RESTRUCTURING OF FINANCIAL INSTITUTIONS IN ARGENTINA

This newsletter has the purpose of briefly describing the procedures normally applied in the restructuring of banks in Argentina.

The legal framework in this subject is the Financial Entities Law No. 21,526 as amended (the “FEL”), complemented by the Commercial Companies Law No. 19,550 as amended (the “CCL”) and the Bankruptcy Law No. 24,522 as amended (the “BL”).

1. Procedures foreseen in the FEL

The FEL sets forth a specific procedure aimed to achieve a successful restructuring of a bank by excluding assets and liabilities of the entity of an equivalent value. This procedure is known as the "Section 35 bis Procedure".

Additionally, the FEL sets forth provisions regarding the dissolution and liquidation of the financial entity, applicable either when the Section 35 bis Procedure is used or not.

1.1. Section 35 bis Procedure

1.1.1. The “tequila effect” and the financial crisis that derived from it were the cause of important amendments introduced in the FEL in 1995 and 1996. Section 35 bis of the FEL was passed in order to set up a mechanism that would guaranty the rights of the depositors in the cases where the solvency and liquidity of a bank are affected.

Section 35 bis has two objectives: a) to rescue an entity in crisis; and b) to provide a more effective defense of the depositors’ rights by excluding and transferring said claims to a third entity, either a new entity constituted for such purpose or an existing financial entity. Additionally, this procedure entitles the preservation of most of the bank’s employees as these are also transferred to the third entity as a way of avoiding layoffs.

When Section 35 bis is applied, the depositors normally end up in a better position as their debtor changes from the original insolvent bank to a more solvent and liquid bank in compliance with the Banco Central de la República Argentina (“BCRA”)’s requirements.

1.1.2. Section 35 bis of the FEL provides that when, according to BCRA’s discretion, a financial entity is undergoing any of the situations described in Section 44 (among which the lack of solvency and liquidity is the most relevant), BCRA may authorize the reorganization of such entity pursuant to this procedure, as a step before deciding the revocation of the authorization to operate, which was the normal procedure before the enactment of the Section 35 bis Procedure.

The FEL does not foresee the possibility that the financial entity itself requests the BCRA to start a formal procedure under the terms of Section 35 bis. However, it is our opinion that should a financial entity be willing to start such proceedings, it should give sufficient evidence to the BCRA regarding the compliance of the requirements foreseen by the FEL for such procedure and the BCRA will act accordingly.

1.1.3. Once the Section 35 bis Procedure is initiated, BCRA may decide:

(i) that the bank registers its losses against the totality or part of the assets, the reduction of the entity’s legal capital and/or the application of the reserves against them;

(ii) that the bank increases its legal capital and reserves, which must be subscribed and paid-in within the timeframe established by the BCRA;

(iii) the revocation of BCRA’s approval to all or some of the shareholders of the financial entity which will obliged to transfer the corresponding shares to third parties; and

(iv) the sale of the entity’s shares or subscription rights of the capital increase.

Additionally the BCRA may decide:

(i) the exclusion of the deposits from the bank’s liabilities and, if applicable, of the BCRA claims against the bank;

(ii) the exclusion of certain assets for an amount equivalent to the liabilities represented by the deposits excluded;

(iii) the transfer of the excluded assets and liabilities to third parties; and

(iv) the granting of waivers to the requirements established by the FEL concerning the complying with technical ratios and limits or the payment of fines. Moreover, BCRA may approve proposals oriented to
reestablish the liquidity of the entity by the rescheduling of the maturity of its liabilities.

1.1.4. BCRA may request the courts to appoint a judicial controller, whenever this measure is necessary for the purpose of enforcing the reorganization process foreseen by Section 35 bis, and the requirements foreseen in Section 44 of the FEL are accomplished. The appointment of said controller may cause the removal of the board of directors of the financial entity if BCRA or the courts so decide.

Additionally, no foreclosure actions can be initiated or continued against the excluded assets whose transference has been authorized, unless said actions are initiated by creditors holding mortgages or pledges or claims deriving from labor relationships. Further, no provisional measures (injunctions) may be ordered over the excluded assets by any court.

The exclusion of assets and liabilities authorized by BCRA is neither subject to judicial authorization nor may be declared voided, or with no effects, vis-à-vis the bank's creditors even if the entity was insolvent when the exclusion was decided. This provision creates a safe harbor to the restructuring process by excluding the application of the preference rules (“ineficacia concursal”) of the BL, even if the entity ends up in bankruptcy.

Finally, the creditors of the bank whose assets were excluded do not have any action or right against the purchaser of said assets, unless these creditors were entitled to special priorities as security interests (mortgages or pledges claims).

1.2. Liquidation

1.2.1. The FEL sets forth three proceedings regarding the liquidation of financial entities: the voluntary self-liquidation, the judicial liquidation and the bankruptcy liquidation.

Before the financial entity enters into a self or judicial liquidation proceeding the BCRA must have issued a resolution revoking the bank's authorization to act as financial entity.

1.2.2. Normally, once the BCRA realizes that the bank's solvency and liquidity do not meet its requirements, it will suspend the entity. This suspension period may not exceed 120 days. During said period no provisional injunctions or foreclosure actions may be ordered against the suspended entity.

1.2.3. The resolution that revokes the bank’s authorization to act as a financial entity may be decided by the BCRA on one of the following grounds:

(i) at the request of the legal or statutory authorities of the bank;

(ii) when the bank has entered into a dissolution procedure according to the applicable law;

(iii) when the solvency and liquidity of the financial entity is affected and this situation cannot be solved by a reorganization plan proposed by the entity; or

(iv) in other situations foreseen in the FEL (i.e. when the revocation to act as a financial entity is imposed as a sanction by BCRA).

Once the authorization to act as a bank has been revoked any commitment increasing the liabilities of the bank shall be voided, and the accruing of interests as well as the bank’s obligation to pay claims when due shall be suspended until the court decides the type of liquidation of the entity.

Following the revocation of the authorization to operate, the BCRA may order the payment of claims of labor creditors and depositors, which are entitled to a special and general priority by the FEL. In the event the funds available are not sufficient to make the payments according to the priority order prescribed by the law, said funds will be distributed pro rata among those creditors sharing the same priority. When the Section 35 bis Procedure is successfully applicable, the deposits shall be transferred to another entity that shall be responsible vis-à-vis the depositors, thus not being an issue any longer for the former bank.

Once the authorization to operate has been revoked, BCRA must immediately notify its decision to the financial entity and to the commercial courts in order to allow the court to initiate the liquidation process, and determine the type of liquidation, i.e., self-liquidation, judicial liquidation or bankruptcy liquidation proceeding.

1.2.4. Voluntary liquidation: If the authorities of the entity so request it, and if the court considers that there are sufficient assets, the court may, with the previous approval of the BCRA, authorize the bank’s authorities (board of directors) to manage the process of liquidation of the entity. The court would likely reject such petition if BCRA has not previously provided its approval.

This voluntary self-liquidation must be carried out according to the rules as provided by the CCL, subject to the changes applicable to these proceedings in case of financial entities as provided in the FEL.

During this self-liquidation period, the statutory authorities shall remain in power being entitled to execute private agreements with creditors with the aim of carrying out a consensual liquidation of the bank’s assets,
applying the proceeds to the payment of its debts.

The non-existence of sufficient assets for the payment of the outstanding debts of the bank normally causes the rejection of the self-liquidation request by the BCRA. Thereafter, the court will reject the bank's petition and will order a judicial liquidation.

1.2.5. Judicial liquidation: In those cases in which the solvency and liquidity of the financial entity have been affected, and this situation cannot be solved by means of a reorganization plan proposed by the bank or when the cause of revocation to act as a financial entity has been any other than the own entity's decision, only the judicial liquidation will proceed. Additionally, this type of liquidation shall proceed when BCRA does not agree with the entity's petition to self-liquidate.

The non-existence of sufficient assets for the payment of the outstanding debts of the bank normally causes the rejection of the self-liquidation request by the BCRA. Thereafter, the court will reject the bank's petition and will order a judicial liquidation.

The main effect of the judicial liquidation is the appointment by the court of a syndic or receiver who shall represent the bank, causing the ordinary representatives (the board of directors) to cease in their functions.

The receiver shall be entitled to execute all necessary acts for the sale of the assets and the settlement of the liabilities. The bank must add to its denomination the words "in liquidation"; if this is not complied the receiver shall be jointly and severally liable for any damages caused.

In general, the procedure foreseen in the FEL for the judicial liquidation of financial entities is close to the liquidation procedure regulated in the BL with an ad-hoc proceeding implemented by the receiver to verify the existence and veracity of the creditors' claims. However, as there is no bankruptcy decision issued during that procedure, the personal effects of any bankruptcy (i.e. the prohibition to the debtor's directors to participate in board of directors of other companies) are not applicable.

In those cases where the receiver considers that the entity is in a cessation of payments status upon which it is not entitled to regularly comply with its obligations, the receiver must ask the court to issue a bankruptcy decision, converting thus the judicial liquidation into bankruptcy liquidation.

Once a bankruptcy proceeding is initiated, the provisions of the BL shall be applicable with certain amendments as set forth by the FEL, notably, the inapplicability of the preferences rules ("ineficacia concursal") to the exclusion of assets and liabilities ordered by BCRA according to the Section 35 bis Procedure.

2. Procedures foreseen in the BL

2.1. Workout agreements

The FEL does not regulate the manner in which the residual entity shall deal with those creditors whose claims were not "excluded" by the Section 35 bis Procedure. As the main creditors (depositors) will have been "excluded" by BCRA and assigned to a third financial entity, deposit holders will not be regarded as creditors any longer vis-à-vis the residual entity.

In this scenario, it would be convenient for the former bank to set up a plan in order to deal with the payment of its outstanding liabilities (those that were not "excluded" by BCRA); otherwise a bankruptcy decision will be issued by the court at the request of the receiver or BCRA and liquidation will be performed according to the BL’s rules under the supervision of a receiver.

The terms and conditions of the workout agreement may be freely agreed by the residual entity and its creditors and the signing parties shall be bound by them. No automatic stay shall be applicable in these cases to creditors law suits against the former bank, being thus important to include in the agreement as many creditors as possible in order to avoid bankruptcy petitions.
These agreements normally include a stand still provision with the major creditors for a minimum term during which negotiations shall be held, compromising the creditors not to file bankruptcy petitions against the debtor.

The debtor’s payment proposal may consist, inter alia, of (i) a discount payment, a rescheduled of debts or a mix of both; (ii) the delivery of assets in payment to the creditors; (iii) the administration of all or part of the debtor’s estate by the creditors; (iv) the issuance of convertible or non-convertible securities, when applicable; and (v) the granting of guarantees by third parties. More likely, the residual entity would be offering a final payment for its claims, achieving thus a consented and orderly liquidation that would normally involve the sale of all its assets. After BCRA revoked the authorization to act as a bank, the former financial entity will dissolve and liquidate, without chance of continuing operations as a bank.

Alternatively a trust may be used as a way of restructuring the residual bank’s obligations. The trust would be formed pursuant to a trust agreement entered into with the creditors and the former bank. Thereafter all or a part of the assets shall be transferred to such trust, which shall assume the debtor’s liabilities. A qualified financial institution selected by the creditors will normally act as trustee. The trustee’s duties usually shall include the liquidation of assets, the distribution of the proceeds and, when applicable, the settlement of any litigation filed against the bank. The beneficiaries of the trust shall be the creditors signing the agreement that shall collect the proceeds according to the procedure set forth therein.

Those creditors which are not part of the agreement may prejudice the whole negotiation process, as they will maintain their individual actions against the former bank and, hence, may file bankruptcy petitions actions precluding the restructuring process to succeed.

The residual bank and the major creditors will not have many ways of dealing with such holdup creditors. Normally, they will buy them out.

Finally, although there are no precedents in this issue, the majority of the authors, based on a traditional interpretation of both the FEL and the BL, conclude that work-out agreements executed by former banks as debtors are not entitled to judicial approval (confirmation).

This interpretation might be loosen by the courts in the near future, specially regarding those entities whose authorization to act as banks has been revoked and upon which the Section 35 bis Procedure was applied. In effect, once the depositors are eliminated as creditors (as their claims are transferred to a new bank) the reason for not allowing former financial entities to arrange the payment of their outstanding liabilities as any other entity in cessation of payments has clearly disappeared.

2.2. Reorganization procedure

According to Section 50 of the FEL, financial entities, as a limited number of other entities mentioned in Section 2 of the BL, may not benefit of reorganization procedures. This issue is clearly stated by the FEL and all authors and the existing case law recognize it.

Notwithstanding the foregoing, it is yet to be decided whether a financial entity once the BCRA revokes its authorization to act as a bank, may initiate such proceeding. In effect, after the revocation to act as a financial entity the entity ceases to be a bank, and, allegedly, it shall not longer be considered included in the above-mentioned exclusion. Furthermore, if the Section 35 bis Procedure is applied the depositors’ rights shall be transferred to a third entity, therefore disappearing the main reason for not allowing these residual entities to file for reorganization.

In an important precedent issued in August 2000, a court located in the Province of Mendoza rejected the filing for reorganization of Banco de Mendoza, whose authorization to act as financial entity had already been revoked by BCRA. Notwithstanding that, the court set up an ad-hoc procedure (“closure of the regulated activity”) with specific provisions taken from the BL.

More recently, two courts, one located in the Province of Santa Fe and the other in the Province of Córdoba, accepted reorganization proceedings filed by two former banks upon which the Section 35 bis Procedure had been applied.

It is expected that this trend be followed by other courts in the near future as the reasons for not allowing former banks to file for reorganization (mainly, the inconvenience of exposing depositors to said collective procedure) are not present in those cases when Section 35 bis was previously and successfully applied.

3. Conclusions

3.1. Section 35 bis of the FEL foresees a procedure that involves the exclusion of assets and secured claims (deposits) and the transfer of said assets and claims to other financial entity with the purpose of successfully achieving the restructuring of the residual financial entity without damaging the depositors and employees’ rights.
If this procedure is successful in the exclusion of all the deposits from the financial entity undergoing a lack of solvency and liquidity situation, the main problem caused by the failing of the bank (the depositors’ rights) should be solved.

3.2. Yet the “residual” entity shall remain indebted to all other creditors (commercial and financial claimants, tort claimants, suppliers, tax claims, among others) and to avoid bankruptcy, a procedure must be organized in order to fully pay those creditors, or, at least, obtain a consented discount from each of them. The FEL does not regulate the manner in which the residual entity, upon which no judicial liquidation procedure has been ordered, shall deal with those creditors that were not “excluded” by the Section 35 bis Procedure.

3.3. The traditional approach of the Argentine courts was to reject that former banks, whose authorization to act as a financial entity was revoked by BCRA, may file for reorganization or ask for judicial approval of a workout agreement. This trend may be modified in the near future, as recent decisions have accepted reorganization filings of former banks upon which Section 35 bis Procedure was applied.

3.4. In addition, there are no legal restraints in the FEL nor in the BL for former banks with a self liquidation procedure authorized by BCRA to execute private agreements with creditors seeking the liquidation of its assets and the payment of its liabilities in an agreed manner, normally at a discount rate. The main problem with this manner of dealing with the creditors is that the consent of all of them shall be necessary since no imposition of the terms and conditions of the agreement to non-consenting creditors is allowed, as in the judicially approved work-out agreements.

3.5. The FEL allows the voluntary self-liquidation of former banks in those cases when the solvency and liquidity of the financial entity was not affected and the revocation to act as a bank was ordered by BCRA at the request of said bank.

Said self-liquidation shall be subject to the existence of sufficient assets and may be managed by its statutory authorities, who shall conduct the entity’s activities for the liquidation of assets and the payment of liabilities, operating with the addition “in liquidation”.

3.6. In those cases in which the solvency and liquidity of the financial entity is affected in a manner that makes impossible the implementation of reorganization plans, or when the cause of revocation of the authorization to operate as a financial entity has been any other than the own entity’s decision, the voluntary self-liquidation will not proceed and the liquidation of the entity will be carried out judicially under the administration of an ad-hoc liquidator (receiver) appointed by the court. Additionally, this type of liquidation shall proceed when BCRA does not agree with the entity’s petition to self-liquidate.

3.7. This judicial liquidation can be converted into bankruptcy liquidation if the receiver so requests to the court because the entity is in a cessation of payment status. If bankruptcy is declared, no preference rules (“ineficacia concursal”) shall be applied to those acts that caused the exclusion of assets and liabilities to third parties, according to Section 35 bis of the FEL.