

Restructuring of financially distressed banks under the New Central Bank and Monetary Sector Law No. 194 of 2020

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Introduction

The new Egyptian Central Bank and Monetary Sector Law No. 194 of 2020 ('Banking Law') as issued and published in the official gazette on 15 September, 2020 which became effective on 16 September, 2020, has set significant supervisory parameters and expanded the role of the Central Bank of Egypt (the 'CBE') in the context of operations of financially distressed and insolvent banks.

In this article, we will shed light on the procedures required to be undertaken by banks and by the CBE in order to restructure financially distressed and insolvent banks and to safeguard the interests of the depositors of banks in question on the microeconomic level as well as protect and maintain the stability of the banking sector on the macroeconomic level.

It should be noted that the Banking Law explicitly excludes the application of the Bankruptcy Law No. 11 of 2018 on financially distressed and insolvent banks and applies the provisions of Chapter 12 of the Banking Law to such banks.

Identifying financially distressed and insolvent banks

It is pertinent at this stage to explore what is perceived by the CBE to be a financially distressed bank. Pursuant to the Banking Law, a bank is considered as financially distressed where:

1. the bank's financial position is greatly weakened, or depositors' interests are at risk;
2. the bank is unable to fulfill its obligations towards depositors or other creditors;
3. the bank's liabilities exceed the value of its assets;
4. a decrease in the value of shareholders' equity in the bank below the formed provisions;
5. the bank loses its ability to access sources of funds or enter financial markets;
6. the bank violates the capital adequacy standards, liquidity and leverage ratios, or other regulatory ratios, beyond the limit determined by the board of directors of the CBE;
7. the value of the bank's assets or profits decreased significantly and continuously, threatening its ability to continue its operations;
8. the bank's reliance on exceptional and costly sources of financing to continue its normal activities;
9. any of the cases giving grounds for the revocation of the banking licence of the bank as stipulated under the Banking Law is in place;
10. the bank does not abide by the "early intervention" procedures stipulated under the Banking Law within the period specified for their implementation; or
11. in the case of a branch of a foreign bank in Egypt, its inability to fulfil its obligations and the failure by the foreign bank in question to fulfil the latter under the unconditional guarantee provided to the CBE in accordance with the provisions of the Banking Law, the failure by the competent authority in the country where the headquarters of the foreign bank is located to issue a decision to rectify the

branch's situation within the period specified by the CBE or the corrective measures provided by such decision were insufficient to maintain banking stability in Egypt or the rights of depositors and creditors of the branch.

It is inferred from the above that the CBE has strong discretionary powers in determining whether or not a bank is financially distressed which shall lead to the CBE's intervention in order to protect the interests of the customers and depositors.

Early intervention and restructuring procedures

The Banking Law also introduced the concept of early intervention, which mainly gives the CBE authority to oblige banks to undertake certain measures in order to rectify existing problems that may result in the insolvency of the bank or damage the interests of the bank's clients. The cases which could result in such intervention by the CBE include: (i) banking malpractices conducted by the bank in question; (ii) low quality of the bank's assets, which would affect the financial soundness of the bank or the interests of depositors; (iii) low level of the profits achieved, which could threaten the continuity of the bank in the medium or long term; and (iv) deficiencies in governance systems, risk management, internal control, or accounting policies.

In such cases, the CBE may intervene in order to oblige the bank in question to undertake any of the following:

- strengthen governance, risk management, internal control and accounting policies;
- form additional allocations and reserves, or increase its issued and paid-up capital or the capital allocated to foreign bank branches;
- prohibit the distribution of dividends to the bank's shareholders and other shareholders;
- change the business model of the bank;
- merge with another bank;
- dissolve the bank's board of directors; and/or
- submit a restructuring plan.

In all cases, the CBE's right to undertake "early intervention" procedures under the Banking Law is not a prerequisite for undertaking any restructuring procedures of distressed banks.

Upon issuance of the CBE's decision to consider a bank financially distressed, the CBE may undertake a series of measures without obtaining the approval of the shareholders, debtors or creditors of the concerned bank which include the following:

- dissolve the board of directors of the distressed bank and appoint a delegate to manage it;
- cease all or part of the bank's operations;
- merge the distressed bank with another bank; and/or
- decrease the nominal value of the shares or decrease the number of issued shares and in such case, the CBE may increase the bank's capital by offering new shares to the current shareholders who are able to bear their obligations to the bank and if it has been proven that they have not previously violated any corrective action, or by offering new shares to new investors without offering them to the current shareholders after guaranteeing to fulfil a number of obligations provided by the CBE towards the bank in question.

Further, the CBE may set up a plan to schedule all or some of the bank's obligations, reduce or capitalise them in a way that enhances its ability to continue its operations, according to the following procedures:

- reducing equity by the value of losses;

- in the event that the equity rights do not absorb the losses, the bank's liabilities that are not excluded from the application of the provisions of the Banking Law shall be reduced with the remaining value of the losses.
- the remaining liabilities of the bank not excluded from the application of the provisions of the Banking Law shall be capitalised to reach the extent that the CBE deems appropriate.

The following liabilities should be excluded from such scheduling plan:

- deposits of clients, but not those of the bank's related parties;
- dues of Tax Authority, Social Insurance Authority and the CBE;
- any obligation arising from retaining the clients' assets;
- debts secured by guarantees, movable or real estate assets;
- wages of bank's employees; and
- obligations due to be paid, setoff and instantaneous settlement within seven days.

The CBE, at its sole discretion, may exclude any other obligations from the scheduling plan to protect the stability of the banking sector.

Pursuant to the Banking Law, the Egyptian Ministry of Finance may, upon request of the CBE, establish a bridge bank to manage the assets and liabilities transferred to it from the distressed bank. The CBE shall determine the activities that the bridge bank may undertake and may, subject to the approval of the CBE, be exempted from any of the regulatory requirements for a period not exceeding one year.

The CBE, in order to restructure distressed banks, may decide to merge the distressed bank with another bank, or transfer the ownership of all or part of its shares to another investor or to a bridge bank, subject to the approval of the other bank or the bridge bank, all in accordance with the rules and procedures determined by the CBE.

In such a case, the bridge bank shall exercise its activity for a temporary period until all or some of its assets and liabilities are transferred to another bank, or the ownership of its shares is transferred to a new buyer or investor, or merged with another bank, in accordance with the exit plan prepared by the bridge bank and approved by the CBE.

The CBE shall revoke the bank's licence and proceed with its liquidation upon the implementation of the exit plan.

Conclusion

It appears that the CBE, under the new Banking Law, expanded its authority regarding the restructuring of financially distressed and insolvent banks compared to its authorities with regards to the subject matter under the old banking law. Further, the new Banking Law introduced a new concept of "bridge bank" enabling a new form of restructuring of distressed banks with the ultimate objective of safeguarding the depositors' rights and maintaining the stability of the banking sector in Egypt.

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