47 as of the above date) continue to be supervised by the Bank of Spain (except for the common procedures, where it acts jointly with the ECB). However, even with less significant entities, the Bank of Spain's supervisory approach must be consistent with the standards and common framework of the SSM.

Despite the ECB being the key authority for supervisory purposes, the Bank of Spain continues to play an essential role in the supervision of Spanish banks. Firstly, the SSM Regulation has only assigned the fulfilment of specific tasks to the ECB and the Bank of Spain remains in charge of those tasks not specifically assigned to the ECB (for instance, the supervision of branches of credit entities of non-EU countries). Secondly, the Bank of Spain is responsible for supervising banks which do not fulfil the conditions to be considered significant. Thirdly, even with respect to the ECB tasks, the SSM Regulation expressly imposes an obligation on the NCA to assist in preparing and implementing those acts, including verification acts (the Bank of Spain acts as a gateway to the ECB for the common procedures, assessing applications received from a credit entity and sending the draft decisions to the ECB for resolution). Finally, the Bank of Spain is still in charge of anti-money laundering matters, transparency, consumer protection and the supervision of payment services.

Examinations

In accordance with CRD IV and the SSM Regulation, the joint supervisory team (for significant entities) and the NCA (for the rest) are required to review the arrangements, strategies, processes and mechanisms implemented by credit entities and evaluate:

- the risks the institutions are, or might be, exposed to;
- the risks an institution poses to the financial system in general; and
- the risks revealed by stress testing, taking into account the nature, scale and complexity of an institution's activities.

Royal Decree 84/2015 imposes an obligation on the Bank of Spain to evaluate the aforementioned risks. The Bank of Spain has the discretion to determine the frequency and scope of the evaluation on a case-by-case basis, taking into account the particular characteristics of each entity. However, the evaluation must include, at least, certain items set out in Royal Decree 84/2015 (for instance, the results of stress tests or the exposure to and management of concentration and liquidity risks) and must be updated at least once a year. Furthermore, the Bank of Spain must perform a periodic comprehensive assessment of the global management of liquidity risk. For the purposes of this assessment, the Bank of Spain must analyse the importance of each entity in the EU financial markets and how its decisions may affect financial stability in the EU.

The above evaluations must be performed in accordance with the allocation of tasks established by the SSM Regulation, that is, by the joint supervisory team for significant entities and by the Bank of Spain for the rest.

10 How do the regulatory authorities enforce banking laws and regulations?

Owing to the SSM, the enforcement of banking laws and regulations in Spain is now shared between the ECB and the Bank of Spain. To enable the ECB to carry out its tasks under the SSM Regulation, it has been granted specific investigatory and supervisory powers. Investigatory powers encompass the power to request information, conduct investigations of any necessary person, carry out on-site inspections and apply for judicial authorisations if required. The list of the ECB's supervisory powers is

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broad and includes, among others, that of requiring entities to hold own funds in excess of the capital requirements, requiring that institutions apply a specific provisioning policy or treatment of assets in terms of own funds' requirements, imposing additional or more frequent reporting requirements and removing members from the management body of credit entities at any time. Additionally, if it is necessary for the ECB to carry out the tasks conferred by the SSM Regulation, the ECB may instruct the Bank of Spain to make use of its powers under Spanish law if the SSM Regulation has not granted these powers to the ECB. The ECB is also entitled to impose pecuniary penalties to carry out its tasks under the SSM Regulation. In general, administrative penalties are calculated as up to twice the amount of the profits gained or losses avoided because of the breach, or up to 10 per cent of the total annual turnover in the preceding business year.

The Bank of Spain remains in charge of enforcing EU legal acts that have not been specifically conferred to the ECB. For this reason, the Bank of Spain has also been granted broad supervisory powers similar to the ECB's under the SSM Regulation, and has the capacity to impose administrative penalties.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In recent years, credit entities have principally faced contentious issues with respect to: the mis-selling of financial products; and the use of floor clauses in variable interest loans.

The recent financial crisis has evidenced that credit entities have generally marketed a wide range of unsuitable financial products to retail consumers and investors. These products were sometimes too complex for the customer to understand, not in line with the customer's profile or marketed without providing clear information to the customer previously.

Since most EU credit entities have engaged in the above practices, the response to this issue has been at a European level. New requirements aimed to ensure consumer protection have been adopted in the Mortgage Credit Directive, the review of the Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive and in a Regulation on a new Key Investor Information Document for Packaged Retail and Insurance-Based Investment Products. In addition, the European Securities Market Authority has issued several opinions in connection with the selling of complex and structured retailed products. From a Spanish regulatory perspective, the National Securities Market Commission has drafted a proposed circular to regulate financial instrument disclosures.

It has also been common for banks to limit the extent to which customers could benefit from decreases in the reference interest rate used to calculate the interest on a variable interest mortgage loan. These clauses are referred to as floor clauses. They were triggered during the financial crisis due to the plummeting of the EURIBOR, the reference interest rate for most mortgage loans. The floor clauses prevented debtors from benefiting from the decrease in the EURIBOR and paying less interest for their mortgage loans. As a result, there was an unprecedented surge of claims from debtors alleging that the floor clauses were abusive. The Supreme Court finally ruled in two cases that the clauses were not clear and comprehensive and, were therefore, null. The nullity rendered the clauses inapplicable from that moment (not retroactively).

12 How has bank supervision changed in response to the 2008 financial crisis?

See question 9.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Under Law 9/2012 banks may be taken over by the FROB during processes of recovery and resolution through the subscription of recapitalisation instruments (ordinary shares or instruments convertible into ordinary shares) or through the transfer of assets and liabilities of a 'bridge bank' owned by the FROB.

In addition, under Law 10/2014 (which replaces Law 26/1988) the Bank of Spain may decide to intervene in a bank or provisionally replace its governing body if there is evidence that it is in an exceptionally serious situation that may jeopardise its stability, liquidity or solvency.

Before the crisis stated in 2008, the Bank of Spain most relevant intervention was in 1993 with Banesto. Banco Santander acquired Banesto in April 1994.

Since the crisis began, the FROB has taken over the running and management of nine Spanish credit entities, all of them savings banks or controlled or created by transformation of saving banks, some of which were subsequently acquired by other credit entities: Caja Castilla La Mancha in March 2009; Cajasur in May 2010; Caja de Ahorros del Mediterráneo (CAM) in July 2011; CatalunyaCaixa and Novacaixagalicia, both in September 2011; Banco de Valencia in November 2011 and Bankia in May 2012.

In all these cases depositors' interests were fully protected. However, if a bank is subject to insolvency proceedings, up to €100,000 of each depositors' money is protected and any excess will rank pari passu with other senior debt claims.

Law 9/2012 or Law 10/2014 do not implement any specific protection mechanisms for employees. Employees will be subject to the ordinary Spanish employment rules and regulations, which include protection for employees in the event of a business unit transfer (transfer of undertaking). However, if a bank is subject to insolvency proceedings, certain employees' claims rank as preferred debts.

In accordance with Law 9/2012, recovery and resolution processes will be based on the following principles:

- the shareholders will bear first loss;
- the subordinated creditors of institutions will, where applicable, bear losses arising from recovery or resolution after the shareholders, and in accordance with the order of priority established in the Spanish insolvency law, subject to the exceptions laid down in Law 9/2012;
- creditors of the same class will be treated in the same way; and
- no creditor will bear losses exceeding those they would have borne if the institution were wound up under insolvency proceedings.

The FROB may resolve to transfer the bank to an acquirer other than a bridge bank. In this case, the consent of the shareholders is not required but the transfer must be made under market conditions bearing in mind the circumstances of each specific case. However, the financial support measures by the FROB will not reduce any losses deriving from the recovery or resolution that should be borne by shareholders and subordinated creditors.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Current Spanish legislation does not require banks to have a recovery or resolution plan as a preventive measure, aside from the action plan, restructuring plan and resolution plan provided under Law 9/2012. Notwithstanding this, the draft bill that will replace Law 9/2012 and that is expected to be approved in the coming months provides the following:

Recovery plan

As a preventive measure, each bank will draw up and maintain a recovery plan providing for measures to be taken by the institution to restore its financial position following a significant deterioration of its financial situation. The recovery plan will be approved by the bank's management body and subsequent reviewed by the Bank of Spain.

The plan will include quantitative and qualitative indicators to be taken into account as a reference to initiate the actions planned. Recovery plans will not assume any access to or the receipt of extraordinary public financial support.

The banks will update their recovery plans at least once a year or following a change to its legal or organisational structure, business or financial situation, which could have a material effect on, or necessitates a change to, the recovery plan or if the Bank of Spain considers it necessary.

Banks that form part of a consolidated group do not need to draw up an individual recovery plan. The recovery plan will be drawn up by the parent company at a level group and will include the measures to be applied by the parent and each of its affiliates.

Individual resolution plan

As a preventive measure, the resolution authority, after consulting the FROB, the competent authority and the resolution authorities of the jurisdictions in which any significant branches are located insofar as it is relevant to the particular branch, will draw up a resolution plan for each

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bank that is not part of a group subject to consolidated supervision. The resolution plan will provide for the resolution actions that the resolution authority may take if the institution meets the conditions for resolution.

When drawing up the resolution plan, the resolution authority identifies any material impediments to resolvability and, where necessary and proportionate, outlines relevant actions for how those impediments could be addressed.

The resolution plan will not assume any of the following:

- extraordinary public financial support besides the use of the financing arrangements established in accordance with article 53 (these include the granting of guarantees, granting of credits or loans, acquisition of assets and liabilities and contributions to a bridge entity);
- central bank emergency liquidity assistance; or
- central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms.

The recovery plans will be updated at least once a year or after a change to the legal or organisational structure of the institution, its business or its financial situation, which could have a material effect on, or necessitates a change to, the recovery plan or if the Bank of Spain considers it necessary.

Group resolution plan

Group-level resolution authorities, together with the resolution authorities of subsidiaries, having consulted the resolution authorities of particular branches insofar as is relevant to the particular branch, draw up group resolution plans. Group resolution plans must include a plan for the resolution of the group headed by the European Union parent undertaking as a whole, either through resolution at the level of the European Union parent undertaking or through the break up and resolution of the subsidiaries. The group resolution plan must identify measures for the resolution of:

- the European Union parent undertaking;
- the subsidiaries that are part of the group and that are located in the European Union;
- the financial holding company, mixed financial holding company and mixed-activity holding company; and
- subject to Title VI, the subsidiaries that are part of the group and that are located outside the European Union.

15 Are managers or directors personally liable in the case of a bank failure?

Bank failure does not automatically result in director liability.

Law 9/2012 provides that pursuant to the provisions of insolvency, commercial and criminal law, the directors of banks will be liable for losses caused in proportion to their level of responsibility and the seriousness of such losses.

Depending on the circumstances, directors may be at risk of facing:

- disciplinary action: if the directors are responsible for breaches of the organisational and disciplinary rules they may be subject to ordinary/standard procedure regulatory sanctions, which may include fines, disqualification as well as banning orders;
- civil liability: directors owe duties to their companies. In particular, they are required to act as loyal representatives in the best interest of the company and to exercise reasonable care, skill and diligence. The failure to comply with these duties exposes the directors to civil liability towards the company; and
- a range of sanctions may apply to acts of misconduct prior to or in the course of insolvency proceedings in which a judge declares the insolvency to be guilty because there has been a double accounting system, accounting irregularities that may affect the calculation of the company's net worth or financial situation; assets of the debtor are fraudulently transferred from the debtor's estate during the two years prior to the declaration of insolvency or if acts are carried out with the intention of creating a false net worth position.

16 How has bank resolution changed in response to the recent crisis?

The first Spanish rule that was passed in response to Spain's financial crisis was Royal Decree-Law 9/2009, which establishes several measures to carry out a bank restructuring process in order to increase the strength and solvency of the Spanish banking system. The bank restructuring model is based on the three existing credit institution deposit guarantee funds and the use of the new entity created for that purpose, FROB. Royal Decree-Law 9/2009 distinguishes between three phases:

- the bank itself will search for a solution;
- the adoption of measures to address the weaknesses that may affect the financial viability of banks (strengthen its resources and solvency; merger with another credit entity or total or partial transfer of its business units to other credit entities); and
- the restructuring process with the intervention of the FROB through the provision of financial support and management measures in order to improve its organisational and internal control procedures.

The second relevant rule on bank resolution is Royal Decree-Law 24/2012 of 31 August (RDL 24/2012), which establishes a framework for the management of crisis situations affecting credit entities on the basis of the European Commission's proposal of 6 June 2012 for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms. The content of RDL 24/2012 was ratified through Law 9/2012 which is Spain's current regulation on the recovery and resolution of credit entities.

Law 9/2012 provides for three different procedures depending on the nature and materiality of the crisis affecting the relevant credit entity.

Early intervention

This occurs when a credit institution, or a consolidated group or sub-group of credit institutions, fails to meet, or for objective reasons it is reasonably likely to be unable to meet, requirements on solvency, liquidity, organisational structure or internal control, but is in a position to be able to resume compliance with requirements without support.

An action plan must be drawn up by the bank and be approved by the Bank of Spain with a favourable report from the FROB.

In addition to an analysis of the credit institution's situation, the action plans includes a business plan that, in a manner proportional and appropriate to the specific circumstances of the bank, must at least encompass:

- specific targets for the efficiency, profitability, leverage and liquidity of the bank, or of the consolidated group or sub-group;
- specific solvency commitments;
- specific commitments to improve efficiency, rationalise administration and management, improve corporate governance, reduce overhead costs and downsize production capacity; and
- in the event that the institution requests public financial support, the terms on which it is to be provided and the measures to be implemented to minimise the use of public resources.

The Bank of Spain may resolve that the board of directors be provisionally replaced.

Restructuring

A bank will be restructured when it requires public financial support to ensure its viability and objective factors make it reasonably foreseeable that such support will be repaid or recovered within the period envisaged for each instrument. A bank may also be restructured in the absence of such objective criteria when the resolution of the institution would have seriously damaging effects on the stability of the financial system as a whole, such that its restructuring is preferable for the purpose of minimising the use of public funds.

A restructuring plan must be drawn up by the bank and be approved by the Bank of Spain and the FROB.

In addition to the above-mentioned elements for action plans, the restructuring plan must include the restructuring instruments (financial support or transfer of assets or liabilities to an asset management company) that will be implemented. It must also include an analysis of the bank's situation substantiating that it has capacity to allow recovery or repayment of the public financial support requested within the time frame envisaged for each instrument or, conversely, substantiating the seriously harmful effects for the stability of the financial system that the resolution of the institution would cause.

Resolution

A bank should be resolved if the two following circumstances simultaneously occur:

- the bank is non-viable, or it is reasonably foreseeable that it will be so in the near future; and
- for reasons of public interest, it is necessary or advisable to undertake the resolution of the bank, since the winding-up and liquidation of the bank under insolvency proceedings would not reasonably allow the

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objectives of Law 9/2012 (not to disrupt the economy or the financial system; to avoid adverse effects on the stability of the financial system; ensure the most efficient use of public resources or to protect depositors and customers) to be attained to the same extent.

Following the initiation of the resolution process, the board of directors of the bank will be replaced by the FROB as director of the management board, and the FROB will in turn appoint the individual(s) or legal person(s) who will act on its behalf.

Within two months of its appointment as director, the FROB will draw up a resolution plan for the bank or, where appropriate, determine whether insolvency proceedings should be initiated.

The resolution plan must at least include:

- the conditions giving rise to the initiation of the resolution process;
- the resolution instruments that have already been implemented or which the FROB intends to implement, and the powers it intends to use to this end, along with the commitments adopted to minimise the use of public funds and the potential competition distortion that might arise from these instruments and powers;
- the financial support measures to be implemented by the Fund under the related regulations;
- the economic valuation of the bank or of its related assets and liabilities;
- the actions to be taken in relation to hybrid capital and subordinated debt instruments; and
- the maximum implementation period.

The resolution instruments are: the sale of the bank's business; the transfer of assets or liabilities to a bridge bank; and the transfer of assets or liabilities to an asset management company.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Since 1 January 2014, the regulatory capital requirements for Spanish authorised banks are determined according to Regulation (EU) No. 575/2013 (CRR) and Law 10/2014.

Spanish legislation requires banks to hold sufficient capital upon initial authorisation and also capital against risk. The former represents a minimum, although for most banks the capital they are required to hold against risks will exceed the authorisation minimum. Upon authorisation, banks must hold capital resources of €18 million. Thereafter, a bank must hold capital equal to the sum of its requirements for credit risk, market risk and operational risk. In addition, banks must comply with liquidity requirements, leverage ratio and the capital conservation buffer, the countercyclical buffer and the systemic risk buffer.

According to the Bank of Spain's Circular 3/2008, banks have a choice between a standardised approach to credit risk and advanced internal ratings-based approaches. Banks may seek the Bank of Spain's approval to use their own internal models to calculate capital requirements for credit risk, including credit risk mitigation and securitisation.

In addition, banks must hold capital for operational risk. Banks may use the following methods for its calculation: basic indicator method, standard method, including alternative standard method and advanced internal method. The use of the alternative standard method and advanced internal method requires the approval of the Bank of Spain. In this regard, the Bank of Spain has issued the Guidelines for applying the Standardised Approach to determine own funds for operational risk (9 March 2009).

Banks are required to assess the adequacy of their capital (through a process known as the Internal Capital Adequacy Assessment Process, or ICAAP), which is then subject to review by the Bank of Spain. The ICAAP must be filed with the Bank of Spain before 30 April of each year and the bank must take into account the June 2008 Guidelines on the Internal Capital Adequacy Assessment Process at credit institutions issued by the Bank of Spain.

In February 2010, the Bank of Spain issued guidelines on the capital review process to inform institutions of the criteria and methodologies used by the Bank of Spain for the review and evaluation of the capital review of credit institutions.

In addition, the Bank of Spain requires banks to carry out annual stress testing and scenario analysis, including 'reverse stress testing' identifying circumstances in which a bank would no longer be viable.

The capital resources that a bank is required to maintain can be constituted by a mixture of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital. With the exception of Common Equity Tier 1 capital, the proportions of each of these types of capital that the total capital can comprise are restricted. The CRR contains detailed legal and technical requirements for the eligibility of capital instruments on the basis of which the Bank of Spain must prior authorise the capital instruments that are eligible as Additional Tier 1 or Tier 2 capital.

The CRR does not recognise forms of contingent capital for the purposes of meeting regulatory capital requirements, with the exception that all instruments recognised as Additional Tier 1 capital are to be written down or converted into Common Equity Tier 1 instruments when the Common Equity Tier 1 capital ratio of the bank falls below 5.125 per cent.

18 How are the capital adequacy guidelines enforced?

The Bank of Spain enforces compliance. Banks are required to submit periodic returns and must notify the Bank of Spain of any failure to hold adequate capital. In addition, banks must submit each year the ICAAP, which should be drafted in accordance with Bank of Spain guidelines on capital adequacy assessment and reviewed by the Bank of Spain pursuant the Bank of Spain guidelines on the capital review process of the Bank of Spain issued on February 2010.

19 What happens in the event that a bank becomes undercapitalised?

Own funds restoration plan

When a bank has a shortfall in its eligible own funds with respect to those required by the solvency regulations, the bank or the required entity of the consolidated group or subgroup, as the case may be, will immediately notify the Bank of Spain and submit within one month a plan detailing the plans for the timely restoration of compliance with the requirements, unless the situation was remedied within that time period. The plan must contain at least those aspects relating to the identification of the causes that determined the own funds shortfall, the plan for a return to compliance which may include restrictions to those activities involving high risks, divestment of particular assets, or measures for increasing the own funds level and the expected time periods for returning to compliance.

The mentioned plan must be approved by the Bank of Spain, which may include as many amendments or additional measures as it deems necessary to ensure a return to the minimum levels of required own funds.

Capital conservation plan

If a bank fails to meet its combined buffer requirement, it must prepare a capital conservation plan and submit it to the Bank of Spain no later than five working days after it identified that it was failing to meet such requirement, unless the Bank of Spain authorises an extension of up to 10 days.

The capital conservation plan must include:

- estimates of income and expenditure and a forecast balance sheet;
- measures to increase the capital ratios of the institution;
- a plan and timeframe for the increase of own funds with the objective of fully meeting the combined buffer requirement; and
- any other information that the competent authority considers to be necessary to carry out the assessment required.

If the Bank of Spain does not approve the capital conservation plan, it will impose one or all of the following measures:

- require the institution to increase own funds to specified levels within specified periods;
- exercise its powers to impose more stringent restrictions on distributions; and
- additional own funds requirements.

When the Bank of Spain requires a bank or a group or subgroup to hold additional own funds (because they do not the meet solvency requirements, including liquidity, or the Bank of Spain has evidence that the bank is likely to breach those requirements) to the minimum required own funds, and such requirement makes the entity's own funds insufficient, the entity or the required entity of the group or subgroup, as the case may be, must submit within a one-month period a plan detailing measures for complying with the additional requirement, unless the situation was remedied within that time period.

The mentioned plan must be approved by the Bank of Spain, which may include as many amendments or additional measures as deemed

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necessary. The plan must include the expected date for compliance with the additional requirement.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Once a recovery and resolution process has begun in accordance with Law 9/2012, Spanish courts cannot accept applications for insolvency proceedings against a bank. Any such actions will be void.

On receiving an application for insolvency proceedings against a bank, the commercial court judge will inform the FROB and give it 14 days to notify whether it intends to commence the institution's recovery or resolution. If the FROB gives notice of its intention to commence either of these processes, the judge will reject the insolvency application.

Subject to the above, Spanish legislation does not have a specific insolvency procedure for banks, except Law 6/2005 which only regulates conflict of law rules and publicity requirements. A bank's insolvency will therefore be subject to the ordinary insolvency process established in Law 22/2003.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The Guidelines on the Internal Capital Adequacy Assessment Process (ICAAP) at credit institutions issued by the Bank of Spain issued in June 2008, have been updated several times, the last of these on February 2014 with the purpose of complying with article 73 of CRD IV. These guidelines also consider the qualitative aspects of risk management and, therefore, they also provide details for implementing article 74 of CRD IV on corporate governance and risk management and control.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

A person who decides to acquire or increase control over a Spanish-authorised bank must notify and obtain consent from the Bank of Spain in advance, without prejudice to the competence of European Central Bank pursuant to the SSM regulator. The consequences of the failure to do so are the following:

- the political right attached to the unlawfully acquired shares cannot be exercised, and if they are exercised, the voting rights will be void and the relevant resolutions can be challenged before the courts;
- if necessary, the relevant entity may be intervened or their directors substituted; and
- a fine equivalent to three to four times of the profits made if they can be quantified or between 5 per cent and 10 per cent of the annual turnover or a fine ranging between €5 million and €10 million.

The implementation of Directive 2007/44/CE and the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector in Spanish legislation has tightened the assessment criteria for objections to a change of control (see question 29).

The Bank of Spain has 60 working days from the receipt of the notice to approve the acquisition of control (with or without conditions), or to object it. This period may be interrupted by up to 20 days if the Bank of Spain requires further information. If there is no express resolution from the Bank of Spain on the acquisition of control, no objection shall be understood to exist.

The thresholds for notifying and obtaining the Bank of Spain's consent of the acquisition of control are 10, 20, 30 and 50 per cent of the shares or voting rights. Likewise, the acquisition of 5 per cent of the shares or voting rights must be communicated to the Bank of Spain.

A parallel regime exists in respect of the reduction of control, where a person is required to give prior notice to the Bank of Spain of any reduction in control to below 50, 30, 20 and 10 per cent of the shares or voting rights. Failure to notify may be sanctioned by the Bank of Spain.

23 Are there any restrictions on foreign ownership of banks?

Apart from the assessment that the Bank of Spain will carry out over potential foreign acquirers of banks, there are no restrictions on the foreign ownership of banks.

Update and trends

Since the beginning of the financial crisis, credit entities have been required to adapt to an ever-changing regulatory environment. At the date of writing, they continue striving to meet the recently approved capital and liquidity requirements. Furthermore, the new corporate governance requirements have placed managers of credit entities in the spotlight. Remuneration policies and risk taking decisions are now subject to extremely close surveillance.

However, the EU banking reform is far from complete. We expect to see new EU initiatives over the next few years which will put even more pressure on credit entities.

24 What are the legal and regulatory implications for entities that control banks?

There are no restrictions on the business activities of a parent or acquirer of a Spanish bank, or on those of affiliates of a Spanish bank, although such activities will be taken into account as part of the Bank of Spain's assessment of the acquisition.

All banks must notify the Bank of Spain of their proposals for the appointment of new board of director members, general directors or the alike for their banks and the entity that controls them.

On the other hand, the Bank of Spain carries out the consolidated supervision of banking groups. The consolidated supervision applies at the level of the highest European Economic Area (EEA) group company whose subsidiaries and participations (basically a 20 per cent holding) are banks or broadly engage in financial activities. The Bank of Spain will not normally undertake the worldwide supervision of a group headed by a parent outside the EEA.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Where a banking group is subject to consolidated supervision, the Bank of Spain will apply its prudential rules to the group as a whole (see response to question 24). However, it will not directly regulate unauthorised entities in the group.

Each regulated entity (including banks) must meet the regulatory requirements applicable to it on a stand-alone basis. This includes, but is not limited to, capital adequacy and liquidity. If a bank belongs to a consolidated group or a subgroup of banks, the plans mentioned in response to question 19 must be ratified by its required entity.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Once a bank becomes insolvent, the controlling entity or individual is not liable for the debts of its insolvent bank subsidiary. Liability depends on the application of the general rules of insolvency law, which also apply to bank insolvency proceedings. Accordingly, the controlling entity or individual is subject to the claw-back provisions of Law 22/2003 of 9 July on Insolvency (any transaction entered into within two years prior to the start of the insolvency proceedings against the bank may be rescinded if the transaction is detrimental to the bank's estate, even if there is no intention of fraud.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

See our response to question 22. Approval may also be required under Spanish or EU competition law.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The place of incorporation or nationality of an acquirer is not relevant. There is no difference in the approval process. Where a proposed new or increased controller is regulated elsewhere in the EU or European Economic Area, the Bank of Spain must consult the relevant home-state regulator. The same applies if a Spanish bank is controlled by a parent company located in another EUor EEA state.

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29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

See our response to question 22. The Bank of Spain may only object to an acquisition on the basis of the following matters (or the submission of incomplete information):

- if, taking into account the need to ensure the sound and prudent management of a bank, it is not satisfied as to the suitability of the shareholders having a qualifying holding and in the absence of shareholders with qualifying holdings, it is not satisfied as to the suitability of any of the 20 larger shareholders of the bank; or
- if any of the members of the management body, general director or similar of the parent company, provided that it is a financial holding company, mixed financial holding company do not meet the suitability requirements (reputation and experience).

30 Describe the required filings for an acquisition of control of a bank.

Circular 5/2010 of the Bank of Spain establishes the information needed for the Bank of Spain to assess the suitability of the legal or natural person that intends to acquire the control of a bank. The Circular is drafted in accordance with the Guidelines for the prudential assessment of acquisitions and increases in holdings issued by the three European financial regulators committee.

There are no specific forms to be provided, but in general terms the information included in Part I and II of Appendix II of the aforementioned Guidelines must be provided to the Bank of Spain. If control of a bank is indirectly acquired, the relevant information must be provided on the direct acquirer and on the ultimate controlling owner.

Upon receiving the notice, the Bank of Spain can request additional information or documents if it considers this necessary.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The Bank of Spain has 60 working days to approve an acquisition, although the process may be shortened where the controllers are already known to the Bank of Spain. The process may also be extended if the Bank of Spain must consult other regulators or as a result of a report to be issued by the Spanish money laundering authorities which is a compulsory part of the process.

An informal discussion with the Bank of Spain on the proposed acquisition is a useful first step. This enables the Bank of Spain to identify potential issues and request any further information before the formal notification is submitted. If approval is granted, the prospective controller must complete the acquisition within 12 months.

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Switzerland

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The Swiss banking sector is subject to official supervision.

From a Swiss perspective, a banking activity means the taking of deposits from the public (or by way of refinancing from other banks) for the purpose of financing a large number of persons or entities. Banking activities may only be conducted in or from Switzerland if the relevant entity has been granted a licence by the Swiss Financial Market Supervisory Authority (FINMA).

FINMA grants the licence to the legal entity pursuing the banking activities (and not to the managers or to the shareholders). The various criteria to be complied with in order to obtain a licence are set out in the Federal Banking Act. Among other things, the applicant must establish that the persons entrusted with its management enjoy a good reputation and thereby assure the proper conduct of business operations (ie, guarantee of irreproachable activity). If, at a later stage, any of the licence requirements is no longer satisfied, FINMA may take administrative measures, including, in extreme cases, the withdrawal of the banking licence.

One of the most highly publicised aspects of Swiss banking regulation is Swiss banking secrecy. Disclosure of information pertaining to the client–bank relationship is prohibited under the Federal Banking Act. Banking secrecy rules encompass all data that pertain to the contractual relationship between the bank and its clients. Disclosure means communication to any third party, including the parent company of the bank as well as the supervisory authority of this parent company or any other affiliate. As a matter of principle, any disclosure amounts to a breach of banking secrecy and may trigger administrative and criminal sanctions, as well as civil liability, for the bank concerned. Exceptions apply under certain circumstances, for instance, in the context of consolidated supervision over an international banking group or pursuant to a formal request issued by Swiss public authorities (acting, as the case may be, based on a request for international judicial or administrative assistance issued by a non-Swiss public authority, including foreign financial intelligence units for AML purposes).

2 Summarise the primary statutes and regulations that govern the banking industry.

The Federal Banking Act is the main statute governing the conduct of banking activities in or from Switzerland. The provisions of the Federal Banking Act have been detailed in several implementing ordinances issued by the Swiss government (the Swiss Federal Council) and by FINMA. Furthermore, FINMA issued a series of circulars setting out its interpretation of the regulatory framework.

In addition to being licensed as banks, most Swiss financial institutions need a licence as a 'securities dealer'. Securities dealing activities are governed by the Swiss Federal Act on Stock Exchanges and Securities Trading (SESTA) and its implementing ordinances. From a Swiss perspective, 'securities dealing' refers to five broad categories of activities, namely: issuing houses; derivative suppliers; market makers; brokers operating on a short-term basis for their own accounts; and brokers acting in a professional manner for the account of their clients.

Swiss banks also qualify as 'financial intermediaries' within the meaning of the Swiss anti-money laundering legal framework and, as such, fall within the ambit of the Federal Anti-Money Laundering Act and its implementing ordinances.

A Swiss bank may also serve as custodian for collective investment schemes. This type of activity is subject to the Collective Investment Scheme Act and its implementing ordinances.

Finally, the Swiss banking supervision system allows for the delegation of certain duties to self-regulating organisations. The Swiss Bankers Association and the Swiss Funds & Asset Management Association regularly issue self-regulatory guidelines to their members, which FINMA recognises as minimum standards that need to be complied with by all Swiss banks. This is true in particular as regards the duty of due diligence in identifying the contracting party and the beneficial owner (Agreement on the Swiss Bank's Code of Conduct with regard to the Exercise of Due Diligence), the rules of conduct for securities dealing and the guidelines governing portfolio management.

3 Which regulatory authorities are primarily responsible for overseeing banks?

FINMA is the supervisory authority in charge of supervising, in particular, banks, securities dealers, collective investment schemes, insurance companies and other financial intermediaries for anti-money laundering purposes. Systemic risks are in turn addressed by the Swiss National Bank. FINMA and the Swiss National Bank have agreed on principles to coordinate their respective tasks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

As a general rule, deposits with Swiss banks are not insured by any public authority in Switzerland.

Special rules apply to cantonal banks, namely, banks that are controlled by a Swiss canton (at least one-third of the capital and voting rights must be held by a Swiss canton in order for a bank to be characterised as 'cantonal'). The relevant cantonal legislation will specify to what extent the liabilities incurred by a cantonal bank are insured by the concerned canton.

In addition, the Federal Banking Act provides for a privileged deposit system, which was revised in December 2008 in reaction to the financial crisis. Small cash deposits, up to an amount determined by the FINMA on a case-by-case basis, are paid out as soon as possible to each depositor following the bankruptcy of a Swiss bank, and are not subject to the standard liquidation procedure set out in the Federal Banking Act and the Federal Debt Enforcement and Bankruptcy Act.

In addition, Swiss banks are under an obligation to participate in a deposit protection system which aims at securing the payment of cash deposits up to 100,000 Swiss francs. Such deposits also rank in a privileged class in the bankruptcy estate of a Swiss bank. The deposit protection system is limited to a maximum aggregate amount of 6 billion Swiss francs.

Finally, banks are now required to secure preferential deposits by claims against third parties secured in Switzerland or by assets in Switzerland for a total amount corresponding to at least 125 per cent of the preferential deposits they hold. FINMA may increase this amount or grant derogations.

The December 2008 revision of the Swiss deposit protection system eventually led in 2011 to a series of amendments to the Federal Banking Act. In addition to these amendments, the revision also introduced other

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changes to the Federal Banking Act, dealing, in particular, with reorganisation procedures, prompter repayment of preferential deposits and the continuation of basic banking services during insolvency proceedings (see also question 16).

Following Lehman Brothers' filing for bankruptcy in autumn 2008, FINMA required Switzerland's two largest banks, Credit Suisse and UBS, to increase their capital basis in order to ensure their financing capacity and restore market confidence. UBS, which had experienced significant losses in the US sub-prime markets, was not able to raise sufficient capital from private investors to reach the required ratio. As a result, the Swiss Confederation decided to make a capital injection into UBS through the subscription of mandatory convertible bonds for 6 billion Swiss francs (see also question 13). In August 2009, the Swiss Confederation exercised its right to convert such convertible bonds into UBS shares, which it subsequently resold to institutional investors.

In parallel, the Swiss National Bank (SNB) set up a stabilisation fund, which, from December 2008 to April 2009, purchased around US$39 billion-worth of UBS's illiquid assets. The purchase primarily took the form of a loan extended by the SNB to UBS for a period of eight to 12 years. In addition, the SNB held a warrant on 100 million UBS shares, representing approximately 2.8 per cent of the bank's share capital, which the SNB could exercise should it incur a loss on its loan when liquidating the assets of the stabilisation fund. The loan granted by the SNB was repaid in full on 15 August 2013, as a result of which the SNB warrant expired. The entire process was eventually completed in November 2013 with the purchase of the stabilisation fund by UBS.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Swiss banking law does not provide for limitations that expressly apply to transactions between a bank and its affiliates. A bank's transactions with its affiliates may, however, fall under the general limits imposed on a bank's risk exposure towards a single counterparty (or a group of related counterparties) for diversification purposes. Risk exposure towards one single counterparty or a group of related counterparties exceeding 10 per cent of the bank's capital is to be monitored by the bank and, under certain circumstances, reported to FINMA. As a rule, such risk concentrations cannot exceed 25 per cent of the bank's capital.

Under Swiss banking laws, entities are considered as 'affiliates' if they are linked through a controlling relationship (ie, directly or indirectly held with more than 50 per cent of the voting rights or capital or dominated in any other manner) or by a factual or legal obligation to assist.

It is worth noting that a financial group or conglomerate, which comprises a Swiss bank or securities dealer or which is effectively managed from Switzerland, may be subject to the consolidated FINMA supervision. In this context, intra-group positions of a Swiss bank would, in principle, fall within the limits imposed on single risk positions for diversification purposes. Only risk positions towards fully consolidated 'affiliates' may, under certain circumstances, be exempted from these limits.

6 What are the principal regulatory challenges facing the banking industry?

In our view, the principal regulatory challenges facing the Swiss banking industry may be summarised as follows.

Banking secrecy and administrative assistance

On 13 March 2009, the Swiss Federal Council announced that Switzerland would adopt the Organisation for Economic Cooperation and Development (OECD) standard on administrative assistance in tax matters, in accordance with article 26 OECD Model Tax Convention. This amendment would in turn allow the lifting of Swiss banking secrecy in situations where suspicions of tax offences exist. The Swiss government thus started the renegotiation of the network of double taxation agreements to which Switzerland is a party. In June 2010, the Swiss parliament had already approved the first 10 double taxation agreements integrating article 26 of the OECD Model Tax Convention. Since then, more than 37 double-taxation agreements have been ratified by the Swiss parliament and 11 have been signed, respectively initialled, by the Swiss government and await ratification. The renegotiation of Switzerland's double taxation treaties network is still ongoing. As a result of this process, the distinction between tax fraud and tax evasion will no longer be relevant in the context of international assistance. In addition, international treaties aiming at dealing with undeclared assets of UK and Austrian taxpayers by way of a withholding tax mechanism were ratified in the autumn of 2012. The German parliament, however, refused to ratify the treaty negotiated with Switzerland at the end of 2012.

In parallel, since its 2009 decision, the Swiss government has been analysing different strategies to facilitate administrative assistance in tax matters, including through the implementation of an automatic exchange of information. In this context, the Swiss Federal Council expressed, in late 2013, a willingness in principle to implement an automatic information exchange standard provided notably that such standard is internationally recognised, ensures reciprocity and strictly complies with the principle of speciality. On 19 November 2014, the Swiss Federal Council approved a declaration aimed at joining the multilateral agreement on the automatic exchange of information in tax matters developed by the OECD. In this context, on 14 February 2015, the Swiss government launched two consultation procedures until 21 April 2015 as regards the implementation of the legal framework introducing the future international automatic exchange of information in tax matters. The list of countries with which Switzerland intends to establish an automatic exchange of information will be presented to the Parliament separately at a later stage. It is planned that the Parliament will discuss the draft legislation from autumn 2015, meaning that the entry into force of the draft should take place at the beginning of 2017. As a result, the Switzerland's first automatic exchange of information with a foreign country it is not expected prior to 2018.

Anti-money laundering regulation and implementation of the latest recommendations of the Financial Action Task Force

A revision of the 1997 Anti-Money Laundering Act (AMLA) was launched in 2012, with the primary purpose of increasing the powers vested in the Money Laundering Reporting Office (MRO), Switzerland's central anti-money laundering office, so as to align these with the recommendations of the Financial Action Task Force (FATF) and the Egmont Group. A final draft of the revised AMLA was issued in June 2012, passed by the Swiss parliament in June 2013 and entered into force on 1 November 2013. In a nutshell, the revision introduced the following three main changes to AMLA:

- the vesting of the MRO with the power to request additional information relating to a suspicious activity report not only from the reporting financial intermediary but also from third-party financial intermediaries, which may be involved;
- the introduction of conditions and specific procedures for the exchange of information, including financial information, between the MRO and its foreign counterparts (ie, foreign financial intelligence units (FIUs)); and
- the vesting of the MRO with the power to execute cooperation agreements with foreign FIUs.

Between 2013 and 2014, the Swiss government worked on a further revision of AMLA with a view to adapting it to the revised FATF recommendations and to addressing certain shortcomings that were identified during Switzerland's evaluations by the FATF. The Swiss parliament adopted the final draft on 12 December 2014. The entry into force of the revised AMLA is expected to take place in two stages, probably first in July 2015 and then in January 2016. The revision includes the following measures:

- the obligation for holders of bearer shares of an unlisted company to disclose their identities to the company or to a financial intermediary appointed by the company;
- the obligation for shareholders whose participation reaches or exceeds 25 per cent of the share capital or voting rights of an unlisted company to disclose the identity of their beneficial owner to the company or to a financial intermediary appointed by the company;
- the obligation for financial intermediaries to establish the identity of the beneficial owner(s) of unlisted operating companies (ie, individuals holding 25 per cent of the share capital or voting rights or controlling the company in any other manner) or, if no beneficial owner can be identified, the identity of the most senior member of management;
- the extension of the concept of 'politically exposed persons' to persons exposed at the local level and within intergovernmental organisations;
- the further due diligence obligations for financial intermediaries who receive cash exceeding 100,000 Swiss francs within a commercial transaction;

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- the addition in the Swiss Criminal Code of certain aggravated tax offences to the list of predicate offences for money laundering and terrorism financing; and
- a two-stage mechanism following the reporting of suspicions to the MRO, which would require the monitoring of the concerned account by the financial intermediary, for a period up to 20 days during the analysis of the case by the MRO, so as to suspend any transaction that may result in preventing the confiscation of the concerned asset, followed, if the case is transferred to a criminal prosecution authority, by the implementation of a full freeze on the account for five days until the decision to maintain the freeze is made by the criminal authority.

In the above context and in view of aligning the provisions of the FINMA AML Ordinance of 8 December 2010 on the revised AMLA, FINMA opened up on 11 February 2015 a consultation procedure on the revised FINMA AML Ordinance. In a nutshell, the draft ordinance sets out a clarification of the concept of control holder within the identification of the beneficial owners of an operating company as well as for specific identification rules for fund management companies, investment companies and fund asset managers subject to the Collective Investment Schemes Act (CISA). The consultation procedure will end on 7 April 2015.

Insider trading

Following the recommendations of an expert commission on market abuses, the Swiss government worked on a revision of the provisions of SESTA and of the Swiss Criminal Code dealing with insider trading and market-manipulating behaviour. The relevant amendments were passed by the Swiss parliament on 28 September 2012 and entered into force on 1 May 2013. One of the main purposes of the revision was to include 'aggravated insider trading' and 'aggravated market manipulation' on the list of relevant crimes for money-laundering purposes. The revised provisions also extend the scope of insider trading and market manipulation behaviour prohibited by Swiss criminal law, so that they cover not only certain qualified investors but all market participants. In addition, the provisions governing the obligations to disclose participations and to tender public offers are strengthened. In this context, FINMA is granted the power to apply supervisory instruments (extension of disclosure obligation, precautionary measures, suspension on voting rights, confiscation) to all market participants, not only to those under its supervision.

Protection of investment advisory and wealth management clients

In 2009, FINMA completed its investigations on the *Madoff* and *Lehman* cases. The analysis of FINMA identified loopholes in the regulatory framework dealing with investors' protection. In particular, FINMA stressed the inadequate level of information given to clients as regards potential returns and risks of loss, as well as inappropriate risk diversification practices. FINMA examined the issue further and published its findings on 10 November 2010 in a comprehensive report entitled 'Regulation of the production and distribution of financial products to retail clients – status, shortcomings and courses of action' (the Distribution Report). In the Distribution Report, FINMA proposes several key regulatory measures for discussion. Based on the feedback and comments of the industry and other interested parties, FINMA issued a position paper (FINMA Position Paper on Distribution Rules) in February 2012, in which specific policy proposals are set out to improve investment advisory and wealth management clients' protection under Swiss law. FINMA notably suggests that the following regulatory measures be taken:

- an extension of the requirements to produce coherent, product-neutral and standardised prospectuses addressing investment products' characteristics, potential for returns and losses, associated risks, legal status and typical investor profile;
- the introduction of a specific format to be used for prospectuses for standardised financial products (such as equities, bonds or structured products issued on a large scale) and the regulation of the contents, sequence and length of prospectuses for complex financial products (ie, products made up of different components such as structure products or insurance products with investment character) inspired by the Key Investor Information Document (KIID) for European UCITS funds;
- the strengthening and harmonisation of the rules governing financial services providers' duties of information and disclosure;
- the mandatory performance by investment advisers or asset managers of suitability tests and, where no advice or management services are provided (eg, execution only), appropriateness tests, with certain exceptions;
- the introduction of a client segmentation that would mirror the one adopted in the EU Prospectus Directive and MiFID;
- a more stringent regulation to govern the cross-border offering of financial services from other countries; and
- the submission of investment advisers to registration and qualification requirements and the introduction of an ongoing supervision of asset managers.

New proposed Swiss legislation on financial services and financial institutions

On 27 June 2014, the Swiss Federal Council published two new drafts of the Swiss Federal Financial Services Act (FFSA) and the Swiss Federal Act on Financial Institutions (FAFI). The publication of these drafts is a response in particular to the 'third country rules' provided by the EU Financial Services Directive (MiFID 2). While the purpose of the draft FAFI is to provide for a 'new legal framework' governing all financial institutions, the objective of the draft FFSA is to regulate financial services in Switzerland, whether performed in Switzerland or on a cross-border basis. The introduction of the new FFSA and the FAFI would, inter alia, involve the following key changes to the current Swiss regulatory framework:

- under the proposed legislative framework, financial services and institutions will be governed in Switzerland by a general set of regulations on the supervision of financial services, embodied in the FFSA, the FAFI and Federal Act on Financial Market Infrastructure;
- the draft FFSA introduces an obligation for foreign services providers, which would be subject to an authorisation in Switzerland, to register, as a prerequisite to providing financial services in Switzerland;
- the draft FFSA introduces categorisation rules based on the EU concept of 'professional clients' and 'private clients';
- the draft FFSA also introduces market conduct rules, including the obligation to verify the appropriateness and suitability of financial services, as well as inducements and transparency rules (integrating into the draft FFSA the most recent case law of the Swiss Supreme Court as regards the transparency and consent requirements for a financial institution to keep trailer fees); and
- the draft FFSA further introduces uniform prospectus rules which generally shall apply to all securities offered publicly into or in Switzerland, as well as a change of paradigm in the enforcement of the claims of investors against financial institutions.

Following the consultation procedure which ended in October 2014, the Swiss government is expected to publish a formal bill during the first quarter of 2015. This bill will serve as a basis for the debates of the draft FFSA and the draft FAFI in the two chambers of the Swiss parliament. The debates are expected to occur in autumn 2015 or winter 2016 at the earliest. The current expected date of the entry into force of the FFSA and the FAFI is 1 January 2017.

Financial market infrastructure

From 13 December 2013 to 31 March 2014, the Swiss government opened up a consultation procedure on a draft Federal Act on Financial Market Infrastructure. On 13 September 2014, it adopted the dispatch on this new act which will probably not enter into force prior to 2016. The purpose of this new statute is twofold. First, from a formal perspective, the draft Financial Market Infrastructure Act aims at achieving consistency by gathering in one single statute all existing provisions related to the organisation and operation of market infrastructures. Second, it aims at harmonising Swiss financial legislation with international recommendations and standards (including Europe's MiFID II, MiFIR and EMIR), in particular as regards the regime applicable to negotiation platforms, central counterparties, central securities depositories, payment and securities settlement systems and derivatives trading. The introduction of a new Financial Market Infrastructure Act would, inter alia, involve the following key changes to the current Swiss regulatory framework:

- the introduction of a licensing regime similar to the one applied to stock exchanges for multilateral trading facilities (MTF) and organised trading facilities;
- the introduction of a licensing obligation for central counterparties, central securities depositories and trade repositories with the application of specific additional requirements; and

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- the introduction of clearing, reporting and risk mitigation obligations for determined exchange-traded and over-the-counter derivative transactions to which a professional investment firm is party.

Revision of the Collective Investment Schemes Act and Ordinance

Following international developments, notably the adoption of the AIMF Directive in the EU, the Swiss authorities worked on a revision of the CISA. On 2 March 2012, the Swiss government issued its final proposal for a revision of the CISA, which was adopted by Parliament on 28 September 2012. The revised CISA and its revised implementing ordinance have entered into force on 1 March 2013. Transitional periods were, however, set for the effectiveness of certain provisions of the revised regime. FINMA subsequently revised its implementing Circular 2013/9 'Distribution of collective investment schemes', which entered into force on 1 October 2013. The amendments to this framework represent a complete overhaul of the rules applicable to the management, the custody and the distribution of collective investment schemes. Among the most notable changes, the following can be mentioned:

- the extension of licensing requirements to every Swiss manager of a Swiss or non-Swiss collective investment scheme, subject to certain de minimis and intra group exemptions;
- the extension to closed-ended investment companies of the requirement to appoint a custodian bank already imposed upon opened collective investment schemes;
- the imposition of specific duties and of a liability regime upon custodians of collective investment schemes, mirroring the requirements of the AIFM Directive;
- the introduction of a segmentation between regulated investors (ie, regulated financial intermediaries), unregulated qualified investors (comprising, in a nutshell, institutional investors, high-net-worth individuals, who have requested on a written basis to be considered as qualified investors, and investors managed based on a written discretionary asset management agreement with a regulated financial intermediary or an independent asset manager, who have not requested not to be considered as qualified investors) and non-qualified investors;
- the mandatory appointment of a Swiss paying agent and a Swiss legal representative, as a point of contact for investors, for the distribution of any non-Swiss collective investment scheme in Switzerland; and
- the discontinuation of the private placement exemptions and introduction of a general licensing requirement for the distributor of collective investment schemes offering shares or investments in or from Switzerland to unregulated investors (irrespective of them being qualified or non-qualified investors), subject to limited exceptions relating to reverse solicitation situations or situations in which the distribution occurs within the context of a written asset management agreement with a regulated financial institution or an independent asset manager.

Tax disputes between Swiss banks and the United States and preparation for the implementation of FATCA

Following the US tax and regulatory investigations initiated against several Swiss banks, as well as the initiation of criminal proceedings against Wegelin & Co on counts of aiding and abetting tax evasion and tax fraud, the US Department of Justice (DoJ) announced a programme for Swiss banks to avoid potential prosecution related to deemed non-tax compliant US client accounts (the US Programme). Further material clarifications were issued on 5 November 2013. The US Programme was endorsed by the Swiss government and FINMA, which strongly recommended participation. For purposes of the US Programme, Swiss banks are divided into four categories:

- those already under investigation by the DoJ, which are not eligible to participate;
- those with reason to believe they may have committed tax-related offences, which request a non-prosecution agreement and are subject to a penalty payment;
- those without reason to believe they may have committed tax-related offences, which request a non-target letter; and
- those purely domestic banks that are deemed compliant under the Foreign Account Tax Compliance Act (FATCA) because they merely have a local client base, which request a non-target letter.

Participation in category 2 had to be announced to the DoJ by 31 December 2013. As of that date, 106 Swiss banks announced their participation in the US Programme in category 2. Swiss banks wishing to participate in categories 3 and 4 must have filed their request by 31 December 2014. 2014 has been a year of intense preparation for the fulfilment of the reporting and cooperation obligations set under the US Programme for the Swiss banks involved.

In parallel, the Swiss and US governments signed on 14 February 2013 an agreement for cooperation to facilitate the implementation of FATCA (the FATCA Agreement). This agreement which entered into force on 2 June 2014, is based on a model agreement (Model II) tailored for countries, such as Switzerland, that do not have an automatic information exchange in place with the United States. Model II allows for an aggregate reporting of pre-existing accounts in the absence of consent of the client to individual disclosure, which may give rise to a group request by the US Internal Revenue Service (IRS). In this context, the Swiss government has further worked on a federal statute dealing with the implementation of the FATCA Agreement to detail financial institutions' participation, identification and communication obligations and to frame the procedures applicable to information exchange and to the levy of a withholding tax under the agreement. On 27 September 2013, the FATCA implementing act was approved by the Swiss Parliament along with the FATCA Agreement. The referendum deadline expired on 16 January 2014 and the FATCA implementing act entered into force on 30 June 2014. Swiss participating and deemed-compliant financial institutions were to register with the IRS by 25 April 2014.

Further changes to the regulatory environment are to be expected in the coming months in line with international initiatives (see also question 8).

7 Are banks subject to consumer protection rules?

Generally speaking, Swiss regulatory law does not provide for a specific consumer protection legal framework. That being said, within a certain type of credits, Swiss financial institutions are to observe mandatory provisions which cannot be varied to the detriment of consumers. Credits granted to individuals for purposes other than business or commercial activities, in the range of 500 Swiss francs and 80,000 Swiss francs (providing that the consumer is not obliged to reimburse the credit within less than three months or in no more than four instalments within one year, are subject to the Consumer Credit Act (CCA). The CCA sets out a series of mandatory consumer protection rules, including the following:

- the consumer credit contracts must be made in writing and comply with a with a maximum rate of interest set by the authorities (ie, in principle, 15 per cent);
- the consumer credit contracts must list a series of information absent which they are null (eg, the right of the consumer to revoke a line of credit in writing and within seven days after the sending or the delivery of the contract to the borrower); and
- the lender is to check the borrower's credit capacity and to report the consumer credit granted, to the Consumer Credit Information Office.

It should be also noted that within national and international transactions with consumers under the Swiss Code of Civil Procedure, the Lugano Convention or the Swiss Private International Law Act, depending on the countries involved, specific consumer protection rules may apply as regards the determination of the competent jurisdiction.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The above-mentioned policy challenges and changes fall within FINMA's general strategic goals for 2013 to 2016, which consist of:

- strengthening financial stability and crisis resistance through prudential supervision;
- promoting integrity, transparency and client protection in business conduct;
- improving international and national cooperation;
- assisting in the ongoing and future legislative revision processes; and
- strengthening FINMA as an authority.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Swiss banking supervision is based on a division of tasks between FINMA and the banks' external auditors.

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Pursuant to this two-tier supervision system, the auditors conduct on-site audits while FINMA retains responsibility for overall supervision and enforcement measures. To a certain extent, the auditors act as an extension (long arm) of FINMA, exercising direct supervision through regular audit checks.

In addition to examining the annual financial statements with an independent valuation of assets and liabilities, the auditors also review whether the banks comply with their articles of association and their organisational rules, as well as with the provisions of Swiss banking law, the circulars issued by FINMA and any applicable self-regulatory provisions.

External auditors must – on an annual basis – prepare so-called 'long-form reports' addressed to the members of the board of directors of the concerned bank and to FINMA. These reports provide a comprehensive overview of the business activities and the internal organisation of the relevant bank. The purpose of these reports is to allow FINMA to ensure that the financial institution complies with the regulatory requirements and that the individuals entrusted with its management enjoy a good reputation and thereby assure the proper conduct of business operations (ie, guarantee of irreproachable activity). These audit reports are the main informational tools through which FINMA exercises its supervision.

In addition to the long-form reports, the auditors are obliged to inform FINMA if they suspect any breach of law or uncover other serious irregularities. FINMA then initiates investigations and takes other measures necessary to ensure compliance with the legal framework and to eliminate irregularities.

A special supervisory regime has been put in place for the largest Swiss banks, UBS, Credit Suisse, Zürcher Kantonalbank and the financial group Raiffeisen given the systemic risk caused by the size of these institutions. In short, FINMA does not rely exclusively on the reports received from the auditors but carries out its own investigations in accordance with its risk-based supervision approach.

10 How do the regulatory authorities enforce banking laws and regulations?

The enforcement of Swiss banking laws and regulations is closely linked to the obligation for Swiss banks to ensure compliance, at all times, with the requirements for a banking licence (continuing compliance with the conditions of a banking licence).

If, at any time after the granting of the licence, any of the licence requirements is no longer satisfied, FINMA may take administrative measures aimed at ensuring that the breach be remedied. FINMA may also appoint an investigator in order to clarify the factual situation and to facilitate the implementation of the measures imposed by the authority. Should the breach of the legal and regulatory framework be characterised as serious, FINMA could ultimately withdraw the banking licence, something that would trigger the forced liquidation of the bank.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In our view, the most common enforcement issues encountered in the practice of FINMA may be summarised as follows:

- the forced liquidation of unauthorised securities dealers;
- the insolvency procedures and protective measures related to authorised and unauthorised entities, such as Kaupthing Bank Luxembourg SA, Geneva Branch, Lehman Brothers Finance AG, ACH Securities SA or Aston Bank SA;
- the issues related to the compliance with the 'know-your-customer' rules set out in the Federal Anti-Money Laundering Act and the Agreement on the Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence (see question 2) and the diligence requirements within the provision of cross-border financial services; and
- the ongoing supervision of licensed entities (especially banks and securities dealers), in particular in order to ensure that the persons entrusted with the management of these entities fulfil on an ongoing basis the guarantee of an irreproachable activity.

12 How has bank supervision changed in response to the 2008 financial crisis?

In addition to the regulatory changes and developments which have been outlined in questions 6 and 7, we note an increased enforcement on the part of FINMA that has been generally more active than was previously the case with Switzerland's largest banks. According to the FINMA annual report of 2013, more than 700 preliminary investigations were initiated by FINMA in 2013.

Recently, FINMA also reoriented its supervision with a focus on systematically important financial institutions. This risk-based supervision approach enables, according to FINMA, to prevent failures of important actors on the financial market that could have a material impact on the Swiss economy as a whole.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Swiss law does not provide for any specific rules setting out the conditions and situations in which a Swiss banking institution may be taken over by the government or regulatory authorities. Hence, the UBS recapitalisation that took place in 2008 by means of the Swiss Confederation's subscription of mandatory convertible bonds (see question 4) required the enactment of a special urgent law, the Federal Ordinance of 15 October 2008 on the Recapitalisation of UBS AG, by the Swiss government.

By contrast, the involvement of FINMA within bank reorganisation and liquidation proceedings is now expressly provided for in the Banking Act and the implementing FINMA-Bank Insolvency Ordinance following a 2011 revision (see questions 14 and 16).

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

FINMA requires that Swiss banks have sound business contingency management in place to ensure that critical business functions can be maintained or restored as quickly as possible in the event of a crisis. Systemically important financial institutions (SIFIs) are, in addition, required to have contingency or recovery plans (so-called living wills) in place. The responsibility for the establishment of such plans lies with the bank's board of directors and senior management.

Also, if a bank becomes over-indebted or experiences serious liquidity issues, FINMA can order broad and far-reaching protective measures, which may directly affect the bank's conduct of business and the role of the bank's management and directors. These protective measures may be taken independently from or in addition to the ordering of formal restructuring or liquidation proceedings. In this context, FINMA is, in particular, vested with the power to:

- give direct instructions to the bank's governing bodies;
- limit the powers of the bank's directors or managers or remove them from office;
- remove the bank's statutory audit company;
- limit the business activities of the bank; and
- order a temporary stay of a counterparty's right to enforce a debt against the bank.

15 Are managers or directors personally liable in the case of a bank failure?

Swiss law does not provide for a specific liability regime applicable to directors or managers of a bank. Should the bank's failure result from an intentional or negligent breach of the directors' or managers' duties, the general rules of Swiss company law would apply to determine the managers' or directors' personal liability for the damage caused to the company, its shareholders or creditors.

This liability for mismanagement must be distinguished from the liability regime applicable to the (managing or non-managing) partners of a Swiss bank, which is set up as a partnership or a limited partnership (often referred to as a Swiss private bank). In case of bankruptcy of a Swiss private bank, the partners with unlimited liability would be jointly and severally liable with their own personal assets.

16 How has bank resolution changed in response to the recent crisis?

A revision of the Banking Act of 18 March 2011, which entered into force on 1 September 2011, amended the reorganisation proceedings applicable to banks. These amendments aim at enhancing the flexibility of such proceedings and confer additional instruments and powers to FINMA. With these amendments, FINMA is newly empowered to order a transfer of

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all or part of a failing bank's activities to a 'bridge bank', the conversion of certain convertible debt instruments issued by the bank (contingent convertible bonds, CoCos), as well as the reduction or cancellation of the bank's equity capital, and, as an ultima ratio, the conversion of the bank's debt into equity. Generally, if compared to the regimes applicable in other jurisdictions, the instruments available to FINMA under the revised Banking Act appear quite broad and far reaching.

Following this 2011 revision, FINMA launched a complete overhaul of the FINMA-Bank Insolvency Ordinance, which entered into force in its revised form on 1 November 2012. The amendments reflect a quite extensive interpretation by FINMA of the provisions of the Banking Act. For instance, the FINMA-Bank Insolvency Ordinance allows the supervisor to order a temporary stay of a counterparty's right to terminate agreements with a bank in the context of a transfer of all or part of such bank's activities to a bridge bank, a power that was part of the amendment to the Banking Act proposed to Parliament, but which was much debated and eventually dropped by the Swiss legislator.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The granting of a banking licence is subject to a minimum equity requirement. The fully paid-up share capital of a Swiss bank must amount to a minimum of 10 million Swiss francs and must not be directly or indirectly financed by the bank, offset against claims of the bank, or secured by assets of the bank. In practice, FINMA determines in each case the appropriate level of capital with regards to the scope of the contemplated activities. Capital adequacy and measurement rules are detailed in the revised Capital Adequacy Ordinance (CAO), the revised Liquidity Ordinance and FINMA Circular 2015/2 'Liquidity risks – banks'.

The current regime provides for minimum capital requirements that call at all times for an aggregate (Tier I and Tier II) capital ratio of 8 per cent of the bank's risk-weighted assets. Risk-weighted positions must, in addition, be covered at a ratio of 4.5 per cent with common equity Tier I (CET I) capital and at a ratio of 6 per cent with Tier I capital. Furthermore, banks will need to have, from 1 January 2016, a capital buffer in the form of CET I capital of 2.5 per cent of the risk-weighted assets. Finally, under certain circumstances, the Swiss National Bank can request that the Swiss government order that an additional counter-cyclical buffer of up to 2.5 per cent of all or certain categories of the risk-weighted assets be maintained in Switzerland in the form of CET I capital. In February 2013, such a counter-cyclical buffer was activated at the level of 1 per cent on loans secured against residential properties in Switzerland. On 30 June 2014, as per the request of the Swiss National Bank, the Swiss Federal Council increased the counter-cyclical buffer at the level of 2 per cent Finally, if FINMA deems risks not adequately covered by these capital requirements, it can order banks to maintain additional capital.

As regards quantitative liquidity requirements applied to non-systemic banks, the Liquidity Ordinance has been revised in order to introduce a liquidity coverage ratio. According to this revision which entered into force on 1 January 2015, non-systemic banks are to comply with 60 per cent of the requirements of the Liquidity Coverage Ratio from 1 January 2015. These requirements will increase in a range of 10 per cent per year until 1 January 2019. The net stable funding ratio will be implemented in January 2018.

As regards SIFIs, the CAO sets out a specific capital adequacy regime. The latter calls for more stringent requirements as regards the bank's risk-weighted assets, which broadly comprise a basic requirement of 4.5 per cent, in line with the Basel III minimum requirements applicable to all banks, an additional equity cushion of 8.5 per cent and an additional progressive component determined on the basis of a progressive rate set yearly by FINMA. While 5.5 per cent of the additional equity cushion must be held in the form of common equity, the remaining 3 per cent and the additional 6 per cent progressive component may be covered by CoCos. SIFIs also have to satisfy counter-cyclical equity buffers and leverage ratio requirements. In addition to capital, liquidity, organisational and risk diversification requirements, the new regime also entails provisions that would allow the government to order adjustments to the remuneration system of a bank which would have to rely on government funding. The requirements introduced by the 'too big to fail' reform will have to be gradually implemented by the relevant SIFIs by the end of 2018.

18 How are the capital adequacy guidelines enforced?

Enforcement of the capital adequacy requirements is part of the ongoing supervision process aimed at ensuring that the requirements of the banking licence are met. Compliance with capital adequacy requirements has to be reported to the Swiss National Bank on a quarterly basis and is one of the topics addressed in the long-form reports issued by the bank's external auditors on a yearly basis (see question 9).

19 What happens in the event that a bank becomes undercapitalised?

FINMA benefits from an exclusive competence to intervene in the event of a bank's undercapitalisation.

Upon the occurrence of a risk of undercapitalisation or insolvency, FINMA can take various protective measures, such as a moratorium of claims. Further, in case of need, FINMA may appoint a trustee in charge of the bank's reorganisation. The latter is then to propose to FINMA a reorganisation plan with the purpose of protecting the bank's creditors. Such a scheme generally aims at recapitalising the bank, for example, through a conversion of debt into equity. As a result of the financial crisis, FINMA was also granted additional powers with a view to increasing the likelihood of successful restructuring of a distressed bank (see also question 16). FINMA may order the transfer of all or part of the bank's activities to a 'bridge bank', compel a conversion of certain convertible debt instruments issued by the bank and/or a reduction (or cancellation) of the bank's equity capital, and, as an ultima ratio, order the conversion of the bank's debt obligations into equity. FINMA is also authorised to liquidate insolvent banks, in particular if no reorganisation is possible. These measures are set out in more detail in the FINMA-Bank Insolvency Ordinance (see also question 16).

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

FINMA benefits from the power to intervene in the event a bank becomes insolvent. Please see question 19 for the intervention tools that are available to FINMA. Please also see question 16 regarding the revised bank reorganisation regime.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

In addition to the special capital adequacy regime and the leverage ratio regime imposed on the two large Swiss banks, UBS and Credit Suisse (see question 17), FINMA implemented capital adequacy and liquidity rules in line with international standards in 2013 (see questions 16 and 17). In order for banks to build up the required capital and replace or phase out capital that no longer qualifies under the new rules, transitional rules provide for an implementation schedule over a time period stretching out to 2018. On 1 January 2015, the liquidity coverage ratio requirement entered into force according to the revised Liquidity Ordinance and the updated FINMA Circular 2015/2 'Liquidity risks – banks' (see question 17). FINMA issued a new circular 2015/3, which entered into force on 1 January 2015, on the calculation methodology of the leverage ratio and which corresponds to the minimum standards of Basel III as defined in the document entitled 'Basel III leverage ratio framework and disclosure requirements' of January 2014.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

For purposes of the Federal Banking Act, a participation is deemed to be a qualified participation if it amounts to 10 per cent or more of the capital or voting rights of the bank or if the holder of the participation is otherwise in a position to significantly influence the business activities of the bank (a 'qualified participation'). In practice, FINMA often requires the disclosure of participations of 5 per cent or more for its assessment of whether or not the requirements of a banking licence are continuously met.

The Federal Banking Act does not set any restrictions on the type of entities or individuals holding a controlling interest in a bank. However, one of the general requirements for a bank to obtain a licence is that individuals or legal entities holding, be it directly or indirectly, a qualified participation in a bank must ensure that their influence will not have any negative impact on the prudent and reliable business activities of the bank.

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Thus, the bank's shareholders and their activities can well be of relevance for the granting and the maintenance of a banking licence.

Examples of circumstances where shareholders with a qualified participation may have a negative influence on the bank are a lack of transparency, unclear organisation or financial difficulties of financial conglomerates, as well as an influence of a criminal organisation on the shareholder. Should FINMA be of the view that the requirements for the banking licence are no longer met because of a shareholder with a qualified participation, it may suspend the voting rights in relation to such qualified participation or, if appropriate and as a measure of last resort, withdraw the licence, which would trigger a liquidation proceeding.

23 Are there any restrictions on foreign ownership of banks?

If foreign nationals with qualified participations directly or indirectly hold more than half of the voting rights of, or otherwise a controlling influence on, a bank incorporated under the laws of Switzerland, the granting of the banking licence is subject to additional requirements. In particular, the corporate name of a foreign-controlled Swiss bank must not indicate or suggest that the bank is controlled by Swiss individuals or entities and the countries where the owners of a qualified participation in a bank have their registered office or their domicile must grant 'reciprocity', that is:

- Swiss residents and Swiss entities must have the possibility to operate a bank in the respective country; and
- such banks operated by Swiss residents are not subject to more restrictive provisions compared to foreign banks in Switzerland.

The reciprocity requirement is subject to any obligations to the contrary in governmental treaties and it is, thus, in particular not applicable to the member states of the World Trade Organization. Furthermore, FINMA may request that the bank is subject to adequate consolidated supervision by a foreign supervisory authority if the bank forms part of a group active in the financial sector.

If a bank incorporated under the laws of Switzerland becomes foreign controlled as described above or if, in the case of a foreign-controlled bank, the foreign holders of a direct or indirect qualified participation in the Swiss bank change, a new special licence for foreign-controlled banks must be obtained prior to such event.

For the purposes of the Federal Banking Act, a 'foreigner' is:

- an individual who is not a Swiss citizen and has no permanent residence permit for Switzerland; or
- a legal entity or partnership that has its registered office outside Switzerland or, if it has its registered office within Switzerland, is controlled by individuals as defined in the first bullet above.

24 What are the legal and regulatory implications for entities that control banks?

There are no restrictions as to the business activities of the entities holding qualified participations in a bank as long as the conditions for the granting and maintenance of the licence (see question 22) are complied with. Generally, transactions between the (controlling) shareholders of a bank and the bank itself may be subject to specific requirements, for example, the granting of loans to significant shareholders must be in compliance with generally recognised principles of the banking industry.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Each controlling shareholder has the duty to give notification of the acquisition or disposal of a qualified participation, as well as the fact that its participation reaches, exceeds or falls below certain thresholds (see question 30). Further, as mentioned above, the holder of a qualified participation must not negatively influence the prudent and reliable business activities of the bank, otherwise the bank may lose its licence.

In cases where justified concerns exist that a bank is overindebted, no longer complies with the capital adequacy rules or has serious liquidity problems, FINMA may order certain protective measures and the establishment of a recapitalisation plan. Under a recapitalisation plan, the rights of creditors and shareholders may be impaired (see also questions 16 and 19).

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

There are no specific implications for a controlling shareholder of a bank if the bank becomes insolvent, other than those described in questions 16 and 19.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Even though the acquisition of a qualified participation in a bank by a Swiss individual or a Swiss entity triggers, in theory, only notification obligations (see question 30), it is necessary to seek a letter of no objection from FINMA for the account of the bank prior to an envisaged transfer of a controlling stake in a Swiss bank, since FINMA controls the continuing compliance with the conditions of a banking licence. FINMA will examine whether the influence of the new shareholder with a qualified participation would be detrimental to the prudent and reliable business activities of the bank.

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Update and trends

On 4 September 2013, the Swiss Federal Council appointed a special group of experts for the purpose of developing the Swiss market strategy. The mandate of these experts comprised the analysis of the revised framework applicable to the financial centre and the elaboration of recommendations as regards the future development of the financial markets strategy. On 5 December 2014, the group of experts presented its final report to the Swiss Federal Council and made recommendations around four key areas: the regulatory process, the market access, the tax legal environment and economic risks. Four priorities were also identified. These deal with the improvement of the access to the international and, in particular, European markets, the extension of the reorganisation measures of the financial sector (too big to fail), the revision of the withholding tax regime and the enhancement of the coordination between authorities and market actors. Following this, the Swiss Federal Council instructed the Federal Department of Finance to appoint an advisory committee called 'Future of the financial centre'. The mission of this committee will be to serve as a point of contact with the key actors of the financial markets strategy and will analyse the future perspectives of the Swiss financial sector within the economy. In the meantime, the Swiss Federal Council will review the above recommendations of the group of experts and decide on their introduction in the Swiss regulatory framework.

In the aftermath of the 2008 financial crisis, the Swiss government has redoubled its activity. A critical assessment of the situation and development of a Swiss market strategy is one of its priorities today. It is to be expected that the crystallisation of this strategy will trigger a certain number of significant changes to the Swiss regulatory legal framework (as it can be already seen with the draft Federal Financial Services Act and the Federal Act on Financial Services) and that it will therefore remain in a state of flux for some years to come.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The notification requirements outlined in question 30 also apply to non-Swiss acquirers. In addition, if a foreign individual or entity acquires a qualified participation in a Swiss bank, the bank must apply to FINMA for a special licence, provided that foreign nationals with qualified participations directly or indirectly hold more than half of the votes of, or otherwise a dominant influence on, the bank. For the conditions of the additional licence, see question 23.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

FINMA generally considers whether the requirements for the banking licence are still met and, in particular, whether the new shareholders with a qualified participation will not negatively influence the bank's prudent and reliable business activities.

30 Describe the required filings for an acquisition of control of a bank.

Each individual or legal entity must notify FINMA prior to acquiring or selling a direct or indirect qualified participation in a bank organised under the laws of Switzerland. This notification duty also applies if a foreigner increases or reduces its qualified participation and thereby attains, falls below or exceeds 20, 33 or 50 per cent of the capital or voting rights in the bank. The notification must include a declaration whether the participation is held for the own account and whether any option or similar rights have been granted over the participation.

The bank itself is also required to notify FINMA of any changes triggering the notification duty of the shareholders once it becomes aware of such change, in any case at least once a year.

In the case of a foreign-controlled bank, prior to any change of a foreign holder of a qualified participation, the bank must apply with FINMA for a special licence. In its application, the bank has to demonstrate all the facts based on which FINMA may assess whether the conditions for the special permit are fulfilled.

As mentioned in question 27, it would be advisable that the bank contacts FINMA prior to a change of a holder of a qualified participation even if the bank is Swiss-controlled. This would not need to be in the form of a formal application.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Generally, the timing of the approvals or statements by FINMA largely depends on the workload of FINMA. The process for a special banking licence in the case of a foreign-controlled bank may take three months. However, if the country of domicile or residence of the foreigner is not a member state of the World Trade Organization, the process may take much longer. FINMA will have to assess whether such country grants the right of reciprocity.

If the acquirer is not a foreigner, there is no formal approval or licence required and, thus, a statement of FINMA is available within a shorter time frame.

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Turkey

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The main policy in the Turkish banking sector is to ensure confidence and stability in financial markets, the efficient functioning of the credit system and the protection of the rights and interests of depositors. The Turkish banking sector, mainly regulated by Banking Law No. 5,411 (the Banking Law) also underscores these policies. The Turkish government pays great attention to the strict monitoring of banks in Turkey, with heavy involvement by the Banking Regulation and Supervision Agency of Turkey (BRSA), which is a public legal entity with administrative and financial autonomy that has supervision over the banks. The BRSA's strategic plan aims to eliminate uncertainties and serves as a guideline with a long-term focus.

The Turkish government sees the banking sector as the most important facet in maintaining a sound economy and growth and it therefore observes a policy of preserving close monitoring and audit of banks, quick and efficient measures, rigid capitalisation requirements, sound funding structures and liquidity, in such a manner as to keep the Turkish banking sector resilient and stable against any risks and shocks within the economy.

2 Summarise the primary statutes and regulations that govern the banking industry.

Primary statutes of banking industry comprise of Banking Law, Capital Markets Law (No. 6,362), Central Bank of Republic of Turkey Law (No. 1,211), The Law on Protection of Competition (No: 4,054), Bank Cards and Credit Cards Law (No. 5,464), Law on Prevention of Crime Revenues Laundering (Law No: 5,549) and so on.

Apart from primary sources, banking sector is supported and detailed by secondary legislation including regulations and communiqués such as the Regulation on Operations of Banks Subject to Permission and Indirect Shareholding, the Regulation on International Systems of Banks, the Regulation on Procedures and Principles for Determination of Qualifications of Loans and Other Receivables by Banks and Provisions to be set aside, the Regulation on Bank Cards and Credit Cards, the Regulation on Equity of Banks, the Regulation Amending the Regulation on the Measurement and Evaluation of Capital Adequacy of Banks, the Regulation on Capital Conservation and Countercyclical Capital Buffers, the Regulation on Measurement and Assessment of Leverage Levels of Banks, and the Communiqué on the Calculation of the Amount Subject to Credit Risk with Approaches Based on Internal Rating and Communiqué on Calculation of Amount Subject to Operational Risk with Advanced Measurement Approach.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The BRSA is the primary authority responsible for regulation and supervision of banks in Turkey. The institution carries out the functions of regulation, supervision and enforcement with the aim of providing reliability and stability in financial markets, ensuring the efficient running of credit system, protecting rights and interests of savers and developing financial sector considers strategic planning as one of the main instruments to fulfil its duties effectively.

The Capital Markets Board of Turkey (CMB) is the regulatory and supervisory authority in charge of fair and effective functioning of securities markets in Turkey and overseeing capital market institutions and publicly held companies. The CMB makes innovative regulations, supervises markets to ensure fairness, efficiency and transparency in Turkish capital markets and aims to improve investors' international competitiveness. Banks fall under the jurisdiction of the CMB as a result of their activties in the securities markets and their entitlement to act as intermediaries, and also to the extent they are publicly held.

The Savings Deposit Insurance Fund (SDIF) insures saving deposits and participation funds in order to protect the rights of depositors and to contribute confidence and stability of the banking system and resolves the banks and assets transferred thereto in the most fitting manner. SDIF takes on the management and supervision of the banks whose operating permission has been revoked and fulfils the necessary operations regarding the bankruptcy and liquidation thereof.

The Central Bank of the Republic of Turkey (CBRT) is responsible for taking measures towards establishing financial stability, implementing monetary exchange rate policies and printing banknotes in Turkey. The CBRT is responsible for and authorised to design and implement the exchange rate policy in line with the agreed exchange rate regime.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

The duties and powers of the SDIF are regulated in Banking Law. As per the Banking Law, the SDIF insures savings deposits and participation funds in credit institutions belonging to real persons and determines the scope and amount of the savings deposits and participation funds that are subject to insurance according the opinion of the CBRT, BRSA and Undersecretariat of the Treasury.

For individual accounts – where commercial transactions are excluded with the exception of checking activities – opened in domestic branches of a credit institution that operates in Turkey, in the form of Turkish lira, foreign exchange currency and precious metals accounts:

- the principal plus the interest of the savings deposit accounts; and
- the unit value of participation fund accounts and special current accounts up to 100,000 lira per each individual, are insured by the SDIF.

There are 51 banks operating in Turkey and 10 of these, including five deposit banks and five development and investment banks, are owned or controlled by government.

Instead of concentrating on the privatisation of banks, the Turkish government is speeding up 'participation bank' investments in government banks. According to a declaration by the Deputy Prime Minister responsible for the economy, the Turkish government wishes to expand the participation bank sector and triple total banking assets. However, most private bankers are against the Turkish government's approach and refer to Law No. 4,046 on Privatisation Practices dated 24 November 1996, which states that, as part of the privatisation process, state banks should be privatised shortly. Furthermore, these attempts of the Turkish government are accused of hampering competition in the banking sector.

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5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

As per the Banking Law, a bank and its qualified shareholders, members of the board of directors and the general manager as well as the undertakings they control individually or jointly, directly or indirectly or participate with unlimited responsibility or where they are members of the board of directors or a general manager constitute a risk group for the bank. The total amount of the loans extended by a bank to the risk group defined above shall not be more than 20 per cent of its own funds.

Further, the total loans to be made available by banks to all shareholders, irrespective of whether they are dominant partners or whether they own qualified shares (excluding those that have less than 1 per cent share in the capital of banks), and to persons who have indirect loan relations with such persons, shall not exceed 50 per cent of own funds.

The loans made available to jointly controlled undertakings shall be considered to have been made available to the risk group including each jointly controlling shareholder, at the rate of the shares owned by such shareholders in the undertaking's capital, to the total of undertaking's capital.

Moreover, the loans made available to a real or legal person or a risk group that equals or exceeds 10 per cent of its own funds shall be considered large loans and the total of such loans shall not exceed eight times own funds.

The avals, guarantees and suretyships of real and legal persons in a risk group for the guarantee of the loans extended to that risk group shall not be taken into account in calculating the loan limits applicable to that risk group.

The transactions carried out pursuant to guarantees, non-cash loans, futures, option contracts shall be taken into account within the framework of the principles and ratios set by the BRSA in calculating the loan limits.

The above-mentioned rules shall also be applied on a consolidated basis for parent undertakings.

6 What are the principal regulatory challenges facing the banking industry?

In recent years, new banking regulations have entered into force in order to comply with EU regulations including Basel II and Basel III (known as Basel Committee on Banking Supervision) provisions. In terms of legislative reliability, Turkey is way ahead of some EU countries.

The BRSA challenges with adequate capital ratio, credit solutions, auditing and risk management. Recent regulations and amendments in accordance with Basel II and Basel III requirements have indicated that the BRSA is willing to create a sustainable internal rating and advanced measurement approach.

7 Are banks subject to consumer protection rules?

New Consumer Law No. 6,502 (the Consumer Law), which entered into force on 28 May 2014, brought innovative reforms to banking practice. As per the new Consumer Law, transactions between consumers and banks are brought into the scope of the new Consumer Law. Therefore, not only consumer loans, but also money transfers and other banking services are evaluated within the scope of the new Consumer Law, which has been widened in favour of consumer protection.

Certain limitations are brought for the service charges, which are deemed as banks' liability, and any action of banks that do not comply with these limitations shall be subject to an administrative fine. However, several service payments are excluded from this scope and the BRSA has been authorised to determine whether these excluded service charges should be paid by consumers or not.

The new Consumer Law includes provisions regarding the subjects related to consumer loans, mortgages (for houses) including personal surety, compound interest in transactions, payments in instalments, obligation of loan insurance and liability of banks in tied loan agreements. Overall, the new Consumer Law has strengthened consumer protection in Turkey.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

In regard to the recent financial crisis, Turkey has enacted new regulations and it is expected to finalise all international regulatory capital standards required by Basel III standards in the near future. The BRSA is also continuing to work on adopting secondary legislation related to other dimensions of Basel III, namely bankleverage levels, cyclical capital buffers and liquidity coverage ratios, which will fully align Turkish legislation with EU acquis and Basel standards. As per these regulatory changes, the Turkish banking sector will become clearer for investors, regulators and other relevant parties.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

As per the Banking Law, banks and their activities are subject to the supervision of the BRSA. The BRSA may send representatives to the meetings of the general assemblies of banks for observation purposes.

Domestic and foreign subsidiaries, jointly controlled undertakings, branches and representative offices of banks, which are subject to limitations and standard ratios on a consolidated basis, are subject to consolidated supervision.

Supervision of the BRSA includes independent processes that are repeated in cycles and follow each other. The supervision cycle differs depending on the risk profile, size, diversity and complexity of the activities conducted by a bank. Experts prepare an audit plan, which determines the scope and level of surveillance or audit and the BRSA approves these audit plans. The BRSA's audit includes on-site and off-site supervision. On-site supervision consists of analysis of the factors affecting financial structure (ie, assets, liabilities, debts, commitments, etc), investigation of adequacy and effectiveness of risk management and internal control systems, determination of risk assessments and risk profile, supervision of financial tables and records, analysis of the adequacy and reliability of information systems, supervision of consolidated structure, assessing quality of corporate management, supervision of service providers, investigation of special operations and other on-site supervision activities (ie, compliance, denunciation and complaint investigation, anti-money laundering investigation, etc). Off-site supervision consists of routine monitoring of solo and consolidated data, high-risk activities, the results of instructions given by banks, developments in credit, interest rate, foreign exchange and liquidity risk, evaluation of financial structure, periodic reports and rating grades and also includes a stress test and scenario analysis.

10 How do the regulatory authorities enforce banking laws and regulations?

Purusant to the Banking Law, where required, the BRSA may apply corrective, rehabilitating and restrictive measures on banks. Furthermore, in some cases, the BRSA may revoke a bank's permission to operate or transfer it to the SDIF. The BRSA may also take measures against systematic risk in cases where a negative development spreads over the entire financial system.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Enforcements regarding illegal service charges and violation of competition rules are the most common. Most of these enforcements are result in monetary fines. The BRSA supervises and imposes such fines.

12 How has bank supervision changed in response to the 2008 financial crisis?

Past experiences and practices in dealing with financial crisis and measures taken for banking sector after 2001 crisis led Turkey to survive 2008's global turmoil with less damage compared to other developed and developing countries. The cyclical policy of the CBRT and the BRSA during the global financial crisis cannot be underestimated; however, it was obvious that new regulatory actions regarding banking supervision would be needed in the future.

Following the 2008 crisis, the BRSA introduced new regulations that are setting the criteria to be applied to credit card limits and raising minimum payment rates, increasing risk weights applied to credit card

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instalments, including individual credit cards in the scope of consumer loans, reducing general reserve rates for export loans and SME loans, establishing regulations regarding the measurement and assessment of the capital adequacy ratios of banks, allocating more general reserves for vehicle loans by banks, introducing instalment limitations for consumer loans and credit cards, applying loan-to-value ratio to vehicle loans, as well as implementing regulations on the harmonisation studies that need to be conducted for compliance with Basel III.

Furthermore, the CBRT has introduced regulatory actions regarding interest rate corridor, reserve requirements and reserve options mechanism, and the SDIF has doubled the deposit cover in recent years.

Since the above-mentioned regulations and amendments made in banking legislation, supervision of banks has become much stricter.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

In a case where,

- the bank has not taken the restrictive measures within the period determined by the BRSA or even if taking these measurements do not strengthen or considered that it cannot strengthen the financial structure of the bank;
- the bank will endanger the rights of the owners of deposits and participation funds as well as the security and stability of the financial system;
- the bank has not fulfilled its obligations as they fall due;
- the bank's total value of the liabilities exceeds the total value of its assets; or
- the dominant partners or managers of the bank fraudulently use the resources of the bank directly or indirectly in their own or others' favour in such a manner that the sound operation of the bank will be at stake, thus causing a loss for the bank

the BRSA shall be authorised, with the affirmative votes of a minimum five members, to revoke the operating permissions of that banks or to transfer the shareholder rights except dividends and the management and supervision of the banks to the SDIF, for the purposes of transferring, selling or merging them partially or fully, on the condition that the loss will be deducted from the capital of the existing partners.

In late 1990s and early 2000s, revocation of operating permissions and transfer of banks to the SDIF was so frequent. However, owing to the measurements taken by the Turkish government, the BRSA and CBRT, these frequent takeovers had been cut in the past decade until February 2015 where shareholders rights other than dividends corresponding to the majority of privileged shares of Bank Asya, a participation bank, were transferred to the SDIF as the bank had not submitted, within the specified time, information and documents belonging to some shareholders with qualified shares showing that they meet the required criteria applicable to founders.

In case where an operating permission of a bank is revoked, its management and supervision shall be transferred to the SDIF. The SDIF shall pay the insured deposits and insured contribution funds with the bank whose management and control has been assumed by it directly or through another bank it may designate and institute bankruptcy proceedings in the name of the owners of deposits and contribution funds against the bank. In cases where bankruptcy has not been issued for the bank, the voluntary liquidation of the bank shall be executed through the appointment of the members of the liquidation board by the SDIF, without requiring the resolution of the general assembly of the bank and without being subject to the provisions of Turkish Commercial Code No. 6,102 regarding the dissolution and liquidation of joint stock companies. After the bankruptcy or liquidation, the SDIF (and depositors), the employees of the bank and the shareholders respectively receive payments.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

As stated in question 13, in case where the operating permission of a bank is revoked pursuant to the provisions of the Banking Law, its management and supervision shall be transferred to the SDIF. In such case, legal body of the bank continues but the management and supervision is transferred to the SDIF and conducted by the SIDF until its bankruptcy or liquidation is completed. In such case, all or some of the directors may be replaced by the SDIF's experts.

15 Are managers or directors personally liable in the case of a bank failure?

If it is determined that the managers and auditors of a bank, or its general manager and assistant general managers, or its authorised signatory officers have caused the revocation of operating permission for the bank or transfer of the bank to the SDIF through their decisions and actions that are in violation of the applicable laws, on the basis of a decision of the SDIF and upon the request of the SDIF, such person shall be held personally liable to the extent of the damage they have caused to the bank and a court may declare any such person bankrupt. Where any such decision or act has been made or taken to provide benefits to dominant partners of the bank, the same provision shall also be applied to such dominant partners to the extent of the benefits so obtained. The outstanding amount of funds collected after the deduction of deposits and contribution funds, as well as their accessory obligations paid by the SDIF, shall be returned to the bank whose liquidation or bankruptcy procedures have been initiated.

16 How has bank resolution changed in response to the recent crisis?

Implementing Basel II regulations regarding harmonisation of capital measurements and international capital standards into banking legislation, strengthening the legal infrastructure concerning non-bank financial institutions, carrying out the studies of the second Financial Sector Assessment Program (FSAP-Turkey) and contributing to Istanbul International Finance have been the main items of the BRSA's strategic plan since the global crisis.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

As a incorporation condition, banks' paid-up capital, consisting of cash and free of all kinds of fictitious transactions, should not be less than 30 million lira and such amount has to be paid before incorporation. For development and investment banks, paid-up capital shall not be less than 20 million lira. However, according to current BRSA practice and the press declarations of both the Deputy Prime Minister responsible from the Economy and the President of the BRSA, the minimum capitalisation requirement for banks is US$300 million. This practice of requiring increased capitalisation has been adopted following a period in which the BRSA refused to issue licences in their entirety. On that basis, the BRSA's approach to licensing of development and investment banks and the minimum capitalisation requirement to be applied to them is not clear. As no development and investment bank has recently been incorporated in Turkey, we have not come across any information stipulating a minimum capital amount to be applied for such banks by the BRSA.

As per banking regulations in Turkey, the minimum capital adequacy ratio (CAR) which has to be met by banks is 8 per cent on a single and consolidated basis. Banks have to meet, remain and report at least the minimum CAR. However, the BRSA seeks 4 per cent more than the minimum ratio. According to the reports of the BRSA, CAR was determined at 16.30 in December 2014, which is higher than the minimum average and the ratio requested by the BRSA.

18 How are the capital adequacy guidelines enforced?

As per banking regulations, banks calculate and report their CARs to the BRSA in every month. The BRSA may decide to change the periods of calculation and submission. In case where it seems necessary, the BRSA may conduct on-site audit at banks' headquarters or branches.

19 What happens in the event that a bank becomes undercapitalised?

In the event that either the standard rate of capital adequacy or standard rate of consolidated capital adequacy falls below the minimum limit, it is essential that the minimum limit be ensured within a specified time period

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of not more than six months as determined by the BRSA from the period of calculation.

After this time period, if it is understood that the funds of the bank are inadequate pursuant to the provisions pertaining to capital adequacy, or such case is likely to occur, corrective or rehabilitating or restrictive measures shall be taken promptly against the relevant bank.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The BRSA may decide on revocation of operating permission or transfer of the bank to the SDIF. See question 13 for further information.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As per the recent amendments which are made in scope of implementing BASEL III requirements, the CAR has not been changed. As the policy of the BRSA is to impose higher CAR, we do not expect any further changes in the near future.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Entities and individuals that own a controlling interest in a bank should bear the qualifications required for the founders of a bank. Accordingly, such persons:

- shall not have been declared bankrupt, not be in possession of a certificate of bankruptcy, not have an approved application for restructuring through reconciliation and not have been issued with a decision for postponement of bankruptcy;
- shall not have qualified shares or not hold control in bank operation permissions which have been revoked or that have been transferred to the SDIF;
- shall not have qualified shares nor hold control in banks subject to liquidation, and in other financial institutions subject to liquidation, excluding voluntary liquidation, in development and investment banks whose operating permissions have been revoked, or in credit institutions whose shareholder rights except dividends and management and control have been transferred to the SDIF or whose permission to conduct banking transactions and accept deposits and participation funds have been revoked, before the transfer of the aforementioned credit institutions to the SDIF or before their permission and authorisation for accepting deposit and participation funds have been revoked;
- shall not have been sentenced to heavy imprisonment or imprisonment of more than five years, even though pardoned, with the exception of negligent offences, have not been sentenced to imprisonment of more than three years or have not been convicted of the violation of the provisions, that require imprisonment, of banking legislation and of the legislation on lending transactions, or have not been convicted of infamous crimes such as embezzlement, extortion, bribery, theft, swindling, forgery, breach of trust, fictitious bankruptcy, smuggling offences other than those arisen by the acts of using and consuming, fraudulent acts in official tenders and trades, money laundering or crimes committed against the prestige of the state and unveiling state secrets, offences committed against the sovereignty of the state or the prestige of its organs, offences committed against the security of state, offences committed against the constitutional order or the functioning of the constitutional order, offences committed against national defence, offences such as espionage committed as regards state secrets, offences committed against relations with other states as well as tax evasion, or have not been engaged in such offences;
- shall have necessary financial strength and standing;
- shall have the honesty and competence required for the business; and
- in the case of a legal entity, they shall have a transparent and open partnership structure together with the risk group.

23 Are there any restrictions on foreign ownership of banks?

As per the Banking Law, banking operations are regulated according to international standards. Unless stipulated by international agreements and other special laws, foreign investors are free to invest in Turkey and shall be subject to equal treatment with domestic investors. Therefore, there are no restrictions provided for the foreign ownership of banks regulated under Turkish banking legislation.

However, if a foreign bank wishes to open a branch in Turkey, the BRSA will require additional information from the country where the headquarters of the bank is located. Further, an application for operating permission cannot be granted for activities prohibited due to the violation of the local legislation in the country where such institutions are headquartered.

24 What are the legal and regulatory implications for entities that control banks?

See questions 10, 19 and 22.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Shareholders have to meet the qualifications stated in question 22. Shareholders with qualified shares who no longer bear these qualifications shall not benefit from shareholder rights other than dividends. Shareholders also have to comply with the share acquisition and transfer provisions of the Banking Law. Share acquisitions and transfers which exceed or fall below the limits (ie, 10 per cent) determined in the Banking Law require the permission of the BRSA.

For personal liability of controlling parties see question 15.

There are also duties and responsibilities of the board of directors, managers, auditors and so on determined in the Regulation on the Internal Systems of Banks.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

In case of insolvency or insolvency risk, the BRSA may decide revocation of operating permission or transfer of bank to the SDIF according to the conditions determined in the Banking Law. The SDIF manages and supervises banks and fulfils the necessary operations regarding the bankruptcy and liquidation thereof. In cases where bankruptcy has not been issued for the bank, the voluntary liquidation of the bank shall be executed. In both cases the SDIF shall be exclusively authorised to take action for insolvency.

The SDIF may request a preliminary injunction or preliminary attachment to be issued by a court in respect of the properties, rights and receivables of the controlling entity or individual without requiring a security deposit. Further, controlling individuals may be prohibited from leaving Turkey.

In addition, such controlling bodies shall be held personally liable to the extent of the damage they have caused to the bank and a court may declare any such person bankrupt.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The BRSA's permission is required for any acquisition of shares that results in the acquisition by one person directly or indirectly of shares representing 10 per cent or more of the capital of a bank or if shares held directly or indirectly by one shareholder exceed 10 per cent, 20 per cent, 33 per cent or 50 per cent of the capital as a result thereof, and assignments of shares that result in shares held by one shareholder falling below these percentages.

Assignment and transfer of preferential shares with the right of promoting a member to the board of directors or audit committee or issue of new shares with privilege shall be subject to the BRSA's authorisation irrespective of the limits defined above.

The transfer of shares of legal persons, directly or indirectly, who own 10 per cent or more of the capital of a bank, under the terms and conditions mentioned in the first paragraph shall be subject to the permission of the board. Permission might be given on the condition that the person who acquires the shares bears the qualifications required by the founders.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The regulatory authorities are receptive to foreign acquirers and the regulatory process is the same as for domestic investors. In some cases, Turkish authorities may apply to the regulatory authorities of the foreign acquirer for additional information. See question 23 for further information.

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After recent announcements, the total share of foreign acquirers in the Turkish banking sector is almost 25 per cent and almost 40 out of 51 banks have foreign shareholders.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The acquisition of a bank shall be evaluated in accordance with competition rules. To protect competition in the sector, the Competition Board shall prevent the abuse of dominance and will not permit acquisitions that would decrease competition to a significant extent. Further, the reciprocity principle, financial plan, acquisition price and its reflections in the media should be considered by acquirers.

30 Describe the required filings for an acquisition of control of a bank.

Acquirers are subject to the permission of the BRSA on condition they obey the corporate governance principles and the preventive provisions stipulated in the law. Permission applications are made to the BRSA together with a report expressing the detailed reasons for acquisition and other required information determined by the regulations.

Further, CMB and the Competition Board require filings if a public held bank is acquired or certain threshold limits are exceeded. All documents and information are submitted separately to the relevant boards or agencies; however, approval of the BRSA is precedent for CMB application.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Research regarding a foreign acquirer or its country may extend the time frame; however, the evaluation of the BRSA takes approximately six to nine months, and the approval of the Competition Board takes eight weeks at most.

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Ukraine

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

According to the Constitution of Ukraine the National Bank of Ukraine (NBU) is the main body responsible for ensuring the stability of the Ukrainian currency. The NBU also develops the main principles of monetary and credit policy and establishes currency control rules and supervises their implementation.

In addition to ensuring monetary stability, the Ukrainian government and the NBU has, in recent years, greatly emphasised policies aimed at achieving financial stability, keeping inflation low, overcoming negative effects of the credit crunch and protecting the interests of depositors and creditors of Ukrainian banks. Moreover, the NBU has lately actively promoted policies aimed at the forced sale of part of foreign currency proceeds, preventing the outflow of foreign currency, and reduction of cash settlements and consolidated supervision.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary pieces of legislation are the Constitution of Ukraine, the Civil Code of Ukraine and the Commercial Code of Ukraine, which set out basic regulation for all business activity in the country, including for the banking sector.

The main laws of Ukraine that govern the banking industry are the Law on the National Bank of Ukraine, the Law on Banks and the Banking Activity (the Banking Act) and the Law on Financial Markets and State Regulation of the Markets of Financial Services. These laws create comprehensive legal framework for financial sector and lay down the regulation of banking activities in Ukraine.

The Law on the System of Guaranteeing Deposits of Individuals establishes protection of deposits of individuals in Ukrainian banks, as well as the procedure for insolvent banks' exit from the market and liquidation of banks by the Deposit Guarantee Fund (DGF).

Also numerous regulations issued by the NBU as the banking regulator govern the banking industry in Ukraine, as well as the Law on Joint-Stock Companies, as all Ukrainian banks are established in the form of public joint-stock companies.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The NBU is the central bank of Ukraine, a specific central body of state power, which pursues common state policy in money circulation, lending and strengthening of national currency (the Ukrainian hryvna). The NBU coordinates the functioning of the banking system in general, oversees banks and payment systems and determines the official exchange rate of the hryvna against foreign currencies. Further, the NBU sets up the order of determining a discount rate and other interest rates, gives permission for registration of commercial banks, issues licences for banking business and determines the capital and liquidity requirement ratios.

The DGF in accordance with the Law on the System of Guaranteeing Deposits of Individuals performs the function of liquidating insolvent banks and insures the deposits of individuals.

The Antimonopoly Committee of Ukraine is responsible for ensuring fair competition on the market and issuing approvals for mergers and acquisitions in the banking sector where such an approval is required by law.

The National Securities and Stock Market Commission ensures implementation of state policy on securities and the stock market in Ukraine, as well as regulates legal relations arising on the stock market.

The National Commission for Regulation of Markets of Financial Services oversees financial companies jointly with the NBU, which are part of the bank groups, as part of the consolidated supervision executed by the NBU.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

The Ukrainian law provides for insurance of deposits made exclusively by individuals. The deposit insurance is provided by DGF, membership in which is obligatory for each Ukrainian bank and automatic for all new banks licensed in Ukraine. The only exception so far is for the State Savings Bank of Ukraine, the biggest state commercial bank in Ukraine.

Deposit insurance coverage is currently limited to 200,000 hrynas per depositor per bank, and may be increased by decision of the administrative board of the DGF. In the event of a bank liquidation, deposit insurance will be paid only in Ukrainian hryvnas, regardless of the currency in which the deposit was made.

Pursuant to the Banking Act, a state bank is a bank in which 100 per cent of its share capital is owned by the state. Before the financial crisis there were only two state banks in Ukraine: the State Savings Bank of Ukraine and the Ukrainian Export-Import Bank.

In late 2008 and early 2009 it became evident that certain medium-sized Ukrainian banks were close to default, which could have had a negative impact on the entire banking system. The government decided to recapitalise several of the most troubled banks (Rodovid Bank, Kyiv Bank and Ukrgazbank). At present, the government, through the Ministry of Finance of Ukraine, holds an almost 100 per cent stake in all three banks. Since Rodovid Bank had the biggest portion of distressed assets, it was designated a 'bad bank' and obtained the corresponding licence from the NBU. At the same time, Kyiv Bank and Ukrgazbank continue operating as traditional banking institutions, even showing a little profit lately.

The situation in the financial sector where around 40 banks were recognised as insolvent during 2014 and the first two months of 2015 shows that the NBU and the Ministry of Finance are not ready to bear new expenses connected with the recapitalisation of insolvent banks.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Banking Act stipulates the notion of 'qualifying holding' for, inter alia, limitations applying to transactions. Qualifying holding means direct, indirect, independent or joint holding of 10 or more per cent of the registered capital or voting rights of a legal entity or the ability to exercise decisive influence on the management or activities of the legal entity irrespective of the formal ownership. The Banking Act provides a definition of affiliates of a bank but its scope is quite narrow and constitutes a part of the more

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comprehensive definition of 'bank-related persons', which is used to limit transactions involving persons connected with a bank who may influence a bank to get more favourable treatment and covers quite a wide circle of persons, including:

- affiliates of the bank (legal entities in which the bank has qualifying holding or that hold a qualifying holding in the bank);
- managers of the bank and owners, qualifying holders of the bank;
- managers and owners of 50 or more per cent of the registered capital or voting rights of a legal entity, and their associated persons (close relatives); and
- other persons indicated in the Banking Act.

An agreement between a bank and its related persons may not provide for more favourable terms than the bank's agreements with other persons. An agreement with more favourable conditions for the bank's related person may be invalidated by the court.

Banks are prohibited from carrying out activities in the sphere of material production, trade (except the sale of commemorative, jubilee and investment coins) and insurance (except the activity of the insurance intermediary). Specialised banks (except savings banks) are prohibited from attracting deposits from individuals in amounts exceeding 5 per cent of the bank's capital.

A bank may own real estate of total value not exceeding 25 per cent of the bank's capital (this restriction does not apply to the bank's technological premises, property obtained via enforcement of a pledge and property acquired by the bank in order to prevent losses, provided that it is alienated within one year from the moment of its acquisition).

6 What are the principal regulatory challenges facing the banking industry?

The main regulatory challenges facing the banking industry in Ukraine are connected with significant devaluation of the local currency and numerous restrictions on transactions in foreign currency established by the NBU.

Among specific regulatory challenges today are issues related to treatment of the non-performing loans, regulatory capital of banks and rules of formation of bank reserves.

There are also several tax problems, which banks currently have to address. In addition, there is no single approach of the various state bodies towards factoring, which makes the sale of distressed banking assets fairly complicated and risky.

7 Are banks subject to consumer protection rules?

Ukrainian banks are subject to consumer protection rules which are established by the Law of Ukraine on Consumer Rights Protection. Article 11 of this Law, which is dedicated to consumer lending, imposes certain obligations on banks in connection with consumer lending. In particular, banks are obliged to provide the consumer with full information about the loan (amount, interest rate, other fees, total amount of payments, possible options for repayment, etc) prior to execution of a loan agreement. In addition banks must refrain from discriminative conditions in loan agreements (eg, unreasonable security, unpredictable change of the interest rate, disclosure of additional information not related to a loan, etc).

A consumer has the right to early repayment of the loan without any additional fees and this right may not be restricted by a loan agreement.

The Law also establishes certain rules for restructuring and enforcement of a consumer loan.

In case of assignment of rights under a consumer loan by a bank to another entity (bank), the initial lender must inform the borrower of such assignment.

The central body on consumer rights protection is in charge of protection of consumers' rights in the banking sector.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Ukraine today is on its way to establishing a more efficient and secure banking system. Nowadays, Basel I requirements are enforced by the NBU, while Basel II requirements are expected to be implemented as obligatory not earlier than 2020.

The liberalisation of banking activities, in our opinion, is going to be quite slow, as the NBU is afraid of currency instability owing to a shortage of foreign currency reserves. In connection with this, we anticipate that the policy aimed at preventing the outflow of foreign currency will continue.

At the same time, in the next few years we expect a certain toughening of the anti-money laundering regulations for banks, and further increases in capital requirements. At the same time, it is probable that the existing currency control regime will be slightly relaxed, but only subject to the stability of the national currency, which, in our opinion, may only be achieved in the long term.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The NBU supervisory powers are quite extensive and cover all Ukrainian banks, their separate divisions, affiliated and related entities, banking groups and members of banking groups in Ukraine and abroad, and branches of foreign banks in Ukraine. Moreover, the NBU exercises supervision over all natural and legal persons in Ukraine as regards their compliance with the Banking Act and is entitled to receive any information, including confidential information, required for the purposes of supervision from the above-mentioned persons, as well as state bodies.

There are two forms of supervision activities carried out by the NBU: off-site and on-site examinations.

For off-site examinations, the NBU may request from the bank copies of documents and written explanations of its activities. Banks are subject to quarterly and yearly mandatory reporting, day-to-day internal and annual external audits. Moreover, legal entities holding 10 or more per cent of the bank's registered capital must submit an annual report on their activities to the NBU.

On-site examination includes a scheduled inspection once per year and unscheduled inspections carried out if necessary in accordance with the law.

10 How do the regulatory authorities enforce banking laws and regulations?

The NBU may apply sanctions for violation of banking laws and regulations or performance of risky activities that jeopardise the interests of banks' depositors and creditors. Sanctions must be applied adequately to the violation or threat, and may involve one of a wide range of instruments available to NBU, including written notices, fines, restriction, suspension or termination of specific kinds of operations, withdrawal of banking licence and liquidation of the bank.

Also, the NBU may declare a bank problematic or insolvent. This allows use of a broader set of instruments to enforce banking laws and regulations that would not otherwise be available if a bank was operating in the regular regime.

If a bank is declared problematic by the NBU, the NBU may prohibit such bank from using direct correspondent accounts, and demand that the problematic bank carry out settlements exclusively through a consolidated correspondent account with the NBU. The problematic bank will inform the NBU within seven days of the measures it will take to bring its activity in compliance with the legislation (for which it has 180 days), and upon the demand of the NBU it will inform the regulator on the progress of execution of such measures.

If a bank is declared insolvent, the NBU does not exercise any further bank supervision, but only accepts the reporting of such bank. In such a case the DGF steps in and introduces a temporary administration in the insolvent bank for a period of three to six months.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In recent years the most common violations from banks were related to trade of foreign currency. These included speculations on the cash foreign currency market (that is, setting unreasonably high exchange rates or changing an exchange rate numerous times during one operational day) and banks' refusing to sell cash foreign currency to individuals despite there being cash foreign currency in their cash desks.

The banks seem to have become more cautious when conducting cash foreign currency trading.

Another issue is meeting regulatory capital adequacy requirements (see question 17).

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12 How has bank supervision changed in response to the 2008 financial crisis?

Significant devaluation of the local currency has forced the NBU to strengthen supervision, introduce new requirements as to reporting, making it more comprehensive, especially in the sphere of disclosure of corporate structure and final beneficiaries.

Another notable change, implemented both as a response to the recent crisis and with the purpose of creating a more transparent banking system, has been the implementation of the banking supervision on a consolidated basis, which means that the NBU is supervising not only the banks, but also the banking groups.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Generally, it should be noted that the NBU is the lender of last resort for commercial banks. Therefore, the regulator appears to be more interested in supporting commercial banks, including providing additional capital by way of refinancing.

Under the Banking Act, if a particular bank encounters difficulties or problems at complying with the legislative requirements, the NBU as a banking regulator may adopt a relevant decision and declare a bank either problematic or insolvent. Declaring a bank problematic is a banking secret under the Banking Act.

When a bank is declared problematic, it still remains under its own management, which will within seven days present to the NBU an action plan for the bank comply once more with the legal and regulatory requirements. If a problematic bank fails to comply with these requirements for 180 days in a row, or the amount of regulatory capital or capital ratios reduces to one-third of the established minimum, or the bank fails 10 days in a row to satisfy 10 or more per cent of its obligations to depositors and other creditors, the NBU will declare the bank insolvent.

The day after official receipt of the NBU decision declaring a bank insolvent, the DGF takes over the insolvent bank by launching the procedure the insolvent bank's exit from the market and establishes a temporary administration in the bank. From then on the NBU stops carrying out supervision of the insolvent bank and receives only reporting from that bank.

From the date of the appointment of the temporary administration (namely, an authorised DGF officer) all powers of the bank's management bodies (those of the general shareholders' meeting, supervisory board, and management board) and of its controlling bodies (the audit committee and the internal audit) will be terminated. The authorised DGF officer is vested with all the powers of the bank's management and control bodies from the date of commencement of the temporary administration until the termination thereof.

During the temporary administration, the following are prohibited:

- settling the claims of depositors and other creditors of the bank, with exception of:
  - deposit payouts under the expired agreements and payments under bank account agreements with individuals within the maximum guaranteed amount of deposit payout (not less than 200,000 hryvnas); and
  - salaries, royalties and compensation of damages caused to the life and health of bank employees;
- enforcement of bank funds and assets, foreclosure of bank assets, arrestment of bank funds and assets; and
- imposition of any financial sanctions for non-performance or improper performance of the bank's obligations to creditors and the bank's tax obligations.

Adoption of a resolution plan is fully within the competence of the temporary administration. There are several scenarios of resolution which may be adopted:

- liquidation of the bank with direct deposit payout by the DGF;
- liquidation of the bank with alienation of its assets and liabilities in favour of the assuming bank;
- alienation of assets and liabilities of an insolvent bank in favour of the assuming bank with withdrawal of the insolvent bank's licence and its further liquidation;
- incorporation of a bridge bank and sale of the bridge bank to an investor accompanied by transfer of the insolvent bank's assets and liabilities to the investor, and further liquidation of the insolvent bank; and
- sale of the insolvent bank to an investor.

The DGF may grant targeted loans to a bank aimed at fulfilling the bank's obligations. The bank's shareholders will be entitled to assets of the bank after satisfaction of all claims of depositors, creditors and other persons.

The government at its own discretion may participate in formation, registered capital increase, or both, of commercial banks. Participation of the state in the recapitalisation of commercial banks must be decided by the Cabinet of Ministers upon proposal by the NBU.

In practice, three banks underwent recapitalisation back in 2009 (see question 4). We do not think that the state is interested in acquiring private banks, because even if they are managed well, re-selling them to private investors may turn to be rather problematic.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

During the temporary administration the authorised DGF officer enjoys the full and exclusive right to manage the bank and take measures envisaged by the resolution plan. All powers of the directors and management are terminated and all structural subdivisions, bodies and officers of a bank are subordinated to the authorised DGF officer in their activities.

Ukrainian legislation currently does not establish an obligation for an operating bank to elaborate a resolution plan or a similar document. Moreover, adoption of a resolution plan is fully within the authority of the DGF for each insolvent bank. Even if there is a living will developed by the bank, the DGF is not obliged to take it into account and will carry out the transformation into a bad bank or liquidation at its own discretion.

15 Are managers or directors personally liable in the case of a bank failure?

Directors and managers are obliged to fulfil duties stipulated by laws and their labour contracts. In the event of improper performance or failure to perform their labour duties managers of the bank will be subject to labour liability and may be required to compensate the full amount of damages and losses, caused to the bank by their actions or lack of action. Also directors and managers will bear civil, administrative and criminal liability for their actions, if they commit an infringement of law or a crime during their terms of office at the bank.

The bank's management will be subject to criminal liability for intentionally causing the bank's insolvency and committing other white-collar crimes such as abuse of powers, bribery and manipulation of the stock market.

In the event of a bank failure due to factors not directly dependent on the bank and its management, directors and managers are usually not held liable.

16 How has bank resolution changed in response to the recent crisis?

The bank resolution system was fully reformed by the Law on the System of Guaranteeing Deposits of Individuals in 2012, shifting the power of appointment of temporary administration and further resolution of the bank from the NBU to the DGF. The main argument for this was that such system will allow the NBU to concentrate more on its specific functions of banking supervision pertaining to the banking regulator, rather than being involved in the management of distressed banks.

In addition, the maximum guaranteed amount of deposit payout has been increased several times over the past four years, and the overall resolution framework has improved and been clarified.

The Law on the System of Guaranteeing Deposits of Individuals is a special law that applies particularly to the resolution of banks. At the same time, the Law on Restoration of the Solvency of the Debtor or Declaring it Bankrupt, which sets up the bankruptcy procedure for legal entities, does not apply to banks.

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Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

At the moment of state registration of a bank the minimum amount of its registered capital may not be less than 120 million hryvnas. The regulatory capital of a bank includes main (Tier I) capital and additional (Tier II) capital.

Tier I capital includes registered capital and disclosed reserves that are formed at the expense of the retained profit, share premiums and additional contributions of shareholders to the registered capital, and the general risk provisioning fund formed for undetermined risk in banking operations, with the exception of losses in the current year and intangible assets. Tier II capital may include undisclosed reserves, re-evaluation reserves, hybrid capital instruments and subordinated debt. Tier II capital may not exceed 100 per cent of the Tier I capital.

A bank's regulatory capital may not be less than the bank's registered capital and no bank is entitled to reduce the size of its regulatory capital lower than the established minimum without approval of the NBU. The only exception is a newly established bank in the first year after the date it receives its banking licence.

The NBU obliges banks to meet the following three requirements with regard to regulatory capital:

- regulatory capital adequacy ratio to be not less than 10 per cent;
- regulatory capital to total assets ratio to be not less than 9 per cent; and
- regulatory capital to liabilities ratio to be not less than 10 per cent.

Regulatory capital adequacy ratio is defined as the ratio of regulatory capital to the amount of total assets, open currency position in all foreign currencies and banking metals, and certain off-balance instruments weighted by the degree of credit risk after reduction of:

- formed reserve funds for active banking operations;
- collaterals in the form of unconditional obligations or cash cover; and
- unencumbered bonds of internal state borrowings refinanced by the NBU and debt securities issued by the NBU under repo agreements.

Contingent capital arrangement is not obligatory for Ukrainian banks, and there is no special statutory regulation of contingent capital in Ukraine. To some extent, such arrangements are regulated through the framework of hybrid capital instruments.

18 How are the capital adequacy guidelines enforced?

If a bank fails to comply with the capital adequacy guidelines it may be subject to sanctions imposed by the NBU. In such case the NBU is entitled to issue warnings, impose fines or restrictions on certain banking operations or request the shareholders to increase the regulatory capital to the required level.

19 What happens in the event that a bank becomes undercapitalised?

The NBU would usually require the bank to take all measures necessary to restore appropriate capital levels; some negotiations with undercapitalised banks may be carried out. Also, the NBU is likely to request that the shareholders increase the regulatory capital of the bank.

If appropriate capital level is not restored, the NBU will impose sanctions on the undercapitalised banks or declare the bank problematic or insolvent in accordance with the order and terms provided for by the Banking Act, or both of the above.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The process would typically be as follows: appointment of temporary administration by the DGF; elaboration and implementation of a resolution plan; satisfaction of claims of depositors, creditors and other persons; and the liquidation of the insolvent bank. At the same time, transformation into a bad bank is possible at any time during temporary administration (see question 13).

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

In late 2011 the NBU set a new capital adequacy requirement, which only entered into force at the beginning of 2013. This standard defines the adequacy of the bank's own funds to meet obligations to depositors and creditors. The regulatory figure of this ratio should be not less than 10 per cent.

The NBU is aiming at full implementation of Basel II capital requirement in next five to seven years, while some Ukrainian subsidiaries of foreign banks are carrying out the process by themselves and will complete it sooner.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Ownership restrictions and implications are based on a notion of 'qualifying holding' stipulated in the Banking Act (see question 5).

According to the Banking Act, the following entities may not be a bank's shareholders:

- religious and charitable organisations; or
- legal entities in which the bank has a qualifying holding.

Mutual investments funds may not be founders of a bank or owners of the qualifying holding in a bank.

All other persons (legal entities and individuals, both residents and non-residents, the Ukrainian state represented by the cabinet of ministers of Ukraine or its authorised bodies) are allowed to be owners and hold shares in banks.

Founders and owners of qualifying holdings in the bank must have an impeccable business reputation, a satisfactory financial position and a transparent ownership structure meeting the requirements established by the NBU.

23 Are there any restrictions on foreign ownership of banks?

There are a number of restrictions on foreign nationals acquiring a qualifying holding or increasing a holding to a level above or equal to 10, 25, 50 or 75 per cent of registered capital or voting rights, or obtaining the ability to exercise decisive influence on the management or activities of the bank. These restrictions are discussed further in question 28.

24 What are the legal and regulatory implications for entities that control banks?

There are restrictions on owners of qualifying holdings with regard to obtaining loans on more favourable terms than could be obtained by others. Also, implications are provided as to maintaining an impeccable business reputation, satisfactory financial position and transparent ownership structure as established by the regulations of the NBU.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

A legal entity that has a qualifying holding in a bank is obliged to notify the NBU of all changes in its ownership structure and also furnish information on the business reputation of its newly appointed managers. An individual that owns a qualifying holding is obliged to notify the NBU of any changes to his or her business reputation and property status and of all persons through which indirect ownership of the qualifying holding in the bank is exercised. Also specific information is required by the NBU on associated persons (list of family members and relatives defined by the Banking Act) and legal entities in which the individual is a manager or controller (if he or she owns 50 per cent or more of the registered capital or voting rights or has the ability to exercise decisive influence on the management or activities of the legal entity irrespective of the formal ownership).

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Should the bank become insolvent, the controlling entity or individual would lose all ability to exercise management and control over it. Moreover, the controlling entity or individual would not have influence over elaboration and implementation of the resolution plan, or on choosing a resolution scenario.

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The amount of liability of the controlling entity or individual would be limited only to the contribution (ie, shares) it made to the registered capital of a certain bank, since in the event of a bank liquidation he or she would not be entitled to any assets of the bank or any compensation for his or her contribution.

The parent company of a bank currently cannot be held liable for mismanagement of the bank, which resulted in the insolvency of the latter.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

A person or entity intending to acquire control of a bank must obtain prior approval from the NBU. Control means a qualifying holding or increasing a qualified holding to a level equal to or above 10, 25, 50 or 75 per cent of charter capital or voting rights, or obtaining the ability to exercise decisive influence on the management or activities of the legal entity.

To obtain approval a person or entity must inform the NBU of his or her intention three months before the acquisition and submit the set of documents required by the Banking Act and the NBU's regulations. If the documents submitted to the NBU fail to comply with the statutory requirements the NBU has the right to refuse approval. Different sets of documents are required from domestic and foreign individuals and legal entities.

Another approval should be obtained from the Antimonopoly Committee of Ukraine in cases prescribed by law, so that the Antimonopoly Committee of Ukraine ensures that acquisition would not harm the market competition (ie, merger control clearance is obtained).

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The Banking Act has very stringent requirements regarding foreign legal entities and individuals obtaining an approval of the NBU for acquisition or increase of the qualifying holding in a bank. The authorities are quite formalistic in their approach to foreign acquirers and would refuse an approval should any non-compliance of documents with the laws and regulations be revealed.

Moreover, the Banking Act contains several requirements applicable to the country and the central bank of the country in which a foreign acquirer is registered:

- compliance with the international anti-money laundering and anti-terrorism financing standards;
- banking supervision adherence to the Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision; and
- agreement between the NBU and the banking supervisory authority of the country on cooperation in the area of banking supervision and harmonisation of banking supervision principles and requirements.

Update and trends

The complicated financial and economic situation in Ukraine and the annexation of Crimea, has caused a significant devaluation of the local currency and lack of foreign currency on the market. In order to stabilise the situation the NBU has implemented numerous restrictions for operations in foreign currency which should decrease the pressure on the currency market and prevent uncontrolled leakage of hard currency from Ukraine.

Moreover, the parliament of Ukraine has recently adopted a law that strengthens the personal liability of beneficial owners and management of banks for actions that have led to the insolvency of a bank or damages to a bank. According to the law, which is still subject to signing by the President of Ukraine, beneficial owners and management of a bank may bear criminal liability for intentional insolvency and are liable by all their personal assets for damages caused to a bank.

The last requirement constitutes a serious obstacle for transnational mergers and acquisitions in the banking sector of Ukraine and, currently there have only about been a dozen such agreements concluded, mostly with central banks of the CIS countries.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

In addition to the factors mentioned in question 28, the NBU would assess the business reputation, financial position and ownership structure for issuing an approval for acquisition of a control of a bank.

30 Describe the required filings for an acquisition of control of a bank.

The list of required filings is quite extensive. A foreign legal entity intending to acquire or increase the qualifying holding in a bank must submit, inter alia, the following documents to the NBU:

- documents specified by the NBU regulations to establish:
- the business reputation of the legal entity, its executive board and supervisory board members, entities that have a qualifying holding and all entities through which indirect ownership or control of the qualifying holding in the bank are likely to be executed;
- the financial standing of the said entity;
- whether the entity has enough of its own funds to make the intended contribution to the bank authorised capital;
- documents to verify the identity of the legal entity and all other entities through which indirect ownership or control of the qualifying holding in the bank are likely to be executed;
- information about the ownership structure;

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- approval by the Antimonopoly Committee of Ukraine for acquisition, in cases provided by the applicable Ukrainian law;
- a decision of the authorised management body of the foreign legal entity in relation to the acquisition of qualifying holding in a bank;
- written permission to have a qualifying holding in a Ukrainian bank granted to the foreign legal entity by the authorised control agency in the country where the head office of the foreign legal entity is registered, if the effective laws in that country require such a permit, or written assurance of the said foreign legal entity that the effective laws in that country do not require such a permit;
- an excerpt from the trade, bank or court registry or any other official document that confirms the registration of the foreign legal entity in the country where its head office is registered; and
- the auditor's report produced by a foreign auditor confirmed by a Ukrainian audit firm on the financial standing of the foreign legal entity as of the end of the latest complete calendar year.

In addition, documents submitted to the NBU by a foreign legal entity or a foreign individual need to be certified by a notary at the place of their issuance and legalised in the established order, unless otherwise established by the international treaties of Ukraine. Moreover, documents in foreign language submitted to the NBU need to be accompanied by a Ukrainian language translation certified by a notary.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

A legal entity or individual (either domestic or foreign) intending to acquire a qualifying holding in a bank must notify the NBU on its intentions three months prior to the acquisition or increase of the qualifying holding.

A 'silent approval' mechanism is stipulated by the Banking Act. Thus, if the NBU has not informed the relevant legal entity or individual of its decision to prohibit it from acquiring or increasing the qualifying holding in a bank within three months, the acquisition or increase must be deemed approved.

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United Arab Emirates

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The principal governmental and regulatory policies that govern the banking sector are UAE Federal Law No. 10 of 1980 concerning the Central Bank, the Monetary System and the Organisation of Banking (the Banking Law), UAE Federal Law No. 18 of 1993, as amended (the Commercial Code), UAE Federal Law No. 6 of 1985 concerning Islamic banks, financial establishments and investment companies (the Islamic Banking Law) and the various circulars, notices and resolutions issued by the board of governors of the UAE Central Bank, from time to time.

2 Summarise the primary statutes and regulations that govern the banking industry.

The Banking Law establishes the UAE Central Bank and contains detailed provisions on the role of the UAE Central Bank, which, among other things, includes issuance of currency; organising, promoting and supervising banking; directing the credit policy; advising the government on financial and monetary issues; acting as the government's bank; maintaining gold and foreign exchange reserves and acting as bank for other banks in the UAE. The Banking Law also contains detailed provisions on the registration, licensing and operation of commercial banks, investment banks, financial institutions, monetary and financial intermediaries and representation offices. The Banking Law is, however, not applicable to:

- public credit institutions set up by law;
- governmental investment institutions and agencies;
- governmental development funds;
- private savings and pension funds; and
- insurance and reinsurance companies and agencies.

The Commercial Code contains detailed provisions on banking operations, which include, among others, provisions governing bank deposits, bank accounts, guarantees, documentary credits, bills of exchange, loans, promissory notes and cheques.

The Islamic Banking Law contains provisions relating to the establishment and operation of Islamic banks. Islamic banks shall also be subject to the provisions of the Banking Law, with certain exceptions.

The various circulars, regulations, notices and resolutions issued by the UAE Central Bank deal with various aspects of banking including bank accounts, maintaining of certain reserve ratios, capital adequacy norms, measures to combat money laundering and reporting requirements to the UAE Central Bank.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The UAE Central Bank is primarily responsible for overseeing banks in the UAE, except in the Dubai International Financial Centre (DIFC), where the regulatory authority is the Dubai Financial Services Authority (DFSA).

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured in the UAE. In practice, the government has intervened on occasions to ensure that depositors do not suffer a loss. From time to time, the governments of various emirates of the UAE or entities owned by such governments have taken ownership interests in the banking sector. Such interests have not increased or decreased as far as we are aware.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

In this regard there are prescribed percentages of maximum exposure that a bank may incur to its parent company or subsidiaries or other subsidiaries of its parent company. A subsidiary is a company in which a bank holds a minimum of 40 per cent of share capital or has controlling influence (for example through the composition of the board of directors).

Also, Circular No. 16/93 issued by the UAE Central Bank governs large exposures incurred by banks. Large exposures are funded exposures (fewer provisions, cash collateral and deposits under lien). Banks are restricted from exceeding the maximum exposure per client or group. Circular No. 32/2013 dated 11 November 2013 has been issued by the UAE Central Bank to replace Circular No. 16/93. Revised restrictions have been imposed with regard to lending to government and government-owned entities. Banks cannot lend sums exceeding 100 per cent of their capital to governments or their related companies or more than 25 per cent to an individual borrower. The rules also prescribe the manner in which different categories of assets are to be risk-weighted. The new Circular, however, provides up to five years to the banks to meet the exposure limits set out in the circular.

With respect to permissible activities of a commercial bank, under the Banking Law, a commercial bank is an institution which customarily receives funds from the public in the form of demand, under notice, time deposits, or which carries on the placement of debt instruments or deposit certificates to be used, in whole or in part, for its account and at its risk, for granting loans and advances. The Banking Law further provides that commercial banks also carry on operations relating to the issue and collection of cheques, the placing of public or private bonds, trade in foreign exchange and precious metals, or any other operations allowed for commercial banks either by law or by customary banking practice.

With respect to Islamic banks, permissible activities are not specified in the Islamic Banking Law, which provides that Islamic banks means those whose memoranda of association include a commitment to abide by the provisions of shariah law and conduct their activities in accordance therewith. Islamic banks have the right to carry on all or part of banking, commercial, financial and investment services and operations. They have the right to engage in all types of services and operations practised by banks and referred to in the Banking Law whether those operations and services were conducted for the Islamic bank's own account or for or in partnership with a third party. Islamic banks also have the right to establish companies and participate in enterprises provided that activities of the latter are in conformity with shariah. The Islamic Banking Law provides that Islamic financial institutions and investment companies shall have the right to carry out lending, credit and other financial operations. They may also participate in enterprises, invest their funds in moveable assets and receive deposits for investment thereof in accordance with the provisions of shariah law. In terms of the Islamic Banking Law, Islamic banks are subject to the provisions of the Banking Law.

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With respect to prohibited activities, article 90 of the Banking Law provides that no commercial bank shall:

- carry on for its own account commercial or industrial activities or acquire, own or trade in goods, unless the acquisition of such goods is for settlement of debts due from others, in which case the goods must be disposed of within the period defined by the governor of the UAE Central Bank;
- acquire immoveable property for its own account, except immoveable property required for the conduct of the bank's business or for housing or amenities for its staff, or immoveable property acquired in settlement of debts, in which case, however, the property must be sold within three years (this period may be extended by decision of the governor of the UAE Central Bank);
- hold or deal in the bank's own shares unless they are acquired in settlement of a debt, in which case they must be sold within two years from the date of their acquisition; and
- purchase shares of, or bonds issued by commercial companies, in an amount which would raise the bank's holding thereof above 25 per cent of the bank's own funds, unless acquired in settlement of a debt, in which case the excess must be sold within two years from the date of acquisition.

Article 90 of the Banking Law further states that the prohibition shall not apply to the acquisition or holding of bonds issued or guaranteed by the government or other public sector institutions.

Article 91 of the Banking Law provides that commercial banks shall not grant loans or advance funds on current accounts to members of their board of directors, to managers of departments or to similar staff members, except by prior licence from the board of directors of the UAE Central Bank, which must be renewed annually. Article 91 further provides that this prohibition shall not include the discount of commercial paper, the issuance of bank guarantees or the opening of documentary letters of credit. Article 91 provides that no bank may offer to its customers credit facilities against the shares in the bank. Further, no bank may grant loans or advances for the purpose of constructing commercial or residential buildings, exceeding in total 20 per cent of its total deposits. This prohibition does not apply to banks specialising in real estate loans and authorised to do so by the UAE Central Bank.

Article 92 of the Banking Law provides that no commercial bank may issue travellers' cheques without prior authorisation from the UAE Central Bank. Article 93 of the Banking Law provides that no person who has been convicted of theft, dishonesty, fraud, embezzlement or the writing, with bad intent, of cheques against insufficient funds may be or remain a member of the board of directors of any commercial bank and no member of the board of directors or manager of any commercial bank may hold, without permission from the board of directors of his bank, a position as bank manager or member of the board of directors of any other bank.

The Islamic Banking Law does not contain specific provisions for prohibited activities. However, article 4 of the Islamic Banking Law provides that Islamic banks, financial institutions and investment companies incorporated in the country, along with branches and offices of foreign Islamic banks, financial institutions and investment companies licensed to operate in the country shall be exempted from the provisions of clause (a) of article 90 of the Banking Law (for discussion on which please see above). Article 4 of the Islamic Banking Law further provides that Islamic banks, financial institutions and investment companies shall also be exempted from provisions of clause (b) of article 90 of the Banking Law and in a manner not contravening established legislation in the emirate concerned.

6 What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenges derive from the fact that the Banking Law has not been amended or updated since it was promulgated in 1980 and, accordingly, does not address developments in financial services that have taken place since 1980. The subsisting regulations generally lack sophistication. Draft amendments to the Banking Law were proposed a decade ago but have yet to be promulgated.

In the immediate future, the banks face the challenge of complying with Basel III norms as and when they come into effect. The compliance with the regulatory requirement may limit the resources available to the banks for active business.

In addition, the banks and the financial institutions in the UAE are now required to comply with the US Foreign Account Tax Compliance Act (FATCA). The UAE and the US reached an agreement in May 2014 to include the UAE on the list of jurisdictions to be treated as having an intergovernmental agreement (IGA) in effect. The UAE has adopted Model 1 and banks and financial institutions in the UAE have started to comply with the requirements of the IGA.

7 Are banks subject to consumer protection rules?

The UAE has promulgated Federal Law No. 24 of 2006 and certain other regulations for consumer protection. However, this legislation does not expressly include 'banks' within their ambit. In addition, as the banks are supervised by the UAE Central Bank, it is unlikely that this legislation would have a bearing on the banking sector.

There are no specific customer protection rules for the banking sector. However, any complaint against a bank can be made by a consumer to the UAE Central Bank.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

As noted in question 6, an overhaul or substantial amendment of banking legislation is overdue. The establishment of the Dubai International Financial Centre (DIFC) in the Emirate of Dubai, with its own jurisdiction and body of modern laws, and its widening jurisdictional approach, might precipitate changes to the wider UAE legal and regulatory policies. Following the success of DIFC, substantial progress has been made towards the establishment of a new financial free zone in Abu Dhabi called the Abu Dhabi Global Market.

The regulatory policy for the banking industry is likely to follow a conservative approach.

The government of the UAE is also working on a draft bankruptcy law that aims to simplify the process and let troubled companies restructure their assets and liabilities.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are supervised by the UAE Central Bank through the various reports that are required to be filed by banks with the UAE Central Bank on a periodic basis. Further, under the Banking Law, the UAE Central Bank is entitled to inspect the books, records and accounts of any bank at its discretion. In certain cases, the Central Bank has appointed administrators or representatives to temporarily manage a bank. These audits are ordinarily conducted once a year and are reasonably extensive.

10 How do the regulatory authorities enforce banking laws and regulations?

Any failure by banks to comply with the laws and regulations would be notified by the UAE Central Bank and the bank given an opportunity to rectify the breach. Continued failure would attract consequences ranging from fines to cancellation of the licence to conduct banking.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The most common issues for the regulator and banks have included approval of investment products, issues pertaining to selling of investment products and concerns regarding institutions operating within the scope of their licences. In July 2012, the Emirates Securities and Commodities Authority (SCA) issued the much-anticipated new UAE Investment Fund Regulation (Fund Regulation). The Fund Regulation transfers regulatory responsibility for the licensing and marketing of investment funds and for a number of related activities from the UAE Central Bank to the SCA. The sale, marketing and promoting of foreign securities and funds in the UAE and the establishment of domestic funds requires the consent of the SCA. However, even under the new regulations, the ambiguity regarding registration requirements for an investment product continues.

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12 How has bank supervision changed in response to the 2008 financial crisis?

In January 2009, the UAE Central Bank announced that all banks in the UAE must provide details of each loan in excess of 10 million dirhams to the UAE Central Bank to enable the UAE Central Bank to scrutinise the asset quality of the banks.

In February 2009, the UAE Central Bank created an online unit to settle disputes among banks. Banks may now lodge a complaint directly with the UAE Central Bank through this online process. Upon receipt of a complaint, the UAE Central Bank will investigate the complaint and hope to be able to notify its decision within eight weeks. However, matters that are already before a judicial process and major financial problems or criminal cases would be outside the purview of this online complaint system. The UAE Central Bank believes that this initiative will help them to better monitor the issues faced by banks in the UAE.

In March 2009, the UAE Central Bank announced that it would set up a joint task force comprised of representatives of the UAE Central Bank and the country's banks to discuss further measures to face the global crisis.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The banks may be taken over by the government or regulatory authorities in the interest of the depositors of the bank. If a bank has insufficient liquidity to meet its obligations and there is risk to the bank's depositors, the bank may be taken over by the government.

While such instances are uncommon, a few such takeovers were reported recently in the wake of the financial crises. The Dubai Bank was taken over by the government of Dubai in 2011 through its majority-owned bank Emirates NBD.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Any commercial bank operation in the UAE is required to maintain a minimum paid-up capital. If the bank's capital falls below the required minimum, the deficiency must be met within the time prescribed by the UAE Central Bank. This period must not be more than one year from the date the deficiency is made known to the concerned bank. There is no specific plan or similar document prescribed under the laws of the UAE.

15 Are managers or directors personally liable in the case of a bank failure?

Managers or directors are not personally liable unless the bank's failure is attributable to any fraud or illegality committed by them.

16 How has bank resolution changed in response to the recent crisis?

Banks have tended obviously to be more conservative and cautious in lending, particularly in relation to off plan real estate lending. In addition, the recent steep drop in the international oil prices could have a negative impact on the assets of the banks. If oil prices continue to drop, banks that rely heavily on government businesses and funds for deposits may feel the effect more than lenders that focus on individual customers.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Pursuant to Circular No. 13/93 issued by the UAE Central Bank all banks are obliged to maintain a minimum capital base relative to the total of their risk-weighted assets, as measured by the risk assets ratio.

The capital base of a bank is defined as the sum of Tier I capital and Tier II capital, less certain prescribed deductions.

Tier I capital shall be the paid-up share capital and published reserves of a bank. Profits of the current period are not allowed to be included except in certain exceptional cases at the discretion of the UAE Central Bank. Goodwill and other intangible assets, own shares held, shortfall in provisions, current-year losses and others (as may be prescribed by the UAE Central Bank from time to time), must be deducted from Tier I capital.

Tier II capital comprises undisclosed results, revaluation of assets limited to a maximum of 45 per cent of the excess of the market value over their net book value (revaluation reserves in respect of a bank's property assets are not to be included), hybrid (debt or equity) capital instruments and subordinated term loans.

The prescribed deductions from the aggregate of the Tier I and Tier II capital are investments in unconsolidated subsidiaries, investment in associate companies, investments in other banks or financial institutions and any other deductions as may be prescribed by the UAE Central Bank from time to time.

Risk weighting of assets is prescribed by the UAE Central Bank from time to time.

The risk assets ratio to be maintained by banks at all times is a minimum of 10 per cent, in which Tier I capital must reach a minimum of 6 per cent of total risk-weighted assets and Tier II capital must not be more than 67 per cent of Tier I capital.

Pursuant to Notice No. 3735/2006 dated 27 August 2006, the UAE Central Bank implemented the Basel II Accord. The implementation was to be in stages. In the first stage, the banks were required to be compliant with the standardised approach for credit risk by 31 December 2007. Furthermore, banks were required to adopt their own procedures for operational risk and to adopt the 1996 Amendment to Basel I for Market Risk.

Further to the above, as mentioned in question 7, in 2009 the UAE Central Bank issued guidelines for implementation of the Basel II Capital Accord. These state that the minimum capital adequacy ratio of banks will be set at 11 per cent, rising to 12 per cent from 30 June 2010, as specified in Notice No. 4004/2009 dated 30 August 2009 of the UAE Central Bank. This notice provides as follows:

- banks should work towards increasing their capital adequacy to 11 per cent at the latest by 30 September 2009, of which Tier I capital must not be less than 7 per cent;
- banks must increase their capital adequacy once more to 12 per cent at the latest by 30 June 2010, of which Tier I capital must not be less than 8 per cent; and
- these percentages will be applied on a temporary basis and will be re-examined at the beginning of 2011 to determine whether they will continue. The notice shall become effective on 31 August 2009.

In July 2012, the UAE Central Bank issued a circular on liquidity regulations as part of a phased implementation of Basel III. The regulations lay down qualitative requirements, quantitative requirements and reporting requirements as part of liquidity risk management at banks. The qualitative requirements require banks to comply with 12 criteria when setting up their liquidity-risk-management and governance frameworks. The quantitative requirements require compliance with four ratios in a phased manner; a liquid assets ratio, a uses (of funds) to stable resources ratio, a liquidity coverage ratio and a net stable funding ratio. As per one of the important quantitative requirements, banks are required to hold 10 percent of their liabilities in 'high-quality liquid assets'. Under the reporting requirements, the banks will be required to complete a liquidity report to enable the UAE Central Bank to monitor effectively the liquidity positions at banks and to take appropriate and timely action on early signs of a liquidity stress. The implementation of some of the above regulations was to commence from 1 January 2013 but has been postponed pending further consideration by the UAE Central Bank.

There is no specific requirement for contingent capital arrangements. However, article 81 of the Banking Law provides that should a commercial bank's capital fall below the minimum requirement provided for in the Banking Law, the deficiency must be met within a period which was to be defined by the executive committee of the UAE Central Bank, which period shall not exceed one year from the date the bank concerned is notified of the deficiency. The executive committee alone may determine the extent of the deficiency. Article 82 of the Banking Law provides in material part that commercial banks and branches of foreign banks shall have to allocate at least 10 per cent of their annual net profits for the establishment of a special reserve until the said reserve equals 50 per cent of the commercial bank's capital or, in the case of branches of foreign banks, of the amount allocated as capital.

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18 How are the capital adequacy guidelines enforced?

Pursuant to Circular No. 13/93 issued by the UAE Central Bank, all banks are required to report to the UAE Central Bank on prescribed banking return forms on a quarterly basis no later than 14 days following the end of each quarter, based on the end-of-quarter figures.

The UAE Central Bank has also issued Basel II Standardised Approach-Returns (including the capital adequacy calculation) which need to be filed by banks. In view of this, the status of Circular No. 13/93 is not clear.

Though the Basel III norms introduced by the UAE Central Bank are yet to come into force, the banking system in the UAE generally seems to be stable with a high solvency sheet.

19 What happens in the event that a bank becomes undercapitalised?

If a bank is undercapitalised at any point, it must rectify the deficiency within one year or any shorter period as may be notified to it by the Central Bank. Any failure to so rectify could attract consequences ranging from fines up to cancellation of its licence to conduct banking.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

Commercial banks in the UAE are incorporated as public joint-stock companies or as branches of foreign banks. Investment banks and other financial institutions may be incorporated as public joint-stock companies or private joint-stock companies or as branches of foreign investment banks and financial institutions. Monetary and financial intermediaries may be incorporated as public joint-stock companies or private joint-stock companies or limited liability companies or as branches of foreign monetary and financial intermediaries.

Insolvency of public joint-stock companies, private joint-stock companies, limited liability companies and branches of foreign companies are governed by the provisions of the UAE Federal Law No. 8 of 1984, as amended (the Companies Law) and the bankruptcy provisions of the Commercial Code. Additionally, pursuant to the Banking Law, a notice of liquidation of any commercial bank must be published in the Official Gazette and in at least two local daily newspapers.

The notice of liquidation shall give the bank's customers at least three months' notice to take necessary steps to enforce their rights. The notice shall also provide the name of the liquidator entrusted with the payment of the outstanding deposits and other transactions relating to the bank.

Traditionally, if any locally incorporated banks face bankruptcy situations, they have been merged with other banks.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

See question 17.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Under the Companies Law at least 51 per cent of any company incorporated in the UAE (outside free zones) must be owned by UAE nationals or entities wholly owned by UAE nationals. Additionally, for financial and monetary intermediaries and finance companies, at least 60 per cent of the shares must be held by UAE nationals or entities wholly owned by UAE nationals.

23 Are there any restrictions on foreign ownership of banks?

Yes. A bank incorporated in the UAE must be majority-owned by UAE nationals. There are several branches of foreign banks operating in the UAE.

24 What are the legal and regulatory implications for entities that control banks?

The experience and expertise of an entity that acquires control of a company involved in banking and financial services will be considered by the UAE Central Bank to approve the acquisition of control. However, there are no formal restrictions on such entity carrying on any other business.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The legal and regulatory duties and responsibilities of an entity or individual who controls the bank would be to ensure that the banking operations are conducted in accordance with the requirements of the Banking Law, the Commercial Code and the various notices, circulars and resolutions of the UAE Central Bank. There will be no express obligation on the shareholders to provide additional capital in the event that a bank becomes undercapitalised, but the Central Bank will require the capital to be increased, failing which the bank may be fined or have its licence cancelled.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Generally, no legal liability attaches to the controlling entity as a result of insolvency of a bank.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

There is no specific definition of control (save in relation to determination of large exposure). Thus 'control' should mean a majority shareholding interest in the bank, a right to exercise control through representation at the board of such bank, or both. Any change in such controlling entity requires the prior written approval of the UAE Central Bank. Upon receipt of such approval subsequent approvals of the local licensing authorities of the emirate where the bank is incorporated must also be obtained.

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28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

In the view of the local ownership requirements, a foreign party may not acquire a UAE-incorporated bank.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

A change in ownership or control of a bank is a relatively rare phenomenon in the UAE. A majority of the locally incorporated banks are owned by the governments or the ruling families of the relevant emirates in which they are based. In the event of a proposed acquisition, we would expect the UAE Central Bank to consider issues such as the identity of the acquirer, its track record, any conflicts of interest as well as the purpose and term of the investment.

30 Describe the required filings for an acquisition of control of a bank.

See questions 27 and 28.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

All approvals from the UAE Central Bank are at its discretion and no approximate time frames may be stated. However, depending on the identity of the acquirer, approval of the Central Bank would be a matter of months, rather than days or weeks.

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United Kingdom

Isabel Paintin and Ben Kingsley

Slaughter and May

Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The banking sector is regulated for the purposes of prudential regulation by the Prudential Regulation Authority (PRA) while the regulation of market conduct is the responsibility of the Financial Conduct Authority (FCA). In addition, the Financial Policy Committee (FPC) operates from within the Bank of England (the UK central bank) as a macro-prudential regulator tasked with identifying and mitigating systemic risks to the UK financial system. Prior to 1 April 2013, the Financial Services Authority (FSA) had been the UK's combined prudential and conduct regulator for banks.

The PRA's statutory objective is to promote the safety and soundness of PRA-authorised persons. That objective is to be advanced primarily by first seeking to ensure that the business of PRA-authorised persons is carried on in a way that avoids any adverse effect on the stability of the UK financial system, and second seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system. The PRA is required to determine its strategy in relation to its objectives, and review it from time to time. On 19 June 2014, the PRA published an updated version of its paper which sets out its approach to banking supervision together with a policy statement on how the PRA uses its formal powers to address serious failings in the culture of firms.

The FCA must, so far as is reasonably possible, act in a way that is compatible with its strategic objective and advances one or more of its operational objectives. The FCA's overarching strategic objective is ensuring that the financial markets function well. The FCA's operational objectives are:

- securing an appropriate degree of protection for consumers;
- protecting and enhancing the integrity of the UK's financial system; and
- promoting effective competition in the interests of consumers in the markets for regulated financial services.

The Financial Services and Markets Act 2000 (as amended by the Financial Services Act 2012) (FSMA 2000) includes specific matters that the FCA may have regard to in considering how to meet its operational objectives. A number of FCA approach documents have been published: the first in June 2011 by the FCA's predecessor, the FSA, which outlined how the FCA would be tougher, bolder and more engaged with consumers in taking steps to improve regulation, followed by a further publication 'Journey to the FCA' in October 2012 and another on the FCA's approach to advancing its objectives in July 2013.

The FPC has primary responsibility to protect and enhance the resilience of the UK's financial system. This involves identifying, monitoring and taking action to reduce systemic risks. The FPC publishes a biannual Financial Stability Report. It also has statutory powers under the Bank of England Act 1998 (as amended) to give directions to the PRA and the FCA to reduce emerging systemic risks including the ability to set a countercyclical capital buffer as well as the power to adjust sectoral capital requirements in certain areas.

The Financial Services Act 2010 established the UK Money Advice Service, which is tasked with enhancing the understanding and knowledge of members of the public regarding financial matters, and the ability of members of the public to manage their own financial affairs.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary statute governing banking in the United Kingdom is the Financial Services and Markets Act 2000 (FSMA 2000). Extensive amendments were made to FSMA 2000 by the Financial Services Act 2012 that abolished the FSA and established the PRA, FCA and FPC as new regulatory bodies. Further changes were made by the Financial Services (Banking Reform) Act 2013 (which received Royal Assent on 18 December 2013) to implement some of the recommendations made by the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. The government intends that all relevant secondary legislation to be made under the Banking Reform Act 2013 will be published by the end of the current parliamentary session in May 2015.

Under FSMA 2000, it is a criminal offence for a person to engage in 'regulated activities' in the United Kingdom unless he or she is authorised to do so or is exempt from the authorisation requirement. Regulated activities are defined in secondary legislation.

Accepting deposits is a regulated activity where such deposits are lent to third parties, or where any other activity is financed wholly or to a material extent out of capital or interest on deposits. Banks must therefore obtain authorisation under FSMA 2000 to accept deposits.

Other regulated activities that may be relevant to banks include dealing in investments as principal, dealing in investments as agent, arranging deals in investments, managing investments, safeguarding and administering investments (ie, custody), providing investment advice and mortgage lending. Investments include shares, debentures (including sukuk), public securities, warrants, futures, options, contracts for differences (eg, swaps) and units in collective investment schemes.

Following a detailed consultation process, responsibility for consumer credit regulation transferred to the FCA from the Office of Fair Trading (OFT) on 1 April 2014. Consumer credit business is now regulated under FSMA 2000 rather than the Consumer Credit Act 1974 and banks are required to apply for relevant consumer credit-related permissions under the FSMA 2000 regime in order to carry on consumer credit business. An interim permission regime has applied from 1 April 2014 to ensure a smooth transition to the FCA, but all banks must be fully authorised and compliant with the new regime by 1 April 2016.

The Banking Act 2009 introduced a Special Resolution Regime to facilitate the orderly resolution of banks in financial difficulties (now largely amended by legislation implementing the EU Recovery and Resolution Directive in the UK – see question 14). That Act also established a new bank insolvency regime as well as formalising the Bank of England's supervisory role in respect of interbank payment systems. A parallel insolvency regime applies to investment banks (including banks carrying on investment banking activities) under the Investment Bank Special Administration Regulations 2011.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The PRA is the principal regulator responsible for the regulation of banks, with its jurisdiction including both authorisation and prudential supervision. The FCA undertakes regulation of banking conduct of business issues. Both the PRA and the FCA have disciplinary and enforcement powers. Since 1 April 2014, the FCA has been responsible for consumer credit, while the OFT's competition function has been combined with that of the Competition Commission to form the Competition and Markets Authority;

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the OFT has ceased to exist. The Bank of England has responsibility for overseeing payment systems and, together with the UK Treasury, has a role in operating the Special Resolution Regime for failing banks. As mentioned, the FPC acts as a macro-prudential regulator responsible for identifying and taking action to reduce systemic risks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured by the UK government but by the Financial Services Compensation Scheme (the Scheme). The Scheme is an independent body set up under FSMA 2000. The PRA and FCA are responsible for determining the rules within which the Scheme operates, including the persons eligible to make a claim, and the level of compensation. The Scheme is free to consumers and protects deposits as well as covering insurance policies, insurance broking, investment business and mortgage advice.

Under changes that came fully into effect on 31 December 2010:

- the maximum amount payable to any claimant was increased to £85,000;
- the eligibility criteria for claims were simplified;
- 'fast payout' of claims is required with a target of payment within seven days;
- compensation is calculated on a gross basis (thereby ignoring any debts a depositor owes to the bank); and
- banks are required to put in place systems to enable them to provide a single customer view (SCV).

The Financial Services (Banking Reform) Act 2013 (Banking Reform Act 2013) amends FSMA 2000 to impose new statutory duties on the Scheme requiring it to operate swiftly and efficiently for the benefit of consumers. It also imposes new governance arrangements and requirements to report accounting and management information to the UK Treasury.

The European Commission adopted a proposal to amend the EU Deposit Guarantee Directive in July 2010. After protracted discussions between the Council of the European Union and the European Parliament, a proposal was agreed in December 2013 confirming the existing level of cover (€100,000) and by 1 January 2024 requiring reimbursement of a certain amount of customer deposits within seven working days. Member states will be permitted to provide temporary protection of higher balances, for example, in connection with real estate transactions. The European Parliament voted to adopt the proposed text in April 2014 and the recast Directive was published in the Official Journal of the European Union on 12 June 2014. It will be required to be implemented by member states 18 months after this date. In the meantime, with effect from 31 August 2012 the UK regulators have required deposit-takers to increase consumer awareness by displaying stickers and posters prominently in branches and on websites explaining their compensation arrangements.

The final report of the Independent Commission on Banking (ICB) recommended the introduction of depositor preference for insured deposits (see question 8). The Banking Reform Act 2013 amends UK insolvency law to give effect to this recommendation making all deposits covered by the Scheme preferred debts, ranking ahead of other unsecured creditors on an insolvency.

Government recapitalisation of the banking sector

The UK government adopted emergency measures in response to the crisis in the banking sector, including liquidity assistance, recapitalisations and an asset protection scheme. Major UK banks were required to increase their Tier I capital significantly. RBS Group plc (RBS) and Lloyds Banking Group (Lloyds), unable to raise additional capital externally, received government capital injections. RBS benefited from a second capital injection at the time of its accession to the UK government's asset protection scheme in 2009.

The government currently holds 9.06 billion shares in RBS, including 5.1 billion non-voting shares following the 2012 10:1 share consolidation. This is equivalent to 70 per cent of the voting share capital and 84 per cent of the total share capital. On 17 September 2013, the government sold £3.2 billion of its ordinary shares in Lloyds to institutional investors, and on 26 March 2014 it sold a further £4.2 billion. It currently holds 24.9 per cent of the total share capital of Lloyds, although the Chancellor of the Exchequer announced in December 2014 a plan to sell a further £3 billion of shares prior to the general election in May 2015 to reduce the government's stake to approximately 20 per cent. The government also nationalised failed mortgage lenders Northern Rock and Bradford & Bingley, although following a good bank/bad bank split the viable part of Northern Rock's business was sold to Virgin Money for £747 million in November 2011. The government is committed to selling its ownership interest in RBS and remaining interest in Lloyds when market conditions permit.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The directors of a bank must act in a way that they consider is most likely to promote its success. While directors can take into account a bank's membership of a wider group, they are not entitled to subordinate the interests of the bank to those of other group companies, such as by lending to an insolvent parent or sister company.

If a bank is a member of a group whose shares are listed on the London Stock Exchange, the Listing Rules impose requirements in respect of 'related party transactions'. Group companies are related parties.

The PRA also restricts 'large exposures'. A large exposure is an exposure of 10 per cent or more of a bank's Tier I and Tier II capital (after deductions from capital) to:

- a single counterparty; or
- a group of connected clients.

Large exposures must be reported periodically to the PRA. Exposures of more than 25 per cent of a bank's capital are prohibited. This limit may, however, be exceeded in respect of intra-group transactions only where the excess arises in respect of trading activity and the bank holds additional capital.

The rules on exposures to connected counterparties were changed in November 2012. Since then, intra-group exposures have been captured by the definition of a 'group of connected clients'. This means either: (i) two or more persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or (ii) two or more persons between whom there is no relationship of control as set out in (i) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or others would also be likely to encounter funding or repayment difficulties. The purpose is to limit the application of the restrictions on intra-group exposures to situations where parties are so interconnected that if one entity were to experience financial difficulties the other would also do so.

The application of the large exposures rules is modified where a bank forms part of a core UK group (a group or subgroup of wholly-owned UK companies that satisfy certain requirements) or a non-core large exposures group. The effect is to relax the limits on intra-group transactions provided that certain conditions are met. A waiver is required from the PRA to apply either of these regimes. In particular, the PRA applies a 100 per cent limit on exposures between members of a core UK group and members of the non-core large exposures group. Non-regulated members of the core UK group must also enter into a capital support agreement in favour of the regulated banks.

There are no specific statutory restrictions on the types of business that a bank can undertake, although if a bank wishes to engage in other activities that are regulated under FSMA 2000 (see question 2) it must obtain permission from the PRA, which would require it to satisfy the PRA (and, where relevant, the FCA) that it could meet the relevant regulatory requirements. A bank may not carry on insurance business as EU directives restrict writing insurance to firms authorised to do so and prohibit them from carrying on any other activity. A bank may, however, own an insurance subsidiary.

6 What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenges facing the banking industry have arisen from the financial crisis and have been manifested in a surge of complex regulatory reforms. Recent bank failures have demonstrated the inadequacy of existing regulatory structures to contain risk within the financial

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system, as well as the need to refocus regulation on macro-prudential issues affecting financial stability. The fourth EU Capital Requirements Directive and Capital Requirements Regulation (together known as CRD IV), which came into force on 1 January 2014, significantly increased the amount of capital and liquidity resources that a bank is required to hold, as well as imposing limits on leverage. New requirements in respect of remuneration were introduced on 1 January 2011 and 1 January 2014 (see question 21).

A further challenge is presented by the implementation of the proposals in the final report of the ICB including the new measures in the Banking Reform Act 2013 such as the ring-fencing of key banking services, a requirement to maintain additional loss-absorbing capital, a new bail-in stabilisation option for the Special Resolution Regime and a new senior persons regime (see question 8). The PRA has also required UK banks to stress-test their eurozone exposures as a result of the European sovereign debt crisis.

Following the global investigation in 2012 and 2013 into the manipulation of Libor and Euribor, and in light of the ongoing global investigations into the manipulation of foreign exchange rates, there are currently several UK, EU and international initiatives to reform the regulation of benchmarks. In the United Kingdom, since 2 April 2013, the activities of providing information to a specified benchmark (currently only Libor) and administering a specified benchmark have been regulated activities under FSMA 2000 for which authorisation from the FCA is required. The FCA also has a code of conduct (including organisational requirements) for benchmark submitters and administrators. The Treasury has the power to add further benchmarks to the regime. Following a consultation process, the government announced in December 2014 that seven additional benchmarks will be brought within the regime: the Sterling Overnight Index Average (SONIA); the Repurchase Overnight Index Average (RONIA); the WM/Reuters (WMR) 4pm London Closing Spot Rate; ISDAFIX; the London Gold Fixing; the LBMA Silver Price; and ICE Brent. The secondary legislation required to implement this extension will come into effect in April 2015.

In September 2013, the European Commission published a proposal for a Benchmarks Regulation, which would regulate the production and use of indices that are referenced in financial instruments and financial contracts. The proposed Regulation deals with the benchmark-setting process, the governance of and controls on that process and measures around transparency and consumer protection. Although a compromise proposal was published in December 2014, at the time of writing, the scope of this regulation is still uncertain, but as well as Euribor it is likely to cover commodity and exchange-traded derivative benchmarks, although equity indices may be carved out. If adopted, the Benchmarks Regulation will affect banks that are benchmark submitters and may limit the ability of banks to reference in financial products benchmarks produced by non-EU administrators. The proposal is currently being considered by the European Parliament and Council and it is hoped that agreement on the text of the Regulation will be reached during the course of 2015.

IOSCO published its Principles for Financial Benchmarks in July 2013. These Principles provide guidance for benchmark administrators on issues such as benchmark quality, methodologies, governance and accountability. They are very broad in scope, covering all prices, estimates, rates, indices or values that are referenced (eg, in financial instruments and contracts). Although the Principles are not binding, benchmark administrators are encouraged to meet their standards and should publicly disclose the extent of their compliance with the Principles annually, starting from July 2014.

Since 1 April 2013, the new conduct regulator, the FCA, is taking a tougher stance on regulatory compliance and enforcement with increasingly higher fines imposed for breaches of law or regulation (see question 11).

7 Are banks subject to consumer protection rules?

There exists in the UK a significant number of pieces of legislation providing for the protection of consumers covering areas such as the supply of goods and services, unfair contract terms and distance selling. Banks must comply with these generally-applicable measures as much as any other business. Among other things, this legislation implies certain terms into consumer contracts for goods and services, protects consumers from unfair or unclear contractual terms and mandates how businesses must contract with consumers under certain circumstances (such as distance selling) or when supplying certain types of services (such as consumer credit). However, consumer protection law is currently undergoing major reform in the UK. The government introduced a Consumer Rights Bill to Parliament in January 2014 which at the time of writing remains in the parliamentary debate process. The purpose of the Bill is to consolidate key strands of consumer protection law in the UK as well as to reform the law on unfair terms in consumer contracts, rights and remedies in relation to contracts for goods and services, to extend the powers of, and remedies which can be imposed by, enforcement authorities and to enable consumers to bring private collective actions against anti-competitive behaviour by businesses. It is currently envisaged that the Bill will be brought into force in October 2015.

The EU Consumer Rights Directive was implemented in the UK via secondary legislation which came into force in April 2013 and June 2014. The key changes made by the Directive were to introduce a ban on excessive payment surcharges attached to certain methods of payment and reform existing regulations on distance and doorstep selling.

From April 2015, the FCA will acquire new competition powers to enforce prohibitions on anti-competitive behaviour in relation to the provision of financial services. These new powers will be exercised concurrently with the existing powers of the Competition and Markets Authority (CMA) which already enforces these prohibitions against businesses generally. The FCA will also gain powers to carry out market studies and to refer markets to the CMA for in-depth review. It has already concluded a review into the cash savings market which found that competition is not working effectively (report published 20 January 2015) and is currently considering a range of remedies to address these concerns.

For banks specifically, as regulated firms they are subject to the FCA's Treating Customers Fairly (TCF) regime which requires them to pay due regard to the interests of their customers and to treat them fairly. This is an overarching principle which applies to every aspect of a bank's business, but is supported by more specific FCA rules mandating how banks should deal with customers when providing certain services such as investment advice. The FCA enforces the TCF regime and can fine or publicly censure banks which breach TCF requirements, as well as requiring them to offer consumer redress where appropriate. Recent enforcement cases have included:

- Clydesdale Bank plc was fined £8.904 million in September 2013 for failing to pay due regard to the interests of its customers and treat them fairly after it discovered an error in its new mortgage repayment calculation system for its customers with variable rate mortgages. Although Clydesdale took steps to investigate and correct the error, the FCA concluded that it was too slow in doing so, prolonging the impact of the error and increasing the value of the shortfall it would need to collect from some customers. Although the bank contacted customers affected by the error and set up a telephone helpline, the FCA concluded that it prioritised repayments from customers and ignored the fact that many customers could have rejected demands to repay shortfalls caused by the bank's calculation error.
- UBS AG was fined £9.45 million in February 2013 for failing to ensure the suitability of its advice and failing to treat customers fairly in relation to its AIG Enhanced Variable Rate Fund customer redress programme. The fund sought to deliver enhanced returns by investing a significant amount in asset-backed securities and floating-rate notes before it was suspended with 565 UBS customers still having approximately £816 million invested. The regulator found that the bank had failed to carry out sufficient due diligence on the fund, failed to take reasonable care to ensure the suitability of its advice and keep sufficient records, and failed to take effective steps when the problems with the fund came to light.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Changes in regulatory policy in the United Kingdom are being driven principally by the need to respond to the lessons of the financial crisis. In broad terms, the PRA's and FCA's policy for supervising banks and banking activity in the United Kingdom has hardened since the financial crisis and reflects a more cautious and stability-focused approach to bank supervision. We see no reason for this approach to soften in the near term.

The Basel Committee on Banking Supervision (the Basel Committee) published the Basel III Capital Accord on 16 December 2010 (which was implemented on 1 January 2014 by CRD IV). This is summarised in question 21.

The ICB published its final report in September 2011. The report included the following recommendations:

- a structural separation of retail and investment banking. UK banks that accept deposits or provide overdrafts to individuals and small and medium-sized enterprises shall be required to establish a separate ring-fenced subsidiary;

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- the ring-fenced retail bank shall be prohibited from engaging in investment banking activities. Other activities (eg, accepting deposits from corporate customers or lending to large companies) may be carried on inside or outside the ring fence;
- the retail bank would need to be economically independent from the rest of the group and meet regulatory requirements on a stand-alone basis;
- large UK retail banks should have equity capital of at least 10 per cent of risk-weighted assets. In addition, the retail activities of large UK banking groups should have primary loss-absorbing capacity (PLAC) of 17 to 20 per cent. Primary loss-absorbing capacity includes (in addition to equity and subordinated debt) long-term unsecured debt that bears losses in resolution (bail-in bonds) as well as, potentially, contingent convertible capital instruments (CoCos); and
- depositor preference should be introduced for insured deposits with depositor claims ranking ahead of other unsecured debts.

Several recommendations were also made to improve competition in the retail banking market including reducing barriers to entry, helping customers to switch accounts, ensuring greater transparency as to the cost of banking services and that regulation promotes competition.

The ICB recommended that its proposals be implemented by 1 January 2019. Responding to the report the government stated that it agreed with the recommendation that vital banking services, especially the taking of retail deposits, should only be provided by ring-fenced banks and that these banks should be prohibited from undertaking certain investment banking activities. A number of the proposals outlined by the ICB have been implemented by the Banking Reform Act which to a certain extent was subsequently overtaken by the EU Recovery and Resolution Directive (RRD) (see question 16).

In June 2012 the UK government published a White Paper on banking reform. This made clear that much of the detail of the new regime would be left to secondary legislation or PRA rules. The government is also more cautious than the ICB in taking steps, especially in respect of bank capital requirements, that go further than present, or future global or EU standards. At the outset only accepting deposits from individuals and SMEs will be mandated as a ring-fenced activity (ie, an activity that can only be carried on by a ring-fenced bank).

The government expects that most essential banking services provided to individuals and SMEs will in practice be undertaken by ring-fenced banks. While most wholesale market activities will be prohibited for ring-fenced banks, limited wholesale market activities in respect of funding, hedging and liquidity will be permitted. Ring-fenced banks will also be permitted to offer 'simple' derivative products to SMEs and individuals for hedging purposes. The government sees a case for imposing limits on, and regulating the terms of, intra-group funding. In October 2012 the government published a further White Paper including a draft bill implementing the ICB's proposals. A bill to implement the reforms was introduced into Parliament in February 2013 and received Royal Assent on 18 December 2013 as the Financial Services (Banking Reform) Act 2013 (the Banking Reform Act 2013). Under the Banking Reform Act 2013 (which adds a new Part 9B (ring-fencing) to FSMA 2000) only deposit-taking is prescribed as an activity that must be carried on within a ring-fenced bank although power is granted to the Treasury to mandate other activities if deemed necessary. Further, only retail and SME deposits will be inside the ring fence; deposits from high net worth individuals and large companies that have chosen to place their deposits outside the ring fence will not be caught. In July 2013, the Treasury published a consultation paper seeking comments on draft versions of secondary legislation establishing the perimeter of the ring-fencing requirements. The final version of secondary legislation governing the scope or ring-fencing (including core and excluded activities) came into force on 1 January 2015.

Further secondary legislation will include regulations governing the way in which the PRA may use its powers to impose debt requirements on specified classes of institutions. This would enable the PRA to require UK banks to issue minimum amounts of loss absorbing debt.

As recommended by the ICB, it is expected that banks will be required to comply with the new ring-fencing requirements by 2019 at the latest.

In addition, the Banking Reform Act 2013 requires the PRA to make regulatory rules on the 'height' of the ring fence (ie, regarding the legal, economic and operational independence of the ring-fenced bank). The PRA will also have the power to require banks to restructure their operations if it considers the ring fence to be ineffective, and will acquire a new continuity objective in relation to the ring fence, requiring the PRA to conduct annual reviews of its operation. The PRA published its first consultation paper on its ring-fencing rules relating to legal structure, governance and continuity of services and facilities in October 2014, and further consultations are expected over the course of 2015.

In February 2013 the Chancellor of the Exchequer announced that if a bank fails to comply with the ring-fencing requirements the PRA and the Treasury will have the power to break up the bank.

Following the financial crisis during which senior individuals in banks were blamed for mismanaging their businesses, regulators are continuing to scrutinise senior management responsibility. The new Senior Managers regime introduced by the Banking Reform Act 2013 sets high standards for senior management and is designed to make it easier for regulators to take enforcement action against them, while the new criminal offence of reckless misconduct in the management of a bank creates a much tougher penalty for individuals who mismanage their banks (see question 15). This represents a shift in regulatory focus from the collective responsibility of a bank's board to the individual responsibility of directors and senior managers.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are supervised by the PRA as regards prudential regulation, while the FCA supervises their conduct. As part of its ongoing work on the recovery and resolution frameworks for financial institutions, the PRA has stated that its judgement about a firm's proximity to failure is captured by the firm's position within the proactive intervention framework (PIF), the supervisory framework that replaces the FSA's advanced risk-responsive operating framework (ARROW). The PIF assessment is derived from the risks faced by a firm and its ability to manage them: external context, business risk, management and governance, risk management and controls, and capital and liquidity. There are five PIF stages denoting a different proximity to failure at a given point in time, and every bank will be allocated to a particular stage. If a firm migrates to a higher risk category (ie, the PRA determines that the firm's viability has deteriorated) the intensity of supervision will increase. The five PIF categories are:

- low risk;
- moderate risk;
- risk to viability absent action by the firm;
- imminent risk to viability of the firm; and
- the firm is in resolution or being wound up.

The PRA does not routinely disclose to firms in which stage they sit as this could destabilise firms in times of stress. Banks have annual internal stocktake meetings with the PRA to discuss the major risks that they face, the supervisory strategy and any proposed remedial actions, including guidance about the appropriate level of capital and liquidity. The PRA also sends an annual letter to the board outlining key risks that are of greatest concern and in respect of which action is required. A firm's PIF stage is accordingly reviewed at least annually, and in response to relevant, material developments.

Senior management of the firm will be expected to ensure appropriate remedial action is taken to reduce the likelihood of failure while the PRA has stated that the regulatory authorities will ensure appropriate preparedness for resolution. The appropriate remedial actions that a firm may be required to take include drawing on the menu of options set out in the firm's approved recovery plan (see question 14). The PRA has additional statutory powers to change the management or board composition, restrict capital distributions and leverage and set tight liquidity or capital requirements. When a firm is deemed to have entered resolution, the PRA may draw on a wide array of powers as set out in the Special Resolution Regime.

The FCA makes its conduct assessment of firms through the firm systematic framework (FSF). This enables the FCA to assess whether a firm is being run, currently and prospectively, in a way that results in the fair treatment of customers, minimises risks to market integrity, and does not impede competition. The FSF is the means by which the FCA conducts structured assessments of firms across all sectors. Common features of the FSF involve:

- business model and strategy analysis (BMSA), which includes consideration of sectoral risk; and

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- the treating customers fairly regime (TCF), which examines consumer culture and control systems.

The FCA will engage directly with priority firms (including retail banks) on an annual basis as well as carrying out cross-sectoral and thematic reviews to address broad areas of concern.

The PRA and FCA have stated in their respective approach documents that they intend to follow the same approach to supervision as the FSA, (ie, in a non-contentious manner and without reliance on formal powers). Nonetheless, such powers exist as a backstop if a bank fails to engage constructively with the PRA and the FCA and both regulators have demonstrated a proactive and interventionist approach to their supervisory roles. Enforcement issues are addressed in question 11.

10 How do the regulatory authorities enforce banking laws and regulations?

If the PRA or FCA identify a breach of their rules or principles they may bring enforcement proceedings. In particular, the FCA aims to intervene early to tackle potential risks to consumers and market integrity before they crystallise, and has been described as being 'tougher and bolder' in building on and enhancing the FSA's policy of credible deterrence. Sanctions include withdrawal of authorisation, fines, banning orders and public disclosure of non-compliance ('naming and shaming'). Where a person has committed criminal offences (eg, insider dealing, market manipulation, or carrying on a regulated activity without authorisation) the PRA or FCA (as relevant) may initiate a criminal prosecution. The Coroners and Justice Act 2009 enhanced the ability of the regulators to prosecute financial crimes including protection for whistle-blowers and powers to engage in plea bargaining. In March 2009, the FSA (the PRA and FCA's predecessor) brought its first successful prosecution for insider dealing. Further successful prosecutions have followed. The FSA also brought successful prosecutions for acquiring control over an authorised person without obtaining FSA consent. In July 2010 the Supreme Court confirmed that the FSA (now the FCA) may also prosecute money laundering offences.

The PRA and FCA are required to cooperate closely in taking enforcement action, although the PRA may veto enforcement action by the FCA if this may threaten the stability of the UK's financial system, or cause the failure of a PRA-authorised person in a way that would adversely affect financial stability. In most cases, including insider dealing and money laundering, the FCA is the authority responsible for prosecuting financial services offences.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The PRA and FCA have policies of maintaining close and regular contact with the senior management of authorised firms in order to spot and resolve problems early on, but, where justified, enforcement action is a key part of the new regulatory landscape. The PRA and FCA's approaches are informed by separate statutory objectives and are pursued through distinct supervisory programmes.

Recent themes in enforcement have been the mis-selling of financial products, the failure to ensure that customers have received suitable investment advice, failings in banks' systems and controls including IT systems and deficiencies in anti-money laundering measures. The most notable wrongdoing that emerged in 2014 was the manipulation of foreign exchange (FX) rates which continues to be the subject of a global investigation by regulators. This follows the major global inquiry which started in 2012 (the investigation of which continued throughout 2013 and 2014) into the manipulation of the Libor and Euribor interbank rates. Examples of recent enforcement action are set out below.

Five banks (Citibank N.A., HSBC Bank plc, Royal Bank of Scotland plc, JPMorgan Chase Bank plc and UBS AG) were fined a total of £1.1 billion in November 2014 for failing to exercise adequate control over their G10 spot foreign exchange trading operations between 1 January 2008 and 15 October 2013, including failing to manage risks around confidentiality, conflicts of interest and trading conduct. The FCA found that the banks allowed their FX traders to put the banks' interests ahead of those of their clients, other market participants and the wider UK financial system. This resulted in traders sharing confidential information about their clients' activities and attempting to manipulate the G10 spot currency rates, including colluding with traders at other banks in ways which had the potential to disadvantage clients and the market. This was the biggest fine ever imposed by the FCA (or its predecessor, the FSA). The FCA is continuing to investigate the G10 spot FX trading business and wider FX business of Barclays Bank plc. The FCA has also launched an industry-wide remediation programme to ensure firms address the root causes of these failings and to raise market standards.

Lloyds Bank plc and Bank of Scotland plc, both part of the Lloyds Banking Group, were fined £105 million in July 2014 for attempting to manipulate the Repo Rate and Libor by manipulating submissions to those benchmarks. The FCA determined that between April 2008 and September 2009, the two banks artificially inflated their three month Repo Rate submissions on days when the fees for drawing on the SLS (a special taxpayer-backed facility to assist UK financial institutions in response to the financial crisis) were calculated. This meant that the banks avoided paying the Bank of England the SLS fees properly due to it and gave rise to the risk that the published Repo Rate would be manipulated. The FCA found that this behaviour amounted to a failure to observe proper standards of market conduct and demonstrated failings in systems and controls within the banks.

These fines followed earlier fines relating to the Libor investigations in 2012 and 2013 for Centrale Raiffeisen–Boerenleenbank BA, RBS, UBS and Barclays.

Among the enforcement action taken in other areas, Barclays Bank plc was fined £26.0335 million in May 2014 for failing adequately to manage conflicts of interest between itself and its customers, and for systems and controls failings, in relation to submissions made to the London Gold Fixing. In particular, the FCA identified one incident in which a Barclays trader with an interest in an options contract whose trigger was linked to the Gold Fixing price, participated actively in the Gold Fixing and made submissions with the intention of trying to fix the gold price at a particular level. The FCA considered the breaches to be particularly serious because the London Gold Fixing is an important price-setting mechanism which provides market users with an opportunity to buy and sell gold at a single quoted price and so any inappropriate conduct in relation to the benchmark-setting process could have a widespread effect on the UK and international financial markets.

Royal Bank of Scotland plc, National Westminster Bank Plc and Ulster Bank Ltd were fined £42 million by the FCA and £14 million by the PRA in November 2014 for IT failures which occurred in 2012. These failures affected 6.5 million banking customers in the UK, including retail customers, commercial customers, customers abroad, individuals who were not customers of the banks and also had an impact on the banks' ability to participate in clearing. This was the first time that the PRA had imposed a financial penalty on a firm.

Barclays Bank plc was fined £37.745 million in September 2014 for safe custody failures, and specifically for failing to take reasonable care to organise and control its affairs responsibly and failing to protect safe custody assets adequately between November 2007 and January 2012. The FCA stated that the failings occurred in the bank's Investment Banking Division in relation to £16.5 billion of safe custody assets belonging to affiliates and affiliates' clients, including assets held by third party sub-custodians. However, the FCA took into account a number of mitigating factors, including the fact that the bank had not acted deliberately or recklessly, had promptly reported the failings, had committed significant resources to investigating the extent of the failings and remediating them and the fact that there had been no actual loss of client assets.

Royal Bank of Scotland plc and National Westminster Bank plc were fined £14.4746 million in August 2014 for what the FCA described as serious failings in their advised mortgage sales business between June 2011 and March 2013. The FCA found that the banks had breached their duties to take reasonable care to ensure the suitability of advice and failed to remedy the failings adequately when they were identified originally by the FSA. Among other things, the FCA found that the banks' process for assessing affordability was inadequate, as was monitoring. The banks were slow to identify the extent of the problems from successive reviews and mystery shopping exercises that highlighted widespread failings, and provided false assurances to the FCA that the problems were being addressed.

Santander UK plc was fined £12.3778 million in March 2014 for what the FCA described as serious failings in the way in which it gave investment advice to retail clients between April 2004 and December 2012. The penalty followed a mystery shopping exercise and wealth management thematic review originally conducted by the FSA. The bank also agreed to conduct a customer contact exercise and a redress exercise for certain customers who might have received a different service from that for which

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they were charged. It also agreed to compensate customers and implement a new annual review process for remaining customers.

Standard Bank was fined £7.6404 million in January 2014 for failing to take reasonable care to ensure that all aspects of its anti-money laundering policies and procedures were applied appropriately and consistently in relation to its corporate customers connected to politically exposed persons. Enhanced due diligence measures (applied prior to establishing banking relationships) were inadequate and ongoing monitoring of existing customer relationships for the purpose of updating customer due diligence was poor. With reference to its new competition objective, the FCA stated that firms that do not meet the minimum standards for anti-money laundering may be perceived as having an unfair competitive (cost) advantage.

State Street Bank Europe Limited and State Street Global Markets International Limited were fined £22.885 million in January 2014 for failures in relation to State Street's transition management (TM) business for structural changes to asset portfolios. The FCA found that State Street had considerably overcharged for this service and did not voluntarily contact all affected customers once it became aware of the error.

Lloyds TSB Bank plc and Bank of Scotland plc were fined £28.0388 million in December 2013 for serious failings in the systems and controls governing the financial incentives that they gave to sales staff in Lloyds, Halifax and BOS branches who sold protection and investment products to customers on an advised basis. The FCA found that the firms had incentivised, through sales targets and variable remuneration policies, a culture of mis-selling without adequate monitoring of product suitability.

JPMorgan Chase Bank, NA was fined £137.61 million in September 2013, in relation to what became known as the London whale trades, for failing to exercise due care, skill and diligence, failure to implement effective risk management systems and observe proper standards of market conduct. This occurred in relation to the US$6.2 billion trading losses sustained in 2012 by the Synthetic Credit Portfolio (SCP), which involved credit instruments, notably credit default swap (CDS) indices. The losses arose from the high-risk trading strategy, weak management of that trading and an inadequate understanding or appreciation of important market information.

12 How has bank supervision changed in response to the 2008 financial crisis?

The PRA has adopted a policy of judgement-based regulation and a forward-looking approach that involves assessing not just current risks to the safety and soundness of banks but also potential future risks. This involves:

- a significant increase in resources devoted to the supervision of complex banks or those banks that are systemically important and therefore whose failure would pose the greatest risk to the stability of the UK financial system;
- a shift in supervisory style to focus on key business outcomes and risks of the specific bank or group, and on the sustainability of its business models and strategies;
- emphasis on technical skills as well as probity in assessing approved persons;
- an increase in supervisory resources devoted to sectoral and firm comparator analysis, to better identify firms that are outliers in terms of risks and business strategies, and to identify emerging sector-wide trends that may create systemic risk; and
- a much more intensive analysis of information relating to key risks.

The PRA and FCA have also adopted the policy of commissioning 'skilled person' reports paid for by firms, on areas such as capital adequacy, governance and complaint handling. In 2013/14, the FCA commissioned 50 and the PRA 33 skilled person reports; for the first three quarters of 2014/15, the figures were 39 (FCA) and 36 (PRA).

The PRA seeks to work closely with boards and senior management of banks when making decisions and works closely with the Bank of England and the FCA in its supervision of banks.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

See question 20. The stabilisation powers exercisable in relation to a bank under the Banking Act 2009 include the transfer of all or part of a bank to a 'bridge bank' owned by the Bank of England or the temporary public ownership of a bank or a bank's holding company. These powers are only exercisable in relation to a bank incorporated in the United Kingdom. Branches of non-UK banks may not be nationalised but may (where not contrary to EU law) be subject to winding-up proceedings in the United Kingdom, including on public interest grounds.

Nationalisation of banks is very uncommon in the United Kingdom and has only occurred to protect the stability of the financial system. Non-systemic banks are subject to insolvency proceedings (mainly, bank insolvency and administration; see question 20 below). Northern Rock was nationalised on 22 February 2008. Bradford & Bingley was nationalised on 28 September 2008, although the deposits and branch network was at the same time sold to the Santander Group. On 28 March 2009 the Bank of England acquired the commercial lending and poorer quality mortgage portfolio of the Dunfermline Building Society. The deposits and branch network were sold to Nationwide Building Society. Previous nationalisations include Johnson Matthey Bankers in 1984 and the Bank of England itself in 1946. The government's shareholding in Lloyds and RBS is discussed in question 4.

In all these cases depositors' interests were fully protected. If, however, a bank is subject to insolvency proceedings, uninsured deposits rank pari passu with other senior claims (although insured deposits now benefit from depositor preference; see question 4). Employees may be protected under employment law where a business unit is transferred, or if redundancies are made. There are, however, no specific protections under the Banking Act 2009. Certain employee claims rank as preferred debts if a bank is wound up.

Under the Banking Act 2009, if the Treasury decides to take a bank or bank holding company into public ownership, it must pay compensation if shareholders suffer a loss compared to the position they would have been in had the failed bank been subject to insolvency proceedings. No account is taken of any financial assistance provided by the Bank of England or the Treasury in valuing the shares in the bank. The independent valuer appointed after the nationalisation of Northern Rock concluded that the value of the shares, after stripping out assistance provided by taxpayers, was nil and that no compensation was payable. An appeal to the Upper Tribunal was dismissed in 2011. An attempt to challenge the basis of compensation was dismissed by the European Court of Human Rights in 2012 as manifestly ill-founded. The European Court considered that it was entirely legitimate for the United Kingdom to decide that, had the Northern Rock shareholders been allowed to benefit from the value created through the provision of state support, this would encourage the managers and shareholders of other banks to seek and rely on similar support, to the detriment of the United Kingdom's economy. The independent valuer appointed in respect of Dunfermline Building Society concluded that the treatment of creditors whose claims were transferred to Nationwide, as well as those creditors whose claims remained behind, was no worse than it would have been had Dunfermline entered insolvency proceedings. Accordingly, no compensation was payable.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

With effect from 1 January 2014, the PRA requires UK banks and banking groups to develop recovery and resolution plans (colloquially referred to as 'living wills'). Under the PRA rules, all UK-incorporated deposit-takers (other than insurers and credit unions) are required to develop recovery and resolution plans. A recovery plan comprises a series of measures that the bank or its group could take to turn the business around following adverse trading conditions, and postulates a range of options that the bank could take to return to adequate levels of liquidity and capital. Recovery options may include disposals, raising new equity, the elimination of dividends, liability management or the sale of the firm. While recovery plans are the responsibility of the bank, their adequacy is evaluated by the PRA. Resolution plans will assist the authorities to wind down a firm if it fails for whatever reason. The resolution data and analysis provided by firms is intended to identify significant barriers to resolution, to facilitate the effective use of the powers under the Banking Act 2009 and so reduce the risk that taxpayers' funds will be required to support the resolution of the bank.

The PRA expects a bank's recovery plan as well as the processes for producing resolution proposals to be subject to oversight and approval by the board or a senior governance committee and subject to review by the audit committee. Firms must nominate an executive director who has

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overall responsibility for the firm's recovery and resolution plan as well as overseeing governance arrangements.

As mentioned in question 9, the PRA's PIF will indicate where on the spectrum a firm lies as well as the measures that should be taken to address the potential risk of the firm failing. Resolution plans will be prepared by the PRA based on information provided by the bank. Where necessary, the PRA will require banks to take steps to reduce the risk of firm failure. A key part of the PRA's ongoing work in this area is to ensure cooperation with the main overseas authorities from countries in which those banks operate.

In June 2012 the European Commission proposed a directive on recovery and resolution which establishes an EU-wide framework for the recovery and resolution of banks and investment firms (the RRD) (see further question 16). The RRD was published in the Official Journal of the European Union on 12 June 2014 and entered into force on 2 July 2014. Member states were required to publish by 31 December 2014 legislation and regulations implementing all the provisions of the RRD (except those relating to the bail-in tool, which must be applied from 1 January 2016). Following the Treasury's July 2014 consultation on the implementation of the RRD, the Directive was implemented by provisions which came into force in the UK in January 2015 via secondary legislation and PRA/FCA Rules (with a few exceptions, including the rules on the contractual recognition of bail-in which will come into force on 1 January 2016). Amendments have also been made to the Special Resolution Regime under the Banking Act 2009 to bring it in line with RRD requirements.

The Banking Reform Act 2013 has introduced a new criminal offence of reckless misconduct in the management of a bank, which covers a bank's directors and other senior managers (see question 15).

15 Are managers or directors personally liable in the case of a bank failure?

Bank failure does not automatically result in liability for the directors. The personal liability of directors in the case of insolvency is discussed in question 26. In addition, depending on the circumstances, directors may be at risk of the following:

- disciplinary action – if the directors are responsible for breaches of the PRA or FCA rules they may be subject to regulatory sanctions in the normal way, which may include fines as well as banning orders;
- civil liability – directors owe fiduciary duties to the company. In particular, they are required to promote the success of the company, to exercise independent judgment and to exercise reasonable care, skill and diligence. Failure to comply with these duties exposes the directors to civil liability to the company;
- a range of criminal offences may be relevant to misconduct prior to or in the course of insolvency proceedings. These include theft, fraud, false accounting, fraudulent trading, transactions in fraud of creditors, conspiracy to defraud and misconduct in the course of winding up, etc. Generally, these offences require proof of dishonesty; and
- disqualification – directors of an insolvent bank may be disqualified if their conduct makes them unfit to be concerned in the management of a company.

The failure of HBOS and RBS demonstrates that errors of commercial judgement are not in themselves sanctionable, unless either the processes and controls that governed how those judgements were reached were clearly deficient, or the judgements were clearly outside the bounds of what might be considered reasonable. The FSA report into the failure of RBS considered options for change and concluded that there was a strong argument for new rules, which would ensure that bank executives and boards place greater weight on avoiding downside risks. The Banking Reform Act 2013 introduces a new Senior Managers regime to replace the current approved persons regime in respect of individuals with key management responsibilities in banks. The Senior Managers regime will hold those individuals to account for their areas of responsibility, introduce a new code of conduct and extend the time limit for taking enforcement action against senior persons. In July 2014, the PRA and FCA jointly published a consultation document on the implementation of these proposals including a new certification regime which would stand alongside the Senior Managers regime and apply to staff whose actions could significantly harm the bank. Final rules are expected to be published early in 2015. The Banking Reform Act 2013 also introduces a new criminal offence of reckless misconduct in the management of a bank for those individuals covered by the Senior Managers regime. The maximum penalty for this offence is seven years' imprisonment or an unlimited fine, or both. In their July 2014 consultation paper, the PRA and FCA suggested that prosecution of the reckless misconduct offence will likely be rare, as it requires (among other things) the financial institution to fail and for a senior manager's conduct to fall significantly below what could reasonably be expected of someone in their position.

16 How has bank resolution changed in response to the recent crisis?

The Banking Act 2009 introduced three stabilisation options as well as two new insolvency procedures for banks. The Banking Reform Act 2013 amended the Banking Act 2009 to introduce a fourth stabilisation option – the new bail-in tool – which will enable resolution authorities to impose losses on a failing bank's creditors (see question 20). In June 2012 the Commission adopted proposals for the RRD and the final text of the RRD was published in the Official Journal of the European Union on 12 June 2014 and entered into force on 2 July 2014. Under the RRD:

- EU member states are required to confer specified resolution powers on national resolution authorities in respect of banks, some investment firms and their groups;
- EU banks are required to establish recovery plans to restore their viability in the event of a material deterioration in their financial position;
- resolution authorities are required to produce plans for resolving banks, investment firms and their groups in a range of scenarios based on information provided by firms. Those resolution authorities will have enhanced early intervention powers where a firm is likely to breach minimum capital requirements;
- resolution authorities have a range of powers where a firm is failing or is likely to fail, including the power to sell the business to third parties on commercial terms, to transfer the business to a state-owned bridge bank, or to transfer the bad assets to a publicly controlled asset management vehicle for eventual sale or orderly wind-down, leaving behind a viable 'good' bank;
- resolution authorities have the power to impose losses of a failed or failing bank on its creditors by means of writing down unsecured liabilities, converting them to equity, or both, thereby facilitating recapitalisation;
- banks will be required to hold a minimum amount of 'bail-inable' liabilities by 1 January 2016; and
- resolution authorities are required to write down shares and other capital instruments before applying any of the resolution tools or exercising the bail-in power.

The Special Resolution Regime under the Banking Act 2009 and the PRA's rules on recovery and resolution plans have now been amended to bring them in line with the requirements of the RRD.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Since 1 January 2014, the regulatory capital requirements for UK-authorised banks are determined according to CRD IV. This implements the Basel III Capital Accord.

The PRA requires banks to hold sufficient capital upon initial authorisation and also capital against risks. The former represents a minimum, although for most banks the capital they are required to hold against risks will be significantly in excess of the authorisation minimum.

Upon authorisation, banks must hold capital resources of €5 million. Thereafter, a bank must hold capital equal to the sum of its requirements for credit risk, market risk and operational risk.

Banks have a choice between a standardised approach to credit risk and advanced internal ratings-based approaches. The standardised approach imposes capital charges on exposures falling into particular classes (eg, corporate, retail, mortgage, interbank and sovereign lending). The capital charge generally depends on the external credit rating of the borrower. The requirements also cover credit risk mitigation (collateral, guarantees, and credit derivatives) and securitisation.

Banks may seek regulatory approval to use their own internal models to calculate capital requirements for credit risk, including credit risk mitigation and securitisation. The PRA recognises two advanced approaches: the foundation internal ratings-based approach (foundation IRB) and the advanced internal ratings-based approach (advanced IRB). Under foundation IRB banks are required to determine the probability of default of

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exposures; the other risk factors are calculated based on supervisory estimates. Under advanced IRB banks determine all the risk factors based on their own internal estimates. For retail exposures, however, there is only one IRB approach under which banks calculate all risk factors.

PRA requirements for market risk follow a 'building block' approach, identifying particular risks against which capital must be held. It follows that if a transaction gives rise to more than one type of risk it may trigger several capital charges. Capital is required to be held in respect of position risk, interest rate risk, counterparty risk, foreign exchange risk and commodities risk. The Capital Requirements Regulation (CRR) has significantly increased the capital requirements in respect of counterparty credit risk on derivatives, repos and securities financing transactions.

In addition, banks must hold capital in respect of operational risk. This is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk includes legal risk but excludes strategic or reputational risk.

Banks are required to assess the adequacy of their capital (a process known as the Internal Capital Adequacy Assessment Process, or ICAAP), which is then subject to review by the PRA (the Supervisory Review and Evaluation Process, or SREP). This usually results in the PRA providing individual capital guidance (ICG) to the firm and setting a capital planning buffer (CPB). In addition, the PRA requires banks to carry out stress testing and scenario analysis, including 'reverse stress testing' identifying circumstances in which a bank would no longer be viable.

The capital resources that a bank is required to maintain can be constituted by a mixture of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital. With the exception of Common Equity Tier 1 capital, however, the proportions of each of these types of capital that the total capital can comprise are restricted. The CRR contains detailed legal and technical requirements for eligibility of capital instruments.

CRD IV does not recognise forms of contingent capital for the purposes of meeting regulatory capital requirements, with the exception that all instruments recognised as Additional Tier 1 capital are required to include terms such that the instruments will be written down or converted into Common Equity Tier 1 instruments when the Common Equity Tier 1 capital ratio of the bank falls below 5.125 per cent. Contingent capital can also help satisfy PRA stress tests (see question 21). The Basel Committee rejected the use of contingent capital to satisfy the new capital buffer for global systemically important banks (G-SIBs).

Throughout 2014 the PRA and the Treasury have issued a number of consultation papers, policy statements and supervisory statements on different aspects of CRD IV (and are likely to continue to do so throughout 2015), providing further guidance and clarity for banks on meeting the requirements of CRD IV.

18 How are the capital adequacy guidelines enforced?

The PRA enforces compliance. Banks are required to submit periodic returns and must notify the PRA of any failure to hold adequate capital. The ICAAP and SREP are an iterative process, although the PRA can require a bank to hold a specified amount of capital.

19 What happens in the event that a bank becomes undercapitalised?

The bank will need to notify and agree with the PRA a remedial programme to bring it back into compliance. The terms of such a programme will depend on the circumstances, and cannot be described in generic terms, but are likely to include raising new capital, a reduction of exposures (including divestment of assets or businesses), or both. If a bank is unable to agree with the PRA on how to remedy the situation, the PRA may revoke the bank's authorisation. Additional powers to deal with failing banks have been enacted in the Banking Act 2009, the Investment Bank Special Administration Regulations 2011 (for banks carrying on investment banking business) and the Banking Reform Act 2013 (see question 20).

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Banking Act 2009 introduced three pre-insolvency stabilisation options as well as two new insolvency procedures for banks in financial difficulties. The intention is to provide the Treasury, the PRA and the Bank of England (the authorities) with a range of tools to deal with failing banks.

The stabilisation options are:

- the transfer of all or part of a bank to a private sector purchaser (PSP);
- the transfer of all or part of a bank to a bridge bank owned by the Bank of England; and
- the transfer of a bank or a bank's holding company into temporary public ownership (TPO).

The Banking Reform Act 2013 amends the Banking Act 2009 to introduce a fourth stabilisation option: the bail-in tool. The bail-in tool is a new stabilisation option available to the Bank of England as lead resolution authority under the Special Resolution Regime. This tool enables resolution authorities to impose losses on a failing bank's creditors. The government has now further amended the bail-in provisions of the Banking Act 2009 to bring them in line with those in the RRD. Although the RRD gives member states until 1 January 2016 to apply the bail-in provisions, the UK government decided to implement them on 1 January 2015.

These powers apply only to a UK bank or bank's holding company. They do not apply to overseas banks with a branch in the UK. UK branches of non-EU or non-EEA banks may be wound up in the United Kingdom, whereas the UK branches of EU or EEA banks are subject to winding up or reorganisation under the law of their home state.

A stabilisation power may only be exercised if the PRA is satisfied that:

- the bank is failing, or is likely to fail, to satisfy the threshold conditions for authorisation under FSMA 2000; and
- having regard to timing and other relevant circumstances, it is not reasonably likely that action will be taken to satisfy those conditions.

In exercising any of the stabilisation powers, or the insolvency procedures, the authorities must have regard to specified objectives. These are the protection and enhancement of the stability of the UK financial systems, the stability of the UK banking systems, protecting depositors, protecting public funds and avoiding unjustified interference with property rights. These objectives are to be balanced as appropriate in each case. The Treasury is required to publish a code of practice about the use of these powers, although this code is not legally binding. A revised code was published in November 2010. The Treasury published a draft annex to the code of practice in October 2013, primarily concerned with the new bail-in tool, but at the time of writing this has not yet been finalised. In October 2014, the Bank of England published a document setting out its approach to bank resolution, which is intended to be read alongside the Treasury's code of practice. The approach document clarifies the Bank of England's views of the three stages to resolution: stabilisation, restructuring and exit.

The Bank of England can exercise the PSP or bridge bank powers if it is satisfied (after consultation with the Treasury and the PRA) that it is necessary having regard to the public interest in the stability of the UK financial systems, the maintenance of public confidence in the stability of the UK banking systems or the protection of depositors.

The Treasury may only exercise the TPO power if it is satisfied (after consultation with the Bank of England and the PRA) that either the exercise of the power is necessary to resolve or reduce a serious threat to the stability of the UK financial systems or that it is necessary to protect the public interest where the Treasury has previously provided financial assistance to a bank.

The stabilisation powers are supplemented by a broad range of powers to transfer shares or property (including foreign property) as well as overriding contractual rights that could interfere with the transfer.

In addition, the Banking Act 2009 created two new insolvency procedures for failing banks: the bank insolvency procedure and the bank administration procedure.

The Bank of England, the PRA or the secretary of state may apply to the court to make a bank insolvency order. An order may be made if:

- the bank is unable, or is likely to be unable, to pay its debts;
- winding up the affairs of the bank would be in the public interest; or
- winding up the bank would be 'fair' (this has the same legal meaning as the phrase 'just and equitable' in the Insolvency Act 1986).

To be eligible for the bank insolvency procedure, the bank must have depositors eligible to be compensated under the Financial Services Compensation Scheme. Banks that do not have such depositors may still be subject to the stabilisation powers referred to above, or to administration or winding up under the Insolvency Act 1986. Once a bank insolvency order is made the liquidator has two objectives. The first is to work with the Scheme to ensure, as soon as is reasonably practicable, that accounts are transferred

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to another bank, or that eligible depositors receive compensation under the Scheme (see question 4). Once this objective has been accomplished, the task of the liquidator is to wind up the affairs of the bank. The general law of insolvency applies with some modifications to bank insolvency and the liquidator has similar powers to access the bank's assets and, once the eligible deposits have been transferred, or compensation paid, creditors will receive a distribution in accordance with their rights. Deposits not protected under the Scheme are unsecured claims and will be paid, if funds are available, pari passu with payment to other unsecured creditors.

Other insolvency proceedings remain possible (eg, administration or liquidation), although no application can be determined until the PRA has decided not to apply for a bank insolvency order. A resolution for voluntary winding up has no effect without prior approval of the court.

The Banking Act 2009 introduced a new bank administration regime. This may be used where part of the business of a UK bank is sold to a commercial purchaser, or is transferred to a bridge bank, under the stabilisation powers. The purpose of bank administration (which should not be confused with administration under the Insolvency Act 1986) is principally to ensure that the non-sold or transferred part of the bank continues to provide services to enable the purchaser or bridge bank to operate effectively. Once the Bank of England notifies the bank administrator that the residual bank is no longer required, the bank will proceed to a normal administration where the objective is either to rescue the residual bank as a going concern or, if this is not possible, to achieve a better result for the bank's creditors as a whole than in a winding up.

Additional insolvency procedures for banks carrying on an investment banking business were introduced by the Investment Bank Special Administration Regulations 2011. These are special administration (bank insolvency) and special administration (bank administration).

The Banking Reform Act 2013 also amends the Insolvency Act 1986 and related Scottish legislation to provide that deposits that are eligible for protection under the Financial Services Compensation Scheme are to be preferential debts. This means that, in the event of a bank's insolvency, they will rank ahead of the claims of other unsecured creditors. The Treasury has also stated that the government has decided not to extend preference to debts relating to pension liabilities, overseas deposits and deposits placed by particular groups (such as charities or local authorities).

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

Yes. A first set of amendments to EU bank capital requirements (CRD II) was adopted in September 2009 and came into force on 31 December 2010. This Directive:

- tightened requirements on banks' large exposures. The former exemption from large exposure limits for interbank loans of less than one year was abolished;
- introduced harmonised requirements for Tier I hybrid capital (preference shares and perpetual subordinated debt); hybrid capital is capped at 50 per cent of Tier I after deductions although the recognition of hybrids has been reduced since implementation of Basel III;
- requires Tier I hybrid capital debt to include a feature enabling the instrument to be written down or converted to ordinary shares in specified circumstances;
- improved the supervision of banking groups through reinforcing colleges of regulators for banking groups operating in more than one EU or EEA state; and
- strengthened the framework for securitisation; banks may only invest in a securitisation if the originator, sponsor or original lender (which may or may not be regulated) has announced its intention to retain a 5 per cent economic exposure (referred to as 'skin in the game').

Further changes (CRD III) were agreed in November 2010 in respect of trading book capital, resecuritisation and remuneration. The requirements on employee remuneration came into force on 1 January 2011 and place limits on the percentage of staff bonuses that can be paid in cash. The other changes came into force on 31 December 2011 and include:

- an additional capital buffer based on a stressed value at risk (VaR) to the ordinary VaR for banks using their own internal model to determine the capital charge for market risks. The intention is to capture tail events as well as sustained movements in market prices that are not adequately captured under existing VaR models;
- extending the capital charge for default risk in the trading book to capture mark-to-market losses caused by changes in creditworthiness (ie, ratings downgrades). Such downgrades were a major source of loss on traded debt positions during the financial crisis;
- introducing new (and higher) capital charges for resecuritisations (such as CDO of ABS); and
- aligning the capital charges for securitisation positions that are held in a bank's trading book with those in the non-trading book. Previously many banks had treated trading book securitisation positions as straightforward debt positions.

These changes were expected on average to more than triple the amount of capital required to be held in respect of banks' trading books.

The Basel Committee published the Basel III Capital Accord in December 2010. This has been implemented into EU law by CRD IV, which came into force on 1 January 2014. The main prudential requirements (including the new definitions of capital) are set out in the CRR, which is directly applicable in the United Kingdom.

The main changes include:

- improving the quality of capital through new definitions of core Tier I capital, non-core Tier I capital and Tier II capital;
- raising the minimum common equity Tier I capital ratio to 4.5 per cent and imposing a further capital conservation buffer of 2.5 per cent resulting in an effective minimum common Tier I ratio of 7 per cent;
- increasing the Tier I capital ratio (including the capital conservation buffer) from 4 to 8.5 per cent and the minimum total capital ratio (including the same buffer) to 10.5 per cent;
- abolishing innovative Tier I capital and Tier III capital. Tier II capital has been simplified with sub-categories removed;
- adopting a harmonised approach to deductions from capital, with most deductions being made from common equity;
- introducing new and more stringent requirements in respect of counterparty credit risk on derivatives, repos and securities financing transactions that will significantly increase the capital requirements for these transactions;
- adopting a leverage ratio as a non-risk-based measure to curtail excessive growth in banks' balance sheets;
- enabling regulators to impose an additional capital buffer in case of excessive credit expansion where local conditions justify this;
- introducing two new liquidity standards: a liquidity coverage ratio designed to enable banks to withstand a short-term liquidity stress, as well as a net stable funding ratio requiring banks to have a minimum amount of stable funding based on the liquidity characteristics of their assets and activities over a one-year horizon; and
- addressing the risks posed by financial institutions that are systemically important. Under the current framework agreed in October 2013, global systemically important banks are subject to a capital surcharge of between 1 per cent and 2.5 per cent of risk-weighted assets to be covered by common equity, with a currently empty 3.5 per cent bucket for systemically important banks that become even more systemically important.

The PRA also requires banks to carry out stress tests to ensure that they hold adequate capital in the event of plausible adverse economic conditions. While the extent and frequency of such testing is subject to the principle of proportionality, the PRA has stated that it expects stress testing to be carried out at least annually. The PRA's most recent stress test was in December 2014 which focused on the vulnerabilities stemming from the UK household sector, in particular reflecting the FPC's assessment of the main domestic risks to financial stability, and covered eight major UK banks and building societies.

Banks are also required to carry out reverse stress tests that require firms to identify and assess scenarios most likely to render their business models unviable. A firm's business model is described as being unviable at the point when crystallising risks cause the market to lose confidence in the firm. This is different to general stress testing, which tests for outcomes arising from changes in circumstances. Reverse stress testing is not designed as a means of introducing a 'zero-failure' regime or as a way of directly influencing a firm's capital requirements. Reverse stress testing is primarily designed to be a risk management tool, encouraging a firm to explore more fully the vulnerabilities and fault lines in its business model, including 'tail risks', and to explore potential mitigating actions. If a firm's reverse stress testing identifies business model vulnerabilities that have not previously been considered, however, the firm may be required to hold a different amount or quality of capital.

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In addition, the European Banking Authority runs EU-wide stress tests that include major UK banking groups. The EBA's 2014 EU-wide stress test was more broadly designed to test the resilience of EU banks to adverse economic developments and covered 123 banking groups across the EU.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The United Kingdom implemented the EU Acquisitions Directive on 21 March 2009. A person who decides to acquire or increase control over a UK-authorised bank must notify and obtain consent from the PRA in advance. Failure to do so is a criminal offence with the maximum penalty being an unlimited fine. The PRA must also consult the FCA before coming to a decision on whether to approve a proposed change of control. The Acquisitions Directive has tightened the assessment criteria for objections to a change of control (see question 29).

The PRA has 60 working days from receipt of the notice to approve the acquisition of control (with or without conditions), or to object. This period may be interrupted by up to 20 days where the PRA requires further information.

The thresholds for notifying the PRA of the acquisition of control are 10, 20, 30 and 50 per cent of the shares or voting power.

A parallel regime exists in respect of the reduction of control, where a person is required to notify the PRA of any reduction in control to below 50, 30, 20 and 10 per cent of the shares or voting power. Failure to notify is an offence, although there is no requirement for PRA consent to the reduction of control.

The FSA report into the failure of RBS recommended that bank acquisitions should be subject to express formal regulatory approval. This would be a fundamental change to the current regime, where acquiring firms are assessed by the regulator of the target firm or group. The report also recommended that the FSA should consider whether and how the governing board of a firm considering a major acquisition should obtain independent advice from an adviser whose remuneration is not linked to the successful conclusion of the transaction. It seems questionable whether a major hostile takeover, such as RBS' acquisition of ABN AMRO, would be permitted in future by the FSA's successor, the PRA.

23 Are there any restrictions on foreign ownership of banks?

No, aside from sanctions imposed by the United Nations, the European Union and the United Kingdom on specified persons and countries.

24 What are the legal and regulatory implications for entities that control banks?

There are no restrictions on the business activities of a parent or acquirer of a UK bank, or on those of affiliates of a UK bank, although such activities will be taken into account as part of the PRA's assessment of the acquisition. A bank may be owned or acquired by a company whose business is wholly non-financial in nature. As a result of changes in August 2009, the directors, officers and employees of a holding company of a UK bank whose decisions or actions are regularly taken into account by that bank's governing body must be approved by the PRA.

The PRA carries out the consolidated supervision of banking groups. Consolidated supervision applies at the level of the highest EEA group company whose subsidiaries and participations (basically a 20 per cent holding) are banks or engage in broadly financial activities. The PRA will not normally undertake worldwide supervision of a group headed by a parent outside the EEA.

The practical effects of consolidated supervision applying will depend on the individual group's structure. However, the following points may be noted:

- the group will need to hold adequate capital to cover the exposures and off-balance-sheet liabilities of all members of the group (and not just regulated entities), including the parent and its subsidiaries and participations; and
- limits on large exposures will apply.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Where a banking group is subject to consolidated supervision, the PRA will apply its prudential rules to the group as a whole (see question 24). It will not, however, directly regulate non-authorised entities in the group.

Each regulated firm (including banks) will need to meet the regulatory requirements applicable to it on a stand-alone basis. This includes, but is not limited to, capital adequacy and liquidity.

FSMA 2000 (as amended by the Financial Services Act 2012) enables the PRA to give 'directions' to the UK parent of a UK bank or investment firm (a qualifying parent undertaking). A direction may require the parent undertaking to take specific action or to refrain from taking specified action. Before giving such a direction the PRA is obliged to consult the FCA. In April 2013 the PRA published a statement of policy with respect to the giving of directions which includes the following non-exhaustive list of possible directions that the PRA may give:

- a requirement to meet specific prudential rules applied at the consolidated level;
- a requirement to improve the system of governance or controls at group level or in relation to (UK or non-UK) subsidiary undertakings, or both;
- a restriction on dividend payments or other payments regarding capital instruments to conserve capital;
- a requirement to move funds or assets around the group to address risk more appropriately;
- a requirement for the group to be restructured;
- a requirement to block or impose restrictions on acquisitions or divestitures;
- a requirement to ensure continuity of service is provided between group entities;
- a requirement to include other entities within the scope of consolidated supervision (including shadow banking entities);
- a requirement to raise new capital;
- a requirement to take steps to remove from office directors of the parent that the PRA does not regard as fit and proper;
- a requirement to remove barriers to resolution; and
- a requirement to issue debt suitable for bail-in.

The government intends to expand the definition of a qualifying parent undertaking to ensure it covers financial holding companies, mixed financial holding companies and mixed activity holding companies which are within the scope of the RRD.

The exercise of the PRA's direction-making power may be appealed to the Upper Tribunal.

As mentioned in question 14, banks are required by the PRA to draw up recovery and resolution plans (referred to as 'living wills'). A recovery plan might include provision for group support in specified circumstances.

Banking groups that establish a core UK group (see question 5) are required to ensure that the non-regulated members of that group enter into a capital maintenance agreement in favour of the regulated firms.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

We have referred in question 20 to the pre-insolvency stabilisation powers as well as the bank insolvency procedure and bank administration and similar procedures for banks that carry on an investment banking business. A controlling entity or individual is not liable for the debts of an insolvent subsidiary although it might be required (by PRA direction) to recapitalise an undercapitalised subsidiary before insolvency (see question 25). Liability depends on the application of general rules of insolvency law, which also apply in a bank insolvency or bank administration. The following are the main circumstances in which a shareholder or parent may incur liability. These powers are also relevant to proceedings under the Banking Act 2009 and the Investment Bank Special Administration Regulations 2011.

Transactions at an undervalue

If a company has entered into a transaction at an undervalue and at the time the company was unable to pay its debts, or became unable to do so as a result of the transaction, in the two years prior to the onset of insolvency, the court has wide powers to set aside the transaction. There is a presumption of insolvency if the transaction is with a controller or parent.

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Update and trends

The regulatory landscape for banks is continuing to undergo dramatic changes with several reforms still on the horizon. Over the next few years, banks will have to meet tougher capital and liquidity requirements, construct robust recovery and resolution plans which meet UK and EU standards and, for the largest UK banking groups, implement the new ring-fencing regime to protect retail and SME deposits from investment banking activities. It is evident that the PRA and FCA are taking a proactive approach to regulation: the PRA is becoming much more interventionist in its supervision of banks, while the FCA has demonstrated a more aggressive attitude to enforcement with increasingly higher fines imposed and criminal prosecutions brought where appropriate. The regulators are now beginning to conclude their investigation into the manipulation of foreign exchange markets which has resulted in the biggest financial regulatory fines ever imposed in the UK. As part of their continuing scrutiny of financial benchmarks, regulators may now turn their attention to other benchmarks such as those used in commodities markets. There is also increasing regulatory focus on the retail aspects of banking and ensuring that consumers are treated fairly. From April 2015, the FCA will have an enhanced role in enforcing competition law and has already conducted a market study into the cash savings market which concluded that competition is not working effectively.

Senior individuals in banks are also coming under increasing scrutiny from regulators. The new Senior Managers regime is intended to make it easier for regulators to hold individuals to account for their role in breaches by banks of relevant laws or rules; reckless misconduct in the management of a bank has been made a criminal offence. Further, EU-wide rules on remuneration now place a cap on bank bonuses and discourage the rewarding of risk-taking.

Preferences

If a company does anything that puts the controller or parent in a better position in the event that the company goes into insolvent liquidation in the two years prior to the onset of insolvency, the court may set aside the preference if the company was insolvent or became insolvent as a result.

Fraud on creditors

The court has broad powers to set aside transactions entered into for the purpose of putting assets beyond the reach of creditors or otherwise prejudicing the company's creditors.

Shadow directorship

A controller or parent may be a shadow director if the directors of the company are accustomed to act in accordance with its directions. A shadow director may incur personal liability for fraudulent trading and wrongful trading. Fraudulent trading requires proof of dishonesty and is also a criminal offence.

A director is responsible for wrongful trading if a company goes into insolvent liquidation and at some time before the commencement of the winding up the director knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation, and the director failed to take every step with a view to minimising the potential loss to the company's creditors as he or she ought to have taken. A director that is guilty of wrongful or fraudulent trading may be ordered to contribute such amount to the company's assets as the court thinks proper.

Disqualification

The court has powers under the Company Directors Disqualification Act 1986 to disqualify company directors (including shadow directors) found guilty of misconduct for up to 15 years. In particular, a director of an insolvent company may be disqualified if his or her conduct makes him or her unfit to be concerned in the management of a company.

Piercing the corporate veil

The courts may pierce the corporate veil, so as to impose liability on a parent company for the debts of its insolvent subsidiary in limited circumstances. These include where the subsidiary was used as a device or façade, thereby avoiding or concealing any liability of the company's controllers. In *Ben Hashem v Ali Shayif* (2009) 1 FLR 115 Munby J said: 'The common theme running through all the cases in which the court has been willing to pierce the veil is that the company was being used by its controller in an attempt to immunise himself from liability for some wrongdoing which existed entirely dehors the company.' More recently, the Court of Appeal emphasised that '[t]he rationale is that a wrongdoer cannot benefit from his dishonest misuse of a corporate structure for improper purposes' (*Petrodel Resources Ltd & Ors v Prest & Ors* (2012) 3 FCR 588).

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

See question 22. Approval may also be required under UK or EU competition law.

Certain changes may require notification to the Information Commissioner under the Data Protection Act 1998.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The place of incorporation or nationality of an acquirer is not relevant. There is no difference in the process for approval.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

See question 22. The PRA may only object to an acquisition on the basis of the following matters (or the submission of incomplete information):

- the reputation of the acquirer;
- the reputation and experience of any person who will direct the business of the UK bank;
- the financial soundness of the acquirer, in particular in relation to the type of business that the bank pursues;
- whether the bank will be able to comply with applicable prudential requirements;
- whether the PRA and FCA can effectively supervise the group including the target; or
- whether there are reasonable grounds to suspect money laundering or terrorist financing in connection with the proposed acquisition.

The PRA must also take into consideration any representations made to it by the FCA in relation to the above matters. The FCA can, however, only direct the PRA not to approve the acquisition if it has reasonable grounds to suspect money laundering or terrorist financing in connection with it.

The European Commission most recently reviewed the application of the Acquisitions Directive in 2012 and published a report on 11 February 2013. The conclusion of the report was that the Directive is working satisfactorily, although it has only been applied since 2009. The Commission was due to issue a communication by the end of 2013 on whether the regime needs to be reinforced, but at the time of writing this has not yet been published.

30 Describe the required filings for an acquisition of control of a bank.

The first step is normally an informal approach to the PRA. This is followed by submission of the required information. A prospective controller is recommended to use the PRA prescribed forms. The following forms are relevant:

- corporate controllers form, for a controller that is a limited company or a limited liability partnership;
- partnership controllers form, for a controller that is a partnership;
- individual controllers form, for an individual controller; and
- trust controllers form for a trustee, settlor or beneficiary of a trust.

Completion of the forms can be time-consuming and requires supporting documentation such as group structure charts, CVs for individual controllers, proof of funding and a business plan. The business plan is required to contain the following:

- a strategic developmental plan;
- estimated financial statements for the target firm(s) for three years; and
- information about the anticipated impact of the acquisition on the target firm.

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Having received the notice, the PRA can require additional information or documents if it considers this necessary and may carry out interviews. Where a proposed new or increased controller is regulated elsewhere in the EU or European Economic Area the PRA must consult the relevant home-state regulator. The same applies if a UK bank is controlled by a parent company located in another EU or EEA state. It should be emphasised that 'control' does not stop at the level of the acquirer and can pass all the way up the corporate chain to the ultimate beneficial owners.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The PRA has 60 working days from the date on which the regulator deems the application for approval to be complete to approve an acquisition, although the process may be shortened where the controllers are already known to the PRA. It facilitates approval for the acquirer to discuss a proposed acquisition with the PRA informally in advance. This enables the PRA to identify potential issues and request any further information before the formal notification is submitted. Up to the 50th working day of the assessment period, the PRA may pause the assessment period for up to 20 working days (or 30 working days in certain circumstances) in order to seek further information from the applicant. If approval is granted, the prospective controller must complete the acquisition within one year, or such shorter period as the PRA specifies. The PRA will consider requests for extension of the approval if required.

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United States

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

Because the deposits held by US banks are insured by the federal government, many governmental and regulatory policies are aimed at protecting these deposits by requiring safe and sound banking practices. This is accomplished through regulatory capital adequacy requirements and regulations relating to appropriate lending, investment and other business practices, and so on. In general, a US banking organisation's obligations to its depositors takes precedence over its obligations to its shareholders.

2 Summarise the primary statutes and regulations that govern the banking industry.

The principal statutes governing the US banking industry are:
- the Federal Deposit Insurance Act (FDIA), which provides for federal deposit insurance and vests the Federal Deposit Insurance Corporation (FDIC) with regulatory authority over FDIC-insured banks;
- the Bank Holding Company Act of 1956, as amended (the BHC Act), which subjects companies that control banks – called 'bank holding companies' – to supervision and regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve);
- the National Bank Act, which provided for the establishment of national banks (ie, banks with charters issued by the federal government) and vested the Office of the Comptroller of the Currency (OCC) with regulatory authority over them;
- the Federal Reserve Act, which established the Federal Reserve System and contains restrictions applicable to banks, such as section 23A of the Federal Reserve Act, which limits transactions between a bank and its affiliates; and
- the Home Owners' Loan Act (HOLA), which provided for the establishment of federal savings banks.

3 Which regulatory authorities are primarily responsible for overseeing banks?

There are three federal bank regulators as well as a multitude of state banking authorities. The three federal bank regulators are:
- the Federal Reserve System, which has primary supervisory authority over bank holding companies, savings and loan holding companies and state-chartered banks that have elected to become members of the Federal Reserve System;
- the Federal Deposit Insurance Corporation (FDIC), which, in addition to administering the Deposit Insurance Fund, also has primary supervisory authority over state-chartered banks that have opted not to become members of the Federal Reserve System (commonly referred to as 'non-member banks'). The FDIC also has oversight authority at a secondary level over all other types of FDIC-insured banks; and
- the Office of the Comptroller of the Currency, which has primary supervisory authority over national banks and federal savings banks.

In addition, the National Credit Union Administration has oversight over federal credit unions and insures deposits held by both federal and state-chartered credit unions through the National Credit Union Share Insurance Fund, a federal fund backed by the full faith and credit of the US government.

Notably, the Consumer Financial Protection Bureau, formed in 2011, has broad responsibilities to enforce federal consumer protection laws over both banks and non-banks.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

The FDIC protects depositors against the loss of their insured deposits if an FDIC-insured institution fails. FDIC insurance is backed by the full faith and credit of the US government. The basic limit on federal deposit insurance coverage is $250,000 per depositor. As a temporary measure in response to the financial crisis, from 31 December 2010 to 31 December 2012 all non-interest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. This was an unprecedented action by the FDIC and the unlimited insurance coverage has now expired.

A non-interest-bearing transaction account is essentially a checking account – a deposit account where interest is neither accrued nor paid; depositors are permitted to make an unlimited number of transfers and withdrawals; and the bank does not reserve the right to require advance notice of an intended withdrawal.

Beginning during the financial crisis in 2008 and continuing through 2009, financial institutions of all sizes sought to increase their capital levels for a variety of reasons, including to help absorb current and future losses, to ensure that capital ratios stayed above regulatory minimums and also to convey a sense of financial strength and confidence to investors, customers, counterparties and competitors. Capital raising in 2008 was significantly aided by the implementation of the Capital Purchase Program (CPP) under the Troubled Asset Relief Program (TARP) in which financial institutions sold senior preferred shares and warrants exercisable for common stock to the Treasury. By 31 December 2008 the Treasury had invested approximately $178 billion in 214 financial institutions through the CPP, and by 31 March 2009 this amount had grown to nearly $199 billion in 532 financial institutions. By year-end 2009, the Treasury had invested in nearly 700 banks with over $200 billion in TARP funds. Since that time, as the US banking industry has returned to health, the vast majority of banks have repaid their TARP funds.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Transactions between an FDIC-insured bank or thrift are subject to sections 23A and 23B of the Federal Reserve Act. The Federal Reserve's Regulation W (12 CFR Part 223) is the implementing regulation. These restrictions effectively make it impracticable for the FDIC-insured institution to lend to its affiliates or purchase assets from them. In addition, all other transactions between the FDIC-insured institution and its affiliates must be at fair market value. For this purpose, an 'affiliate' is any company:
- that controls the bank or thrift;
- that is under common control with the bank or thrift;
- with a majority of interlocking directors with a bank or thrift; or
- that is sponsored or advised by a bank or thrift.

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'Control' for this purpose is ownership of 25 per cent or more of any class of voting securities, but also includes control in any other manner. Note that a controlling relationship can exist for the purposes of section 23A even at an ownership level of less than 25 per cent of voting securities.

Companies that control a US bank or thrift are generally limited in the types of activities in which they can engage to financial services activities including securities underwriting, insurance (both agency and underwriting) and merchant banking. While there are certain exceptions to this rule, over the past several years US regulators and Congress have gradually eliminated or scaled back these exceptions.

6 What are the principal regulatory challenges facing the banking industry?

Much of the focus of the US banking industry has been to adjust to heightened supervision by the bank regulators in the aftermath of the financial crisis that occurred in 2008 and 2009. Pre-crisis, bank regulators focused on ensuring that individual banks had sufficient capital to avoid failure, but did not consider systemic implications. Consequently, the same capital requirements applied to both small and large banks. Post-crisis, the US bank regulators have adopted a 'macroprudential' perspective and have expanded their focus to ensuring that the financial system avoids failure. The net effect is that capital requirements increase the larger and more complex that a bank grows. In addition, activities deemed overly risky, such as proprietary trading, are being limited or banned altogether. The regulators have also instituted annual stress tests in which banks are required to demonstrate to their regulators that they would retain an adequate amount of capital even under extremely adverse hypothetical economic scenarios. In addition, a broad spectrum of legislators has attributed part of the blame for the financial crisis to a lack of comprehensive and rigorous regulatory supervision and a breakdown in culture, ethics and risk management on the part of the affected financial institutions. The net effect has been a wave of sweeping enforcement actions, including enormous financial penalties, primarily focused on the largest banks.

7 Are banks subject to consumer protection rules?

US banks are subject to extensive consumer protection rules at both the federal and state level. At the federal level, they are primarily enforced by the CFPB. The CFPB has rapidly become a powerful regulator and has been notably active both in issuing regulations and in bringing investigations and enforcement actions against a wide variety of financial companies – banks, credit card companies, credit reporting companies, debt collection agencies, mortgage brokers, mortgage lenders, mortgage insurers, debt relief companies (including law firms) and student loan companies. Banks with assets of $10 billion or less are examined by their primary bank regulators, but need to comply with CFPB rules. Banks with assets in excess of $10 billion are subject to examination by the CFPB.

Although auto dealers are exempt by statute from CFPB regulation, the CFPB has used its authority over banks engaged in indirect auto lending to address alleged discriminatory mark-ups and similar dealer practices through enforcement activity and by imposing monitoring requirements on the banks conducting the indirect lending. Much of the CFPB's early rulemaking has focused on mortgage lending and servicing, including an important rule, issued in early 2013, requiring lenders to ensure that prospective buyers have the ability to repay their mortgages. Other areas of current CFPB focus include consumer protections for prepaid cards, payday lending, debt collection, overdraft services and privacy notices.

Virtually all consumer protection functions of the Federal Trade Commission, the Department of Housing and Urban Development, the Federal Reserve and other federal banking regulators have been moved to the CFPB. Accordingly, the CFPB now has the authority to enforce numerous FTC regulations as well as more than a dozen federal consumer protection statutes, including the Home Owners Protection Act, the Fair Debt Collection Practices Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Truth in Lending Act and the privacy protections of Gramm-Leach-Bliley. States may also enact their own consumer protection law – the CFPB's position is that federal consumer protection statutes set the floor and do not pre-empt more rigorous state laws.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

In addition to the reform mandated by Dodd-Frank, the difficulties experienced by the US financial services industry have resulted in more rigorous regulation that has cut across the industry. Post-crisis, the regulatory pendulum has swung sharply to more extensive and more burdensome regulation as well as more frequent and more severe enforcement actions. Increased capital requirements have been accompanied by a greater emphasis on higher quality forms of capital, with a focus on common equity and the Tier I common equity ratio. It is the federal banking regulators' position that common equity should constitute a majority of a banking firm's Tier I capital because it is permanent, deeply subordinated and does not oblige the issuer to make any payments to investors. Capital must absorb losses and permit the issuer to continue operating as a going concern, as opposed to just serving as a buffer against losses in the event of a liquidation. At the same time, the regulators have been pressuring the banking industry to decrease its level of risk. The combination of more extensive regulation, higher capital requirements and lower risk has deeply impaired the profitability of the industry. Over time, the pendulum should begin to swing in the other direction, but we are still years away from a meaningful reduction in regulation.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are subject to extensive statutes and regulations. In addition, the applicable banking authorities conduct periodic on-site examinations. Based on these examinations, the authorities issue detailed written reports articulating these concerns.

10 How do the regulatory authorities enforce banking laws and regulations?

Federal bank regulators have a formidable array of enforcement mechanisms. Set out below is a brief overview of the types of enforcement actions generally used by the federal bank regulators in order of increasing severity, including whether the actions are made public by the regulators. In general, enforcement actions can be divided into two categories: informal and formal. Usually less severe in scope, informal actions are generally not made public by the regulators and often remain undisclosed by the target, while formal actions are in all but a few rare instances made public.

Informal actions

Informal supervisory directives

All banks maintain a close supervisory relationship with their primary regulators. When that relationship is functioning at its best, all material transactions and plans are shared and discussed with the bank's regulators, and a good deal of informal supervisory direction is provided by the regulators to the bank. All banks receive informal advice and direction from their regulators and often make significant adjustments to their operations and capital, liquidity and controls as a result of that informal input.

Supervisory criticisms within examination reports

Bank regulators deliver formal examination reports to their regulated institutions on a regular periodic basis. These examination reports often contain express criticisms or concerns regarding a bank's operations or controls and directives from the regulators concerning the steps that need to be taken to correct such deficiencies or address such concerns. Examination materials are expressly confidential and may not be publicly disclosed by the institution.

Supervisory letter

A supervisory letter is an informal communication from a regulator to a bank either requesting information with respect to a targeted area or specific transaction or requesting that the bank take, or refrain from taking, certain actions. Supervisory letters are generally not publicly disclosed by the regulators and are used to call attention to specific areas of concern.

Commitment letter

A commitment letter is an informal written agreement between a bank and its regulator in which the bank commits to take certain corrective actions. Commitment letters often are entered into in connection with an approval request for a specific transaction or an expansion of powers. Commitment letters are generally not publicly disclosed by the regulators. The regulators also sometimes seek board level commitments through the adoption by the board of formal resolutions on a given matter.

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Memorandum of understanding

A memorandum of understanding is also considered an informal enforcement action, and is typically executed by the full board of a banking organisation and the regulator. Memoranda of understanding are generally not publicly disclosed by the regulators.

Formal actions

Formal written agreement

A formal written agreement is an agreement typically signed by the board of directors of a bank and the regulator. Formal written agreements are generally publicly disclosed by the regulators in the absence of a compelling reason to maintain confidentiality.

Cease-and-desist order

A cease-and-desist order is imposed after the issuance of a notice of charges, a hearing before an administrative law judge and a final decision by the regulator. More often, banks consent to a cease-and-desist order in order to expedite resolution by dispensing with the need for the notice and administrative hearing – these are often referred to as 'consent orders'. Temporary cease-and-desist orders can be issued on an interim basis pending completion of the steps necessary to issue a final cease-and-desist order. The regulators are required by law to publicly disclose cease-and-desist orders.

Troubled condition

The federal bank regulators also have the ability to declare a bank or bank holding company to be in 'troubled condition', which then subjects the bank or bank holding company to heightened scrutiny, including a requirement that any addition or change of directors or senior executive officers be subject to prior regulatory approval. A troubled bank or bank holding company also becomes subject to the FDIC's 'golden parachute' regulations, which require prior regulatory approval in order to enter into an agreement to make, or to actually make, a broad range of payments to any officers, directors, employees or controlling shareholders that are contingent on the termination of that person's employment.

In addition, federal bank regulators may impose civil money penalties in a number of circumstances, including: violations of law, formal written agreements, final orders or conditions imposed in writing; unsafe or unsound banking practices; or breaches of fiduciary duty.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

2014 witnessed some of the largest ever enforcement actions in the US. Remarkably, two of the world's biggest banks pleaded guilty to criminal violations and agreed to pay staggering fines – BNP paid $8.9 billion to resolve criminal and civil investigations into violations of US sanctions law and Credit Suisse paid $2.6 billion to resolve a criminal federal income tax investigation. Six large financial institutions paid a total of $4.3 billion in fines, penalties and disgorgement in connection with alleged attempted manipulation of foreign exchange benchmark rates. Separately, governmental settlements arising out of the financial crisis with a number of financial institutions amounted to over $24 billion.

For regional and community banks, the most common enforcement issue was probably Bank Secrecy Act/anti-money laundering compliance. Following the terrorist attacks on 11 September 2001, enforcement actions requiring that banks strengthen their BSA/AML compliance programmes became particularly widespread. Then, during the financial crisis, BSA/AML concerns took a back seat to more fundamental concerns by the US bank regulators centring on capital adequacy, asset quality, managerial competence and risk management. Post-crisis, regulatory enforcement actions have focused again on BSA/AML. Enforcement actions often have a direct impact on a bank's ability to expand via acquisitions and often result in them being put into a 'penalty box' while the enforcement action is pending. During that time, the bank is not permitted to make any acquisitions.

12 How has bank supervision changed in response to the 2008 financial crisis?

US bank regulators have assumed a much more assertive stance in the financial services industry. This dynamic has placed an even greater premium on the importance of bank's maintaining good regulatory relations.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The FDIC may acquire control of a bank if the bank becomes insolvent or is in danger of becoming so. The primary regulator of the bank (the OCC in the case of national banks) has the formal responsibility of closing the bank and appointing the FDIC as receiver. Once appointed, the FDIC is charged with selling or liquidating the bank while at the same time minimising the cost of the failure to the Deposit Insurance Fund. Depositors are paid by the FDIC up to the maximum amount of deposit insurance coverage. The FDIC then uses the remaining proceeds of the receivership, if any, to repay creditors. Shareholders do not receive any payments from the FDIC in return for their equity stock in the bank.

Prior to the passage of the Dodd-Frank Act, the FDIC's resolution authority was limited to banks or thrifts whose deposits were insured by the FDIC. The FDIC's resolution authority did not extend to the parent holding company or other nonbank affiliates of an insured depository institution. Now, the Federal Reserve and the FDIC may recommend that, based on an assessment of systemic risk, the Secretary of the Treasury appoint the FDIC as receiver for a 'financial company'. Covered companies include domestic bank holding companies, nonbank financial companies supervised by the Federal Reserve, companies predominantly engaged in activities that the Federal Reserve determines are financial in nature or incidental thereto, and any subsidiary of the foregoing. The Secretary can appoint the FDIC as receiver if the Secretary determines that: the financial company is in default or in danger of default; the company's failure and resolution through other means would have a serious adverse effect on the financial stability of the US; no viable private sector alternative is available; any effect on the claims or interests of creditors, counterparties, shareholders and other market participants is appropriate given the impact of a receivership on the financial stability of the US; any liquidation would avoid or mitigate such effects; and a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order.

Any financial company put into receivership must be liquidated. No taxpayer funds may be used to prevent liquidation, which will limit the alternatives to FDIC receivership and may make it more challenging for a company to arrange private investment once it is within the 'zone of danger'. The FDIC issued a final rule with respect to its orderly liquidation authority in July 2011. Among other things, the final rule provides that compensation paid to a senior executive or director deemed by the FDIC as 'substantially responsible' for a financial company's failure may be clawed back if the executive or director acted negligently.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

In the event of a bank failure, bank management and directors typically have very little involvement. Members of management may be employed by the acquirer of the failed bank but do not play a meaningful role in the seizure of the bank. The regulations require that large banks and bank holding companies have a resolution plan in place.

15 Are managers or directors personally liable in the case of a bank failure?

Bank failures are often followed by lawsuits by the FDIC against the bank's managers and directors alleging mismanagement and seeking money damages. The FDIC has filed a large number of these lawsuits following the wave of bank failures that occurred in 2008 and 2009.

16 How has bank resolution changed in response to the recent crisis?

Procedurally, the bank resolution process has largely remained unchanged following the advent of the financial crisis. Historically, the FDIC has offered loss protection to purchasers of failed banks to protect against losses relating to loans held by the failed banks. Because of the large number of bank failures since 2008, the FDIC has attempted to decrease the popularity of loss protection by making the terms less favourable.

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Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

In July 2013, the US federal bank regulators adopted final capital regulations implementing the Basel III capital framework established by the Basel Committee on Banking Supervision. The new capital regulations became effective on 1 January 2015, and will be fully phased in on 1 January 2019. The regulations require that US banks and bank holding companies maintain capital sufficient to meet both a risk-based asset ratio test and a leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and certain types of off-balance sheet commitments into risk-weighted categories, with higher weighting assigned to categories with greater risk. The risk-based ratio represents total capital divided by total risk-weighted assets. The leverage ratio is Tier 1 capital (which includes common equity, certain types of perpetual preferred and other instruments) divided by total assets which are subject to adjustment but are not risk weighted. In addition, the regulations include a new minimum ratio of common equity tier 1 capital called 'Tier 1 Common' to risk-weighted assets and a Tier 1 Common capital conservation buffer of 2.5 per cent of risk-weighted assets. The regulations also include a minimum leverage ratio of 4 per cent. The following are the minimum Basel III regulatory capital levels in order to avoid limitations on capital distributions and discretionary bonus payments during the transition period until 1 January 2019:

Basel III regulatory capital levels

	1 January 2015	1 January 2016	1 January 2017	1 January 2018	1 January 2019
Tier 1 Common	4.5%	5.125%	5.75%	6.375%	7.0%
Tier 1 risk-based capital ratio	6.0%	6.625%	7.25%	7.875%	8.5%
Total risk-based capital ratio	8.0%	8.625%	9.25%	9.875%	10.5%

18 How are the capital adequacy guidelines enforced?

For US banks, meeting the regulatory requirements to be deemed 'well capitalised' is critical to maintaining an institution's status and privileges as a financial holding company, making capital distributions that deviate from the institution's capital plan, engaging in interstate acquisitions, and receiving approval from a federal bank regulator to engage in a merger or acquisition. The well capitalised percentages discussed below should be considered a starting point. The federal banking agencies have advised that institutions and their holding companies should maintain capital ratios well above the minimums for well-capitalised status. In addition, an institution's or holding company's primary regulator may require additional capital based on the institution's size, complexity and risk profile. Weaker institutions are required to address their capital and operating deficiencies promptly or face regulatory-driven corrective actions, including a possible forced recapitalisation or merger.

Under the FDIA, the US federal banking regulators must take 'prompt corrective action' to resolve the problems of insured depository institutions. The prompt corrective action regulations establish five categories based on a depository institution's capital position:

- well capitalised institutions have a total risk-based capital ratio of > 10 per cent, a Tier 1 risk-based capital ratio of > 6 per cent (increased to > 8 per cent effective as of 1 January 2015 under the Basel III implementing rules), a leverage ratio of > 5 per cent, effective as of 1 January 2015, a common equity Tier 1 ratio of > 6.5 per cent, and may not be subject to an order, written agreement or directive relating to capital;
- adequately capitalised institutions have a total risk-based capital ratio of > 8 per cent, a Tier 1 risk-based capital ratio of > 4 per cent (> 6 per cent effective as of 1 January 2015) and a leverage ratio of > 4 per cent (or, until 1 January 2015, a leverage ratio of > 3 per cent if the institution has a supervisory rating of 1) and, effective as of 1 January 2015, a common equity Tier 1 ratio of > 4.5 per cent;
- undercapitalised institutions are those which fail to meet the requirements of an adequately capitalised institution;
- significantly undercapitalised institutions are those with a total risk-based capital ratio of < 6 per cent, a Tier 1 risk-based capital ratio of < 3 per cent (< 4 per cent effective as of 1 January 2015) or a leverage ratio of < 3 per cent or, effective as of 1 January 2015, a common equity Tier 1 ratio of < 3 per cent; and
- critically undercapitalised institutions are those with less than 2 per cent tangible equity to total asset ratio.

If an agency determines that an institution is in an unsafe or unsound condition or engaging in an unsafe or unsound activity, it may impose more stringent treatment than would otherwise apply, based upon the category of capitalisation into which the institution falls. An institution may be deemed to be engaging in an unsafe or unsound practice if it has received a less than satisfactory rating for asset quality, management, earnings or liquidity in its most recent report on examination. Dodd-Frank mandates enhanced prudential standards for bank holding companies with $50 billion or more in assets that become stricter as companies grow in size and complexity, and the federal supervisors' Basel III implementing rules adopted in 2013 require enhanced regulatory capital requirements for banking organisations of all sizes.

19 What happens in the event that a bank becomes undercapitalised?

Once an institution becomes undercapitalised (whether by failure to meet capital ratios or by regulatory determination), a host of significant restrictions and regulations come into play. The federal agencies are required to closely monitor all undercapitalised institutions and their compliance with FDICIA capital restoration plans.

All undercapitalised institutions are required to submit an acceptable capital restoration plan to the appropriate federal agencies pursuant to a deadline to be established by the agencies. The capital restoration plan must specify:

- the steps that the institution will take to become adequately capitalised;
- the levels of capital to be obtained during each year that the plan is in effect;
- how the institution will comply with the restrictions applicable to the institution; and
- the types and levels of activities in which the institution will engage.

In addition, before a plan can be accepted, each company having control of the institution must guarantee that the institution will comply with the plan until said institution has been adequately capitalised on average during four consecutive quarters and provide appropriate assurances of performance. 'Control' for this purpose is defined as it is under the BHC Act.

The aggregate liability of controlling companies under such guarantees is limited to the lesser of 5 per cent of the depository institution's total assets at the time it becomes undercapitalised and the amount necessary to bring the institution into compliance with all applicable capital standards as of the time that the institution fails to comply with the plan. The provision requiring a holding company to guarantee the performance of its subsidiary depository institutions can raise significant creditors' rights issues that should be carefully examined before any such guarantee is granted.

In addition, the asset growth of undercapitalised institutions is restricted. An undercapitalised institution may not increase its quarterly average total assets unless:

- its capital restoration plan has been accepted by the appropriate agency;
- any increase is consistent with the plan; and
- the institution's ratio of tangible equity to assets increases during the calendar quarter at a rate sufficient to enable the institution to become adequately capitalised within a reasonable period.

Likewise, an undercapitalised institution may not acquire any interest in any company, establish any additional branch office or engage in any new line of business unless its capital restoration plan has been accepted and the board of the FDIC determines that the proposed action will further the purposes of FDIA. These requirements make significant expansion by undercapitalised institutions generally unfeasible.

Significantly undercapitalised institutions

Once an institution becomes significantly undercapitalised (or if it fails to take steps to become adequately capitalised) it becomes potentially

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subject to a series of draconian measures, within the discretion of the regulatory agencies. In addition, as described below, companies controlling such institutions also become potentially subject to several significant restrictions.

The following may be imposed by statute or by appropriate agency action:
- requiring the institution to recapitalise by selling enough shares (including voting stock) or obligations to adequately capitalise the institution and, if grounds for appointment of a receiver or conservator exist, requiring that the institution be sold or merged;
- requiring any company having control of the institution to divest the institution if the appropriate agency determines that divestiture would improve the institution's financial condition and future prospects;
- requiring the institution to comply with section 23A of the Federal Reserve Act if the provision exempting transactions with certain affiliated institutions did not apply, or otherwise restricting transactions with affiliates;
- restricting interest rates paid on new deposits, including renewals and rollovers, substantially to the prevailing rates of interest on deposits of comparable amounts and maturities in the region where the institution is located;
- restricting asset growth even more stringently than for undercapitalised institutions, or requiring asset shrinkage;
- requiring the institution to alter, reduce or terminate any activity the agency determines poses excessive risk;
- ordering a new election of the board; dismissing any director or senior executive officer who held office for more than 180 days immediately before the institution became undercapitalised; or requiring the institution to employ qualified senior executive officers who, if the agency so specifies, shall be subject to agency approval. While directors and senior executive officers that have been dismissed have the right to petition the agency for reinstatement, they bear the burden of proving that their continued employment would materially strengthen the institution;
- prohibiting the acceptance of deposits, including renewals and rollovers, from deposit brokers;
- prohibiting any bank holding company having control of the institution from making any capital distribution without prior approval of the Federal Reserve;
- requiring the institution to divest or liquidate any subsidiary the agency determines to be in danger of becoming insolvent and a significant risk to the institution or likely to cause a significant dissipation of the institution's assets or earnings;
- requiring any company having control of the institution to divest or liquidate any affiliate other than an insured depository institution the appropriate agency for such company determines to be in danger of becoming insolvent and a significant risk to the institution or likely to cause a significant dissipation of the institution's assets or earnings; or
- requiring the institution to take any other action the agency determines to be more appropriate.

The FDIA sets out a presumption that the following actions will be taken unless the agency determines such actions would not be appropriate:
- requiring the sale of shares or obligations or requiring the institution to be sold or merged;
- restrictions on affiliate transactions; and
- restrictions on interest rates.

All significantly undercapitalised institutions and all undercapitalised institutions that fail to submit an acceptable capital restoration plan in a timely manner or that fail in any material respect to implement a plan accepted by the agency are required to obtain prior agency approval before paying any bonus to any senior executive officer or providing compensation to any senior executive officer at a rate that exceeds the officer's rate of compensation (excluding bonuses, stock options and profit sharing) during the 12 months prior to the month in which the institution became undercapitalised. Agency approval may not be granted if the institution has failed to submit an acceptable capital restoration plan.

Critically undercapitalised institutions

The FDIC is required to act by regulation or order to restrict the activities of critically undercapitalised institutions. At a minimum, the FDIC is required to prohibit critically undercapitalised institutions from doing any of the following without the FDIC's prior written approval:
- entering into any material transaction other than in the ordinary course of business;
- extending credit for any highly leveraged transaction;
- amending the institution's charter or by-laws;
- making any material change in accounting methods;
- engaging in certain types of affiliate transactions;
- paying excessive compensation or bonuses; and
- paying interest on new or renewed liabilities at a rate that would increase the institution's weighted average cost of funds to a rate significantly exceeding the prevailing market rate on insured deposits.

The FDIA calls for the appropriate federal agency within 90 days after an institution becomes critically undercapitalised to either:
- appoint a receiver, or with the concurrence of the FDIC, a conservator, for the institution; or
- take such other action as the agency determines with the concurrence of the FDIC would be more appropriate (after documenting why such action would be better).

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

When confronted with an insured depository institution on the brink of failure, the FDIC is required by law to guarantee insured deposits and dispose of the failed institution's assets in the 'least costly' manner to the FDIC's bank insurance fund (with surplus funds after repaying the FDIC, if any, flowing to uninsured depositors, creditors and then shareholders of the failed institution). This disposition process is referred to as a 'resolution'. The FDIA expressly requires the affirmative, documented determination by the FDIC that its exercise of authority with respect to a resolution of a troubled institution is necessary to meet the FDIC's insurance obligations on insured deposits and provides for a resolution that when measured in terms of the total amount of expenditures (immediate or long-term, direct or contingent) is the 'least costly to the [FDIC] of all possible methods'. The statute clarifies that the cost of any efforts at a resolution must be less than the value of insured deposits minus the present value of reasonably expected recoveries in a liquidation of the troubled bank. This exacting 'least cost' standard may only be waived if, upon the written recommendation of and approval by two-thirds of the members of the board of directors of the FDIC and two-thirds of the board of governors of the Federal Reserve System, the secretary of the Treasury (in consultation with the president) determines that:
- the least cost approach would pose systemic risks (ie, have serious adverse effects on economic conditions or financial stability); and
- the proposed resolution would mitigate these adverse effects.

FDIC-orchestrated dispositions of failed or failing federally insured depository institutions are most commonly structured as a purchase and assumption (P&A) transaction whereby the FDIC oversees the assumption of all insured deposits of the failed bank by one or more acquiring banks and the transfer of some or all assets of, and the assumption of some or all other liabilities of, the failing bank by the acquiring banks. A number of variations of P&A transactions exist and features of different variations may be combined in a particular case. The two most prevalent variants are bridge bank arrangements and loss-sharing agreements. Each of these two variants has proven particularly useful in large, complex resolutions. A P&A transaction affords the opportunity for the acquiring bank to pay a premium for the going-concern value of the failed bank, thereby reducing the FDIC's total cost of resolution and increasing the probability that the FDIC may avoid a loss in guaranteeing insured deposits. A P&A transaction may also provide for assistance to the acquiring bank in capitalising or supporting the credit risk of the acquired assets and liabilities. The terms of the transaction may be highly customised based on the intentions of the ultimate acquirer and may exclude certain assets or categories of assets that are carved out by the FDIC into a segregated fund to be professionally managed and liquidated over time (whether by the acquirer or by some other third party).

Two less common structures are an open bank assistance transaction and a deposit payoff. In an open bank assistance transaction, the FDIC provides ongoing support to the troubled institution to facilitate a turnaround plan as it works through its capital issues. In order to provide open bank assistance, the board of directors of the FDIC, the Federal Reserve and the

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secretary of the Treasury must all determine that not to do so would cause systemic risks. In a deposit payoff, the FDIC assumes and honours insured deposits (and possibly uninsured deposits) and liquidates the troubled institutions assets through receivership.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As noted in question 17, the US bank regulators adopted new Basel III capital guidelines in July 2013 that became effective in January 2015. In addition, Dodd-Frank requires the Federal Reserve to increase capital requirements the larger and more complex a banking organisation becomes.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Both individuals and companies, regardless of whether they are foreign or domestic, may acquire controlling interests in US banks, provided they meet the applicable statutory and regulatory requirements discussed in question 27 and obtain prior approval from the appropriate regulators. As discussed in question 27, the need for prior approval can be triggered by an acquisition of as little as 10 per cent of the voting stock of a bank or a company that controls a bank or even by the acquisition of non-voting equity securities.

23 Are there any restrictions on foreign ownership of banks?

Foreign acquirers of US banks are generally subject to the same limitations and processes as US acquirers. The principal difference is that the US regulators will first ensure that the foreign acquirer is subject to comprehensive consolidated supervision in its home country. This is discussed in more detail in question 28. Foreign acquirers should also be aware of filing requirements with the Committee on Foreign Investment in the US (CFIUS).

In February 2014, the Federal Reserve issued final regulations that substantially tightened the regulation of foreign banks operating in the US. Foreign banks with $50 billion or more in US assets (excluding assets held in US branches and agencies) must form a US intermediate holding company (IHC) to act as the parent company of substantially all of the foreign bank's US subsidiaries. The IHC will be regulated by the Federal Reserve as if it were a domestic bank holding company and must comply with US regulatory capital requirements, stress testing, liquidity management requirements and a host of other regulatory requirements. Foreign banks have until 1 July 2016 to establish an IHC that is fully compliant with these regulations.

24 What are the legal and regulatory implications for entities that control banks?

With certain exceptions, companies (but not individuals) that acquire control of a US bank will be limited to engaging in financial services activities. For example, an automobile manufacturer is generally precluded from acquiring a US bank. Non-financial companies are not, however, precluded by law from acquiring or establishing an FDIC-insured 'industrial bank', a special type of bank – although the ownership by non-financial companies of industrial banks has generated significant controversy in recent years and there was a moratorium in place on such transactions, which was imposed by Dodd-Frank and expired in July 2013.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

An investment that constitutes 'control' under the BHC Act by a company in a bank has several implications. From a bank regulatory perspective, the company would be deemed to be the parent bank holding company of the bank. Consequently, the company would be subject to the Federal Reserve's 'source of strength' doctrine, which provides that a bank holding company must serve as a source of financial and managerial strength to its subsidiary banks. Under this doctrine, the Federal Reserve may require the company to provide additional capital to the bank in the event that the bank was under financial stress. Note that there is no cap on the amount of capital that the Federal Reserve can require that the company provide to the bank. By its terms, the source-of-strength doctrine only applies to companies and not to individuals that control banks because, under the BHC Act, individuals cannot be deemed to be bank holding companies.

In addition, a finding of control under the BHC Act would mean that the company would control the bank for purposes of the prompt corrective action regulations issued by the federal bank regulators, which are discussed in greater detail in question 19. Under these regulations, an FDIC insured bank is required to file a capital restoration plan with its primary federal bank regulator within 45 days of becoming 'undercapitalised', 'significantly undercapitalised' or 'critically undercapitalised'. The regulations further require that the capital plan include a performance guarantee by each company that 'controls' the bank – control for this purpose is identical to control under the BHC Act. The prompt corrective action regulations limit the aggregate liability under performance guarantees, which are joint and several obligations, for all companies that control a bank to the lesser of:

- an amount equal to 5 per cent of the bank's total assets at the time that the bank was notified that it was undercapitalised; or
- the amount necessary to restore the bank to adequately capitalised status (ie, a total risk-based capital ratio of 8 per cent or greater, a Tier I capital ratio of 4 per cent or greater and a leverage ratio of 4 per cent or greater).

A finding of control would have other regulatory implications as well. Sections 23A and 23B of the Federal Reserve Act would place restrictions on transactions between the company (including its affiliates) and the bank. Hence, any loan, asset transfer or other transactions between the company and the bank would be subject to a number of stringent limitations and an overall requirement that they be at arm's length. Moreover, if the Federal Reserve were to commence an enforcement action against the bank, its controlling shareholders may become parties to the proceeding, depending on the particular facts and circumstances.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

In the event that a bank is declared insolvent, the US bank regulators may assume control of the bank and ultimately offer it for sale to third parties. If the regulators determine that the bank failed due to mismanagement by the parent company or controlling individual, they may pursue enforcement actions.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The statutory authority for federal regulation of acquisitions of banks, other insured depository institutions, bank holding companies and other insured depository institution holding companies, and their respective subsidiaries, emanates primarily from:

- the Bank Holding Company (BHC) Act, which regulates acquisitions of control of a bank or bank holding company by a 'company', as well as the acquisition of foreign subsidiaries and the commencement or acquisition of companies engaged in non-bank activities by a holding company or non-bank subsidiary;
- the Bank Merger Act, which regulates mergers between insured depository institutions and acquisitions of assets and assumptions of liabilities of one insured depository institution by another;
- The Home Owners' Loan Act (HOLA), which regulates acquisitions of control of thrifts and thrift holding companies; and
- the Change in Bank Control Act of 1978 (the Control Act), which governs all acquisitions of control of a bank, thrift or holding company by a 'company' other than those covered by the BHC Act, HOLA and the Bank Merger Act as well as by individuals. The Control Act provides that if a proposed acquisition is subject to the provisions of the BHC Act, HOLA or the Bank Merger Act, then the acquiring person need not comply with the Control Act.

Frequently, a particular bank acquisition involves the acquisition by one bank holding company of shares of another bank holding company followed by a merger between the two subsidiary banks. Such transactions are subject to prior regulatory approval under the BHC Act, on the one hand, and the Bank Merger Act, on the other.

BHC Act

Under the BHC Act, prior approval by the Federal Reserve is required for the acquisition by a 'company' of 'control' of a bank or of substantially

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all of the assets of a bank. Prior Federal Reserve approval also is required under the BHC Act for an existing bank holding company to acquire direct or indirect ownership or control of voting shares of a bank or bank holding company if it will own or control more than 5 per cent of the voting shares after such acquisition and merge with another bank holding company. Such approval is not required for the acquisition of additional shares in a bank or bank holding company by a company that already owns or controls a majority of the voting shares prior to such acquisition.

A company is deemed to 'control' a bank or bank holding company under the BHC Act if:
- it has the power to vote 25 per cent or more of any class of 'voting securities' of the bank or holding company;
- it has the power to control 'in any manner' the election of a majority of the board of the bank or holding company; or
- the Federal Reserve determines, after notice and an opportunity for hearing, that the company has the power to directly or indirectly exercise a controlling influence over the management or policies of the bank or holding company.

The BHC Act contains a statutory presumption that a company that owns, controls or has the power to vote less than 5 per cent of the voting securities of a bank or bank holding company does not have 'control' for purposes of the BHC Act.

The Federal Reserve's regulations provide that the term 'voting securities' includes any securities giving the holder power to vote for directors or to direct the conduct of operations or other significant policies of the issuer. Preferred stock is deemed not to be a class of voting securities if it does not carry the right to vote for directors, its voting rights are limited solely to the type customarily provided by statute with regard to matters that significantly and adversely affect the rights or preferences of the preferred stock and it represents an essentially passive investment or financing device.

In addition to acquisitions of voting securities, Federal Reserve regulations identify a number of situations in which there is a rebuttable presumption that a company controls a bank or bank holding company for purposes of the BHC Act. This presumption will apply if:
- a company enters into a contract with a bank or bank holding company pursuant to which the first company directs or exercises significant influence over the management of the bank;
- a company and its management and principal shareholders own, control or hold with the power to vote, 25 per cent or more of any class of voting securities of a bank or bank holding company and the first company itself owns, controls or holds, with the power to vote, more than 5 per cent of any class of voting securities of the bank or bank holding company; or
- the two companies have one or more management officials in common, the first company owns, controls or holds, with the power to vote, more than 5 per cent of any class of voting securities of the other company and no other person controls as much as 5 per cent of any class of voting securities of the other company.

The Federal Reserve has also identified a number of circumstances that may indicate the existence of a control relationship under the BHC Act. Such indicia of control include:
- agreements that substantially limit the discretion of a bank holding company's management over major policies of the company, including restrictions on entering into new banking activities without approval of another company or requirements for extensive consultation with the other company regarding financial matters;
- agreements that restrict a bank holding company from selling a majority of the voting shares of its subsidiary banks;
- agreements that give another company the ability to control the ultimate disposition of voting securities to a person of the other company's choice and to secure the economic benefits therefrom;
- an investment of substantial size, even if in non-voting securities;
- agreements that require that one holder's voting securities be redeemed at a premium upon transfer of shares held by another holder; and
- agreements giving a company the ability to direct a bank holding company's use of the proceeds of the first company's investment.

The Federal Reserve has stated that provisions of the type described above may be acceptable if combined with other provisions that serve to preclude control of the acquiree by the acquiring company. Such mitigating provisions may include:
- covenants that leave management free to conduct banking and permissible non-banking activities;
- a 'call' right that permits the acquiree to repurchase the acquiring company's equity investment;
- a provision granting the acquiree a right of first refusal before warrants, options or other rights may be sold and requiring a public and dispersed distribution of these rights if the right of first refusal is not exercised;
- agreements involving rights with respect to less than 25 per cent of the acquiree's voting shares; and
- holding down the size of any non-voting equity investment in the acquiree below the 25 per cent level.

With respect to the last point, the Federal Reserve has consistently taken the view (except in rare circumstances) that non-voting equity investments by bank holding companies may not be equal to 25 per cent or more of a target's total equity. In addition, the Federal Reserve has viewed subordinated debt as equity for purposes of this limitation.

Change in the Bank Control Act

The Control Act provides that a 'person' seeking to effect an acquisition of 'control' of a bank holding company or a federally insured depository institution must give prior written notice to the 'appropriate federal banking agency'. The agency then has a specified period to disapprove the acquisition. If not disapproved within that period, the acquisition may be consummated. An acquisition may be made prior to expiry of the period if the agency issues written notice of its intent not to disapprove the acquisition.

The concept of control used in the Control Act differs somewhat from that used in the BHC Act. The Control Act defines 'control' as the power, directly or indirectly, to direct the management or policies, or to vote 25 per cent or more of any class of voting securities, of an insured bank. In addition, Federal Reserve regulations provide that a person is rebuttably presumed to 'control' a bank under the Control Act if the person:
- 'owns, controls, or holds with the power to vote 25 per cent or more of any class of voting securities of the institution'; or
- 'owns, controls or holds with power to vote 10 per cent or more [...] of any class of voting securities of the institution'; and if
- the institution's shares are registered pursuant to section 12 of the Exchange Act; or
- no other person would own a greater percentage of the institution's outstanding shares.

Bank Merger Act

The Bank Merger Act provides that no insured bank or other insured depository institution may merge with, or acquire the assets or assume the liabilities of, another insured depository institution without the prior written approval of the 'responsible agency' and prescribes certain procedures (including procedures for obtaining shareholder approval and for appraisal of shares held by dissenting holders) for such mergers.

Where the acquiring or resulting bank is to be a national bank or a bank chartered in the District of Columbia, the OCC is the responsible agency. Where the acquiring or resulting bank is to be a state-chartered bank that is a member of the Federal Reserve System, the Federal Reserve is the responsible agency. Where the acquiring or resulting bank will be a state-chartered bank (other than a savings bank) that is not a member of the Federal Reserve System, the FDIC is the responsible agency.

Where the acquiring or resulting institution is to be a thrift, the OCC is the responsible agency. In addition, a 'deposit transfer' application to the OCC may be required where the transferring or disappearing institution is a thrift.

HOLA

HOLA governs acquisitions of control of insured federal or state thrifts (including savings associations, savings and loan associations, building and loan associations and federal savings banks) and holding companies of such thrifts.

Thrift regulations provide that a company generally cannot acquire control of a thrift, directly or indirectly, unless it first receives written approval from the Federal Reserve. The regulations create two thresholds for determining 'control': conclusive control and control subject to rebuttal. The regulations also establish presumptions of concerted action for purposes of determining the circumstances under which it might be appropriate to aggregate the holdings of different investors.

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A company will be deemed to conclusively control a thrift if an acquirer directly or indirectly, or acting in concert with one or more persons or companies:

- acquires more than 25 per cent of any class of voting stock;
- acquires irrevocable proxies representing more than 25 per cent of any class of voting stock;
- acquires any combination of voting stock and irrevocable proxies representing more than 25 per cent of any class of voting stock;
- controls in any manner the election of a majority of the directors of the thrift; or
- can exercise a controlling influence over the management or policies of the thrift.

Subject to rebuttal, an acquirer will be deemed to control a thrift if the acquirer directly or indirectly, or acting in concert with one or more persons or companies:

- acquires more than 10 per cent of any class of voting stock and one or more additional 'control factors' are present, including:
- being one of the two largest holders of any class of voting stock;
- holding more than 25 per cent of total equity;
- holding more than 35 per cent of combined debt securities and equity; or
- being party to agreements that give an investor a material economic stake in a thrift or thrift holding company or that give an investor the power to influence a material aspect of management or policy;
- acquires more than 25 per cent of any class of stock and one or more of the above control factors are present; or
- holds any combination of voting stock and proxies, representing more than 25 per cent of any class of voting stock, that enables an acquirer to:
- elect one-third of the board of directors;
- cause the shareholders of the thrift to approve its acquisition or reorganisation; or
- exert a controlling influence on a material aspect of its business operations.

To satisfy the thrift regulations, an investor should, prior to an acquisition of equity securities, debt securities, or both, of a thrift or thrift holding company that could subject the investor to a finding of control subject to rebuttal, submit to and have approved by the Federal Reserve a rebuttal of control agreement. Rebuttals of control contain a series of passivity commitments.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The receptivity of the US regulatory authorities to foreign acquirers of US banks depends in large part on whether the acquirer is subject to comprehensive consolidated supervision by its home country supervisor as discussed below. The filings are essentially the same for a foreign acquirer of a US bank; a foreign acquirer, however, raises some different considerations. Also, as noted in question 21, foreign acquirers need to be mindful of CFIUS filing requirements.

Capital

In considering applications by foreign banks to acquire US banks, the Federal Reserve has looked to whether the capital levels of a foreign bank exceed the minimum levels that would be required under the Basel Capital Accord both before and after the merger. The Federal Reserve also looks to whether a foreign bank's capital levels are considered to be equivalent to the capital levels that would be required of a US banking organisation. In doing so, the Federal Reserve will typically consult a foreign bank's home country supervisor. Another important factor is that the US-insured depository institutions controlled by the foreign bank both before and after the merger meet the requirements to be deemed well capitalised. As discussed in question 23, in February 2014, the Federal Reserve issued regulations that would substantially tighten the regulation of foreign banks operating in the US.

Requirement of comprehensive supervision

Under the BHC Act, the Federal Reserve is precluded from approving an application by a foreign bank to acquire a US bank unless the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor. In essence, the Federal Reserve must determine that the bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the bank, including its relationships to any affiliate, to assess the bank's overall financial condition and its compliance with laws and regulations. If the Federal Reserve has previously determined that a particular home country supervisor practices comprehensive consolidated supervision, the finding is relatively easy for the Federal Reserve to make in the context of subsequent acquisitions by other banks from the same home country. Conversely, if the Federal Reserve has not previously made such a determination with respect to particular home country supervisor, the determination process can take months and even years.

Similarly, the Federal Reserve must also determine that a foreign bank that is applying to acquire a US bank provide adequate assurances that it will make available such information on its operations and activities and those of its affiliates as the Federal Reserve deems appropriate to determine and enforce compliance with the BHC Act. To make this determination, the Federal Reserve reviews the restrictions on disclosures in jurisdictions where the foreign bank has material operations and consults with the relevant non-US governmental authorities concerning access to information. The Federal Reserve also expects that the foreign bank commit to making available such information on its operations and those of its affiliates that the Federal Reserve deems necessary.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

Section 3(c) of the BHC Act sets out the criteria that the Federal Reserve must apply in acting upon BHC Act applications. The criteria are:

- antitrust;
- financial condition and future prospects;
- management resources;
- convenience and needs of the community; and
- impact on systemic risk.

In every case, the Federal Reserve must also take into consideration the effectiveness of the company or companies in combating money laundering activities, including in overseas branches.

Antitrust

The BHC Act provides that the Federal Reserve may not approve an acquisition that would result in a monopoly in or furtherance of a combination or conspiracy to monopolise or to attempt to monopolise the business of banking in any part of the US or might have the effect in any section of the country of substantially lessening competition, unless the board finds that the anti-competitive effects of the transaction are clearly outweighed by the convenience and needs of the communities to be served.

During the Federal Reserve's review of an acquisition under the BHC Act, the Antitrust Division of the Department of Justice (DoJ) also has an opportunity to evaluate the competitive issues raised by the proposed transaction and may submit its comments to the Federal Reserve. If the Federal Reserve approves the acquisition, the BHC Act provides that the transaction may not be consummated for 30 days (or 15 days if the DoJ has not submitted adverse comments with respect to competitive factors), during which time the DoJ may challenge the transaction in a federal district court.

Evaluating the antitrust implications raised by in-market bank acquisitions can be a complex task owing to the fact that the Federal Reserve and the DoJ apply different methodologies and focus on different competitive concerns. Most notable among those differences is the relevant product market defined by the two agencies. The Federal Reserve continues to invoke the 'cluster' of banking services market definition adopted by the US Supreme Court more than 40 years ago. The Federal Reserve's primary tool for evaluating the antitrust implications raised by a bank merger is to measure the effect of the proposed merger on the concentration levels within locally limited geographic markets. In contrast, the DoJ evaluates disaggregated product markets, including small-business lending and middle-market lending, in addition to retail banking services. At times, these differences can lead to conflicting outcomes at the two agencies with respect to whether a particular transaction raises antitrust concerns, and, if so, the level of divestiture required to resolve those concerns.

Financial condition and future prospects

The BHC Act provides that, in considering proposed acquisitions of bank shares or assets, '[i]n every case, the Federal Reserve Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned'. The Federal

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Reserve's consideration of this factor generally centres round the adequacy of the resulting company's capital. This analysis turns on the following three measures of capital adequacy:

- whether the resulting company will satisfy the Federal Reserve's published risk-based capital adequacy guidelines, which establish minimum levels of capital that bank holding companies are expected to meet;
- how the resulting company's capitalisation compares to the capitalisation of the two combining companies; and
- how the resulting company's capitalisation compares to the capitalisation of its peers.

Management resources

The BHC Act requires the Federal Reserve to take 'managerial resources' into account in considering applications for acquisitions. Applications that have been denied on the grounds of inadequate managerial resources have generally involved attempted acquisitions of relatively small banks by persons with little or no experience in managing a banking business.

Such managerial concerns are not limited to these circumstances, however. As part of the application process, the Federal Reserve staff frequently seeks and obtains detailed information to document an acquirer's managerial resources. Such information often takes the form of strategic business plans for the combined company, integration plans and staffing and cost savings projections. In addition, the federal regulators also scrutinise the larger bank holding companies' management, staffing, planning and implementation of acquisitions as part of the examination process. Any adverse examination reports in this area can be expected to affect applicant during the application process.

Convenience and needs of the community

The Federal Reserve is required to take into consideration the 'convenience and needs of the community to be served' in approving or rejecting an application under section 3 of the BHC Act. This consideration generally relates to the nature, quality and availability of the applicant's actual or planned products and services, including, for example, the hours and locations of operation, interest rates on deposits and size of available loans.

As a practical matter, the Federal Reserve has almost always determined that the general convenience and needs aspects of an application are consistent with approval of the application, even if the applicant plans to offer no new services or products. On the other hand, the Federal Reserve has found increases in services, greater loan limits, increased hours and, in particular, the reopening, or the assumption of the deposits, of a closed institution to be positive factors weighing in favour of approval of an application because of more effective service to the community.

Systemic risk

Under Dodd-Frank, the Federal Reserve is also required to consider the impact of a bank acquisition on systemic risk. In assessing this factor, the Federal Reserve looks at five factors:

- the size of the combined company;
- the availability of substitute providers for the critical services offered by the combined company;
- the combined company's interconnectedness with the rest of the US financial system;
- the degree to which the combined company contributes to the complexity of the US financial system; and
- the extent of the combined company's cross-border activities.

Update and trends

The US bank regulatory environment continues to be very challenging. New and more burdensome regulations, such as Basel III, the Volcker Rule, the foreign bank IHC regulations and many others have now been issued in final form and are gradually going into effect. In addition, as noted above, enormous governmental enforcement actions continue to be announced against the largest banks. The perceived recidivism has prompted the US bank regulators to raise fundamental questions about culture and ethics. While there may be incremental regulatory relief for the smaller regional and community banks, we do not expect these trends to change materially in the short term.

The Community Reinvestment Act

In considering the convenience and needs of the community, the Federal Reserve is required under the Community Reinvestment Act (CRA) to consider an applicant's record of serving the credit needs of its entire community, including low and moderate-income neighbourhoods, consistent with the safe and sound operation of the applicant. The CRA requires the federal banking regulators to 'encourage financial institutions to help meet the credit needs of the local communities in which they are chartered' and, to that end, the Federal Reserve is required to take an applicant's CRA record into account under section 3 of the BHC Act.

The CRA provides a four-tier system for rating an institution's record of meeting community credit needs: 'outstanding', 'satisfactory', 'needs to improve' and 'substantial non-compliance'. Each bank's primary regulator performs periodic examinations of, and assigns a rating to, the bank's CRA performance.

An applicant's CRA record may be the basis for the denial of an application – although denials solely on CRA grounds are rare. The Federal Reserve takes into account both an institution's CRA rating and CRA evaluations in making its CRA determination in connection with an application. Of the few CRA-based denials of applications, most, if not all, have involved applicants having subsidiaries with low CRA ratings.

Control Act criteria

The appropriate agency may disapprove a proposed acquisition under the Control Act:

- if the acquisition would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolise or to attempt to monopolise the business of banking in any part of the United States;

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- if the acquisition may have the effect in any section of the country of substantially lessening competition, unless the responsible agency finds that the anti-competitive effects of the proposed transaction are clearly outweighed by the convenience and needs of the community to be served;
- if the financial condition of any acquiring person is inadequate;
- based upon the competence, experience or integrity of any acquiring person or of any of the proposed management personnel;
- if any acquiring person neglects, fails or refuses to furnish the appropriate agency all the information required by it; or
- if the acquisition would adversely affect the Deposit Insurance Fund.

Bank Merger Act criteria

The Bank Merger Act provides that the responsible agency may not approve any proposed merger that:

- would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolise or to attempt to monopolise the business of banking in any part of the United States; or
- might have the effect in any section of the country of substantially lessening competition, unless the responsible agency finds that the anti-competitive effects of the proposed transaction are clearly outweighed by the convenience and needs of the community to be served.

In addition, the responsible agency is required to take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the communities to be served and the impact of the merger on systemic risk. The responsible agency must also take into consideration the effectiveness of any insured depository institution involved in the proposed merger in combating money laundering activities, including in overseas branches.

30 Describe the required filings for an acquisition of control of a bank.

In order to acquire a US bank, an application must be filed under the appropriate statute set out in question 27. In general, the filings require detailed information regarding the acquirer, including all individuals who have the authority to participate in major policy-making functions. In addition, detailed personal information of individuals with the most senior decision-making authority must often be provided for the acquirer.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

An acquisition of a bank or bank holding company differs from most other types of acquisitions by virtue of the often elaborate and extended regulatory approval process. In general, when a bank holding company or a financial holding company acquires more than 5 per cent of the voting shares of another bank or bank holding company, it must first receive Federal Reserve approval. Depending on the size and complexity of the proposal, the approval process can be as short as 45 days or longer than six months.

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