How to Compensate Expropriated Investors? The Case of SNS Reaal

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Abstract

In 2013, the Dutch Minister of Finance nationalised financial conglomerate SNS Reaal by expropriating all outstanding shares in and all subordinated debt owed by it. This article examines the ruling of the Dutch Supreme Court of 20 March 2015 on how the compensation for expropriated investors should be determined. It also discusses the provisions on compensation under the European Bank Recovery and Resolution Directive.

Introduction

On 1 February 2013, the Dutch Minister of Finance (the Minister) decided to expropriate all outstanding shares in, all subordinated bonds issued by and all subordinated loans taken up by both the Dutch holding company SNS Reaal and by SNS Bank (together: SNS).[1] SNS Bank was the fourth largest bank in the Netherlands and was considered to be a systemically important institution. Reaal, the holding company of SNS Reaal's insurance arm, was the third largest insurer and fifth largest nonlife insurer in the Netherlands.[2] The nationalisation of SNS represented the first time the expropriation tool under the Dutch Intervention Act (*Interventiewet*),[3] which entered into force one year before the decision, was applied.[4] Dutch Act on Financial Supervision (*Wet op het financieel toezicht*, "Wft") art.6:2[5] empowered the Minister to expropriate securities issued by or assets and/or liabilities of a credit institution or insurance company if the situation of the relevant institution was posing a serious and immediate threat to the stability of the financial system.[6] Shortly after the nationalisation hundreds of interested parties lodged an appeal against the expropriation decree with the Administrative Jurisdiction Division of the Council of State (*Afdeling Bestuursrechtspraak van de Raad van State*), the highest Dutch administrative law court in the Netherlands. They argued that the expropriation violated civil rights, that the expropriation of subordinated debt was unnecessary and that the position of SNS did not pose an immediate threat to the financial stability. The highest Dutch administrative court, however, upheld the major part of the decision.[7] Following this administrative decision another crucial issue arose: how to compensate the expropriated investors? In a separate court proceeding on the damages to be paid as compensation to the expropriated investors, the Enterprise Chamber of the Amsterdam Court of Appeal (*Ondernemingskamer*) held in its interim ruling on 11 July 2013, that the Minister had failed to convincingly justify his position that the compensation offer of EUR 0 represented full compensation, as required by law. Experts were appointed to advise on the proper value of the expropriated securities at the moment immediately prior to the nationalisation.[8] The Minister subsequently lodged an interim appeal with the Dutch Supreme Court (*Hoge Raad der Nederlanden*) against this interim judgement of the Enterprise Chamber. On 20 March 2015, the Supreme Court issued its ruling and clarified the manner in which compensation for expropriation should be determined pursuant to the Intervention Act.[9] This article aims to provide an overview of the considerations of the Supreme Court as regards the determination of the compensation. Secondly, it discusses the provisions on

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[1] See Decree by the Minister of Finance of 1 February 2013 regarding the expropriation of securities and assets of SNS REAAL NV and SNS Bank NV in connection with the stability of the financial system, and to take immediate measures with regard to SNS REAAL NV. Available at: *https://www.government.nl/documents/decrees/2013/02/01/decree-by-the-minister-of-finance-regarding-the-expropriation-of-securities-and-capital-components-of-sns-reaal-nv-and-sns-bank* [Accessed 2 February 2016]. See for an English overview of the developments in the run-up to the nationalisation, the nationalisation decision itself and an evaluation of the nationalisation, Financial Stability Board, *Peer Review of the Netherlands: Review Report*, 11 November 2014. Available at: *http://www.fsb.org/wp-content/uploads/Netherlands-peer-review-report.pdf* [Accessed 2 February 2016].

[2] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.2.13; Financial Stability Board, *Peer Review of the Netherlands: Review Report* 11 November 2014, p.46.

[3] An unofficial translation of the Intervention Act is available at: *www.dnb.nl* [Accessed 9 December 2015].

[4] *Wet van 24 mei 2012 tot wijziging van de Wet op het financieel toezicht en de Faillissementswet, alsmede enige andere wetten in verband met de introductie van aanvullende bevoegdheden tot interventie bij financiële ondernemingen in problemen (Wet bijzondere maatregelen financiële ondernemingen)*, *Stb.* 2012, 241. The Act came into force with retroactive effect from 20 January 2012.

[5] As implemented by the Intervention Act.

[6] Wft art.6:2.

[7] Administrative Law Section of the Dutch Council of State (Raad van State) 25 February 2013, ECLI:NL:RVS:2013:BZ2265. The English version of this judgment is available at: *www.raadvanstate.nl* [Accessed 9 December 2015]. See B. Bierens, "Over het besluit tot nationalisatie van SNS Reaal en de rechterlijke toetsing daarvan: terugkijken en vooruitblikken" [2013] *Tijdschrift voor Financieel Recht* 109–117. In subsequent cases concerning the expropriation before the European Court of Human Rights, the Court rejected several complaints in a partial decision on 14 January 2014 (see *Adorisio v The Netherlands* (47315/13) (2015) 61 E.H.R.R. SE1) and held other applications inadmissible (see ECHR 11 February 2014, *VEB NCVB v The Netherlands* (50494/13)) and ECHR 17 March 2015 (*Adorisio v The Netherlands* (47315/13, 48490/13 and 49016/13)). On 26 March 2014, the Court of Justice of the EU (T-321/13) ruled the challenge to the European Commission's decision C1053 (22 February 2013), which determined that the State aid provided by the Dutch Government to SNS was compatible with the internal market, inadmissible.

[8] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966.

[9] Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661.

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compensation under the European Bank Recovery and Resolution Directive (BRRD), which had to be transposed into the national laws of all European Member States by 1 January 2015.[10] The BRRD aims to provide national authorities in the EU with a harmonised and expanded set of tools and powers to intervene in a failing credit institution or investment firm and contains rules on the compensation of involved parties.

Compensation under the Dutch Intervention Act

The Dutch Constitution states that expropriation may only take place in the public interest and with compensation assured in advance, in accordance with rules set by or pursuant to the law.[11] The Dutch State shall grant compensation to a title holder as regards an asset or security that is expropriated under Wft art.6:2 or a right to securities to be newly issued that is lost under application of Wft art.6:2. The compensation must represent a full reimbursement of the damage the expropriated party directly and necessarily suffered as a result of losing his asset, security or right and must amount to the "actual value" of the expropriated asset, security or right at the time of expropriation.[12] Pursuant to Wft art.6:9(1), two aspects have to be taken into account for the determination of the mentioned actual value. First, the future prospects of the financial institution concerned in case no expropriation would have taken place. Secondly, the price that, given the prospects, would have been concluded at the time of the expropriation in a hypothetical sale in the open market between the expropriated party as a reasonable seller and the expropriating party as a reasonable buyer.[13] When an expropriation decision has been taken, the Minister must make an offer of compensation to the expropriated parties. Subsequently, the Enterprise Chamber has to confirm this offer or determine a higher amount of compensation if the offer is deemed insufficient.[14]

Offer of the Minister

On 4 March 2013, the Minister announced his offer for compensation. In his opinion, "… without the expropriation SNS REAAL and SNS Bank would have gone bankrupt or have gone into liquidation …" and in that scenario, following the ranking of the creditors' claims, "… the proceeds of the winding-up would be insufficient to pay all ordinary creditors, and nothing would remain to the subordinated creditors, let alone the shareholders". Given these prospects, his offer for compensation to the expropriated securities and assets amounted to EUR 0 per financial instrument.[15] In the interim ruling on 11 July 2013, the Enterprise Chamber ruled that the Minister's justification underlying the offer was unconvincing and that it was likely that the offer did not constitute full compensation for the damage suffered.[16] The Enterprise Chamber therefore considered that it now had to determine an amount of compensation exceeding the Minister's offer and it appointed experts to advise on the valuation.[17] The Dutch Supreme Court, however, struck down this decision. It held that the Enterprise Chamber must determine the level of compensation independently.[18] This means that the Enterprise Chamber is not bound to the offer of the Minister, although the offer may serve as a basis. It may declare a higher amount of compensation if it considers that the offer does not constitute a full reimbursement for the damage suffered through the expropriation.[19] Thus, the Enterprise Chamber could not decide that a higher amount of compensation than EUR 0 had to be paid, solely because of an insufficient reasoning by the Minister.[20]

Reasonable seller and buyer

Dutch law requires full compensation by the State, which must be calculated by reference to the "actual value" of the expropriated assets at the moment of expropriation.[21] As mentioned above, to determine the actual value several assumptions must be met. These include the price that, given the prospects of SNS, would have been concluded at the time of the expropriation in a hypothetical sale in the open market between the expropriated party as a reasonable seller and the expropriating party as a

[10] Directive 2014/59 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891, and Directives 2001/24, 2002/47, 2004/25, 2005/56, 2007/36, 2011/35, 2012/30 and 2013/36, and Regulations 1093/2010 and 648/2012, of the European Parliament and of the Council [2014] OJ L173/190.
[11] Dutch Constitution art.14.
[12] Wft arts 6:8–6:13 provide for the procedure how the compensation should be determined.
[13] Wft arts 6:8 and 6:9.
[14] Wft arts 6:10 and 6:11.
[15] For the official letter and a translation of the letter of the Dutch Minister of Finance regarding the offer for compensation with respect to the expropriation of securities and assets of SNS REAAL and SNS Bank of 4 March 2013. Available at: *https://www.government.nl/documents/letters/2013/03/04/letter-and-unofficial-translation-of-the-letter-with-offer-for-compensation-sns-reaal* [Accessed 2 February 2016]. The principle that in determining the compensation for the expropriated parties it should be assessed what the parties would have received in a liquidation scenario, can also be found in the BRRD, see BRRD Recital 50: "Affected shareholders and creditors should not incur greater losses than those which they would have incurred if the institution had been wound up at the time that the resolution decision is taken", and see BRRD Recital 51: "If it is determined that shareholders and creditors have received, in payment of, or compensation for, their claims, the equivalent of less than the amount that they would have received under normal insolvency proceedings, they should be entitled to the payment of the difference where required under this Directive".
[16] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.6.25.
[17] In accordance with Wft art.6:11(3). Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.6.26.
[18] In accordance with Wft arts 6:10 and 6:11.
[19] In accordance with Wft arts 6:8 and 6:9. *Kamerstukken II* 2011/12, 33 059, nr.3 (Explanatory Memorandum Intervention Act), p.68; Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, paras 4.8.2–4.8.3; Opinion Advocate General Timmerman 10 October 2014, ECLI:NL:PHR:2014:1825, para.7.4.
[20] Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.8.3; Opinion Advocate General Timmerman 10 October 2014, ECLI:NL:PHR:2014:1825, para.7.4.
[21] Wft art.6:8.

reasonable buyer.[22] The Enterprise Chamber interpreted this as follows: The actual value is deemed to be the price that would be paid by the highest bidder in case of a sale of the expropriated assets and securities in the most appropriate manner and after the best preparation. Moreover, the valuation should be based on individual hypothetical transactions and not, at least not necessarily, on a sale of all the expropriated assets and securities at once.[23] In its ruling, the Supreme Court held that this interpretation is not in line with the text of the Intervention Act nor with the parliamentary history. According to the Supreme Court, the actual value should be assumed to be the result of only one hypothetical sale in the open market, which will not necessarily give rise to the best possible price.[24]

Listed price of the securities

The Dutch legislator debated whether or not to primarily base the compensation for expropriated listed securities on the listed price prior to nationalisation, being the most recent listed price or the weighted average listed price over a specific period.[25] He decided against doing so although he considered that it is obvious to base the valuation of securities partly on the listed price. Consequently, the Enterprise Chamber saw no reason why—for the determination of the actual value of the securities, besides other factors—the appointed experts should not particularly take into account the listed price at or immediately prior to the expropriation.[26] The Supreme Court, however, did not agree with this analysis. It held that in determining the actual value of the securities one should attempt to approach the real financial position of the institution, taking into account all relevant facts and circumstances, including those not yet known by the investors.[27] For this reason, the method of valuation should not heavily depend on the listed price, which might not necessarily be an adequate reflection of the price that a reasonable buyer would be willing to pay.[28]

Supervisory actions Dutch Central Bank

Following SNS Bank's poor financial position, the Dutch prudential supervisory authority, the Dutch Central Bank (*De Nederlandsche Bank*, DNB), intensified its supervision of SNS Bank from 2008 onwards. At the end of 2011, DNB concluded that SNS Reaal was not capable of resolving its financial position through private means.[29] DNB and the Ministry of Finance established a project group to analyse potential scenarios for SNS Reaal. One year later, DNB determined that SNS Bank suffered a large capital deficit. Following the periodic evaluation of the capitalisation of SNS Bank (known as the Supervisory Review and Evaluation Process, or SREP) and after notifying the Ministry of Finance, DNB sent a letter to SNS Bank on 27 January 2013 (a so-called SREP decision), imposing a deadline of 31 January 2013 to present a final solution how the capital shortage could be covered on a short term. Since neither a solution nor a possible alternative was found, DNB advised the Minister to exercise his powers under the Intervention Act.[30] In its interim ruling, the Enterprise Chamber emphasised the interconnectedness of the preparations for the expropriation on the one hand and the possible initiating of an insolvency proceeding or revocation of SNS Bank's banking licence by DNB on the other. The Enterprise Chamber held that it was likely that DNB, assuming that no expropriation would take place and being aware of all the relevant facts and circumstances, would have taken the SREP decision not at all or not in the same form. Consequently, the valuation to be made by the Enterprise Chamber should possibly take into account other possible actions of DNB than actually occurred in the period prior to the expropriation.[31] Yet, in the Supreme Court's view, DNB holds an independent position with its own supervisory powers in relation to the Dutch State. Therefore, in contrast to the decision of the Enterprise Chamber, the Supreme Court held that the action of DNB that actually took place at the moment immediately prior to the expropriation has to be taken into account in determining the compensation.[32] In other words: in determining the actual value of the expropriated asset, the fiction that the SREP decision could have been taken in another form or not at all should not be taken into account.

Discounting State aid

In 2008, the Dutch Government strengthened SNS Reaal's capital position by buying Core Tier 1 capital securities of SNS Reaal.[33] The Enterprise Chamber as well as the Supreme Court considers this transaction to be qualified

[22] Wft art.6:9(1).
[23] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, paras 6.8, 6.9 and 6.75.
[24] Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.15.3; Opinion Advocate General Timmerman 10 October 2014, ECLI:NL:PHR:2014:1825, para.7.23.
[25] *Kamerstukken II* 2011/12, 33 059, nr.3 (Explanatory Memorandum Intervention Act), p.74.
[26] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, paras 6.15 and 6.75.
[27] Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.19.2.
[28] As acknowledged by the Dutch legislator, a compensation which is primarily based on the listed price, could lead to the situation where investors would speculate on the possible expropriation of a failing institution, knowing that a higher listed price would lead automatically to a higher compensation. *Kamerstukken II* 2011/12, 33 059, nr.3 (Explanatory Memorandum Intervention Act), p.74; Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.19.2.
[29] Financial Stability Board, "Peer Review of the Netherlands: Review Report" 11 November 2014, p.47.
[30] Financial Stability Board, "Peer Review of the Netherlands: Review Report" 11 November 2014, pp.47–49; Letter of the Dutch Minister of Finance to the Parliament of 1 February 2013 concerning the nationalisation of SNS Reaal. Available at: *https://www.government.nl/documents/parliamentary-documents/2013/02/01/nationalisation-of-sns-reaal* [Accessed 2 February 2016].
[31] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, paras 6.11 and 6.19.
[32] Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.16.
[33] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.2.9.

as State aid.[34] The State aid that the institution already received has to be taken into account in determining the actual value of the expropriated asset.[35] The Enterprise Chamber as well as the Supreme Court found that the State aid has to be taken into account to prevent expropriated parties from receiving a higher amount of compensation than would be justified in view of the actual damage suffered.[36] The Enterprise Chamber decided that the appointed experts must assess the actual financial benefit the expropriated parties received from the State aid.[37] Moreover, in contrast to the opinion of the Minister, the Supreme Court held that discounting State aid does not mean that every euro SNS Reaal increased in value after the recapitalisation of 2008 has to be deducted in determining the actual value of the expropriated asset, but merely the amount of State aid in the strict sense.[38] The value of an institution may increase as a result of State aid, eventually even exceeding the amount of the initial State aid. In his opinion of 10 October 2014, the Advocate General at the Dutch Supreme Court clarified this with an example. A bank is granted State aid to avert insolvency and subsequently issues new bonds, but nevertheless ends up in a financially critical situation. The Minister expropriates the bonds. In calculating the damage suffered by the "new" bondholders, the value of the institution immediately prior to the expropriation is of importance. The value of the institution in the hypothetical case it was not granted State aid and the institution had entered into an insolvency proceeding instead, does not give any indication of the damage the new bondholders suffered. Hence, an increase in value of the institution exceeding the amount of State aid should be regarded as (part of) the new bondholders' damage. Moreover, deducting every euro the institution has increased in value after the State aid was provided can discourage investors to invest in recapitalised institutions.[39]

Bank Recovery and Resolution Directive

The BRRD aims to provide national authorities in the EU with a harmonised and expanded set of tools and powers to intervene in a failing credit institution or investment firm. The new rules enable a so-called resolution authority, which in the Netherlands is DNB, inter alia, to transfer (part of) a failing bank or investment firm to a private sector purchaser or a publicly owned bridge institution, to transfer the institution's "bad" assets to an asset management vehicle and to exercise a bail-in, i.e. the cancellation or dilution of shares and a write-down or conversion into equity of liabilities.[40] The Dutch legislator has not yet implemented the rules of the BRRD, although a recently published legislative proposal has been brought before the Dutch Parliament. The Explanatory Memorandum to the legislative proposal briefly examines the relationship between the new tools and powers of DNB under the BRRD and the expropriation power of the Minister under the Dutch Intervention Act.[41] The expropriation power of the Minister will continue to exist alongside the powers of DNB under the BRRD, also with regard to credit institutions. Nevertheless, the Dutch legislator considers the expropriation power to be in the nature of emergency powers legislation (*staatsnoodrecht*), applicable in case the BRRD and the Single Resolution Mechanism (SRM)[42] do not provide for suitable solutions or in case all options under the BRRD and the SRM have been exhausted.[43] Following the exercise of the resolution tools and powers under the BRRD, the entitlement to compensation of the involved shareholders and creditors can be based on two grounds. First, pursuant to art.1 First Protocol to the European Convention on Human Rights interferences with property rights may not be disproportionate and may require compensation to the amount which is in reasonable proportion to the value of the property. Secondly, the BRRD requires that in the application of the resolution powers and tools no creditor shall incur greater losses than it would have incurred if the institution had been wound up under a normal national insolvency proceeding: the "no creditor worse off" principle. If the involved creditors and shareholders are worse off, they must be compensated by the difference between the amount they have actually received and the (larger) amount they would have received, in case the financial institution would have entered into a normal insolvency proceeding immediately before the resolution measure.[44] Thus the compensation arrangement under the BRRD focuses on the gone-concern scenario of the institution, whereas the Intervention Act takes into account a broader set of assumptions, including the future prospects of the

[34] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.6.28; Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.22.1.
[35] Wft art.6:9(2).
[36] *Kamerstukken II* 2011/12, 33 059, nr.3 (Explanatory Memorandum Intervention Act), p.74; Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.6.28; Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.22.1.
[37] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.6.32.
[38] Amsterdam Court of Appeal 11 July 2013, ECLI:NL:GHAMS:2013:1966, para.6.29; Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.22.3.
[39] Opinion Advocate General Timmerman 10 October 2014, ECLI:NL:PHR:2014:1825, para.7.39; Dutch Supreme Court 20 March 2015, ECLI:NL:HR:2015:661, para.4.22.3.
[40] BRRD Ch.IV.
[41] *Kamerstukken II* 2014/15, 34 208, nr.3 (Explanatory Memorandum to the Implementation Act for the European Framework for the Recovery and Resolution of Credit Institutions and Investment Firms), pp.50–51. The initial consultation proposal did not consider the relationship between the expropriation power of the Minister under the Intervention Act and the powers of DNB under the BRRD, as observed in the reaction to this consultation proposal by the Hazelhoff Centre for Financial Law, see Hazelhoff Centre for Financial Law, Reactie inzake het consultatievoorstel Implementatiewet Europees kader voor herstel en afwikkeling banken en beleggingsondernemingen van 21 november 2014 (*Reaction on the consultation proposal for the Implementation Act for the European Framework for the Recovery and Resolution of Credit Institutions and Investment Firms of November 21, 2014*), 19 December 2014. Available at: *www.internetconsultatie.nl* [Accessed 9 December 2015], p.6.
[42] Regulation 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation 1093/2010 [2014] OJ L225/1.
[43] The SRM, the second pillar of the European Banking Union, establishes a European resolution board, i.e. the Single Resolution Board, which will apply the rules of the BRRD and will adopt decisions regarding the resolution of significant credit institutions in the euro area as of 1 January 2016.
[44] BRRD Recitals 50–51; BRRD arts 34(1)(g) and 74–75.

institution. Nevertheless, in case of an insolvency scenario the compensation arrangements may lead to the same results.

Conclusion

The Dutch Supreme Court referred the case back to the Dutch Enterprise Chamber, which now has to come to a new decision as regards the amount of compensation the expropriated SNS investors should receive for their expropriated shares and bonds, based on the advice of appointed experts and on the guiding principles provided by the Supreme Court. One of these principles requires the Enterprise Chamber to determine the level of compensation independently if it deems the Minister's compensation offer insufficient. However, the Enterprise Chamber can also confirm the Minister's offer for compensation, which was in this case EUR 0 per financial instrument. Furthermore, the Supreme Court held that the loss of the expropriated investors has to be compensated at the actual value the assets and the securities represented at the time of expropriation. In determining the actual value of the expropriated securities, the listed price of the expropriated securities prior to the expropriation may not particularly be taken into account. The powers and tools under the Dutch Intervention Act are broadly comparable with the powers and tools national resolution authorities have under the BRRD, although the provisions on the compensation for the involved parties use different principles and criteria. Notwithstanding these different approaches to calculating compensation, both paths could lead to the same result if the Dutch Enterprise Chamber concludes that, without the expropriation, SNS would have gone into insolvency proceedings. In that case the expropriated investors will be entitled to a compensation of EUR 0 per financial instrument. Hence, the "no creditor worse off" principle seems bad news for investors.