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ISSUES PAPER

1. This document provides a preliminary illustration of the issues that the UNIDROIT Working Group on Bank Insolvency may wish to consider at its first session.

2. The issues considered in this document were identified by the participants in the Exploratory Workshop on Bank Liquidation that was co-organised by UNIDROIT and the Financial Stability Institute of the Bank for International Settlements (BIS) on 7-8 June 2021, as interpreted and further elaborated by the UNIDROIT Secretariat.

3. This document does not intend to provide an exhaustive list of issues nor a full legal analysis of each one. Rather, the purpose of the document is to provide a starting point for the Working Group's deliberations and a structure for discussions at its first session.

4. The document is divided into three sections: (i) preliminary matters; (ii) scope of the future Guidance Document; and (iii) content of the Guidance Document. It provides a number of questions and recommendations that the Working Group may wish to consider. This document also contains an annex that provides links to relevant materials to assist the Working Group.

5. This document may be read alongside the Summary Report of the Exploratory Workshop on Bank Liquidation (here), which summarises the discussion that took place among international and national experts and organisations regarding the various topics.

6. The Secretariat is grateful to Marco Bodellini (Centre for Commercial Law Studies, Queen Mary University of London) and to Ruth Walters and Rastko Vrbaski (BIS Financial Stability Institute) for their contributions to this document.

TABLE OF CONTENTS

I. PRELIMINARY MATTERS

A. Background of the project

7. Since the Global Financial Crisis of 2008, the international community has developed a framework to manage the crisis of so-called "too big to fail" financial institutions in order to preserve financial stability. These efforts resulted in the issuance of the Financial Stability Board's (FSB) 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (Key Attributes) as a set of international standards which informed the adoption of bank "resolution regimes" in jurisdictions around the world; at a regional level, the European Union adopted the Bank Recovery and Resolution Directive (BRRD); and many national legislations updated their bank resolution systems. Despite this significant progress, however, critical gaps remain. In particular, there is no international standard or guidance on bank insolvency[1] frameworks, and accordingly the effectiveness of bank insolvency laws varies substantially across countries. This creates problems in particular when dealing with the failure of small and medium-sized banks, for which, in some jurisdictions, the resolution framework would not apply. In addition, national insolvency laws still play a key role in the implementation of resolution tools in respect of systemic banks.

8. Against this background, in the run-up to the drafting of the Work Programme for 2020-2022, the UNIDROIT Secretariat received two separate but partially coincidental proposals concerning the harmonisation of rules in the field of bank insolvency, one from the Bank of Italy and one from the European Banking Institute (EBI) (see UNIDROIT 2019 – C.D. (98) 14 rev. 2, Annex 4 and 6 respectively).

9. The Governing Council at its 98th session (Rome, 8-10 May 2019) acknowledged the importance of the topic, admitted the high potential impact of the work to be conducted, and agreed to recommend that the General Assembly includes the project on bank insolvency in the 2020-2022 Work Programme with medium priority. The assigned level of priority was merely formal. The Governing 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 transnational institution (see UNIDROIT 2019 – C.D. (98) 17, para. 261).

10. The Governing Council at its 99th session (Rome, 23-25 September 2020) was informed by the Secretariat that steps had been taken to reinforce the capacity and expertise of the organisation to carry out the project. In particular: (i) the Financial Stability Institute (FSI) of the Bank of International Settlements (BIS) had shown availability to collaborate with UNIDROIT on this project and their willingness to provide both research expertise and, where needed, contribute to the development of the project with financial resources; and (ii) the process for the creation of an UNIDROIT-Bank of Italy Chair was in an advanced stage (see UNIDROIT 2020 – C.D. (99) B.6, paras. 4-6). The Governing Council took note of the information provided by the Secretariat during the 99th session and agreed with the proposed action plan, leading to the drafting of a feasibility study to be presented to the Governing Council at its 100th session (see UNIDROIT 2020 – C.D. (99) B.21, para. 117).

[1] In the absence of a decision on terminology (see below Section III, point A), the terms "bank insolvency" and "bank liquidation" are used interchangeably in this paper as referring to any process that aims at the exit of a failing bank from the market, thus falling within the scope of the Guidance Document. "Plain liquidation", "atomistic liquidation" and "piecemeal liquidation" refer to a specific type of bank liquidation where activities are disrupted immediately and assets are sold to repay creditors, as explained in Section III, point H.

11. The Governing Council at its 100th session (A) in April/May 2021 was informed that: (i) the UNIDROIT-Bank of Italy Chair had been officially established and a Chair Holder had been recruited; and (ii) a first workshop on bank liquidation would be organised jointly by UNIDROIT and the FSI (see Unidroit 2021 – C.D. (100) A.2, paras. 25-27), with a view to analysing and discussing the feasibility of the project.

12. On 7 and 8 June 2021, UNIDROIT and the FSI jointly organised an Exploratory Workshop, which gathered 40 international experts and stakeholders with a view to (i) assessing the need for an international instrument in the area of bank insolvency; (ii) determining the most suitable form of such instrument; and (iii) defining the scope of the project.

13. The Secretariat presented the results of the deliberations of the Exploratory Workshop and of additional analysis at the September session of the 100th UNIDROIT Governing Council (C.D. (100) B.4). On that occasion, the Governing Council agreed to recommend proceeding with this project as a high priority, allowing the Secretariat to establish a Working Group (C.D. (100) B Misc 2, paras. 5-6).

B. Format and title of the Guidance Document

14. It is anticipated that the Working Group will prepare legal guidance and a set of best practices in the area of bank insolvency proceedings. A functional approach to legal concepts may be most appropriate in order to produce a guidance document that would not be jurisdiction specific, but could be applied and reflected in any legal system or culture. The international guidance could enable jurisdictions to take a common approach to legal issues arising out of the failure of banks, specifically small and medium-sized banks.

15. Concerning the form and type of content, the Working Group may wish to consider existing UNIDROIT instruments such as the UNIDROIT Principles on the Operation of Close-Out Netting Provisions, the UNIDROIT Legislative Guide on Intermediated Securities or the UNIDROIT Principles of International Commercial Contracts.

16. The title of the future instrument could be the 'Legal Guide on Bank Insolvency Proceedings'. Once the project has advanced sufficiently, the Governing Council's endorsement will be sought for an appropriate title.

C. Target Audience

17. As consistent with all UNIDROIT instruments, the prospective Guidance Document should be relevant for countries irrespective of their particular legal tradition and would aim to help countries make their bank insolvency frameworks more effective, allowing practitioners, judges, legislators, regulators, bank supervisors, resolution authorities and market participants to better deal with failures of (especially small and medium-sized) banks.

D. Composition of the UNIDROIT Working Group

18. Consistent with UNIDROIT's established working methods, the Working Group is composed of experts selected for their expertise in the field of bank insolvency, restructuring and deposit insurance. Experts participate in a personal capacity and represent different legal systems and geographical regions.

19. To date, the Bank Insolvency Working Group is composed of the following members:

- Ms Stefania Bariatti, (Chair), Professor, University of Milan (Italy), UNIDROIT Governing Council member

- Ms Anna Gelpern, Professor, Georgetown Law (United States)
- Mr Christos Hadjiemmanuil, Professor, University of Piraeus (Greece)
- Mr Matthias Haentjens, Professor, University of Leiden (the Netherlands)
- Mr Marco Lamandini, Professor, University of Bologna (Italy)
- Ms Rosa Lastra, Professor, Queen Mary University of London (United Kingdom)
- Mr Matthias Lehmann, Professor, University of Vienna (Austria)
- Ms Irit Mevorach, Professor, University of Nottingham (United Kingdom)
- Ms Janis Sarra, Professor, Peter A. Allard School of Law, University of British Columbia (Canada)
- Mr Reto Schiltknecht, Attorney-at-law (Switzerland)

Marco Bodellini, Centre for Commercial Law Studies, Queen Mary University of London (United Kingdom) will act as advisor to the UNIDROIT Secretariat.

20. UNIDROIT has also invited a number of intergovernmental organisations and public sector stakeholders with expertise in the field of bank insolvency, bank restructuring and deposit insurance to participate as observers in the Working Group. Participation of these organisations and stakeholders will ensure that different regional perspectives are taken into account in the development and adoption of the instrument. It is also anticipated that the cooperating organisations will assist in the regional promotion, dissemination and implementation of the Guidance Document once it has been adopted. Strong collaboration with existing standard setters in the area is of particular relevance in this project. The following organisations and public sector stakeholders have been invited to participate as observers in the Working Group to date:

- Bank for International Settlements (BIS) / Financial Stability Institute (FSI) [co-host]
- Australian Prudential Regulation Authority (APRA)
- Banca d'Italia
- Banco de España
- Bank of Ghana
- Banque de France / Autorité de Contrôle Prudentiel et de Résolution (ACPR)
- Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) (Germany)
- Canada Deposit Insurance Corporation (CDIC)
- Central Bank of Brazil
- De Nederlandsche Bank (DNB)
- Deposit Insurance Corporation of Japan (DICJ)
- European Banking Institute (EBI)
- European Central Bank (ECB)
- European Commission
- Federal Deposit Insurance Corporation (FDIC) (United States)
- Federal Reserve Bank of New York
- Swiss Financial Market Supervisory Authority (FINMA)
- Financial Stability Board (FSB)

- Hong Kong Monetary Authority (HKMA)
- International Association of Deposit Insurers (IADI)
- International Insolvency Institute
- International Monetary Fund (IMF)
- Reserve Bank of India (RBI)
- People's Bank of China (PBC)
- Single Resolution Board (SRB)
- South African Reserve Bank (SARB)
- United Nations Commission on International Trade Law (UNCITRAL)
- World Bank Group

21. Finally, UNIDROIT may invite industry associations and other private sector stakeholders to participate as observers in the Working Group, to ensure that the Guidance Document will address those stakeholders' needs. The latter may also assist in promoting the implementation and use of the Guidance Document. To date, however, no private sector stakeholders have been invited to participate as observers.

E. Methodology and Timeline

22. Under the guidance of the Chair of the Working Group and UNIDROIT Governing Council Member, Professor Stefania Bariatti, the Working Group will undertake its work in an open, inclusive and collaborative manner. As consistent with UNIDROIT's practice, in principle the Working Group will not adopt any formal rules of procedure and seeks to make decisions through consensus. Working Group meetings will be conducted under Chatham House rules in order to encourage open discussion.

23. The Working Group will meet at least twice a year (for two-three days) in Rome, unless external funding is provided to hold a meeting in a different location. Meetings are held in English without translation. Remote participation is possible, although experts are expected to attend in person if circumstances permit.

24. The documents for the Working Group meetings will generally be distributed at least 2 weeks in advance of each session. After each meeting of the Working Group, the Secretariat will share a summary report with all participants on a confidential basis, for internal purposes of the Working Group only. A separate, high level summary of the meeting will be published on the UNIDROIT website.

25. The preparation of a Guidance Document on Bank Insolvency Proceedings is a high priority project on the UNIDROIT Work Programme for the period 2020-2022. However, taking into account that the project started in the second half of 2021, it is unlikely to be feasible to complete the entire project during the current Work Programme. The following would be a tentative calendar.

(a) Development of a guidance document on Bank Insolvency over five in-person sessions of the Bank Insolvency Working Group in 2021-2023:

(i) First session: December 2021
(ii) Second session: April 2022
(iii) Third session: Autumn 2022
(iv) Fourth session: Early 2023
(v) Fifth session: Summer 2023

It is envisaged that remote meetings may be conducted when deemed necessary. Given the extraordinary circumstances, one or more of the in-person meetings may be replaced by hybrid or remote meetings. Intense inter-sessional work is planned, possibly in the form of sub-groups.

(b) Consultations and finalisation: Second half of 2023.

(c) Adoption by the Governing Council of the complete draft in 2024.

26. For a schematic overview of the proposed work plan for the period 2021-2023, please see Annex II.

F. Relationship with existing international instruments

27. The Guidance Document will focus on the key aspects of insolvency procedures applicable to banks (see in detail on the scope Section II below), for which there is currently a lack of international guidance. However, there are several international instruments that are relevant when developing the Guidance Document. It is suggested that the terminology and concepts used in the Guidance Document on Bank Insolvency Proceedings be harmonised with those of existing instruments to the extent possible, and that uniformity and consistency with their provisions ought to be ensured, while avoiding overlap in scope.

28. The *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes, adopted originally in 2011) of the Financial Stability Board (FSB) were developed after the 2008 Global Financial Crisis as an international standard and aim at allowing authorities to resolve institutions that are systemic in failure in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of their vital economic functions. The 2011 Key Attributes were complemented by general and sector-specific guidance in 2014, incorporated as Annexes to the Key Attributes. In addition, the FSB *Principles for Cross-border Effectiveness of Resolution Actions* (2015) set out statutory and contractual mechanisms that jurisdictions should consider including in their legal frameworks to give cross-border effect to resolution actions in accordance with the Key Attributes.

29. The *Core Principles for Effective Deposit Insurance Systems* (Core Principles, revised 2014) of the International Association of Deposit Insurers (IADI) are intended as a framework supporting effective deposit insurance practices by jurisdictions across the world. Jurisdictions can use the Core Principles as a benchmark for assessing the quality of their deposit insurance systems and for identifying gaps in their deposit insurance practices and measures to address them. The Core Principles are also used by the International Monetary Fund (IMF) and the World Bank, in the context of the Financial Sector Assessment Program (FSAP), to assess the effectiveness of jurisdictions' deposit insurance systems and practices.

30. Furthermore, UNCITRAL has developed a number of international instruments in the area of insolvency law. The *UNCITRAL Model law on Cross-Border Insolvency* (MLCBI, 1997) is designed to assist States to more effectively address cross-border corporate insolvency proceedings. It focuses on authorising and encouraging cooperation and coordination between jurisdictions, rather than attempting the unification of substantive insolvency law, and respects the differences among national procedural laws. In particular, it concentrates on four elements identified as key to the conduct of cross-border insolvency cases: access, recognition, relief (assistance) and cooperation.

31. The *UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation* (2009) refers to actual cases to provide information for practitioners and judges on practical aspects of cooperation and

communication in cross-border insolvency cases. Further, the *UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective* (2011, updated in 2013), offers general guidance on the issues a judge might need to consider, based on the intentions of those who developed the MLCBI and the experiences of those who have used it in practice.

32. The *UNCITRAL Legislative Guide on Insolvency Law* (2004) provides a comprehensive statement of the key objectives and principles that should be reflected in a State's corporate insolvency law. It is intended to inform and assist insolvency law reform around the world. Special considerations arising from the insolvency of banks are not specifically addressed in the Legislative Guide.

33. The *UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments* (MLIJ, 2018) was adopted to assist States in establishing a framework of provisions for recognising and enforcing insolvency-related judgments, and the Guide to Enactment to provide background and explanatory information.

34. The *UNCITRAL Model Law on Enterprise Group Insolvency* (MLEGI, 2019) was designed to equip States with modern legislation addressing the domestic and cross-border insolvency of enterprise groups, complementing the MLCBI and part three of the UNCITRAL Legislative Guide on Insolvency Law. The MLEGI focuses on insolvency proceedings relating to multiple debtors that are members of the same enterprise group, which may be located in one or more jurisdictions.

35. The UNCITRAL Model Laws explicitly allow jurisdictions to exclude banks from their scope.

36. The *World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes* (ICR Principles, originally developed in 2001) are a distillation of international best practice on design aspects of corporate insolvency and creditor/debtor systems, emphasising contextual, integrated solutions and the policy choices involved in developing those solutions. The ICR Principles were revised several times; most recently (in 2021) to help policymakers build and improve the insolvency and bankruptcy systems that support micro, small and medium enterprises (MSMEs). The *Insolvency and Creditor Rights Standard* (ICR Standard, 2011), based on the ICR Principles and the UNCITRAL Legislative Guide on Insolvency Law, is designed as a tool to assist countries in their efforts to evaluate and improve insolvency and creditor/debtor regimes. Furthermore, the *World Bank Study on Out-of-Court Debt Restructuring* (2011) offers an overview of out-of-court restructuring techniques as forming a continuum to address the problem of corporate distress.

37. The publication *Orderly and Effective Insolvency Procedures: Key Issues* (1999) of the International Monetary Fund (IMF)'s Legal Department outlines the key issues that arise in the design and application of orderly and effective insolvency procedures, including an analysis of the major policy choices that countries need to address when designing an insolvency system, a discussion of the advantages and disadvantages of these choices, and a number of specific recommendations.

Question for the Working Group:

- *Are there further international instruments and initiatives, in addition to the above-mentioned ones, that need to be considered when developing the Guidance Document?*

II. SCOPE OF THE GUIDANCE DOCUMENT

38. With regard to the scope of the Guidance Document, the experts and stakeholders that participated in the Exploratory Workshop and the UNIDROIT Secretariat concluded that the initial focus of a Guidance Document should only be on banks. The Governing Council in its 100th session confirmed this limitation of the scope, underlining the need to focus on smaller banks. The need to broaden the scope – by including aspects specific to insurance companies – could be reassessed at a later stage and is subject to the approval of UNIDROIT's Governing Council.

39. The Guidance Document would thus cover banks, irrespective of their corporate structure (e.g. joint stock companies, cooperative banks, mutual savings banks, State-owned banks etc.), however accounting for such different features where appropriate.

40. Furthermore, it was agreed that the Guidance Document should focus on scenarios of 'market exit' – i.e. proceedings aiming at the exit of the legal entity from the market – rather than restructuring. This does not mean that the activities of the failing bank would necessarily be discontinued. In fact, it may be preferable to preserve some activities of the bank in liquidation in order to avoid the destruction of value and protect depositors' savings.

41. Accordingly, the Guidance Document should cover, where deemed necessary to provide complete guidance, the key features of bank insolvency proceedings, including:

- a set of definitions of the main concepts;
- the objectives of bank insolvency proceedings;
- the institutional set-up;
- the procedural and operational aspects of the insolvency procedure;
- the preparatory phase;
- grounds for opening insolvency proceedings;
- creditor hierarchy;
- tools;
- funding;
- the treatment of derivatives, security rights, set-off;
- cross-border aspects;
- group aspects.

42. The Guidance Document should seek to identify a comprehensive set of best practices in the area of bank liquidation, with special regard to smaller banks, to complement - without any possible overlap and in full consistency with - existing international standards in related matters (see Section I above).

43. The Guidance Document would duly take into account any restrictions in the design of international guidance arising from constitutional principles and fundamental rights.

Questions for the Working Group:

- *Should the Guidance Document support the identification of criteria that would help to determine ex ante which type of 'banks' (e.g. in terms of size, business model and funding structure, e.g. only deposit-taking institutions) should be dealt with under the bank* *insolvency process and/or be subject to specific tools? And should the Guidance Document provide examples?*

- *How should the Guidance Document account for resolution regimes and tools based on the FSB Key Attributes, e.g. should it provide that insolvency proceedings should be initiated with regard to every failing bank that is not resolved under such regime?*
- *Should the Guidance Document cover holding companies of banking groups?*
- *When reviewing Section III below, the Working Group is invited to identify and consider additional aspects that should be included in the scope of the Guidance Document.*
- *The Working Group may wish to identify specific aspects for which a (comparative) analysis of constitutional principles and/or fundamental rights may be needed.*
- *The Working Group may wish to consider how, and to what extent, to account for differences in corporate structures of banks (e.g. joint stock companies, cooperative banks, mutual savings banks, State-owned banks etc.), in business models (fintech, only online institutions, etc.) or in types of activity (deposit taking institutions, investment banks, etc.).*

III. CONTENT OF THE GUIDANCE DOCUMENT

A. Definitions and legislative frameworks

44. The use of key terms such as "resolution", "insolvency" and "liquidation" varies among jurisdictions. The inconsistent use of these terms may be connected to the existence of different types of legislative frameworks for dealing with failing banks among jurisdictions.

45. First, jurisdictions may have: (i) a bank-specific insolvency regime; (ii); an ordinary corporate insolvency regime; or (iii) a modified corporate insolvency regime, meaning, a regime where corporate insolvency laws are applicable to banks but with adaptations that respond to the activities of banks and their special role in the financial system and the real economy (e.g., special tools, appointment of trustees by financial authority, etc).[2] Ordinary corporate insolvency laws are often considered ill-suited for dealing with bank failures. Due to the special nature of banks, their failure is more likely to give rise to public policy concerns than the failure of an ordinary company. A different institutional set-up and a dedicated range of tools and powers may thus be needed to effectively deal with failing banks.

46. Second, jurisdictions may have either a 'single-track' or a 'dual-track' framework for dealing with bank failures. In a single-track framework, any bank failure is dealt with under a uniform framework – generally specifically designed for banks and managed by a single administrative authority – which provides various tools and powers to enable bank failures of different sizes to be handled efficiently. In such a framework, the terms "resolution" and "insolvency" may be used as umbrella terms, encompassing various options for how to address failing banks. For instance, in the United States, "resolution" broadly covers various ways to manage a non-viable bank.

47. A dual-track framework generally distinguishes between "resolution", on the one hand, and "liquidation" or "insolvency", on the other. These are subject to separate legal frameworks and may be managed by different authorities. In the European Union, for example, insolvency proceedings are the default option for dealing with bank failures, while resolution actions – referring to the use of tools and powers based on the FSB *Key Attributes* – are taken only when specific objectives cannot be achieved in insolvency.

48. During the Exploratory Workshop, it was suggested that "insolvency" should be used as an umbrella term, encompassing resolution and liquidation, while distinguishing between the latter concepts by looking at various key aspects such as: (i) the objectives; (ii) the tools (with bail-in being a tool that is typically exclusive to resolution); (iii) the types of funding available (which would likely be more limited in liquidation); and (iv) the extent of interference with creditor expectations (e.g. the ability to deviate from the *pari passu* principle).

49. It should be noted that using "insolvency" as umbrella term would seem to be in line with practice at the IMF and the World Bank, which, in the context of bank insolvency, use the term "insolvency proceedings" as referring to *"all types of official action involving the removal of management and/or the imposition of limits on, or suspension of, the rights of shareholders and the assumption of direct control by a banking authority or other officially-appointed person over a bank that has crossed a 'threshold' for the commencement of insolvency proceedings".*[3]

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[2] According to the World Bank, approximately 69% of jurisdictions have some form of separate bank insolvency regime, see World Bank, Bank Regulation and Supervision Survey, 2019 Database-2021 Update, available at https://datacatalog.worldbank.org/dataset/bank-regulation-and-supervision-survey#tab2.

[3] IMF and World Bank, *'An overview of the legal, institutional, and regulatory framework for bank insolvency'*, Policy Papers, 2009, p. 4, available at https://www.imf.org/en/Publications/Policy-

Recommendations for the Working Group:

- *The Working Group is invited to consider how key terms such as "resolution", "insolvency" and "liquidation" may best be defined for the purposes of the Guidance Document and how these concepts could be integrated in a legal framework in a manner allowing for clear interaction and, to the extent possible, providing transparent and predictable circumstances in which specific tools and powers may be used.*

- *The Working Group is invited to consider whether any other terms should be defined in the Guidance Document (e.g. "bank", "pre-insolvency", etc.).*

B. Objectives of a bank insolvency regime

50. The main objective of corporate insolvency proceedings is typically to maximise the value of the insolvency estate to enhance payments to creditors. This can be done by means of an agreement between the debtor and its creditors, through a transfer of the business as a going concern (either through a plan with a debt for equity swap or through a sale of the business), or, when the debtor's business is not viable, through a sale of the assets on a break-up basis. By contrast, an essential and overarching objective of bank resolution systems is to maintain financial stability and avoid contagion, and the procurement of this additional aim plays a role in the application of the relevant tools. Related to this objective, resolution regimes also generally aim to ensure the continuity of a bank's critical functions; to protect insured depositors and investors; to protect public funds; to avoid unnecessary destruction of value and to minimise the overall costs of the resolution procedure (to the extent compatible with other objectives).

51. The objectives of bank insolvency regimes differ among jurisdictions, which may have an impact on the options that are available to deal with failing banks. During the Exploratory Workshop it was acknowledged that, due to the special nature of banks, focussing exclusively on value maximisation in bank liquidation proceedings might not be enough. Indeed, jurisdictions often add depositor protection to that conventional objective, for public interest reasons; the inability of depositors to access their deposits and make payments could create destabilising effects and reduce confidence in the banking sector, which may lead to contagion.

52. Other possible objectives of bank insolvency regimes mentioned during the Exploratory Workshop were ensuring the safety and soundness of the financial system (i.e. financial stability considerations) and limiting fiscal consequences.

Question and recommendation for the Working Group:

- *Should value maximisation and depositor protection be considered the main objectives of bank insolvency proceedings and/or should other objectives be identified?*

- *The Working Group may wish to follow a holistic approach when identifying the main objectives of bank insolvency proceedings, considering that they may have an impact on the design of key aspects of bank insolvency proceedings, such as the type of tools and powers that are available to deal with failing banks, the institutional model and management of the process (see points C, D and H below).*

Papers/Issues/2016/12/31/An-Overview-of-the-Legal-Institutional-and-Regulatory-Framework-for-Bank-Insolvency-PP4327.

C. Institutional models

53. There are significant divergencies among jurisdictions in the institutional set-up for bank insolvency proceedings. Institutional models can either be: (i) predominantly administrative, where the bank insolvency proceeding is managed by an administrative authority with little or no role for judicial authorities (e.g. in Brazil, Greece, Italy, Mexico, the Philippines, Poland, Switzerland and the United States); (ii) or predominantly court-based (e.g. in Canada, the United Kingdom and the majority of European Union member states), where the proceeding is driven by a court-appointed liquidator, with little or no role for administrative authorities.

54. The choice between an administrative or a court-based model entails trade-offs between factors such as speed, efficiency, specialist expertise and safeguards for creditors. The choice will likely be linked to the legal tradition of jurisdictions, the type of framework (single or dual-track), the objectives that are prioritised in the framework and the available tools.

55. During the Exploratory Workshop, participants discussed how compelling arguments may be brought forward in favour of the involvement of an administrative authority. An administrative authority with appropriate expertise may be better able to manage a bank liquidation procedure in a way that takes into account public interest objectives. Furthermore, administrative authorities may be better equipped to apply non-conventional insolvency tools such as those aiming at the transfer of deposits to another bank (see point H). Administrative authorities may also be better suited to make decisions on the use of external funding (see point I). In addition, an administrative authority may be able to proceed more swiftly than a court, which is crucial in bank insolvency procedures. Lastly, there may be a connection with resolution actions managed by an administrative authority, which could create synergies (for instance, if resolution tools are applied to a failing bank, but part of the entity needs to be liquidated or possibly in the context of a group resolution where some controlled subsidiaries – authorised as banks – might have to be liquidated).

56. On the other hand, there may be legal constraints in adopting a fully administrative-based model in some jurisdictions, since certain matters may fall within the exclusive jurisdiction of the court. Furthermore, some more 'traditional' aspects of a bank insolvency procedure might well be dealt with effectively by a court. A court-based model may also be perceived as offering greater procedural protections to creditors.

57. It was therefore posited during the Exploratory Workshop that it might be considered to apply a functional, rather than authority-based, approach.

58. There are jurisdictions that already follow a 'hybrid' approach, in which administrative authorities and courts each have a distinct role, tailored to their expertise. The resolution authority or the deposit insurer may for instance be appointed as liquidator, whereas the procedure is carried out under the supervision of the court.

59. A potential challenge in a hybrid model could be the cooperation between the court and the administrative authority and the possible tension between their functions. For example, the court will likely be more focused on due process while the administrative authority might want to proceed swiftly, for reasons of public interest. Arrangements may therefore need to be put in place to ensure that public interest considerations (including timeliness) are duly taken into account in the design of the process. For instance, any involvement of the court prior to the opening of bank liquidation proceedings could be limited to a specific timeframe and/or the insolvency procedure could be designed in different phases (e.g. an initial administrative phase for dealing swiftly with elements of public interest such as the transfer of deposits, followed by a judicial phase for dealing with the remaining assets and liabilities).

<u>*Question and recommendation for the Working Group:*</u>

- *What approach should be taken in the Guidance Document with respect to the institutional arrangements for bank insolvency proceedings? For instance, should the Guidance Document: (i) identify a preferred institutional model; (ii) follow a modular approach, whereby potential suitable actors would be identified depending on the nature of the functions within the insolvency procedure; or (iii) identify the outcomes to be achieved by the institutional model (e.g. speed, ability to take account of public interest considerations, due process etc.) without specifying the institutional arrangements to achieve those outcomes?*
- *The Working Group is invited to consider which arrangements may be appropriate in 'hybrid' models to facilitate smooth cooperation between courts and administrative authorities and to ensure a swift process.*
- *Should the Guidance Document cover judicial review mechanisms?*

D. Procedural and operational aspects of the insolvency procedure

60. Depending on the institutional model, different actors may be involved in the management of the bank insolvency process. In a court-based model, a private liquidator or insolvency administrator will likely play a key role in the proceedings. Under an administrative model, the administrative authority may either carry out the process itself or appoint and supervise one or more liquidators. Systems may furthermore provide for the establishment of a supervisory committee tasked with monitoring the liquidators.

61. In several jurisdictions with administrative-based models, the bank insolvency procedure is managed by the deposit insurer or the resolution authority. Having either of these authorities involved in the procedure may create synergies. For instance, the involvement of the deposit insurer may support the efficiency of the process since its interests are aligned with those of a substantial part of the failing bank's creditors (although this may at the same time lead to a perceived lack of impartiality). However, not all jurisdictions currently have a (public) deposit insurance authority. An advantage of involving the resolution authority (if different from the deposit insurer) would be that it would have the necessary knowledge and expertise for applying resolution-like tools, in particular the transfer of assets and liabilities of the failing bank (see point H). Involving the resolution authority could also create synergies, for instance if resolution tools are applied to a failing bank (or banking group) while part of the entity (or certain group entities) would need to be liquidated.

62. Furthermore, there are differences among jurisdictions with respect to aspects such as the selection, appointment, supervision, remuneration, accountability and legal protection of the person in charge of the insolvency proceedings. For instance, the remuneration of an appointed liquidator may be either fixed, time-based or recovery-based. As regards legal protection, taking into account that certain aspects of the procedure will likely entail discretion, it may be considered whether to provide the person in charge of the procedure with protection against liability from acts or omissions in good faith in the exercise of its functions, to reduce the risk that legal challenges would impede the bank insolvency process. In addition, divergences exist with respect to the legal standing to file insolvency and the role of creditors in the procedure (which in bank-specific or modified proceedings is generally limited compared to ordinary corporate insolvency regimes).

Recommendations for the Working Group:

- *The Working Group is invited to consider whether to recommend the involvement of specific administrative authorities in (certain parts of) the bank liquidation process.*
- *The Working Group is invited to identify and analyse the possible options regarding the selection, appointment, supervision, remuneration, accountability and legal protection of the person managing the bank liquidation procedure; the legal standing to file insolvency; and the role of creditors in the procedure.*

E. Preparation

63. In ordinary corporate insolvency scenarios, the amount of preparation prior to the opening of the liquidation procedure is generally limited (or, in the case of piece meal liquidation, often absent). In bank resolution, on the other hand, advance preparation is key. In fact, a significant part of the work of resolution authorities is devoted to planning for potential resolution actions and ensuring that the identified strategy can be applied. For instance, resolution authorities draw up resolution plans, banks are required to build up and maintain loss-absorbing capacity and resolution authorities have a range of powers to improve banks' resolvability. In addition, a valuation of the assets and liabilities is generally carried out – by an independent valuer or the resolution authority itself – prior to taking resolution action.

64. For a bank insolvency procedure, the amount of required preparation may vary depending on the available toolkit (see point H), hence the existing differences among jurisdictions. In particular, a swift transfer of deposits from the failing bank to another bank may not be feasible unless the relevant authority has access to comprehensive, accurate and up-to-date data (which may come from the supervisor and/or directly from the bank). Preparation may also include carrying out a valuation of the assets and liabilities of the failing bank, setting up a virtual data room, enabling potential purchasers to conduct on-site due diligence, and drawing up the necessary documentation to carry out a competitive bidding process. On the other hand, preparation may be more limited (focused on the pay-out of depositors) in jurisdictions where only a piecemeal liquidation is possible.

65. It was noted during the Exploratory Workshop that, while the level of planning for bank insolvency proceedings may not need to be the same as for resolution action, in order to effectively meet the relevant objectives – e.g. depositor protection – some form of preparation is likely needed. For instance, some form of valuation may be needed to identify the perimeter to be transferred, the potential funding gap and to assess the appropriateness of any offers of potential purchasers. On the other hand, it could be argued that - provided that a sufficiently competitive sales process is followed during which potential purchasers carry out a due diligence – these elements could be left to be determined directly by the market.

66. Readiness may be facilitated by the authority in charge of the bank liquidation process having sufficient advance notice that a bank is likely to fail. Therefore, the Working Group may wish to consider to what extent the Guidance Document should reflect that bank failures typically give rise to measures by a range of actors (supervisors, central banks, deposit insurers), for example by describing how jurisdictions coordinate such measures with insolvency proceedings (e.g. a notification requirement from the banking supervisor that the bank is (likely) failing, etc.).

Recommendations and questions for the Working Group:

- *The Working Group is invited to consider to what extent prior preparation may be required for bank insolvency proceedings and what such preparation may consist in, with special consideration for small banks. For instance:*
  - *Should the Guidance Document provide guidance on any valuation of the assets and liabilities of the failing bank?*
  - *Depending on the type of tools, should the Guidance Document provide for criteria to carry out a marketing process, e.g. in order to ensure transparency and sufficient competition, and address preparatory actions such as the setting up of a virtual data room?*
  - *Should the Guidance Document provide best practices on confidentiality and public disclosure? E.g. should it suggest an exemption/temporary delay from potentially applicable public disclosure requirements during the preparatory process?*
- *The Working Group is invited to consider how readiness may be facilitated and how to ensure a smooth continuum in the crisis management framework, for instance by considering cooperation requirements with the banking supervisor.*

F. Grounds for opening insolvency proceedings

67. Ordinary corporate liquidation proceedings are generally triggered on the grounds that: (i) the company's liabilities exceed its assets (balance sheet insolvency); or (ii) the company is unable to pay its debts as they fall due (illiquidity).

68. Due to the special nature of banks, these grounds may be inappropriate as triggers to commence bank insolvency proceedings. In particular, waiting for balance sheet insolvency may lead to an undesirable destruction of value and contagion, and the concept of illiquidity (as applied in corporate insolvency proceedings) may not be adequate given banks' function in maturity transformation and their high reliance on demand deposits. In many jurisdictions, bank insolvency regimes therefore include a wider range of grounds for opening bank liquidation proceedings, although the content of these triggers may vary. Generally, two types of additional grounds may be identified: forward-looking triggers and regulatory triggers.

69. Forward-looking triggers allow the opening of the insolvency proceedings if the bank is technically solvent and liquid but that is likely to change (the bank is 'likely to fail' or 'likely to be no longer viable'). Timely opening of insolvency proceedings reduces the risk of value being destroyed in the period prior to insolvency, e.g. due to the exit of sophisticated investors, and may facilitate the use of transfer tools.

70. Regulatory triggers may include, for instance, the breach of bank-specific regulatory thresholds (e.g. if the bank's capital ratio falls below a certain level) or other breaches that may cause the withdrawal of the banking licence. Certain jurisdictions may have automatic quantitative triggers. However, during the Exploratory Workshop it was suggested that automatic triggers on the basis of quantitative criteria may not be appropriate, considering the need to take into account the macroeconomic situation and specific circumstances of the case. There may also be legal constraints on the introduction of automatic triggers.

71. Furthermore, an additional 'negative' condition, namely the absence of alternatives to insolvency (e.g. supervisory measures and private or public sector interventions) was also suggested during the Exploratory Workshop.

72. In dual-track frameworks (see point A), some jurisdictions have different triggers for resolution and insolvency. This risks creating situations in which a bank that is no longer viable may not be subject to either regime. In order to avoid such situations, the non-viability conditions for bank insolvency proceedings should ideally be aligned with the triggers for resolution.

Recommendation and questions for the Working Group:

- *The Working Group is invited to consider how traditional insolvency grounds need to be adapted to the specific needs of banking. Moreover, it is invited to consider identifying forward-looking and regulatory grounds, and to take the relationship with the conditions for the application of resolution tools into account.*
- *Should the grounds for initiating bank insolvency proceedings include a 'negative' condition?*
- *Should meeting the grounds for bank insolvency automatically lead to the withdrawal of the banking license? Should the license be withdrawn within a specific timeframe?*
- *Who should be able to open the bank insolvency process? For instance, should this be exclusively in the hands of public authorities (e.g. banking supervisor or resolution authority) or should also e.g. the bank itself and/or shareholders or creditors have legal standing? Should the Guidance Document express views on potentially existing private/voluntary liquidation processes?*

G. Creditor hierarchy

73. The significant divergences among jurisdictions in creditor hierarchies are generally regarded as one of the core issues arising from the lack of harmonised bank liquidation laws, and are problematic for several reasons. They can lead to unequal treatment of creditors across jurisdictions, uncertainties and unpredictability in a cross-border bank liquidation scenario. Moreover, in certain jurisdictions, the ranking of creditors in liquidation may differ from the order of loss absorption in resolution, leading to challenges in the application of the 'no-creditor-worse-off' principle in resolution and an increase in litigation risks.

74. Some jurisdictions have a general creditor hierarchy that is applicable to all firms, whereas others apply a specific creditor hierarchy for banks, or have introduced specific rules concerning the ranking in insolvency only with a view to facilitating the application of the bank resolution regime.

75. Apart from these formal differences, great divergences exist in the substance of creditor hierarchies. A distinction can be drawn between four broad categories of claims: (i) subordinated claims; (ii) senior claims; (iii) preferred claims; and (iv) secured claims.

76. There are important differences, for instance, with respect to the treatment of shareholder loans and intragroup liabilities, which may or may not be subject to statutory subordination. The difference between the treatment of claims of depositors is particularly relevant in the context of

bank insolvency proceedings. While many jurisdictions have introduced a "depositor preference",[4] this may take various forms. In particular, jurisdictions may have:

(i) General depositor preference, meaning that all deposits have a higher ranking than claims of ordinary unsecured, non-preferred creditors;

(ii) Tiered depositor preference, meaning that deposits eligible for deposit insurance coverage rank higher than claims of ordinary unsecured, non-preferred creditors, while insured depositors have an even higher ranking than eligible deposits;

(iii) Eligible depositor preference, meaning that all eligible depositors have a higher ranking than claims of ordinary unsecured, non-preferred creditors;

(iv) Insured depositor preference, meaning that only insured depositors are granted a priority ranking; or

(v) No depositor preference, meaning that deposits are ranked *pari passu* with other unsecured, non-preferred creditors.

Furthermore, there are differences among jurisdictions concerning the treatment of domestic and foreign deposits.

77. The design and scope of depositor preference entails trade-offs in allocating proceeds between different classes of depositors and other creditors, and in the expected reimbursement of the deposit insurer (which subrogates to the rights of the insured depositors). The latter may also have a critical impact on the available funding in bank liquidation proceedings to the extent that some form of financial cap applies that compares the costs to the deposit insurer of such funding to the costs of pay-out.

78. A full alignment of creditor hierarchies among jurisdictions would be unrealistic, given the close relationship with policy considerations and domestic corporate insolvency law. It may also be challenging to achieve a full alignment between the ranking in liquidation and the resolution hierarchy. While this may be operationally preferable, a special treatment of certain liabilities (i.e. their exclusion from bail-in) may be justified in a resolution context while this may not be the case in a liquidation scenario. Nevertheless, a certain extent of harmonisation might already greatly contribute to addressing the current problems.

Questions and recommendation for the Working Group:

- *Should the Guidance Document focus on specific elements of creditor hierarchies and, if so, which ones?*
    - *If addressing the ranking of depositors in the Guidance Document, how should this be done (e.g. by describing different options and their implications and/or by identifying preferred solutions)? Should insured depositors and the DGS subrogating to these deposits have the same ranking?*
    - *If addressing the ranking of intragroup liabilities, should the Guidance Document identify a preferred solution?*

[4] The IADI Core Principles define "depositor preference" as: *"granting deposit liabilities a higher claim class than other general creditors against the proceeds of liquidation of an insolvent bank's assets. Depositors must be paid in full before remaining creditors can collect on their claims. Depositor preference can take a number of different forms. […]."*

  - *Should any guidance be provided on the ranking of financing provided in the pre-liquidation stage, when the bank was already in a situation of distress (e.g. 'recovery' / debtor-in-possession financing)*

- *Should the Guidance Document aim at aligning the ranking in insolvency with the order of loss absorption in resolution, e.g. implying that liabilities excluded from bail-in would be granted a priority ranking in insolvency?*

- *The Working Group may consider analysing creditor hierarchy as a relative concept, rather than focusing on absolute ranks.*

H. Tools

79. The range of tools available in bank liquidation proceedings varies across jurisdictions. In some countries, only an 'atomistic' or 'piecemeal' liquidation is possible. In such case, the bank's operations are disrupted immediately and all customer relationships are resolved. Assets and collateral are sold and creditors' claims are settled against the proceeds from the liquidation. Losses are distributed in accordance with the creditor hierarchy. Insured depositors are generally protected from having to suffer losses and receive a pay-out from the relevant deposit insurance scheme. Other creditors need to wait until a later stage for the potential reimbursement of their claims.

80. In other jurisdictions, the insolvency regime applicable to banks provides for a broader toolkit. Jurisdictions may allow the transfer of part of the failing bank's business – in particular, the deposits – to another bank. It may also be possible to transfer assets and liabilities to a bridge bank – generally a publicly-owned entity intended to take over and continue operating certain functions of the bank – or to an asset management company, generally used to work out distressed assets in the most effective way.

81. A piecemeal liquidation has several drawbacks. It could lead to a destruction of value if assets are sold at fire sale prices, borrowers may be exposed to liquidity constraints and creditors (other than insured depositors) would likely need to wait a long time for a potentially partial reimbursement. Furthermore, while legislation generally requires a rapid pay-out to insured depositors, the actual speed and timing of such pay-out may differ among jurisdictions. Considering that the use of cash is decreasing, the lack of access to deposits and payment systems may increasingly create disturbance. Depending on the characteristics of the bank and the macroeconomic situation, a piecemeal liquidation may also reduce confidence in the banking system and lead to contagion.

82. The use of transfer tools in bank insolvency proceedings may address these shortcomings. By having the ability to transfer entire customer relationships, franchise value may be preserved, which would lead to an increase in returns for creditors. Furthermore, a pay-out of insured deposits could be avoided, and depositors experience minimal interruption in accessing and using their bank accounts. Given that certain functions of the bank may continue, the risk of contagion is lower.

83. At the same time, the transfer of part of the failing bank's business relies on there being market appetite for the acquisition. This may not always be the case. In particular, there may be a need to transfer a large amount of liabilities – such as insured deposits – while the market value of the accompanying assets may be lower, due to their more limited amount and/or quality. This means there may be a 'funding gap'. In the absence of a solution to fill the funding gap, it may be challenging, if not impossible, to find a willing buyer. Some jurisdictions therefore provide for the possibility of financial support, often in the form of a contribution from the deposit insurer (see point

I). In addition, the effective use of transfer tools may be connected to the type of institutional model (see point C) and the extent of preparation prior to the bank's failure (see point E).

Questions for the Working Group:

- *Should bank insolvency regimes include the possibility of transferring assets and liabilities of the failing bank to a private purchaser, a bridge institution and/or asset management company? If so, which aspects should the Guidance Document address? E.g. Should it provide best practices regarding the preparation for such transfer and/or the factors that may impact the ability to carry out the transfer effectively (e.g. the ability to override consent requirements)?*

- *Should any other tools and/or powers be available to the person in charge of the liquidation process?*

- *Should tools be available if and when the grounds for opening insolvency proceedings are established, or should certain tools be subject to additional conditions? Is there a need to establish a 'hierarchy' of tools?*

- *Should bank liquidation regimes provide specific protections for creditors in relation to the choice of liquidation tools or their treatment of certain liabilities?*

I. Funding

84. The type and extent of funding available in bank liquidation proceedings varies across jurisdictions. In general, it is considered that the use of public funding should be avoided in order to reduce moral hazard, protect the public budget and preserve a level playing field. Some jurisdictions do not foresee any type of funding, except for the use of a deposit insurance scheme for the pay-out of insured depositors. In other jurisdictions, the resources of the deposit insurer may also be used beyond the pay-out of insured depositors in an atomistic liquidation, e.g. to fill the funding gap when transferring assets and liabilities of the failing bank to a third party. Other forms of financial support that may be available in bank liquidation regimes are the provision of guarantees or the entry into loss-sharing arrangements with banks that take over part of the failing banks' assets and liabilities.

85. In jurisdictions where the deposit insurer can use its funds for purposes other than pay-out, the use of the deposit insurance fund is generally limited through the application of a financial cap or 'least-cost principle'. The exact meaning of this principle varies among the jurisdictions where it exists. For instance, in the European Union it refers to the requirement whereby the costs borne by the deposit insurer must remain below the net costs that the deposit insurance fund would have incurred for pay-out to insured depositors of the failing bank (i.e. in a piecemeal liquidation).[5] In other jurisdictions (e.g. the United States), the deposit insurer must pursue the least cost option in most cases, requiring the costs to the deposit insurance fund to be compared not only with pay-out but with any other alternatives in liquidation.

86. In several jurisdictions where the deposit insurance fund may in principle be used beyond depositor pay-out, its use is currently limited. This may be the result, for instance, of a super-priority ranking of insured depositors in combination with the application of the least-cost principle. A high ranking of insured depositors risks that the deposit insurance fund, which subrogates to their claims, may face only limited costs in a pay-out scenario. When applying the least-cost principle in a manner

[5] Article 11(6) of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes.

that limits the use of the deposit insurance fund to the net amount of costs in a pay-out, this would make the use of deposit insurance funding to finance a transfer of assets and liabilities highly unlikely.

<u>*Questions and recommendation for the Working Group:*</u>

- *Should bank insolvency regimes include the possibility to use external funding to facilitate the use of specific tools? If so, what should the source of such funding be and who should decide on its use?*
- *The Working Group is invited to consider the relationship between the potential use of the deposit insurance fund and the ranking of deposits, the insurance level of insured deposits and the computation and application of the least-cost principle.*
- *Should the Guidance Document provide best practices on the calculation of the potential funding gap, e.g. by means of an ex ante due diligence/valuation process? Should it be possible to make adjustments to the amount of external funding ex post, by foreseeing this as a possibility in the sales documentation and/or in statutory provisions?*
- *Should the Guidance Document establish principles regarding private-sector burden-sharing where a transfer tool is used? E.g. should external funding be allowed only after certain classes of creditors have suffered a certain amount of losses?*

J. Treatment of financial contracts

87. Financial contracts may be treated differently in going concern, liquidation and resolution. The extent to which close-out netting of financial contracts is possible is particularly relevant, since this can dramatically shrink the pool of assets available for other unsecured creditors.

88. Close-out netting is described as follows in the UNIDROIT Principles on Close-Out Netting:

> *"Close-out netting is best described in functional terms, i.e., by reference to a result. The process, in practical terms, is the following. A bundle of transactions with mutual obligations between the parties is contractually covered by a netting provision. Upon the occurrence of a predefined event, all outstanding obligations covered by the netting provision cease to be treated individually and their aggregate value is computed so as to result in a single net payment obligation. This obligation is owed by the party which is 'out of the money' to the party which is 'in the money'. This obligation remains the only obligation (which, depending upon the terms of the relevant provision, may include incidental fees, costs or other expenses) to be settled and is generally due and payable shortly after being determined."*[6]

89. Existing international standards promote the enforceability of close-out netting provisions also upon commencement of insolvency proceedings, in order to reduce counterparty and systemic risk. For instance, the UNICTRAL Legislative Guide on Insolvency Law refers to the enforceability of close-out netting as a feature to be considered when designing insolvency law, and advises that close-out netting be allowed under the applicable insolvency procedure.[7]

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[6] UNIDROIT, Principles on the Operation of Close-Out Netting Provisions (2013), Principle 2 and par. 19.
[7] UNCITRAL Legislative Guide on Insolvency Law (2004), Recommendations 7(g) and 101-107.

90. On the other hand, a discretionary or automatic temporary stay on termination rights may be applicable when resolution tools are applied, to allow the resolution authority the time needed to decide whether and how to resolve an ailing financial institution in an orderly fashion.[8]

Question and recommendations for the Working Group:

- *To what extent should the Guidance Document provide guidance on the treatment of financial contracts in bank insolvency proceedings? For instance, should it address safe harbours for derivatives? Should it take into account that different tools may be used in bank insolvency proceedings?*
- *The Working Group is invited to consider whether a contractual or a statutory approach would be preferable for establishing rules on the treatment of financial contracts in bank insolvency.*
- *The Working Group is invited to identify, and consider including in the scope, other aspects of bank liquidation proceedings where similar issues may be at stake, such as the bank's right of set-off and the treatment of secured debt.*

K. Cross-border aspects

91. The Exploratory Workshop discussed how cross-border aspects are key for any bank. Yet, there are no international standards to guide such aspects of bank insolvency proceedings.[9] Cross-border complexities and divergencies lead to legal uncertainty and unpredictability. The scale of the problems increases with the number of jurisdictions involved, which may be many in the case of banks. The lack of international standards is problematic, particularly with regard to two key aspects: (i) cross-border coordination between authorities involved in bank liquidation proceedings; and (ii) the arrangements for recognising or giving effect to foreign bank liquidation proceedings.

92. Firstly, material differences between bank liquidation proceedings hinders adequate cross-border coordination and cooperation. Jurisdictions have different institutional models, different steps within their liquidation processes and different rules governing the exchange of information, which makes effective cooperation challenging. It may also be challenging to access courts and participate in bank liquidation proceedings in foreign jurisdictions.

93. Second, jurisdictions have different mechanisms in place for cross-border recognition or support measures. They may apply the doctrine of international comity, however there may be differences in the application of the doctrine and the process is generally time-consuming. Jurisdictions may also rely on statutory or contractual[10] mechanisms. However, the content of such mechanisms varies, and makes cross-border recognition subject to different terms and conditions. For instance, foreign jurisdictions may be permitted to consider the impact that providing or refusing recognition or support may have on their jurisdiction, including in terms of financial stability, fiscal consequences and creditor protection. Furthermore, it may or may not be possible to only partially

[8] FSB Key Attribute 4.2 and 4.3.

[9] The UNCITRAL Model Laws on Cross-Border Insolvency and on Enterprise Group Insolvency are global frameworks that address coordination and recognition of cross-border (group) insolvency actions. However, these Model Laws allow jurisdictions to exclude banks from the framework.

[10] For instance, in bank resolution procedures, the ISDA 2015 Universal Resolution Stay Protocol and the ISDA Resolution Stay Jurisdictional Modular Protocol play a significant role.

recognise or give effect to the measures taken by the authority in the jurisdiction that initiated the proceedings.

94. The Exploratory Workshop discussed the possible merits of establishing a principle of recognition for bank liquidation proceedings. The scope of such a principle should be clearly identified, e.g. by including a list of decisions in the various jurisdictions that may be subject to recognition. It was further discussed that the grounds for refusal should be limited, as clearly defined as possible, and adapted to the measures for which recognition is being sought.

95. The Working Group may wish to consider existing standards for cross-border resolution, to the extent they may provide elements appropriate for bank liquidation. The FSB *Key Attributes* require jurisdictions to provide for transparent and expedited processes to enable resolution measures taken by a foreign resolution authority to have cross-border effect provided that domestic creditors are treated equitably in the foreign resolution proceedings.[11] Further guidance is provided in the FSB *Principles for Cross-border Effectiveness of Resolution Actions*. Those principles recommend that jurisdictions apply a statutory framework for the recognition, enforcement or support actions, which clearly establishes the conditions, the grounds for refusal – which ought to be limited – and the process. They also indicate that the process for giving effect to foreign resolution measures should be guided by the principle of equitable treatment of creditors, and that the process should be expedited. Until statutory approaches have been fully implemented, it recommends the adoption of contractual approaches, in particular in relation to: (i) temporary stays on the exercise of early termination rights in financial contracts; and (ii) the write-down, cancellation or conversion of debt instruments governed by the law of a foreign jurisdiction (bail-in).

Recommendations and questions for the Working Group:

- *The Working Group is invited to identify the specific issues and challenges that are currently encountered with respect to cross-border recognition or giving effect to bank liquidation proceedings (as opposed, perhaps, to bank resolution measures).*

- *The Working Group is invited to consider how the Guidance Document might facilitate cross-border recognition. For instance, should it establish a principle of cross-border recognition? If so, what should be the scope of such a principle and the grounds for refusing recognition?*

- *The Working Group is invited to consider how the Guidance Document might facilitate effective cooperation between home and host authorities, irrespective of the institutional model and actors involved. For instance, should it contain a principle of cooperation?*

- *The Working Group is invited to identify any other aspects of cross-cooperation to be addressed in the Guidance Document, such as notice, information-sharing, access to courts and standing.*

L. Group dimension

96. Generally, national insolvency rules are entity-centric, meaning that entities of a banking group in different jurisdictions are normally subject to distinct insolvency regimes and procedures.[12] Entities within a banking group may even be subject to different rules within a certain jurisdiction, depending

[11] FSB Key Attribute 7.5.

[12] By contrast, in resolution a 'single point of entry' strategy may be followed whereby tools are applied - and losses are absorbed - at the level of a specific group entity, usually the parent / holding company.

on the type of activities they carry out. Indeed, few countries, if any, have tools for resolving domestic financial groups – as distinct from individual banks – in an integrated manner in their own jurisdictions, let alone on a cross-border basis. Apart from the difficulties that this may cause in terms of cross-border recognition and coordination (see point K), not taking account of the integrated, multinational reality of banking groups may create further issues.

97. In particular, the lack of international guidance[13] in combination with legal entity-based proceedings may be problematic when dealing with intra-group connections and exposures. Entities within a banking group may be connected through: (i) financial support measures, such as intra-group guarantees, loans or equity arrangements; and (ii) operational support measures, such as a common IT system or common legal services.

98. Intra-group support measures are designed to benefit from synergies, create an integrated group and prevent fragmentation. While these measures may work well in a going-concern situation, they may conflict with the objectives in liquidation proceedings. For instance, there is an inherent clash between intragroup support measures and the objective of insolvency administrators to maximise the value of the estate.

Recommendation and questions for the Working Group:

- *The Working Group is invited to consider how to address and account for the integrated nature of banking groups in bank liquidation proceedings. For instance: (i) Should foreign branches be included within the scope of liquidation of a legal entity? (ii) What should be the role, if any, of group insolvency plans drawn up by the banking group? (iii) Should a safe harbour provision be introduced for intragroup support measures?*

[13] The UNCITRAL Model Law on Enterprise Group Insolvency provides a carve-out option for banks and the Directive 2001/24/EC on the reorganisation and winding up of credit institutions (Credit Institutions Winding Up Directive) is only applicable within the European Union.

ANNEX I

ADDITIONAL RESOURCES

UNIDROIT Instruments

UNIDROIT, Principles on the Operation of Close-Out Netting Provisions (2013)
https://www.unidroit.org/wp-content/uploads/2021/06/netting-English.pdf

UNCITRAL Instruments

UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law (2004-2019)
https://uncitral.un.org/en/texts/insolvency/legislativeguides/insolvency_law

UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency (1997) with Guide to Enactment (2013)
https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/1997-model-law-insol-2013-guide-enactment-e.pdf.

UNCITRAL, UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment (2019)
https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-11346_mloegi.pdf.

UNCITRAL, UNCITRAL Model law on Recognition and Enforcement of Insolvency-Related Judgments (2018)
https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/ml_recognition_gte_e.pdf

UNCITRAL, UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective (revised 2013)
https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/judicial-perspective-2013-e.pdf

UNCITRAL, UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (2009)
https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/practice_guide_ebook_eng.pdf

Other Instruments

FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, revised (2014)
Key Attributes of Effective Resolution Regimes for Financial Institutions (fsb.org)

FSB, Principles for Cross-border Effectiveness of Resolution Actions (2015)
https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf

IADI, Core Principles for Effective Deposit Insurance Systems, revised (2014)
https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf

IMF, Orderly and Effective Insolvency Procedures: Key Issues (1999)
https://www.elibrary.imf.org/view/books/071/05062-9781557758200-en/05062-9781557758200-en-book.xml

World Bank, Principles for Effective Insolvency and Creditor/Debtor Regimes, revised (2021)
https://openknowledge.worldbank.org/bitstream/handle/10986/35506/Principles-for-Effective-Insolvency-and-Creditor-and-Debtor-Regimes.pdf?sequence=1&isAllowed=y

World Bank, Study on Out-of-Court Debt Restructuring (2011)
https://documents1.worldbank.org/curated/en/417551468159322109/pdf/662320PUB0EPI00turing09780821389836.pdf

ANNEX II

WORK PLAN 2021-2023

Activity	**Responsibility***	**2021**	**2022**				**2023**				**2024**
		Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Set up of WG	UNIDROIT Sec										
1st WG meeting	UNIDROIT Sec										
Preparation of 1st version of selected draft chapters	UNIDROIT Sec & WG rapporteurs										
2nd WG meeting	UNIDROIT Sec										
Preparation of (revised) draft chapters	UNIDROIT Sec & WG rapporteurs										
3rd WG meeting	UNIDROIT Sec										
Preparation of (revised) draft chapters	UNIDROIT Sec & WG rapporteurs										
4th WG meeting	UNIDROIT Sec										
Preparation of revised draft Guidance Document	UNIDROIT Sec & WG rapporteurs										
5th WG meeting	UNIDROIT Sec										
Consultations and finalisation of draft Guidance Document	UNIDROIT Sec, in coordination with WG										
Submission of draft to UNIDROIT GC for adoption	UNIDROIT Sec										

*Throughout the project, the UNIDROIT Secretariat will work in close cooperation with the FSI.