María Lidón Lara Ortiz

Associate Professor of Administrative Law, Universitat Jaume I (Spain)

The private property guarantee in the banking resolution administrative procedures[1]

ABSTRACT

Subject of research: Human needs and the quality of law

Objective: The need of the determination of the content of the right of the private property as a human right has a new scope. Since the development of a new public power, as the banking resolution one, englobes the possibility of intervening credit institutions, requires the delimitation of its exercise, from the perspective that contributes to the safeguarding of this human right of private property.

Research methods: The methodology used in the preparation of this paper has been both deductive and inductive. The deductive logic method has generally been applied in the analysis of the authorities powers' new regulation (from the general to the particular rule), and the inductive empirical one has also been applied, through the study of the case, that is, through the legal analysis of jurisprudence (from the particular to the general rule).

Keywords: private property, banking resolution, administrative procedures, bank resolution authority.

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1. Introduction: private property as a human right and public utility as a limit

The article 17 of the UN Universal Declaration of Human Rights of 1948 recognizes the right of everyone to individual or collective ownership, declaring that no one "shall be arbitrarily deprived of his property". This right is further clarified in other rules, as in the I Additional Protocol to the European Convention for the Protection of Human Rights and Fundamental Freedoms of March 20, 1952, which article 1 provides that any person or company has right to respect for their property. No one may be deprived of his property other than for the sake of public utility and under the conditions provided by the Law and the general principles of international law, but it must be understood without prejudice of the right of States to enforce such Acts as they deem necessary for the regulation of the use of the property in accordance with the general interest, or to guarantee the payment of taxes or other contributions or fines. In a similar sense, the national rules of the different Member States of the European Union include in their Constitutions the limitation of the right of private property in favour of public utility or social interest, but always recognizing the right to compensation, thus respecting its essential content. Therefore, the right of private property is not absolute but must yield to the needs of public utility or general interest.

However, limitations to this right that can be ruled by States laws must be balanced according to the principle of proportionality between private property and the reasons of general interest that confines it, as it had been emphasized by the European Court of Human Rights in the Judgment of 1 March 2001 (case Malama v. Greece).

2. Financial stability as a collective good of general interest

The serious consequences of the global economic crisis that began in 2007-2008, which originated in the instability of the financial system, has introduced the concept of financial stability as a collective good in the general interest. Financial stability is now considered as a global public good (PALÁ LAGUNA, 2013, pp. 39-40; and GARCIA ARIAS, 2004,

pp. 45 a 60), and its neglect can generate damages on a general scale as a result of irresponsible private actions. This is what legitimizes the public intervention for its control.

Financial stability has traditionally been identified with the good functioning of the economy by performing its functions, such as channelling funds from savers to investors, providing financial services to the general economy, executing payments, and distributing the risk among economic agents in an orderly and efficient manner. Currently, the extension of its concept tends to guarantee a correct functioning of the credit institutions, the financial markets and the operating infrastructures that support them, so that the system as a whole can cope with unexpected shocks without jeopardizing its functions (VERGARA, 2006, p. 14). In general, financial stability is protected by the prudential supervision of entities, however, the rules introduced from 2009 onwards at International, European and national level (in Spain) tend to expand the concept of prudential supervision so that controls go beyond mere supervision of solvency controls. In the European Union, the Banking Union has been created for this purpose, following the international standards of the Basel Committee, which are strictly assumed[2]. From European law, those standards pass to the laws of the Member States as a set of rules with binding legal effects. These standards constitute hard law and not soft law. The unification of European legislation is sought through Regulation (EU) N. 575/2013 of the European Parliament and of the Council of 26 June 2013 on the prudential requirements of credit institutions and investment firms and the Directive 2013/36/EU, which constitute the legal framework to rule access to the activity, supervision framework and prudential provisions of credit institutions and investment firms. In both cases, prudential supervision is defined

[2] Vid Recital 79 et seq. Directive 2013/36/ EU of the European Parliament and of the Council of 26 June 2013. In addition, in the European Union, the High Level Group on Financial Supervision in the EU chaired by Jacques de Larosière proposed to the Union to develop a more harmonized financial regulation and the European Council of June, the 18th and the 19th, 2009 also stressed the need to create a single European regulatory code applicable to all credit institutions and investment firms in the internal market. This project arises parallel to the gestation of the international standards of Basel III.

as a minimum regulation that does not prevent the adoption of more restrictive regulatory measures if its national characteristics advise it to protect its financial stability[3].

One of the basic elements of the structural reform of the banking regulation in Europe is the European Mechanism of Resolution, through which a network of national authorities of the participating Member States is created to intervene in the cases in which the standards of solvency by the national credit entities are not fulfilled. This mechanism is able to apply measures of early action or even bank resolution. The latter measures involve the public intervention of entities and may involve measures similar to a compulsory expropriation of the assets of the intervened entities and their partners or participants, and even their creditors.

3. The impact on private property as result of the resolution measures

Looking at the Spanish legislation, the intervention of credit institutions is a manifestation of the administrative intervention power on private companies whose foundation is found in Article 128.2 CE. The interpretation of an administrative intervention of this kind, despite being very invasive of the citizens' rights especially affecting the business freedom, is that we are in front of an administrative procedure by which its management is affected without the ownership of its patrimonial elements (Martín-Retortillo, 1989, p.30).

At present this sense can be maintained if we refer to the procedures regulated in articles 70 and ss. of the Act on management, supervision and solvency of credit institutions, of the Jun 26, 2014, that contain measures of intervention and substitution of credit institutions, in situations that could be considered normal or not exceptional. However, Act number 11/2015 on the Recovery and Resolution of Credit Institutions and Investment Services Companies that develops and incorporates into Spanish Law Regulation (EU) No. 806/2014 of July 15, 2014, includes exceptional cases that allow the management of the non-viability of credit institutions by

[3] In this regard, Recommendation N. 10, Report of the Larosière group (The High-level Group on financial supervision in the EU Report) of February, the 25th, 2009.

the public authority and in defence of the general interests. These general interests are concretized in the possibility that the non-viability of the entity in crisis may affect financial stability.

Thus, the Preamble the referred law makes a distinction between the administrative activity that has always been identified with the intervention of credit institutions and the new banking resolution activity, which is still an administrative intervention, but goes further, setting: «The classic mandate of the supervisory authorities is to ensure compliance with regulations governing the activity of entities and, in particular, solvency regulations, with the ultimate aim of protecting financial stability. On this mandate, a new call is now being added to ensure that if an entity becomes unable to remain active on its own, despite traditional regulation and supervision, its closure will occur with minimal distortions over the financial system as a whole, and, in particular, without any impact on public finances. It is time to articulate a new public-financial function aimed at ensuring that entities are, in fact, liquid able without carrying an economic impact of such a magnitude that it can harm the economy as a whole. It is not, therefore, a simple new supervisor approach, but a new area of public intervention that, autonomously, will require the entities to exercise their activity in such a way that its resolution is feasible and respectful of the interest in cases where traditional supervision is insufficient»[4].

The current meaning of what we understand as a bank intervention depends on whether we are in a situation that we could call normal or exceptional. The first one complies with the rules of the Act on management, supervision and solvency of credit institutions, and allows the Bank of Spain to intervene or substitute the administrators of the entity. We must classify as exceptional the banking interventions regulated in Law 11/2015, which may also affect the ownership of the private corporate participations, since the resolution instruments are: a) The sale of the entity's business, b) The transfer of assets or liabilities to a bridge-entity,

[4] The Preamble of the Act number 11/2015 specifies that this new function is intended to „ensure that if an entity becomes unable to remain active on its own initiative, despite traditional regulation and supervision, its closure will occur with minimal distortions on the whole of the financial system and, in particular, without any impact on public finances".

c) The transfer of assets or liabilities to an asset management company, and d) Internal recapitalization. So that, the three former cases produce effects similar to forced expropriation, because they affect the ownership of the assets to which they are referring to[5].

For this reason, bank intervention as a manifestation of the new power of resolution of credit institutions that is carried out by the bank resolution authority of Spain (FROB, of the acronym in Spanish), must be analysed, from the outlook of its effects, because can be fully identified with the traditional concept of administrative intervention of companies, and its current regulation does not take it into account, with the result of the detriment of some of the classic guarantees of administrative law. Appraising the result of all the bank resolution system we must reconsider its legal regime.

4. Requirements to settle bank resolution measures: weak guarantees of the owner of the assets affected.

The bank resolution is defined by the 11/2015 Act as an administrative (non-judicial) process, which manages the non-viability of credit institutions and investment services companies that cannot be undertaken through liquidation of bankruptcy for reasons of public interest and financial stability[6]. It is conceived as an insolvency proceeding (Fernández Torres, 2015, p. 9), which is applied as an alternative to the ordinary one, and that is special for credit institutions and in view of their particular characteristics and systemic importance (Mingot, 2014, p. 260). The resolution procedure may involve its restructure so that the entity continues the activity, or may involve its liquidation, but with some differences from ordinary bankruptcy proceedings (Pérez Troya, 2010, pp. 241–259).

[5] In the case of Bank of Valencia resolution, the interests of the holders of the affected assets were analyzed in the Judgment of the Audiencia Nacional, Chamber of Contentious Administrative, Section Six, No. 2292/2016, of June 16, which referred to Sentence of the Tribunal Constitucional n. 166/1986, according to it: expropriatory laws are subject to limits because the guarantees established in art. 33.3 of the Spanish Constitution.

[6] In this sense, the Preamble of the n. 11/2015 Act.

The administrative resolution settlement will proceed when in an entity concur the circumstances provided in article 19 of n. 11/2015 Act. These circumstances are the enabling requirements of administrative intervention in this case, and as we shall see, not every circumstance is defined as it might be in order to guarantee the necessary legal security of the intervened entity. They are the following requirements:

a) The unfeasibility of the entity: it is necessary that the entity was unfeasible, or that was reasonably foreseeable that it would be unfeasible in the near future.

The main problem in relation to this circumstance is the legal sense of the term ‘’viability” since it is identified both with cases of true insolvency according to ordinary bankruptcy regulations, and cases of non-compliance with the solvency standards according to the regulations of prudential supervision (Fernández Torres, 2015, p. 17). In the task of determining the non-viability requirements we also encounter difficulties because some of them are indeterminate legal concepts. Thus, according to article 20 of the same law, an entity is unviable if it is in any of the following circumstances: a) The entity breaches in a significant or reasonably foreseeable way that it breaches in a significant way in the near future the solvency requirements or other requirements necessary to maintain its authorization. b) The entity's liabilities are higher than its assets or it is reasonably foreseeable that they will be in the near future. c) The entity cannot, or is reasonably foreseeable that in the near future it will not be able, to fulfil punctually its obligations. d) The entity needs extraordinary public financial assistance (in the latter case, the entity shall not be considered unworkable if extraordinary public financial assistance is provided to avoid or remedy serious disturbances of the economy and preserve financial stability).

In the assessment of the reasonable predictability of insolvency, its elements are very difficult to identify and this is incompatible with what would be desirable in terms of legal certainty. As an example, we can refer to the Resolution of the Governing Commission of the FROB of January 14, 2014 that agreed the intervention of the Caja Rural de Mota del Cuervo, Cooperative Society of Credit of Castilla La Mancha, and applied as an instrument of resolution the sale of the assets of social capital. In this case, although there was no declared insolvency situation of the entity, the non-viability of the entity was related to the systematic non-

compliance of the solvency requirements, and without the possibility of overcoming this situation by its own means. The impossibility of resolving the situation by the entity's own means was estimated by the Bank of Spain in view of the entity's own agreements, which led to the supervisor's understanding that there was a reasonable predictability of insolvency in the near future. In this case, we appreciate that the magnitude of the margin of discretionality granted to the resolution authority to assess the bank resolution requirement was immense.

The property right that may be affected as a result of administrative activity requires the rational application of the power of resolution (Rodriguez Pellitero, 2013, p. 854–855.), since the danger to the stability of the system and the public interest concerned which legitimizes administrative activity is justified but does not preclude the application of the principle of proportionality (Carrillo Donaire, 2013, p. 824.)[7].

b) The second enabling requirement to settle the initiation of the resolution procedure is that there is no reasonable prospect of what measures from the private sector may prevent the entity from being unfeasible within a reasonable period of time. It is the inadequacy of bail-in measures to recover the situation of stability of the entity.

Public interventions made through the resolution procedures must observe the principle of minimizing the burden borne by taxpayers, so that it results from various rules, which in the first instance require measures that apply the resources of the (bail-in mechanisms), which should imply for the competent authorities the observance of a strict legal regime aimed at achieving the application of capitalization instruments that best fit this principle (Tejedor Bielsa, 2014, p. 268.), avoiding if possible, a public bailout.

Thus, the problem will be for the supervisor to appreciate the inadequacy of the bail-in measures in order to recover the stability of the entity, as well as the concurrent circumstances that advise the immediate application of the

[7] In this sense, we can look at the STEDH Sporrong and Lonnroth c. Sweden of 23 September 1982, that refers to the need for proportionality or "fair balance" between deprivation of property for reasons of public utility and the safeguarding of the right to property. In this way, we must not only consider that proportionality exists in the proper valuation of the assets that are expropriated or intervened in some way, but that the same proportionality of the means used with the general interest that is intended to protect with public activity, because it is what gives to the whole process legitimacy.

resolution phase, which implies the a greater administrative intervention. The possibility of intervening by adopting resolution measures, bypassing those of early action, should be justified by the fact that the latter would not serve to redress the financial situation of the entity, since the principle of gradation or proportionality requires other measures. Proportionality must be understood in terms of the intensity of the intervention, and it reaches the proportionality of the planning of the measures (Colino Mediavilla and Freire Costas, 2015, p. 183–184)

In this case, the supervisor's decision is protected by a considerable margin of discretionality as it was in the assessment of the bank in viability.

c) The third requisite is that public interest reasons should be involved, so that it was necessary or appropriate to undertake the resolution of the entity to ensure the continuity of the entity, or avoid adverse effects to the stability of the financial system.

The resolution of an entity, as a case of administrative intervention, displacing a possible ordinary insolvency liquidation procedure, is justified in the trust of the relationship of credit intermediation and in the detrimental consequences that the application of general insolvency rules would entail for stability of the whole financial system (Alonso Ledesma, 2014, p. 349–350).

Resolution procedures should be based on a public interest that has been recognized as a global general interest recently, and it is financial stability (Conlledo Lantero, 2014–2015, p. 159–174). The Spanish Administrative Court of the Audiencia Nacional, has identified the public interest of these administrative actions with financial stability, in its Judgment 2559/2016 of June 23 (Fourth Law Foundation), and it has been specified that this public interest entails the purposes or objectives of the resolution authority according to article 3 of the 11/2015 Act, which in essence are confined to the limitation in the use of public resources and the protection of depositors, making both compatible with the continuity of the entity or its ordered liquidation.

In its application, the resolution of the FROB of January 14, 2014, which agreed the resolution of the Caja Rural de Mota del Cuervo referred to financial stability as a general interest subject to protection in that settlement, and implied that it was anticipating the estimation of a systemic hazard based on the difficult predictability of the transmission

of instabilities but that these were not based on the importance of the intervened entity that was of small size. At the same time, it was considered that this general interest agreed the resolution of the entity by the exceptional way provided by law and at that time, it was not considered convenient to wait for the entity's real insolvency to liquidate it through the channels of ordinary bankruptcies estimating that this last scenario would be more unfavourable for the interests affected by the loss of value of the assets. However, the affectation of financial stability, as remote as it was raised in the resolution, does not seem very convincing to motivate the concurrence of the public interest in this case.

The public interest understood in this way allows to affect to some extent the guarantees of the concurrent individual interests, being essential that a specific system of challenges be introduced in the current regulation in order to be able, if appropriate, to fight the compensations received in pay of the deprivation of rights resulting from public intervention (Conlledo Lantero, 2014-2015, p. 163), or to challenge the procedure on formal issues. Both mechanisms in the current regulation are not foreseen.

5. Conclusions

Administrative measures adopted in favour of the public interest are justified in accordance with EU Directive 2014/59 where they are strictly necessary in the defence of that public interest and any interference with the rights of shareholders and creditors must be compatible with the Charter of Fundamental Rights of the European Union, and such interference must be proportionate to the risks to be faced. Spanish regulation follows this criterion, but, as we have seen, to a great extent the problem is the lack of definition of the requirements to be assessed by the resolution authority, which makes a rational judgment inevitable to respect the principle of proportionality in each specific case. No general rules can be established, being indeterminate in the Law when the public interest allows carrying out a resolution procedure. This lack of definition weakens the guarantees that the classic Administrative Law recognizes to the citizens to protect their property right in front of the procedures of public intervention.

Consequently, in view of the lack of definition and the flexibility of the law it is necessary that in order to adequately guarantee the right of ownership as a human right, a specific system of administrative challenges should be introduced into the administrative procedure for bank resolution, through which the citizens affected by the resolution authority settlement would apply for the fair redress of the affected property.

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