



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

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**UNIDROIT Working Group on Bank
Insolvency**

First session (hybrid)
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SUMMARY REPORT
OF THE FIRST SESSION
(13-14 December 2021)

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1. The first session of the Working Group on Bank Insolvency (the Working Group) took place in a hybrid format on 13 and 14 December 2021. The Working Group was attended by 10 Working Group members and 28 observers, including representatives from international and transnational organisations, central banks, deposit insurance corporations and resolution authorities, as well as members of the UNIDROIT Secretariat (the list of participants is available in [Annex I](#)).

Item 1: Opening of the session and welcome by the UNIDROIT Secretary-General and the Chair of the BIS Financial Stability Institute

2. *The Chair* welcomed all participants to the first session of the Working Group, followed by opening remarks by *the Chair of the BIS Financial Stability Institute* and *the UNIDROIT Secretary-General*.

3. *The Chair of the BIS Financial Stability Institute* noted that financial crisis management is at the core of the work of the BIS and that international guidance in the area of bank insolvency is much needed. As an example, he referred to the conditions for initiating bank insolvency proceedings, which differ across jurisdictions and may impact the adequacy of the process. He noted that this example also illustrates why bank-specific guidance is needed: since the failure of banks may give rise to public policy concerns, the grounds for bank insolvency proceedings may need to be broader than the balance sheet test used in corporate insolvency proceedings. He underlined that the guidance to be developed by the Working Group would complement the FSB *Key Attributes* and aim at assisting policymakers around the world to ensure that bank insolvency frameworks are fit for purpose, especially for dealing with the failure of small and medium-sized banks.

4. *The UNIDROIT Secretary-General* explained that the project on Bank Insolvency was initiated at the request of the Bank of Italy and the European Banking Institute, and motivated by the lack of international guidance on insolvency proceedings for failing smaller banks and the existence of different practices across jurisdictions. He indicated that the project aims at identifying best practices and, where appropriate, at advancing recommendations, while taking into account the context of jurisdictions around the world. Since the subject matter involves both private law and regulatory law, UNIDROIT is undertaking a partnership with the BIS Financial Stability Institute.

5. *The UNIDROIT Secretary-General* indicated that the project will be conducted under Chatham House Rules and is expected to take approximately two years, with three-day meetings of the Working Group at least twice a year, intersessional work through subgroups, and *ad hoc* workshops where appropriate. He noted the significant expertise and experience of the participants and asked everyone to provide input and share experiences during the course of the project.

Item 2: Adoption of the agenda of the meeting and organisation of the session

6. *The Chair* introduced the annotated draft agenda and the organisation of the session.

7. *The Working Group adopted the draft Agenda as proposed (UNIDROIT 2021 – Study 84 – W.G.1 – Doc. 1, available in Annex II). In the course of the meeting, it was agreed to maintain only one coffee break on both days.*

Item 3: Consideration of matters identified in the Issues Paper

a) Preliminary matters

8. *A member of the UNIDROIT Secretariat* introduced Section I of the Issues Paper. Concerning the format of the future document, inspiration could be drawn from previous UNIDROIT instruments, as

mentioned in Section I.B of the Issues Paper. Regarding the composition of the Working Group (Section I.D), she noted that several additional observers had joined. After briefly touching upon the methodology and timeline for the project (Section I.E), she explained that Section I.F of the Issues Paper provided an overview of existing international instruments that may be relevant when developing the future Guidance Document, in particular for terminology and definitions but also to avoid overlap and ensure consistency with existing standards. Participants were invited to express their views on the international documents that should be referred to in the Issues Paper.

9. It was suggested that the following additional documents be included in the list of relevant existing international instruments: the *Report and Recommendations of the Cross-Border Bank Resolution Group* of the Basel Committee on Banking Supervision (BCBS); the IMF's *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination*; the joint IMF-World Bank publication *An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency*, which followed the Global Bank Insolvency Initiative; the FSB's *Key Attributes Assessment Methodology for the Banking Sector*; and the BCBS' *Core Principles for Effective Banking Supervision* (in particular, Core Principle 11). Furthermore, some clarifications were made regarding relevant UNCITRAL documents.

10. It was discussed that transnational documents, such as European Union (EU) legislation, could be considered as relevant law for the purposes of comparative analyses.

11. Lastly, it was explained that the structure of the Guidance Document would be defined over time, based on the discussions in the Working Group and the evolution of the Issues paper.

b) Scope of the proposed Guidance Document

12. A member of the UNIDROIT Secretariat introduced Section II of the Issues Paper, which discussed the scope of the Guidance Document. She noted that the future instrument would cover banks, especially smaller banks. Participants were invited to define the type of entities to be covered by the Guidance Document in more detail.

13. It was discussed that it could be considered to adopt a functional approach towards the definition of 'bank', i.e., identifying mainly deposit-taking or deposit-taking and lending as core functions. The need to focus on smaller banks was underlined, even if this project may also be relevant for larger banks.

14. It was underlined that the bank insolvency regime should be a seamless complement to resolution frameworks, which may in principle apply to any bank. Therefore, it was argued, it may be preferable to avoid developing detailed criteria that classify banks as subject to one specific regime in advance of their failure. It was noted that the scope of the future Guidance Document could be defined by exclusion, i.e., to cover institutions that would not (entirely) be resolved under a resolution regime.

15. The Working Group generally supported the inclusion of bank holding companies in the scope, even if some suggested focusing on single entity liquidation first. Participants also discussed whether investment banks should be included. Furthermore, participants generally agreed that the Guidance Document should cover banks irrespective of their legal structure. It was suggested to develop an overview of the types of banks across the world, taking into account different legal structures and business models.

16. The Working Group also discussed to what extent technological developments and Fintech (e.g., digital banks) should be taken into account. It was considered that there may be merit in adopting a flexible approach in terms of business model and technological developments to ensure that the instrument would be, to the extent possible, future-proof.

17. As for the topics to be covered by the Guidance Document, it was suggested to consider adding 'safeguards' and 'access to liquidity'. Several possible subtopics of liquidity were discussed and participants took different views as to whether to address them in the future instrument. There was agreement that this project should in any case not revise any existing standards, including central bank standards.

18. Lastly, as regards constitutional principles and/or fundamental rights for which further analysis may be needed, it was suggested that property rights and expropriation may be relevant issues.

c) Content of the proposed Guidance Document

Definitions and legislative frameworks

19. A member of the UNIDROIT Secretariat introduced Section III.A of the Issues Paper, on definitions and legislative frameworks. She invited participants to express their views on the potential use of an umbrella term – which would encompass both bank resolution and bank liquidation proceedings – and on other definitions to be included in the future Guidance Document.

20. The Working Group considered several possible umbrella terms. While some contemplated that "insolvency proceedings", might be used as an umbrella term, many participants preferred to avoid the term "insolvency", noting its potential ambiguity. The Working Group reached some consensus on the use of "bank failure management" as an umbrella term.

21. Furthermore, it was discussed that there may be merit in understanding liquidation proceedings as a process leading to the dissolution of a legal entity. It was also noted that the objectives may be relevant for the definitions.

22. The Working Group considered whether and, if so, how to define the difference between resolution and liquidation. While some tried to distinguish clearly between resolution and liquidation, others suggested that it may not be possible, desirable or necessary to completely separate the two regimes. In this context, it was recalled that the future instrument would be a valuable complement to the existing resolution standards, since it would integrate an effective bank liquidation framework in the resolution framework.

23. As for other definitions to be included in the Guidance Document, it was suggested that "bank" should be defined and an inventory of relevant banking terms and insolvency terms developed.

24. It was suggested that the terminology be further refined as work progressed, taking into account the discussions on other topics.

Objectives of a bank insolvency regime

25. A member of the UNIDROIT Secretariat introduced Section III.B of the Issues Paper on objectives of a bank insolvency regime. Participants were invited to express their views on value maximisation and depositor protection as potential main objectives, and on any further objectives to be included in the instrument.

26. It was discussed that there may be merit in identifying a limited number of general objectives, and to consider establishing a hierarchy in case multiple objectives would be identified.

27. The Working Group generally agreed that value maximisation and depositor protection could be considered relevant objectives of bank liquidation proceedings. As regards depositor protection, it was discussed whether to specify which depositors should be protected. It was also noted that the relevance of the objectives may depend on the circumstances of the case.

28. The Working Group discussed whether overlap with the resolution objectives (e.g., the continuation of critical functions, maintaining financial stability) would be beneficial or should, to the contrary, be minimised. Arguments for both views were brought forward and considered by the Working Group. Furthermore, it was raised whether to include the need to reduce fiscal implications as a guiding principle.

29. It was proposed to revisit the subtopic of objectives in the future, also given the link with other subtopics.

Institutional models

30. The meeting continued the following day with a discussion on institutional arrangements, introduced by a *member of the BIS Financial Stability Institute*.

31. The discussion initially focused on the benefits of predominantly administrative proceedings, supported by several participants for reasons mainly of efficiency, speed and international cooperation. It then moved to a more granular discussion on the functions of the person or authority managing the liquidation process. Many participants suggested focusing on the outcomes that the proceedings, whether administrative or court-based, aim to achieve, rather than prescribing one particular model. Such functional, outcomes-based approach was also considered more flexible, given differences in constitutional arrangements and the mandates of institutions involved in the process. The discussion also highlighted how procedural objectives should be linked to institutional arrangements and how accountability and due process should be ensured.

32. The Working Group agreed that the key is to propose the right combination, applying a flexible approach that is focused on outcomes and accommodates differences in established national arrangements, bearing in mind that the FSB *Key Attributes* prescribe that resolution authorities should be administrative bodies. On the other hand, it was noted that there is a well-developed regime for the cross-border recognition of court decisions whereas cooperation among administrative authorities takes place on a more *ad hoc* basis. In addition to pre-existing arrangements, the discussion also showed the need to consider practical aspects, such as authorities' resource constraints or differences in expertise. Differences in legal protection of decision makers was also noted as an important aspect.

33. Discussing the issue of judicial review, the Working Group agreed that there should be no reversal or annulment of administrative decisions, but rather compensation of losses, and that the process requires expeditious judicial reviews.

34. It was agreed that the future discussion will further explore a functional approach and the outcomes to be achieved by the proceedings, while being mindful of the important role of administrative authorities.

Procedural and operational aspects

35. The discussion started with the reiteration that the project will respect existing standards and would therefore not prescribe e.g., best practices in the way deposit insurers operate. Participants were invited to express views on the extent to which the Guidance Document should reflect the universe of potential decisions to be made over the course of a proceeding.

36. The Working Group considered some possible decisions that would need to be taken during proceedings, but overall felt that day-to-day decisions will likely depend on the legal tradition of a jurisdiction, which speaks against too much granularity. Arguments were exchanged in favour and against a deeper discussion of potential conflicts of interests if major creditors are operationally involved.

37. The Working Group discussed the issue of legal standing of creditors to petition for bank insolvency proceedings and there seemed to be agreement that, in principle, individual creditors should not have such legal standing for financial stability reasons. In case creditors have such right under national law, specific safeguards could be put in place to avoid unwarranted consequences. It was felt necessary to analyse in greater detail how the rights of individual creditors to foreclose on banks' assets would be coordinated with an insolvency proceeding.

38. Other issues discussed included legal protection for persons managing the process and types of institutions that might be eligible for the role of liquidator.

Grounds for opening insolvency proceedings

39. A member of the *BIS Financial Stability Institute* introduced the topic by stating that traditional grounds for insolvency are not appropriate indicators of bank failure. Participants were invited to express their views on more suitable grounds for opening bank insolvency proceedings.

40. The Working Group agreed that conventional insolvency grounds need to be adapted. Aspects to consider in that regard include forward looking criteria as indication of imminent failure, public policy concerns, negative conditions (lack of private sector solutions) and the relation with license requirements and withdrawal.

41. The Working Group considered that legal protection of decision makers is relevant, in particular in relation to forward looking elements and negative conditions which are difficult to prove. In terms of a license withdrawal, the Working Group discussed both an automatic linkage between that process and insolvency and a more discretionary approach.

42. Participants agreed that conditions for resolution and grounds for insolvency should be aligned to the greatest extent possible, with some participants arguing that they should be the same or basically overlapping, allowing authorities to exercise discretion in accordance with the requirements of the situation.

43. The Working Group agreed on including forward looking elements into grounds for insolvency, provided this is coordinated with the discussion on institutional arrangements to ensure that a proper interaction with breaches of regulatory requirements is guaranteed.

Preparation

44. A member of the *UNIDROIT Secretariat* introduced the topic by comparing the preparation for ordinary corporate insolvencies with preparations for bank resolution. The Working Group was invited to discuss the appropriate extent and type of prior preparation for bank liquidation proceedings.

45. The discussion highlighted that, as banks are supervised, some level of preparation will naturally take place, building on on-site inspections and potentially other interventions of supervisors. Preparation, prevention and intervention are therefore linked with one another in resolution, and while there cannot be perfect alignment between resolution and insolvency, there should not be inconsistencies.

46. In terms of preparation, there was agreement that proportionality is important, as preparatory actions may create costs and stretch resources of both banks and authorities. At the least, however, the involvement of deposit insurers is likely to require some preparatory actions and cooperation to facilitate either pay-out or an alternative transaction, and such preparatory actions will differ according to the nature of failures and the mandates of authorities.

47. Participants raised further issues which they felt needed to be considered in the context of preparation, such as whether a bank is listed and what this implies for disclosure requirements, and the merits, if any, of moratoria.

48. The Working Group agreed to continue the discussion at subgroup level.

Creditor hierarchy

49. To introduce this discussion, *a member of the UNIDROIT Secretariat* stated that it may be explored whether hierarchies that apply in general corporate insolvency are also relevant for banks and whether specific claims should have a specific relative rank.

50. The Working Group agreed not to discuss or prescribe an absolute creditor hierarchy *per se*, given that creditor hierarchies reflect jurisdictions' differing policies on many issues and often also societies' differing values and cultures. On the other hand, there was broad support for analysing the relative rank of specific claims relevant in bank insolvency. Moreover, participants acknowledged that, given its relevance for the no creditor worse off safeguard in resolution, some contemplation of hierarchy issues is desirable to ensure consistency of frameworks.

51. In terms of depositor preference, the Working Group agreed that there is merit in analysing different models, bearing in mind consistency with existing standards as well as the importance of depositor preference for stakeholders' incentives, options such as transfer strategies and funding.

52. It was agreed to further discuss this important topic at subgroup level.

Item 4: Organisation of future work

53. *The Chair* drew the attention of the Working Group to Item 4 on the agenda, and invited the Secretariat to address the organisation of future work. *The Secretariat* proposed that intersessional work be conducted through three subgroups:

1. Subgroup 1 on Scope and Definitions; Objectives; Institutional models; Procedural and operational aspects
2. Subgroup 2 on Preparation; Grounds for opening insolvency proceedings; Tools; Funding
3. Subgroup 3 on Safeguards; Cross-border aspects; Group dimension; Creditor hierarchy; Financial contracts.

All participants were invited to express their interest in joining one or more of these subgroups, after the Working Group meeting.

54. The second session of the Working Group would be held on 11-13 April 2022.

Item 5: Any other business

In the absence of any other business, *the Chair* thanked all participants for their valuable contributions and a fruitful discussion, and declared the session closed.

ANNEX I**LIST OF PARTICIPANTS****MEMBERS**

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Ms Irit MEVORACH	Professor University of Nottingham
Ms Janis SARRA	Professor Peter A. Allard School of Law University of British Columbia
Mr Reto SCHILTKNECHT	Doctor of Laws (LL.D.), Attorney-at-Law, Lecturer at the University of St. Gallen and Research Associate at the University of Zurich Switzerland

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ANNEX II**ANNOTATED DRAFT AGENDA**

1. Opening of the session and welcome by the UNIDROIT Secretary-General and the Chair of the BIS Financial Stability Institute
2. Adoption of the agenda of the meeting and organisation of the session
3. Consideration of matters identified in the Issues Paper
 - (a) Preliminary matters;
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4. Organisation of future work
5. Any other business