



EN

GOVERNING COUNCIL
99th session (B)
Rome, 23 - 25 September 2020

UNIDROIT 2020
C.D. (99) B.6
Original:
English/French
August 2020

Item No. 4 on the agenda: Update and determination of scope of certain projects on the 2020-2022 Work Programme

(d) Bank Insolvency

<i>Summary</i>	<i>Refinement of the project scope</i>
<i>Action to be taken</i>	<i>The Governing Council is invited to take note of the information provided and make any comments or objections to the proposed action plan</i>
<i>Mandate</i>	<i>Implementation of the decision of the General Assembly in relation to the Work Programme 2020-2022</i>
<i>Priority</i>	<i>Original priority –medium- to remain unchanged</i>
<i>Related documents</i>	<u>UNIDROIT 2019 C.D. (98) 14 rev.2</u> ; <u>UNIDROIT 2019 C.D. (98) 17</u>

I. BACKGROUND

1. In the run-up to the drafting of a Work Programme for 2020-2022, the Secretariat received two separate proposals, one from the Bank of Italy, and one from the European Banking Institute (EBI), relating to the harmonisation of rules in cases of the insolvency of a bank. Following the 2008 global financial crisis, the international financial community joined forces to protect the banking and financial sectors from contagion and risk. These efforts had culminated in revamped legal infrastructure for the international banking system. However, the global banking regulatory architecture left a part untouched. Where financial distress concerned a bank which was too small to cause systemic damage, or an already insolvent financial institution, which needed to be liquidated without any additional resolution, there exists neither a set of international standards nor mechanisms for adequate coordination and cooperation. This last stage relating to bank liquidation is left purely to domestic legislation, which often differed substantially from country to country. This situation -it was argued- was creating problems in practice, had a potential for important financial disruption (mainly, but not only, at domestic level), and could be addressed by a global institution, which was not necessarily part of the global financial ecosystem, producing an international standard.

2. In light of the above, the Secretariat considered that UNIDROIT was well positioned to undertake work and proposed that the Governing Council, at its 98th Session, approve the inclusion in the new Work Programme of legislative work on the subject matter, covering, at least, the following matters: (i) the most efficient institutional mechanism for bank liquidation (e.g. judicial system versus administrative model, or a hybrid system); (ii) the type of powers that ought to be assigned to the court/administrative authority; (iii) the entry gate to liquidation proceedings and its coordination with banking resolution systems; (iv) which rules of general corporate insolvency proceedings should apply to the liquidation of banks; and (v) the rules of coordination between national courts/administrative authorities in case of cross-border cases. Further, outside liquidation and from the standpoint of resolution measures, an international standard and coordination mechanisms could be envisaged concerning (a) the domestic system of priorities in insolvency and its relationship with bail-in rules (“no creditor worse off” principle and Total Loss Absorbing Capacity (TLAC) rules); (b) aspects of recognition of resolution measures; and (c) the mechanisms for recognition of contractual clauses that subject banks to resolution systems.

3. The Council had a lively discussion, where two members were not in favour of the project, one expressed doubts, whereas three more members posed some queries, and seemed to favour a postponement of a decision on the project until a document with a more defined scope was provided. In conclusion, the Governing Council agreed to recommend to the General Assembly to include the project in the Work Programme and: “[t]o assign medium priority to this proposal. The assigned level of priority was merely formal. The Council asked the Secretariat to conduct further research and provide a more defined scope for the project, as well as further justification of its adequacy as work to be conducted by a global institution. This would include including exploring parts (b) and (c) of the original proposal. There was agreement on the importance of the topic and on the possible impact of the work to be conducted. Subject to agreement with the Secretariat’s enhanced note, the 99th session of the Governing Council would reconsider the status of the project”.

II. THE CURRENT STATUS OF THE PROJECT AND POSSIBLE WAY FORWARD

4. Bearing the decision of the Governing Council in mind, considering the limited resources available and the mandate to concentrate on other projects with higher priority, the Secretariat has not conducted any specific material work on this project. No events have been held and only negligible legal-officer time has been assigned to this project. The Secretariat, however, has continued to canvass support and to ascertain the need and the relevance of the project, with positive results. Moreover, the Secretariat has sought to address two objections expressly raised by Governing Council Members: (a) the limitation of resources and (b) the expertise and adequacy of the organization to carry out work on the subject matter.

5. Following several conversations with the leadership of the Financial Stability Institute (FSI), a Basel-based institution founded by the Bank of International Settlements and the Basel Committee on Banking Supervision, the Secretariat has been able to confirm the interest of the project from a global standpoint. The topic is generally regarded as both practically relevant and highly topical, even more in light of the current circumstances. The COVID-19 related measures around the world are very likely to create a global economic crisis which would undoubtedly reach the banking system, the weaker components of which (namely the smaller entities) may be more severely affected. These are an important part of the scope of the project (domestic liquidation of banks), and hence international guidance would seem more important than ever. The interest of the Financial Stability Institute is not merely theoretical. At the highest representative level, they have expressly shown interest in partnering up with UNIDROIT to undertake work on the subject matter. They have also expressed willingness to support the joint venture financially, if required. The exact terms would be defined in due course in the absence of any objection from the Governing Council.

6. In addition to the research expertise that would be provided by the FSI, the Secretariat has taken steps to strengthen its specific expertise on the subject matter. Following contacts with the legal department of the Bank of Italy, the Secretariat prepared and submitted a formal request for a joint project consisting on the creation of a Bank of Italy-UNIDROIT Chair, with an initial duration of one year, extendable for at least one additional year. The Secretariat has learnt, informally, that the project to create the Chair has been approved by the relevant technical committee of the central bank, subject to the decision being ratified and formalised by the Board. Until this decision is adopted and notified, the project cannot be deemed approved and the Chair created. However, should the creation of this Chair be confirmed, the Institute would count on an additional, highly qualified banking law academic or expert working with the Secretariat in Rome as an additional resource. This would reinforce the suitability and technical preparation to carry out the project.

7. In the light of the arguments included in the previous paragraphs, and in a manner consistent with the mandate received from the Governing Council in its 98th session to further assess the feasibility of the project and define its scope, the Secretariat would purport to pursue the following course of action:

- (i) UNIDROIT would formalise an agreement with the Financial Stability Institute to work together towards the identification, definition and analysis of best practices in the area of bank liquidation. It must be noted that the FSI has not shown interest to collaborate in matters concerning (a) aspects of recognition of resolution measures, and (b) the mechanisms for recognition of contractual clauses that subject banks to resolution systems;
- (ii) The said partnership may lead, for the time being, to the drafting of a feasibility study (as main output for UNIDROIT) and/or to a research paper (as possible main initial output for the FSI);
- (iii) The said agreement would include the provision of research expertise and financial resources by the FSI. The resources would be limited to ordinary research costs, and the possible holding of a workshop or one or more meetings to discuss progress of the research;
- (iv) The results of the work would be presented to the Governing Council at its 100th session in 2021. Such result may lead to propose legislative work on the topic, including a definition of which instrument (a legislative guide or a model law) and the detailed scope of the work, or not, in case the project was found not to be feasible or unnecessary.
- (v) If the Bank of Italy-UNIDROIT Chair is created, the person selected to hold the Chair would be assigned, in part, to this line of work; in addition, and otherwise, the Secretariat would dedicate a limited amount of legal officer time to the project. The Secretariat would create an informal, reduced working group, to work through this stage together with the FSI. In order to canvass the existing need for a legislative instrument, the Secretariat would purport to conduct a number of meetings and interviews with central banks and relevant private stakeholders. If deemed helpful, we would circulate questionnaires to relevant stakeholders, in line with previous practice of the Institute (e.g., for the Space Protocol or the Contract Farming Legal Guide).

III. ACTION TO BE TAKEN

8. *The UNIDROIT Secretariat would invite the Governing Council to take note of the actions taken since the 98th session, and to provide any comments or objections to the next steps of the project as described herein.*