

THE EFFECTS OF THE FINANCIAL CRISIS ON THE METHODS OF BANKS STRAIGHTENING OUT

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Abstract

The banks straightening out is a concept different from the reorganization of any other commercial companies, due to the causes that trigger the specific methods of the straightening out, due to its characteristics and its unique purpose: the financial straightening out, without a direct concern for the covering of the bank liabilities and with the exclusion of the bank insolvency status.

The present financial systemic crisis enforced some exceptional forms of banks “express” straightening out, with the subsequent enforcement of the classic, conventional methods of banks straightening out, but, at the same time, modifying some of their important characteristics.

Keywords: *banks, straightening out, systemic crisis, bankruptcy.*

JEL Classification: G01, K20, K40

I. Introduction

It is generally known that the prudential supervision of the banks, meant to ensure their stability and viability, cannot entirely prevent the problems of these entities.

The failure of the banks activity is real and a realistic approach of this problem aims at remedying the situation, and as a final solution, at the acceptance of bankruptcy.

The practice proved that the banks problems should be identified at an early stage, in order to be prevented or eliminated and this can be achieved only by a periodical control and assessment of the banks by the supervisory authority¹.

In this context, in our country, an essential part of the activity of the National Bank of Romania, the national supervisory authority of control of the activity of the credit institutions, is represented by its competences concerning the risk assessment a bank is exposed to, and its authority to set in motion the early warning system in order to identify, prevent and eliminate any problems that might affect the banking stability.

The supervision of the banking market in Romania, by the National Bank of Romania, allows the central bank to identify the deterioration of the activity of a certain credit institution within the early stages or a possible deterioration revealed by

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¹ The importance of this type of action can be understood by studying the failures of European and World banks, see: “*Bank Failures in Mature Economics*”, Working Paper no. 13, Basel Committee on Banking Supervision, April 2004, http://www.bis.org/publ/bcbs_wp13.pdf?noframes=1.

infringements of the banking discipline or of the discipline within the area of payments systems.

Meaning that, due to this prudential control, we can talk about an anticipatory phase of the insolvency, which can be identified and eliminated by the supervisory authority –“pre insolvency phase” – using measures, rules, procedures suitable to this phase, legal actions to straightening them out¹.

The straightening out of the banks with problems represents the main objective but, if the bank does not meet the necessary conditions for this goal to be achieved, then the preserving of the discipline within the banking market, the protection of the bank clients and for the large banks, of the national economy, entitles the National Bank of Romania to proceed to the closure of the bank, by liquidation or by transferring it (by merging) to another credit institution, that is solvent.

These principles are valid both under normal circumstances of the financial services market and under exceptional circumstances, under financial systemic crisis.

However, the financial crisis may significantly modify the methods of the supervision and control authorities, so that the traditional methods of banks straightening out be used subsidiarily, after the “instant” straightening out measures had already been enforced.

II. Banks Straightening out. Concept, Forms and Characteristics.

The banks straightening out is a concept different from the reorganization of any other commercial companies, mainly because of its unique goal: the financial straightening out, with the elimination of the direct concern for the bank liabilities coverage and with the exclusion of the bank insolvency as well as due to the permanent enforcement of the prudential regulations.

The principle of banks insolvency prevention has, as a corollary, the principle of prevention by warning, of the immediate setting in motion of the intervention of the supervisory and control authority, any time when any significant infringements of the laws, of the regulations and of the issued documents for the compliance with the law concerning the supervision or the conditions of the banking activity occur.

In most of the National Law Systems, the reorganization of the banks is achieved by using procedures of banks management as “*statutory administration*” exerted by the supervision and control authority, through a special administrator, without judicial intervention or, by means of a *judicial administration*, exerted by a Court of Law, usually together with the supervision and control authority².

¹ For a thorough analysis of the problems of risk assessments within the credit institution and the early warning system see: Ranjana Sahajwala, Paul Van den Bertgh, “Supervisory risk assessment and early warning systems”, http://www.bis.org/publ/bcbs_wp4.pdt?noframes=1.

² The detailed presentation of the procedures for banks management in: “principles and orders governing the approach to insolvency and to the protection of the creditors’ rights” issued by the World Bank.

For example, France – that transported and inserted the Order 2001/ 24/ EC within the Financial and Currency Code¹ – chose the judicial straightening out of banks, using judicial administration procedures: the safeguarding (“sauvergarde”) procedure that does not imply banks insolvency and the judicial reorganization procedure² mainly complying with the general regulations in the French Commercial Code.

The denomination the Romanian law chose to regulate the banks straightening out: “special procedures”, does not make any difference between straightening out and reorganization.

That is why we cannot qualify the banks straightening out procedure as a reorganization specific to the banks, taking into account the distinction between the reorganization procedures and the straightening out procedures, criterion that is implicitly stipulated by Order 2001/ 24/ EC of the European Parliament and of the European Board, concerning the reorganization and the liquidation of the credit institutions³.

The Order 2001/ 24/ EC stipulates that *reorganization measures “mean measures taken to maintain or to reestablish the financial situation of a credit institution, and that might affect the preexistent rights of third parties, as well as measures that might involve a possible payments cessation, a suspension of the execution measures, or a reducing of claims (...)"* (art. 2 Order 2001/ 24/ EC).

Consequently, the criterion of the distinction between the banks reorganization and straightening out is represented by the outcome of the measures taken within each procedure: it is only the reorganization measures that can influence the preexisting rights of third parties.

The reorganization definition in Order 2001/ 24/ EC stipulates that the reorganization procedure triggers a suspension of the execution of the requests of the debtor's creditors enforced by courts of law or other competent authorities⁴.

As a rule, the methods entailing an agreement between the bank and its creditors, concerning the bank obligations, do not qualify a procedure as a reorganization procedure, if they are performed without the intervention of a Court of Law, or of any supervisory authorities for the suspension of the fulfillment of the banks obligations.

¹ To be found in the subchapter concerning the reorganization methods and the liquidation of the European credit institutions: Book VI, title I, chapter III, <http://legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006072026&dateTexte=20080817>.

² The reconciliation procedure stipulated by art. 611-4 c.com.fr. (that replaced “*amiable reglement*” procedure) cannot be considered a reorganization method as stipulated by Order 2001/ 24/ EC because its purpose is to maintain, to preserve the credit institution situation. Similar, see: Gabriel Moss QC, Bob Wessels; EU Banking and Insurance Insolvency, Oxford University Press, New York, 2006, pg. 55.

³ Order 2001/ 24/ EC on April 4, 2001, concerning the reorganization and liquidation of the credit institutions was published in J.O.L. 125/ 05.05.2001, pg. 15 – 23.

⁴ Gabriel Moss QC, Bob Wessels, previously mentioned work, pg 113.

Based on the content of the bank reorganization notion and especially on the fact that, by the special procedures stipulated in O.U.G. (Urgency Government Order) № 99/ 2006¹, the preexisting rights of third parties are not affected, we consider the two special procedures: *the special supervision and the special administration as procedures or measures of banks administrative or statutory straightening out*.

These two straightening out measures can be used successively or independently one from the other.

As previously mentioned, the banks straightening out, in any of its forms, differs from the judicial reorganization of common companies² by its characteristics: banks straightening out *excludes the status of banks insolvency, aims at the bank financial straightening out, is decided and acted upon only by the supervisory and control authorities, excludes the interference of the Courts of Law, of the creditors, the payment of the banks obligations and the liquidation of the bank patrimonial assets*.

The statutory administrative character of the banks straightening out is requested by the rapid, efficient and specialized actions performed to eliminate the problems of the bank and, obviously, the supervisory and control authority can use efficient means to detect and eliminate the risk generating causes.

On the other hand, the straightening out of the bank is a component of the prudential supervision of the banking system, supervision that is in the exclusive competence of the National Bank of Romania, the only competent authority (administrative authority³) for banks straightening out.

As stipulated by the law, the National Bank of Romania is the only competent authority to enforce the special supervision or, as necessary, the special administration of a bank, Romanian legal person, that violates the provisions of the law, of the regulations issued to enforce the law concerning the supervision or the banking activity, or does not comply with a recommendation from the National Bank of Romania, in order to eliminate the deficiency of the bank's activity and their causes, so that the bank situation should be straightened out as soon as possible.

The National Bank of Romania exerts its competences in banks straightening out through an Administrator: the Special Supervisory Board (for the special supervisory procedure) and the Special Administrator (for the special administration procedure) with the exclusion of the courts of law.

¹ OUG №99/ 06.12.2006, concerning the credit institutions, and assets balancing, published in Official Gazette part I, №1027/ 27.12.26, with further modifications and additions.

² Opposite opinion in: I.M. Niculeasa “*The credit institutions bankruptcy*”, published in the Romanian Business Law Magazine №5/ 203, pg 48.

³ “*Administrative Authorities*” represent the administrative authorities of the member states that are competent in reorganization methods and liquidation procedures – art. 2 in Order 2001/ 24/ EC; the definition points out to the existing national differences, in some states (Great Britain and Italy) banks are submitted to general preventive methods while, in other states (Belgium, Luxemburg, Germany) they are submitted to special conditions. The difference will be made only by the member states using this open definition. Specifics in Gabriel Moss QC, Bob Wessels, previously mentioned work, pg. 55.

The Romanian law chose the straightening out of a distressed bank by the competent authority, the National Bank of Romania, with the exclusion of a reorganizing/ straightening out procedure by the Courts of Law, in accordance with the reality of extremely negative effects of a judicial procedure, emphasized both by experience and by specialized studies.

The special regulations concerning the straightening out are essential in solving the problems of a bank because a judicial straightening out will fail due to the panic that would result among the depositors, who would liquidate their deposits¹.

The confidentiality of the straightening out measures enforcement can be ensured only if the respective measures are applied by the competent administrative authority² and the regulation of the professional secret observance is compulsory during the whole period of the banks straightening out.

The prevention of the banks insolvency represents the basis of the prudential supervision, established to ensure the stability and the viability of the banking system.

The banks straightening out does never occur when the bank is insolvent, so that the prevention of the bank insolvency is the characteristic and the purpose of the bank straightening out.

As a rule, if the bank is in insolvency, the situation is irremediably compromised and any financial straightening out by its own possibilities is impossible.

The purpose of the bank straightening out, of the special supervision and of the special administration is the financial straightening out so that the bank should not be declared in insolvency {the measures are taken "to eliminate the deficiencies"-the final part of art. 225 in O.U.G. № 99/2006), "to ensure the straightening out of the situation as soon as possible" (the final part of art. 226 line 1 in O.U.G. № 99/2006) . "If the National Bank of Romania establishes (...) that the credit institution under special administration straightened out financially and it was within the limits of the prudential administration (...) it may decide the cessation of the special administration and the resuming of the activity of the credit institution under the statutory bodies control" (art. 253, line I, in O.U.G. № 99/2006)}.

The failure of the straightening out measures represents the absolute proof of the impossibility of the financial straightening out of the bank, in insolvency, situation that can trigger the onset of the bankruptcy procedure.

The preventive character the banks administrative straightening out explains the non-involvement of the bank creditors whose rights are not violated during the

¹ Eva H.G.Hupkes, "Insolvency – What is different about banks?" Financing and Refinancing Companies in the Perspective of Insolvency, International Legal Debate, 2004, Geneva, Switzerland, [www.unige.ch/droit/insolvency-symposium 2004](http://www.unige.ch/droit/insolvency-symposium-2004); Arin Octav Stanescu "Government Order № 10/2004 concerning the judicial reorganization method and the credit institution bankruptcy – a critical outlook" The Commercial Law Magazine no. 3/2004, pg. 75.

² The confidentiality refers to the effective steps taken to straighten out the bank activity, not to the existence of the bank straightening out methods that has to be notified by the publication of the decision of the special supervision establishment within the Official Gazette of Romania, as stipulated in art. 240, line 2, in O.U.G. № 99/ 2006.

straightening out process.

The general notification of the straightening out procedures, compulsory only for the intervention of the National Bank of Romania, concerning the setting up of the special administration measure and published in the Official Gazette of Romania, is sufficient for protecting the creditors' rights.

On the other hand O.U.G. № 99/2006 does not stipulate the compulsoriness to publish the decision of the bank straightening out in the Official Journal of the European Community¹ because, as we have already mentioned, the straightening out measures, as they are established by the special *administrator* or "silent"², do not affect the rights of third parties within the host member states and, the cumulative conditions stipulated in Order 2001/24/EC for publishing are not fulfilled: the reorganization measures (1) may affect the rights of the third parties in the host member states (2).

The National Bank of Romania can put into practice its own policy concerning the bank straightening out, that has to be fulfilled within a period of time too short to be affected by the measures taken abroad³.

The character of remedy of the banks administrative straightening out is a natural consequence of the preventive character of this procedure.

The preventive action is restoring the bank financial situation by enforcing the straightening out measures, so that the bank may carry on its activity.

The decision of the bank takeover – by merging or division – by another credit institution does not influence this characteristic of the administrative straightening out.

III. The Straightening out by Special Supervision

The existence and the establishment of a difficult financial situation of the banking institution, of the violations of the law or of the regulations and stipulations passed for its enforcement, in fact, of a deficient activity, justifies the onset of the bank special supervision procedure of the bank, by the National Bank of Romania, for a period of maximum three months.

The violations of the banking discipline are less serious than those that would require the special administration, violations that may prudentially alert and trigger the supervision authority intervention.

At least during the first stage of its assessment, the National Bank of Romania may decide that the existent deficiencies may be eliminated without resorting to an

¹ The publication of the straightening out steps is done only if, the bank, Romanian legal person, has branches within member states and the enforcement of the straightening out steps may influence the rights of third parties in a host member state, and if there is the possibility of a law action. – art 6 in Order 2001/ 24 EC.

² Gabriel Moss QC, Bob Wessels, previously mentioned work, pg. 59.

³ Jean Pierre Deguee, "The Winding Up Directive Finally Establishes Uniform Private Law for Banking Insolvency Proceeding", European Business Law Review (EBLR), 2004, pg. 108.

ample reorganization, as the special administration is.

Although the law stipulations do not define “*a difficult financial situation*” that will entitle the central bank to restore to this remedy measure, we consider that “*a difficult financial situation*” stands for the diminution of its own capital below the minimum level of the capital request established to cover the principal risks, providing the respective diminution of the capital is at a level that exceeds half of the minimum level of the requests for capital.

This happens because the diminution of the bank own capital to half of the minimum level of the requests for capital represents a cause for the establishing of another measure of reorganization: the bank special administration, as the last possibility of a bank straightening out.

The special supervision of the credit institution is done by a board of maximum 7 specialists within the central bank, a board that reorganizes the bank activity without acting as a substitute of the board of the respective entity, in what concerns its management activity and its competence of committing the bank.

The prerogatives of the special Supervision Board of the National Bank of Romania, stipulated in art. 238, line 1 in O.U.G. № 99/ 2006 aim at the elimination of the deficiencies in the bank activity and at the bank straightening out.

The measures taken by the Special Supervision Board are compulsory for the bank under a double aspect: the bank has to do everything to enforce the respective measures and it has to refrain from carrying out any action that may lead to any resolution contrary to the decisions passed by the Supervision Board, by the General Assembly of the Shareholders, by the Administrative Board and by the bank managers or, as requested, by the Supervision Board and the managers board.

The results of the activity of the Supervision Board, of its assessments and decisions will be presented through periodical reports, submitted to the National Bank of Romania.

The latest date, that the National Bank of Romania passes a decision concerning the cessation of the special supervision based on the report of the Supervision Board is at the end of the maximum legal period for the bank special supervision.

If the bank activity is restored within the parameters of the banking regulations requests, the cessation of the special supervision does not trigger; further effects.

If severe deficiencies are still observed within the bank activity, the National Bank of Romania may decide to restore to the special administration measure or to pass other decisions, as stipulated by the law, including the withdrawal of the license that triggers the dissolution and the liquidation of the respective bank.

If the report of the Supervision Board mentions severe deficiencies in the activity of the bank with the possibility of the straightening out of the bank activity, the central bank will usually decide to enforce the special administration procedure for the bank.

IV. Straightening out through Special Administration

The last chance of financial straightening out of a bank, Romanian legal person, is the straightening out through the special administration of the respective bank by the National Bank of Romania.

The straightening out through special administration decided by the Administrative Board of the National Bank of Romania covers the whole range of activities of the bank, including the activity performed by its branches in other member states, or third party states, and it is required by severe violations of the banking legislation and by a financial situation depreciated to such an extent that the carrying out of the bank activity within the same parameters that have caused the respective situation will inevitably lead to bankruptcy.

If the special administration is established, the National Bank of Romania decides on the withdrawal of the approvals granted to the persons entrusted with administrative and / or management responsibilities, and on the financial audit of the credit institution, Romanian legal person, and, as requested, on the suspending of the vote rights of the shareholders.

This method of the bank straightening out may be ordered if:

- a) The established special supervision measure failed within an up to 3 months' period;
- b) The bank capital is at a level that does not exceed half of the minimum level of the capital requests, computed as per the regulations stipulated in art. 126 and 148 in O.U.G. №99/ 2006;
- c) The credit institution repeatedly violated the provisions of the law and/ or the regulations, or of any other additional issued dispositions.
- d) The administrative and / or management responsibilities (art. 240, line 1 in O.U.G. № 99/ 2006) are no longer exercised at the level of the credit institution.

The special administration measure is also enforced by the National Bank of Romania if the competent authority requests the onset of the bankruptcy procedure for a credit institution until the syndic judge appoints the liquidator.

Apparently, this case of the special administration measure enforcement does not represent a real straightening out of the bank; in fact, it represents a protection measure to preserve the bank between the registration of the request for the onset of the bankruptcy procedure and the time the syndic judge orders the onset of the bankruptcy procedure and the appointment of the liquidator.

In this case, the Court of Law will inform the National Bank of Romania, only if the request for the onset of the bankruptcy procedure was required by the debit bank or by the bank creditors, as soon as the respective request was registered.

If hypothetically, the debit bank request or the creditors' request for the onset of the insolvency procedure is rejected by a Court of Law, the reasons that have caused these individuals to request the onset of the bankruptcy procedure trigger the carrying on of the bank special administrator, this time as a real measure for the bank

straightening out.

The method of the bank straightening out through special administration by the National Bank of Romania is established for one year period from the date the National Bank of Romania decides on the procedure, except the case when a shorter period is ordered or when the National Bank of Romania decides the cessation of the special administration, as per art. 252, line (4) in O.U.G. № 99/ 2006, as well as when, due to exceptional situations, the initial period is extended with maximum 6 months.

The special administration of the bank is carried on by the National Bank of Romania through a special administrator, appointed by the National Bank of Romania, through the decision of the enforcement of the respective measure.

Any legal or natural person with adequate experience within the banking management and the Guarantee Trust of the Deposits in the banking system, can be appointed as a special administrator of a bank.

Starting with the appointment date of the special administrator by the National Bank of Romania, the bank loses, as stipulated by law, the administration right, so that *the special administrator takes over the prerogatives of the bank administrators and managers entirely*; the shareholders' right to convene the General Assembly is suspended during the entire period of the special administration.

The main prerogatives of the special administrator are also general legal obligations for him: *the establishment of the best conditions for the preserving of the value of the assets of the credit institution, the liquidation of the deficiencies existing in the administration of the patrimony, the cashing of the claims and the establishment of possibilities for the financial straightening out of the credit institution*.

By exception, when the special administration aims at the appointment of the bank management and administration bodies, the special administrator's prerogatives are limited to this purpose only.

No matter how general the special administrator's prerogatives are, *he has to reach the minimum standards*, by the steps he takes: the diminishing of losses, the cessation of the fraudulent activities and of any fraud committed by persons with special connections with the credit institution, the canceling of the fraudulent documents previously concluded by the credit institution, including the contracts where the obligations assumed by the credit institution are disproportionate as compared to the obligations assumed by the other contracting party, the safe keeping of the credit institution assets and documents, the notifying of the competent authorities if there are any indications concerning any violation of the law.

The special administrator's prerogatives are similar to the prerogatives of the administrative/supervision board, of the managers/managing board, so that *he cannot make decisions that have to be made only by the shareholders' General Assembly of the bank*. He can only submit, for approval, to the shareholders' General Assembly, some decisions, after he has previously consulted with the National Bank of Romania.

The first step the special administrator takes, after his appointment, is to make sure that his appointment is notified to the authorities, this step is compulsory, due to the importance of the decisions he is going to make during his administration; the notification will be in writing and will include his authenticated signature and the announcement of his quality as representative of bank; the notification will be sent to the Trade Register, to the departments within the bank and to the bank branches, to the corresponding credit institutions and, if necessary, to the Trust of Guarantee of the Deposits within the banking system.

The special administrator will take any necessary steps to straighten out the operational, the financial and the corporate activity of the bank, based on the evaluation of the bank situation.

In order to correctly evaluate the situation and the problems of the bank, the administrator has the right to request the bank personnel to re-draw up the annually financial balance sheets of the bank, concluded previously to his appointment, when the respective documents were not approved as stipulated by the law as well as when he has any doubt concerning the correctness of the respective documents.

The bank operational and financial straightening out is one of the direct competencies of the special administrator, so that, in order to enforce the strategic methods, he/she does not need the approval of the shareholders' General Assembly or of the National Bank of Romania (with exception of the appointment of new members or replacing the old ones within the Administrative Board and/or the Supervision Board).

In order to enforce the bank operational and financial straightening out, the special administrator can negotiate the claims of the credit institution, and/or a new term for their payment, the suspension of deposits drawing and/or credits granting, the closure of the non-profitable branches, or whose activity cannot be justified, re-sizing of the personnel scheme.

The bank corporate straightening out by capital increasing or by the bank takeover - through merging or division – by another credit institution, may represent, a strategic method for the bank straightening out, but the approval of the shareholders' General Assembly is necessary for its enforcement.

Generally the bank takeover through merging or division is considered an extreme method, pointing to the failure of the financial straightening out through the respective bank own means.

The most used method within the banking practice is the takeover through social capital increasing.

The bank shareholders, representing 50% of the voting rights, have the right to suggest the bank corporate straightening out through capital increase to the special administrator, who, in turn, will decide on the method he/she will uphold.

The takeover of the distressed banks by other secure banking institutions represents an extreme method, but that proved to be viable within the international banking system, method that has been enforced in our country too, within the last decade, as the Romanian banking system straightened.

Hence, in order not to present only the special case of takeover by absorption of the Foreign Trade Romanian Bank (Bancorex) S.R.L. by the Romanian Commercial Bank on October 21, 1999, we'll mention another concrete example: Bayerische Hypo-und Vereinsbank AG, Munich (HVB Bank), an Austrian bank specialized in retail, with more than 850 branches, more than 8.5 million clients, approximately 25,000 employees and with subsidiaries all over Europe, including Romania.

During 2004-2005, the Austrian bank chose the corporate straightening out method, at group level, through takeover by the Unicredit Group SpA. Italy. Thus, the HVB Bank, the mother company, was completely taken over by Unicredit Group SpA, through HVB Bank social capital increasing and by offering 5 (five) new HVB Bank shares for one Unicredit Group Sp.A share; the whole offer amounting to 93.93% out of the HVB Bank. This way, HVB Group (that also includes the Bank Austria Creditanstalt AG) became a member of Unicredit Group.

The Romanian branch was straightened out by takeover - HVB Bank Romania being taken over, through merging, by "Ion Tiriac" Commercial Bank S.A. in August 2006¹; the result of this merging was HVB Tiriac Commercial Bank S.A.

Subsequently to this merging, as a strategic option for the bank financial stability, HVB Tiriac Commercial Bank took over by absorption Unicredit Romania Bank S.A., thus resulting, by merging through absorption, the Unicredit Tiriac Bank S.A.², part of the large banking group: Unicredit Group.

The special administrator will convene the shareholders' General Assembly – after previously consulting the National Bank of Romania on the agenda of the Assembly – when he/she decides on the bank corporate straightening out or on the operational and financial straightening out, that requests, the shareholders' approval (the diminishing of the bank social capital, the appointment of the members of the administration/supervision boards, the takeover of the bank through merging/division – all request the shareholders' approval).

The shareholders' General Assembly may decide only on suggestions submitted by the special administrator and recorded in the agenda of the meeting, based on the legal stipulation, that it is only the special administrator who can decide whether the corporate straightening out and certain possibilities of the financial one represent a viable method; the shareholders' General Assembly may or may not approve the respective decision.

The increasing of the bank social capital may be decided only if it ensures at least a level of its own capital, capable to allow the credit institution to be included

¹ The National Bank of Romania Order № 21/ 14.08.2006, published in the Official Gazette, Part I, № 718/ 22.08.2006.

² The National Bank of Romania Order № 11/ 22.05.2007, published in the Official Gazette, Part I, № 382/ 06.06.2007; the further information have been mainly taken from the official site of S.C.Unicredit Tiriac Romania S.A.: <http://www.unicredit-tiriac.ro/companie/unicredit-tiriac-bank> and the official site of Unicredit Group: www.unicreditgroup.eu; the annual Report of Bank Austria Creditanstalt A.G.: <http://annualreport2005.ba-ca.com/notes/chaingesingroupstrcture.html>.

within the prudential requests stipulated by the banking regulations.

The shareholders may suggest individuals to exercise the responsibility of bank administration.

We mentioned that the special administrator does not take over the competences of the shareholders' General Assembly, but this aspect entails a significant derogation when the General Assembly decides on the increasing of the bank social capital. Under such circumstances, *for solid reasons, justified by the existence of serious intentions from an investor to invest in the bank capital*, the special administrator, with the approval of the National Bank of Romania, may withhold the shareholders' right to subscribe to new shares.

Within 2 months from his appointment¹, the special administrator must submit, to the National Bank of Romania, a written report, detailed enough, so that it may substantiate his/her recommendations concerning the measures taken, from the safety point of view, starting with the establishment of the special administration, and of their effects on the financial position of the credit institution based on the possibility of the institution straightening out, submitting his recommendations, including those concerning a potential takeover of the credit institution, by merging/ division by another / other credit institutions. Documents, concerning the assets and the liabilities of the credit institution assessment, the state of the claims recovering, the cost assessment of the assets maintaining and the situation of the liabilities liquidation, are annexed to the rapport.

The administrator's recommendations, concerning the corporate straightening out, included in the report to the National Bank of Romania, are submitted after the shareholders' General Assembly has passed the decision concerning the increasing of the social capital or/and the bank takeover through merging/ division.

There is no reason for the special administrator to recommend the corporate straightening out to the National Bank of Romania, and to subsequently submit the decision to the shareholders' General Assembly, after getting the approval of the National Bank of Romania, to submit the decision to the shareholders' General Assembly in order to get their agreed approval.

The National Bank of Romania decides on the advisability of maintaining of the special administration and passes the decision on the special administrator's recommendations, based on the special administrator's report.

If the National Bank of Romania establishes, based on the special administrator's report, that there are no conditions for the improvement of the bank financial situation, so that the respective bank should abide by the prudential requests stipulated by the law and by the regulations for the law enforcement or if new individuals, capable to exercise responsibilities of bank administration and/or management, have not been appointed and approved, may decide to:

a) establish a period during which the special administrator may take the necessary steps for the identification of the possible credit institutions interested in

¹ The two months period may be extended by one month at most, for well founded reasons, by the National Bank of Romania, at the special administrator's suggestion.

the takeover, through merging/ division of the credit institution under special administration;

b) withdraw the authorization of the credit institution and inform the competent Court of Law to begin the bankruptcy procedure or, as requested, to withdraw the authorization and to dissolve and liquidate the credit institution.

The first method triggers the carrying on of the special administration procedure and advises on the option of the law for the qualification of the bank takeover through merging or division, as an expression of the impossibility of the straightening out through the bank own possibilities.

The administrator must submit periodical reports concerning the negotiations for the bank takeover.

If the special administrator's report states the possibility of the straightening out of the bank financial situation using one of the banks straightening out procedures, the National Bank of Romania may decide the carrying on of the special administration, in order to fulfill the straightening out procedures.

If the financial straightening out is possible, the special administrator must fulfill this objective by using all the necessary procedures, the increasing of the social capital, merging, division, etc.

During the period of the special administration, the special administrator must submit periodic reports, in order to inform the National Bank of Romania on the steps taken and on their results.

The special administration procedure is concluded when its purpose, restoring the bank activity within the requests of the banking discipline is achieved, when the reorganization failure occurs, when the impossibility of the bank financial straightening out is established, or when the impossibility of the appointment of new individuals to exercise the administrative and/or management prerogatives occurs, and when the bank merging or division takes place.

When it is established, based on the special administrator's periodical reports, that the bank has straightened out financially, and it is within the prudential requests, stipulated in O.U.G. № 99/2006, and within the banking regulations passed to enforce the law, or, as requested, new individuals, responsible for the administration and/or the management of the bank, were appointed, the National Bank of Romania may order the cessation of the special administration and the resuming of the credit institution activity, under the control of its statutory bodies.

Additionally, it is stipulated that the special administrator must take all the necessary steps to appoint the new administrators and, as requested, the new managers of the credit institution, thus ensuring the bank administration and management.

This legal stipulation cannot apparently be explained. If the bank management had to be changed, as part of the straightening out process, this step had to be taken by the special administrator during the special administration period, not later, especially, because the failure to fulfill the steps concerning the persons exercising administrative or management responsibilities represented a reason to establish the special administration procedure in the first place.

We think that, under any circumstances, the National Bank of Romania considers the removal of the managing board as opportune, when the bank activity resumes, irrespective of the cause that has triggered the establishment of the special administrative procedure and of the withdrawal or not of the approval of the members of the administrative board or/and of managers, or of the members of the supervision board and/or of the managers board (as an additional step to the enforcing of the special administration procedure).

The impossibility of the bank financial straightening out and the impossibility to appoint new bank administrators or/and managers, determines the National Bank of Romania to order the cessation of the straightening out procedure through special administration, the withdrawal of the bank activity authorization and, as requested, the bank dissolving and liquidation, or the notifying of the Court of Law for the onset of the bankruptcy procedure.

The difference, between the two distinct effects of the withdrawal of the bank activity authorization, is given by the cause that has determined the enforcement of the special administration.

The National Bank of Romania decides the bank dissolving and liquidation, when the special administration measure was enforced, as stipulated in art. 240, line 1, letter d, in O.U.G. № 99/2006 *and the reason for the special administration termination is represented by the impossibility to appoint new bank administrators or/and managers*.

For all the other cases, the termination of the special administration and the withdrawal of the activity authorization, triggers the bankruptcy of the bank.

Even if, for the last mentioned case, the special administrator still administrates the bank, until the liquidator is appointed by the Court of Law, he/she exercises his/her prerogatives, based on a distinct legal prerogative, that extends his/her commission, limited now to the bank administration, not within the special administration procedure.

The bank takeover through merging or division leads to a special case of termination of the special administration measure, starting with the moment the National Bank of Romania decides the preliminary approval for the bank merging or division.

V. The Exceptional Straightening Out of Banks through State Support

The recent bankruptcies contradicted the opinion that banks are too big and too strong to fail (“*too big to be failed*”) and replaced it with the opinion that banks are *too big to be let to fail*.

The systemic financial crises require exceptional measures to be used in protecting the banking system and the economy, both at national level and at regional level, in our case at European level.

As we have mentioned, the classic methods of banks straightening out trigger the elimination of the causes that have produced serious deficiencies in the banking activity, for these methods the time factor does not represent a very urgent problem.

In all cases, the bank straightening out through the standard methods is enforced within a limited time frame, without being sure that the intended goal, the bank straightening out, will be reached.

Under the systemic crisis circumstances, the banks financial difficulties must be solved at once “over night”, urgently, in the first stage, without any analysis of the causes (endogenous or exogenous) of these problems.

As a rule, the urgent straightening out of the financial situation of a distressed bank or that face a liquidities crisis can be solved only by a substantial infusion of liquidities.

Even under normal conditions, for a bank, the lack of money amounts available for the exigible obligations payment, especially for the depositors' payment, represents a much more severe problem than for any other commercial company, taking into account the fact that, at any moment, the bank can liquidate part of its assets, can get a credit line from other partner banks or from the National Bank of Romania.

This is the reason of the *difference between the liquidity risk*, defined as a risk of registering losses or the risk of not reaching the estimated profits, resulting from the bank impossibility to honor, at any given moment, its short time payment obligations; this impossibility does not trigger costs and losses that cannot be covered by the bank, *and the liquidity crisis, situation when the bank cannot entirely honor all the assumed obligations on falling due.*

The bank insolvency condition does not occur by liquidity risk, by the decreasing of the liquidity index below 1, and independently, by other banking risks occurrence.

The bank has the possibility to overcome “the temporary financial trouble” or “the house incident”, using liquidities injection from inter-banking loans, from assets sale, from operations on the currency market done by the National Bank of Romania, such as: sale of eligible assets (State titles, deposit certificates issued by the National Bank of Romania, etc), from collateral credits, currency swap, overnight credits², etc, so that, liquidity risk cannot generate the liquidity crisis intrinsically, meaning the bank insolvency.

As a rule, the bank will not be able to balance the liquidity index when the occurrence of the liquidity risk was triggered by other banking risks, such as the solvency risk, so that the effects of the liquidity risk occurrence cannot be eliminated³.

¹ Maurice Nussebaum, “La cessation des paiements des banques”, Revue de droit bancaire et de la bourse, May / Juin 1986, № 55, page 79.

² To see Regulations № 1/ 30.03.2000 concerning the operations on the currency market done by the National Bank of Romania and the permanent facilities granted by it to the eligible participants, published in The Official Gazette, part I, № 142/ 05.04.2000, republished in The Official Gazette, part I, № 84/ 01.02.2008.

³ If the bank has any significant solvability problems, this is known, and it will not be able to get any loans, so it will not be able to face the liquidity crisis.

Under the systemic crisis conditions the liquidity risk and the liquidity crisis may emerge even at financially healthy banks, not only at the banks with endogenous problems.

There is no doubt that, during a financial crisis, the intervention for the maintaining of the financial market stability is compulsory, because there is a real analogy between the cessation of payments and the cessation of activity: a bank under payment cessation, no matter the causes, cannot carry on its activity because of the lack of confidence in its capacity of fulfilling its obligations and, from this point of view, the important banks of the system, left in this desperate situation, without a way out or irremediably discredited¹, would discredit, in turn, most of the banking system, through the systemic panic that would trigger huge withdrawals of deposits².

Under these circumstances, the ECOFIN Board passed, during the meeting in October 7, 2008, a resolution by which they committed themselves to take the necessary steps to increase the solidity and the stability of the banking system, in order to reestablish the confidence in the financial system and to allow the resuming of the normal activity within the financial system.

During a systemic crisis, the main method of a rapid straightening out of the distressed banks is through State support, public support through the recapitalization of the vulnerable banks, which are important within the system, or the guarantying of their loans, mainly by the State, through the guarantee methods.

The specificity of the financial market and the systemic financial crisis triggers variations, but not substantial modifications of the qualifying criteria for the public intervention, as State support, of the content of this notion, but we are not going to present the details requested for this qualification; we'll present only the situations when the banks benefit from the State support, as a modality of rapid and exceptional rescue, within the very special context of the present financial crisis.

Firstly, we have to state that *the acceptance of the methods of the banks rapid and exceptional rescue through public support, involved the modification of the traditional interpretation of the art. 87, line 3, letter b) and c) in the European Commission Treaty, a very restrictive interpretation of what it may be considered a severe perturbation of the economy of a member state.*

Taking into account the seriousness of the present financial crisis and its potential impact on the global economy of the member states, *the Commission considered that the exception, stipulated in art. 87, line 3, letter b) in the Treaty, based on which the support meant to promote the achievement of a project of European common interest or to remedy severe perturbations of the economy of a member state, may represent the juridical basis of the support granted to the banks to solve the systemic crisis.*

¹ Ion Turcu, *Bankruptcy – The new procedure* – Treatise, Lumina Lex Bucuresti, 2003, page 194.

² As per the National Bank of Romania data, in Romania, during the present economic – financial crisis, the depositors' only panic period was between October – December 2008, when, in a single month (October 2008), deposits that amounted to 4.7 billion lei (the first withdrawn deposits were those amounting to more than 100.000 lei) were withdrawn.

Likewise, based on the Commission Notification 2008/ 270/ 02¹, although considered as State support, the guarantees and the recapitalization granted to the important banks within the system by the State, are authorized by the Commission, if they are meant “to remedy severe perturbations of the economy of a member state”.

In any of the forms the State support should be granted to the banks in accordance with the general principles that form the basis of the regulations concerning the State support stipulated in the Treaty. The respective norms establish that the granted support should not exceed what was strictly necessary for reaching its legitimate purpose and in such a way that the misrepresentations of the competition should be avoided or diminished as much as possible.

As State support for the distressed banks during the present financial crisis, the guarantee schemes protect the debts acknowledged by a declaration, through legislation or through a contractual policy and include both the general guarantees protecting the taxpayers' deposits (retail deposits) and the claims of the retail clients as well as the big clients claims (wholesale deposits) and even the short and average term credit instruments, if these assets are not already protected by the agreements among investors or by other means.

Such an extension of the area of the guarantee schemes can be accepted only if it is justified by a decreasing of the inter-banking loans triggered by the erosion of the confidence among the financial institutions.

The banks recapitalization, a systemic measure, used to eliminate the liquidities crises of the banks that are submitted to the market pressures, due to the financial crisis, provides the necessary liquidities through public capital, in order to directly straighten the bank position on the market or to indirectly straighten it by the stimulation of private capital investments².

In addition to the rapid intervention within the financial system, the banks recapitalization is organized on two main levels: the temporary recapitalization of the essentially strong banks, in order to promote the financial stability and the loans within the real economy and the recapitalization done to save the banks which are not essentially strong.

Except for the special conditions requested by the specificity of each of the two forms of the State support, the guarantees and the recapitalization through the public intervention of the banks, which are not essentially strong, must be granted based on additional analyses and conditions as compared to the ones for the banks that are essentially strong.

¹ Commission notification 2008/ 270/ 02 – Norms enforcement concerning State support for the measures passed in connection with the financial institutions within the world present financial crisis, published in JO EU C 270/ 8 from 25.10.2008.

² Further details of the conditions and the principals of recapitalization in the Commission Notification – recapitalization of the financing institutions within the present financial crisis: the limitations of the support to the necessary minimum and guarantees against the unjustified misrepresentation of competition, published in JO EU C010, 15/ 01/ 2009, page 002 -0010.

It is very important to that *the state capital, used for the banks that are not strong, should be granted only if the beneficiary bank was submitted to the controlled liquidation or to a profound and extended straightening out, after the State intervention; the straightening out should involve changes at the management level and corporate governing.*

Under these conditions, within 6 months from the recapitalization carrying out and mutatis mutandis from the guarantee granting, either a straightening out project or a project for the liquidation of the beneficiaries of the State support should be notified to the Commission; the Commission will examine each of the projects separately.

The straightening-out projects, for a period of time as short as possible, must ensure the reestablishment of the respective financial institutions viability within a reasonable time span and will be assessed in accordance with the principles presented in the disposition concerning the rescue and straightening out of the distressed companies¹ and will have to include compensatory measures².

For all cases, the straightening projects will be analyzed by the Commission taking into account the differences between the essentially strong banks afflicted only by temporary restrictions connected to the excess of liquidities and the banks, that are also affected by both some structural solvency problems and by the impact of this difference on the degree of the necessary straightening.

There is also the possibility that essentially strong banks, beneficiary of the recapitalization, should not be submitted to the straightening out process unless they start to face difficulties after the recapitalization.

From the beginning of the present financial crisis and up to the first half of 2009, the measures for the reinforcement of financial institutions liquidity and capital in the total amount of approx. 2.9 thousand of billions Euro, that have been taken in EU countries, lead to the stabilization of the banks liquidity³.

Up to now, in our country, the main method used for avoiding the pressures of the liquidities crisis, was the method of avoiding the liquidity risk occurrence. The central banks in the source countries of the Romanian banking capital, injected important amounts of money in their financial systems to resume the crediting and the functionality of the currency market⁴.

These injections had a different impact on the financial resources of the branches of the Romanian banks: some of them registered increases of their own

¹ <http://www.avas.gov.ro/upload/Comunicarea%20Comisiei.pdf>.

² The compensatory measure may include: the assets sale, the diminution of the capacity or of the presence on the market and the diminution of barriers to the admission on the respective markets. The measures must be proportional to the misrepresentation effects of the State support.

³ Source: the Report on the financial stability, 2009, of the National Bank of Romania, <http://www.bnro.ro/studii-si-publicatii-BNR-3400.aspx>.

⁴ The due commitments were offered at the request of the IMF and of the European Commission and during the two meetings of the main mother banks with branches in Romania, from March and May 2009, they reasserted their decision to maintain their exposures in Romania and the granting of a minimum solvability of 10%.

capital and external liabilities, while others registered an exactly opposite situation. Under these conditions, the locally drawn funds became more and more important¹.

VI. Conclusions

The bank administrative straightening, within a professional environment, achieved by professionals within the banking management area, ensures the reaching of the proposed goal.

The banks straightening excludes the banks insolvency status, aims at the bank financial straightening, begins and is enforced only by the supervision and control authority, excludes the Court of Law interference, the creditors' interference, the purpose of the bank payment obligations and the bank patrimonial assets liquidation.

The measures of the bank exceptional straightening represented by State support, respectively of the guarantee schemes and of recapitalization, are rescue supports and cannot be qualified as banks straightening methods, as the notion is traditionally and legally accepted.

They represent emergency rescue measures, used to temporally eliminate the liquidities crisis, to keep the insolvable institutions at an acceptable level; further on, in accordance with the causes of the banks viability problems (exogenous causes - the systemic financial crisis, or endogenous causes, inefficiency and excessive risk assuming, etc), they will be straightened more or less profoundly or will be liquidated in a controlled way.

A profound straightening out or a controlled liquidation takes place when the beneficiaries of the State support suffer losses caused by inefficiency, by deficient administration of the assets and claims or by risky strategies enforcement.

These two systemic measures represent temporary emergency measures necessary to cope with the severe symptoms of the financial market within the present financial crisis.

The banks will be straightened through classic methods of straightening, as mentioned above, after the liquidities crisis and the solvability crisis have been overcome.

The specificity of the restructuring plan or of the straightening out project enforced, as the subsequent stage, is given by the fact that this restructuring is analyzed and approved by the European Commission as part of the general conditions enforced for the state interference acceptance within the rescuing of the beneficiary bank.

And last, but not least, by exception, the banks straightening out, as a sub-sequential stage of the public support does not exclude the bank insolvency under the liquidities crisis form and solvability crisis. If so, the purpose of the bank administrative straightening out is re-dimensioned by including, as main objective, the elimination of the insolvency state.

We can say that, as a matter of fact, the banks problems, with the exception of the big frauds or of the systemic crisis, if they are discovered at an early stage by a permanent and careful control, can be eliminated using one of the straightening out measures.

¹ The Report on the Financial Stability, 2009, of the National Bank of Romania, June 2009, <http://www.bnro/Studii-si-publicatii-BNR-3400.aspx>.

On the other hand, the reality proves that, even within the present worldwide financial crisis, qualified as unprecedented by the specialists, the financial difficulties of the relevant banks within the system, can be eliminated by non-conventional rapid straightening out methods enforced due to the rapid response of the European decision authorities and, subsequently, by enforcing the conventional straightening out methods, which have proved to be perfectly compatible with the subsidiarity of their enforcement and its inherent specificity.