

## Client Briefing

3 November 2008

### Austrian Bank Stability Update

#### Background

On 13 October 2008 the Austrian government announced coordinated stability measures for the financial markets following the joint declaration on the concerted European action plan of the euro area countries on 12 October 2008. The new legislation aiming at the protection of banks and insurance companies from the possibly serious effects of the international financial crisis passed parliament on 20/21 October 2008, was published in the Federal Legal Gazette (*Bundesgesetzblatt*) on 26 October 2008 and therefore is effective as from 27 October 2008 (except for amendments on the deposit guarantee which are effective as from 1 October 2008).

The new legislative measures, inter alia, include the implementation of the Inter-Bank Market Enhancement Act (*Interbankmarktstärkungsgesetz – IBSG*), the Financial Market Stabilization Act (*Finanzmarktstabilitätsgesetz – FinStaG*) and certain amendments to the Banking Act (*Bankwesengesetz – BWG*) and the Stock Exchange Act (*Börsegesetz – BörseG*). In addition, a regulation was issued by the Federal Minister of Finance on 30 October 2008 further specifying the terms and conditions for stability measures carried out pursuant to the FinStaG and the IBSG.

Austria will earmark up to EUR 100 billion in support of the banking system. EUR 15 billion are to be used for recapitalization measures, EUR 75 billion shall be made available for state guarantees. EUR 10 billion will be used to support the Austrian deposit protection scheme.

We have briefly summarized the Austrian government's stability measures. This reflects developments as at 3 November 2008.

### **Guarantee fund**

**Up to Euro 75 billion** shall be made available for state guarantees, sureties or similar assumption of liability, down from an originally planned EUR 85 billion.

According to the IBSG a **separate entity** shall be set-up as clearing house to facilitate refinancing of banks on the inter-bank market. The newly established entity shall borrow funds from banks or insurance companies on the inter-bank market and on-lend such funds to banks and insurance companies on arm's length terms (sufficient security, interest taking into account an adequate fee for state guarantees).

According to the IBSG the Federal Minister of Finance shall be entitled to (i) guarantee liabilities of such entity and (ii) assume liability for losses incurred by this entity in connection with such arrangements for a limited period of time. The proposed IBSG does not specify any maximum period of time for such state guarantees given under (i).

The entity shall also be entitled to issue notes. Any issue by such entity may be guaranteed by the Austrian state.

The services of this new entity are open to credit institutions **holding a license pursuant to the BWG** (including branches of foreign banks) and Austrian insurance companies only. Credit institutions and insurance companies rendering services in Austria by using the EEA single passport regime will not benefit from the IBSG. Moreover, the IBSG does not confer a right on banks or insurance companies to claim any such stabilization measures from the state.

According to the draft IBSG, any claims of such entity against the state may not be assigned or pledged to third parties and shall not be subject to an attachment (*Pfändung*).

The Federal Minister of Finance may also assume liability (in the form of a guarantee, surety or joint and several liability) for **notes issued by banks** (according to § 1 para 1 no 10 BWG) with a maturity of up to five years in order to facilitate the raising of fresh capital. § 2 para 5 FinStaG (providing for possible conditions

attached to stability measures – see below for details) shall also apply to such measures.

The scheme is scheduled to expire by 31 December 2009. However, state guarantees issued under the IBSG before this date will not be affected.

### **Deposit guarantee**

Under the Austrian banking system banks must belong to the depositors' protection scheme of their trade association (*Fachverband*). Each protection scheme is financed by contributions from its respective member banks. If any protection scheme should be unable to pay out the guaranteed deposits or claims in full, the protection schemes of the other trade associations are obliged to make proportionate contributions to cover the shortfall. In cases where the protection schemes as a whole are unable to pay out guaranteed deposits (claims) in full, the protection scheme originally concerned must issue notes or, according to the proposed stability measures, take out a loan to meet the remaining payment obligations. The Federal Minister of Finance may assume liability for such issue or loan according to a special legal authorization.

The stability measures provide for an amendment of the current Austrian depositor's protection scheme, in particular an increase of the protected amount from EUR 20,000 per depositary and bank to 100% of bank deposits of **natural persons** as from 1 October 2008. For claims of small companies (basically partnerships and small corporations) the protection scheme's cover obligation will be increased to 90% of the guaranteed deposit in the maximum amount of EUR 50,000 per depositary and bank. The claims of all other creditors will remain to be limited to 90% of the guaranteed deposit in the maximum amount of EUR 20,000 per depositary and bank (subject to further exemptions, e.g. for "big" companies the claims of which are not guaranteed at all).

Due to the Commission proposal to increase the protected amount to EUR 100,000 as from 1 January 2010 bank deposits of natural persons shall be guaranteed up to a maximum amount of EUR 100,000. The other maximum amounts shall remain unchanged.

## Recapitalization

**Up to EUR 15 billion** (or an additional amount not utilized under the guarantee fund) are earmarked for the recapitalization of credit institutions holding a license pursuant to the BWG (including branches of foreign banks) and Austrian insurance companies.

According to the FinStaG the Federal Minister of Finance shall be authorized to (i) guarantee the liabilities of the bank or insurance company, (ii) assume liability vis-à-vis the bank or insurance company, (iii) grant loans to the bank or insurance company or provide such entity with own funds (*Eigenmittel*), (iv) acquire shares (whether in a capital increase or from existing shareholders) or convertible bonds and (v) take over the assets of the company by way of merger pursuant to § 235 Stock Corporation Act (*Aktiengesetz – AktG*).

According to the draft FinStaG, any claims against the state may not be assigned or pledged to third parties and shall not be subject to an attachment (*Pfändung*).

If there is a risk that the bank or insurance company cannot fulfill its obligations vis-à-vis its creditors and the abovementioned measures are not sufficient or are not available in due time, the Federal Minister of Finance shall, in consultation with the Federal Chancellor, be authorized to expropriate the owners of the bank against payment of an adequate compensation where required to protect the national economy from severe disruption. The ordinance to be issued by the Federal Minister of Finance effecting the expropriation shall specify the terms and conditions for the assertion of compensation claims by the respective owners. At the request of the owners, the Federal Minister of Finance shall determine such compensation. Such decision shall be suspended in case the owner makes an application to the competent court for re-assessment of the compensation.

To enhance flexibility, a **separate entity** may be set-up and may carry out such capital measures. Such newly established entity can be formed as a direct subsidiary of the Österreichische Industrieholding AG, the Austrian investment and privatization agency owned by the state.

Once the aims of the recapitalization measures have been achieved the state shall dispose of its equity stakes to private investors.

Further conditions may be imposed. The stability measures also extend the rights of the FMA, which shall be entitled to lay down rules pursuant to which banks have to take on additional own funds which are suitable for the current risk situation and which go beyond the statutory minimum requirements.

In addition, the Federal Minister of Finance issued a regulation on 30 October 2008 which further specifies the terms and conditions for the assumption of liability for notes issued by banks pursuant to the IBSG and stability measures pursuant to the FinStaG.. When making use of these stability measures, the Federal Minister of Finance shall enter into agreements with credit institutions / insurance companies benefiting from such measures. These agreements shall contain provisions on:

- the sustainability (*Nachhaltigkeit*) of the business model of the benefiting company;
- the allocation of funds provided to the benefiting company, with a particular view on the funding of small and medium sized companies and the provision of mortgage loans to private households;
- the remuneration of directors, employees and third parties retained for carrying out their tasks;
- minimum capital requirements of the benefiting company;
- the distribution of dividends;
- the preservation of jobs at the company benefiting from the stability measures;
- the avoidance of distortion of competition;
- the calculation and amount of interest/(guarantee) fee payable by the company receiving such funds;
- the scope of information to be provided by the benefiting company; and
- the content of the declaration to be published by the directors and the supervisory board of the benefiting company (such declaration also needs to contain an undertaking to comply with such conditions).

Compliance with the above terms and conditions shall be ensured by contractual provisions (such as liquidated damages clauses etc).

Contrary to the Financial Market Stabilization Funds Regulation (*Finanzmarktstabilisierungsfonds-Verordnung*) implementing the stability measures in the Federal Republic of Germany the Austrian regulation does, in particular, not (i) restrict the payment of dividends to shareholders for the duration of the stability measures (as long as such dividend payments are reasonable taking into account the financial situation of the benefiting entity) and (ii) limit the remuneration of management board members to a specified maximum amount. Such remuneration payments must rather satisfy the requirements of reasonableness and transparency.

The FinStaG does not confer a right on banks or insurance companies to claim any such stabilization measures from the state.

#### **Prohibition on short selling**

Under certain circumstances the FMA may for a period of not more than three months prohibit or restrict short selling of financial instruments specified by the FMA (including derivative products) at the Vienna Stock Exchange. For details see our Client Briefing dated 21 October 2008.

#### **Minimum capital requirements**

Under the amended Banking Act the FMA has to require a higher minimum capital, if an adequate limitation of the risks arising from banking transactions and banking operations of credit institution or group of credit institutions does not exist and proper recording and limitation of those risks cannot be expected in the short term. Such higher minimum capital shall be imposed by the FMA immediately, in cases where it is expected that other measures will not be sufficient to ensure the proper recording and limitation of risks as well as compliance with legal regulations within due time.

## Useful links

**Austrian Federal Government**

<http://www.austria.gv.at>

**The Austrian National Bank**

<http://www.oenb.at>

**Austrian Parliament**

<http://www.parlinkom.gv.at>

**The Austrian Financial Market Authority**

<http://www.fma.gv.at>

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