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**Item No. 5 on the agenda: Ongoing legislative activities**

**(e) Bank Insolvency**

(prepared by the Secretariat)

<i>Summary</i>	<i>Update on the Bank Insolvency project</i>
<i>Action to be taken</i>	<i>The Governing Council is invited to take note of the progress of the project</i>
<i>Mandate</i>	<i>Work Programme 2020-2022</i>
<i>Priority level</i>	<i>High</i>
<i>Related documents</i>	<a href="#"><i>UNIDROIT 2019 C.D. (98) 14 rev. 2</i></a> ; <a href="#"><i>UNIDROIT 2019 A.G. (78) 12</i></a> ; <a href="#"><i>UNIDROIT 2019 C.D. (98) 17</i></a> ; <a href="#"><i>UNIDROIT 2021 Exploratory Workshop – Summary Report</i></a> ; <a href="#"><i>UNIDROIT 2021 C.D. (100) B.4</i></a> ; <a href="#"><i>UNIDROIT 2021 A.G. (80) 10</i></a> ; <a href="#"><i>UNIDROIT 2021 - Study 84 – W.G. 1 – Doc. 2</i></a> ; <a href="#"><i>UNIDROIT 2021 - Study 84 – W.G. 1 – Doc. 3</i></a>

**I. INTRODUCTION**

1. The purpose of this document is to update Members of the Governing Council on the development of the project on Bank Insolvency since the 100<sup>th</sup> session of the Council in September 2021. In particular, it briefly recalls the background of the project ([Section II](#)), provides information on the composition of Working Group on Bank Insolvency ([Section III](#)) and its first two sessions ([Section IV](#)), as well as a brief description of the anticipated next steps ([Section V](#)).

**II. BACKGROUND**

**A. Procedure**

2. Following proposals from the Bank of Italy and from the European Banking Institute ([C.D. \(98\) 14 rev. 2](#)), the project on Bank Insolvency was included in UNIDROIT's Work Programme for 2020-2022, initially with medium priority ([A.G. \(78\) 12](#), paras. 44 and 51). Pursuant to the Governing Council's mandate, the Secretariat conducted legal research and canvassed international support for the project. Importantly, the Financial Stability Institute (FSI) of the Bank of International Settlements (BIS) became a partner for the project, and a UNIDROIT-Bank of Italy Chair was

established. In June 2021, UNIDROIT and the FSI jointly organised an Exploratory Workshop ([Exploratory Workshop on Bank Liquidation – Summary Report](#)).

3. Drawing from the conclusions of the Exploratory Workshop and thorough additional research, at the Governing Council's 100<sup>th</sup> session in September 2021, the Secretariat provided a detailed account of the feasibility analysis and exploratory work conducted for the project ([C.D. \(100\) B.4](#)). On that occasion, broad support was expressed for the Secretariat's proposal to upgrade the priority of the Bank Insolvency project and establish a Working Group. The General Assembly allocated a high priority status to the project at its 80<sup>th</sup> session in December 2021 ([A.G. \(80\) 10](#), paras. 44 and 46).

## **B. Substance**

4. The international community developed a legal framework to manage the failure of "too big to fail" financial institutions in the wake of the global financial crisis in 2008, in a way that preserved financial stability. This has informed the adoption of bank "resolution" regimes in jurisdictions around the world, and yet critical gaps remain. In particular, there is no international guidance on how to effectively deal with the failure of banks that would not be resolved under these newly established resolution regimes (generally small and medium-sized banks). The design of bank insolvency laws is left purely to domestic legislation and differs substantially across the globe.

5. The project on Bank Insolvency aims at addressing the current gap in the international legal architecture, by developing an international soft law instrument covering the key features of bank liquidation proceedings.

## **III. THE WORKING GROUP**

6. As consistent with UNIDROIT's established working methodology, the instrument on bank insolvency is being developed by a Working Group composed of members representing different legal systems and geographical regions, selected for their expertise in the field of insolvency law, bank crisis management and deposit insurance. The Working Group is chaired by Governing Council Member Professor Stefania Bariatti and is composed of the following members:

- Ms Stefania Bariatti (Chair), Professor, University of Milan (Italy)
- Ms Anna Gelpern, Professor, Georgetown University (United States of America)
- 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, University of British Columbia (Canada)
- Mr Reto Schiltknecht, Doctor of Laws, Attorney-at-law, Lecturer and Research Associate (Switzerland).

7. In addition, given the importance of banking and regulatory law for this project, a significant number of international and transnational organisations, central banks, banking supervisors, resolution authorities and deposit insurers has been invited to participate in the Working Group as institutional observers:

- 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
- Central Bank of Brazil
- Central Bank of Nigeria (CBN) and Nigerian Deposit Insurance Corporation (NDIC)
- 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)
- Fondo de Garantías de Instituciones Financieras (Fogafín) and Superintendencia Financiera de Colombia (Colombia)
- Financial Stability Board (FSB)
- Hong Kong Monetary Authority (HKMA)
- International Association of Deposit Insurers (IADI)
- International Insolvency Institute
- International Monetary Fund (IMF)
- National Bank of Belgium
- Perbadanan Insurans Deposit Malaysia (PIDM)
- People's Bank of China (PBC)
- Reserve Bank of India (RBI)
- Single Resolution Board (SRB)
- South African Reserve Bank (SARB)
- United Nations Commission on International Trade Law (UNCITRAL)
- World Bank Group (WBG).

8. Concetta Brescia Morra (Professor, Roma Tre University) participates in the Working Group as an individual expert observer. David Ramos Muñoz (Professor, University Carlos III of Madrid) and Marco Bodellini (Queen Mary University of London) are advisors to the UNIDROIT Secretariat for this project.

9. Given the participation of a large number of financial regulators in the Working Group and taking into account the sensitive nature of the issues to be discussed, some specificities were introduced in the working methodology. In particular, the meetings are conducted under Chatham House rules to encourage open discussion among all participants in the Working Group. Furthermore, two distinct reports are drawn up following each Working Group session: a detailed report that is shared, on a confidential basis, with the participants in the Working Group only, and a high-level summary that is made publicly available on the UNIDROIT website.

## **IV. MEETINGS OF THE WORKING GROUP AND INTERSESSIONAL WORK**

### **A. First session of the Working Group (13–14 December 2021)**

10. The first session of the Working Group was held at the UNIDROIT premises in Rome and remotely on 13-14 December 2021 and was attended by 60 participants. The discussions during this session were guided by an Issues Paper ([Study 84 – W.G. 1 – Doc. 2](#)) prepared by the Secretariat in collaboration with the FSI.

11. Regarding the project's scope, the Working Group underlined that bank liquidation regimes should be a seamless complement to resolution frameworks. The scope of the instrument would therefore be defined by exclusion, *i.e.*, covering banks that would not (entirely) be resolved under a resolution regime. Consideration was given to using the term 'bank failure management' as an overarching notion, that is, to encompass both bank resolution and bank liquidation proceedings. Further, a first discussion took place on the type of banks that should be covered by the instrument (for instance, whether this should include bank holding companies, investment banks and/or FinTechs). It was also discussed that liquidation proceedings should be understood as referring to a process ending with the disappearance of a legal entity – while not excluding that certain parts of the business would be transferred to another entity, including as a going-concern.

12. Moreover, the Working Group discussed the possible objectives of a bank insolvency regime. To this end, it considered the application to bank insolvency of corporate insolvency's key objective of value maximisation, on the one hand, and the broader public interest objective, the main driver in the context of bank resolution (*e.g.*, maintaining financial stability), on the other hand. Also in the discussion on the grounds for opening insolvency proceedings, a comparison was made between the grounds for the initiation of corporate insolvency proceedings (balance sheet insolvency and illiquidity) and the triggers for bank resolution, which, in light of the special characteristics of banking business, must allow for early action and include forward-looking elements.

13. Other matters examined during the first session include preparatory actions (*e.g.*, the sharing of data between authorities to facilitate a pay-out to insured depositors), institutional arrangements (analysing the possible involvement of courts and administrative authorities in the liquidation process), the ranking of claims (with the Working Group concluding that the instrument should mainly analyse the relative rank of specific claims rather than prescribing an absolute creditor hierarchy), and procedural aspects such as whether individual creditors should have legal standing to file for the insolvency of a bank.

14. For more information, reference is made to the publicly available report of the Working Group's first session ([Study 84 – W.G. 1 – Doc. 3](#)). A more comprehensive report will be made available by the Secretariat upon request should Governing Council Members be interested in its consultation.

### **B. Intersessional work**

15. At its first session, the Working Group decided to establish three thematic Subgroups to advance the work on the project during the intersessional period:

- Subgroup 1 on Scope and definitions; Objectives; Institutional models; Procedural and Operational aspects of the liquidation procedure. Co-Chairs: Ms Elsie Addo Awadzi (Bank of Ghana) and Ms Ruth Walters (FSI).
- Subgroup 2 on Preparation; Grounds for opening liquidation proceedings; Tools; Funding. Co-Chairs: Mr Christos Hadjiemmanuil (University of Piraeus) and Mr Rastko Vrbaski (FSI).

- Subgroup 3 on Creditor hierarchy; Financial contracts; Banking Groups; Cross-border aspects; Safeguards. Co-Chairs: Ms Anna Gelpert (Georgetown Law) and Ms Irit Mevorach (University of Nottingham).

16. Between January and March 2022, nearly all Working Group members and observers were involved in an intense working schedule established by the Co-Chairs of the Subgroups and supported by the Secretariat. Each of the Subgroups met virtually twice, to discuss the organisation of their work and the subtopics assigned to them, mainly to suggest more precise parameters for each subtopic and to identify different approaches and possible solutions to specific issues. Written input was provided by the Subgroup participants to advance the work. Moreover, the Secretariat set up three coordination meetings between the Co-Chairs of the Subgroups to discuss common issues and coordinate the work.

17. The intersessional work conducted by the Subgroups resulted in three comprehensive reports, one for each Subgroup, which were the main object of the deliberations at the second session of the Working Group. These reports are not public; the Secretariat will make them available upon request should Governing Council Members be interested in its consultation.

### **C. Second session of the Working Group (11–13 April 2022)**

18. The second session of the Working Group took place in hybrid format on 11–13 April 2022 and was attended by 75 participants. The deliberations mainly focused on the Reports prepared by the three abovementioned Subgroups, accompanied by a Revised Issues Paper with questions to guide the discussion (Study 84 – W.G. 2 – Doc. 2).

19. Subgroup 1 had prepared a document that encapsulated its discussions and consolidated the written contributions from its members. On matters of scope, whether the future instrument should cover all institutions accepting deposits and granting loans ('functional approach') or be restricted to institutions with a banking license ('institution-focused approach') was discussed. Furthermore, on the basis of the arguments and views set out in the Subgroup 1 Report, the Working Group discussed the objectives of insolvency procedures applicable to banks (maximisation of the value of the insolvency estate and depositor protection, while financial stability would also play a role) as well as possible institutional set-ups and procedural aspects (*e.g.*, legal standing and liability).

20. The Report of Subgroup 2 reflected the discussions and written contributions by subgroup members on the topics of 'preparation', 'grounds for opening insolvency proceedings', 'tools' and 'funding'. During the second session of the Working Group, the Co-Chairs of Subgroup 2 introduced these subtopics by focusing mainly on the areas of agreement within the Subgroup, proposing to continue the discussion on highly technical and/or contentious issues at a later stage. For instance, there was general consensus that the toolkit of the person in charge of the bank insolvency procedure should extend beyond atomistic liquidation, allowing also the transfer of (large parts of) the failing bank's assets and liabilities to another entity. Participants agreed that external funding may be needed to address bank failures and that the deposit insurer should play some role in such matters. Moreover, the Working Group discussed the possible triggers to open bank liquidation procedures – which, everyone agreed, should differ from ordinary corporate insolvency grounds – and the interaction with the revocation of the banking license.

21. The Report of Subgroup 3 had been prepared by small drafting teams and contained a detailed description of the main issues of each subtopic, together with options or recommendations to be considered by the Working Group. On this basis, among others, the Working Group discussed how to treat banking groups in the insolvency process (and related aspects, *e.g.*, intragroup liabilities) and cross-border issues such as recognition, support and cross-border coordination. The Working Group also analysed aspects relating to the ranking of claims; arguments for and against

the enforceability of close-out netting provisions upon commencement of insolvency proceedings; and safeguards for creditors, such as due process and the protection of legitimate expectations.

22. As a general matter, the Working Group discussed how it would be beneficial to conduct a cross-jurisdictional survey to collect information and data on relevant aspects of, and experiences with, bank liquidation regimes worldwide.

## **V. FUTURE STEPS**

23. The Secretariat is continuing to provide support to the Working Group members and observers for the organisation of intersessional Subgroup meetings to advance the preparation of documents and drafts. Informal coordination meetings between the Co-Chairs are also envisaged to ensure consistency of the output of the Subgroups. In collaboration with the Subgroups, the Secretariat will also develop a cross-jurisdictional survey, so that a stock-taking exercise could be conducted within the Working Group on existing bank insolvency laws across the world and the application of such frameworks in practice (with a focus on small and medium-sized banks). The survey would contain questions on a number of subtopics that are currently being considered by the Working Group, such as experiences with court-based and administrative-based institutional models; information and data on actual bank crises where different liquidation strategies have been pursued; current rules and practices on cross-border aspects (*e.g.*, recognition and support); etc. The empirical input that would be collected through the survey would ensure that the Working Group has a comprehensive overview of different possible approaches to the various subtopics and the relevant implications thereof – which would be reflected in the final instrument.

24. The third session of the Working Group is scheduled to take place on 17–19 October 2022 and will be hosted by the Single Resolution Board in Brussels.

## **VI. ACTION TO BE TAKEN**

25. *The Governing Council is invited to take note of the status and development of the project on Bank Insolvency.*