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ISSUES PAPER

1. This document provides a discussion of issues that the UNIDROIT Working Group on Bank Insolvency may wish to consider at its second session.
2. The issues considered in this document were identified by participants in the first Working Group session, participants in Subgroups, the Chair of the Working Group and the Secretariat. This document does not intend to provide an exhaustive list of issues. Rather, its purpose is to provide a starting point for the Working Group's discussions at its second session.
3. This document retains a revised version of parts of the Issues Paper from the first session ([Study LXXXIV – W.G.1 – Doc. 2](#)) relating to Preliminary Matters ([Part I](#)) and Structure ([Part II](#)).
4. [Part III](#) of this document relates to the content of the future instrument, based on the intersessional work conducted following the first session. This section is accompanied by three additional documents, that represent the detailed outcome of the intersessional work and that will be the main object of the deliberations at the second session:
 - [Report of Subgroup 1 on Scope and definitions; Objectives; Institutional models; Procedural and operational aspects.](#)
 - [Report of Subgroup 2 on Preparation; Grounds for opening liquidation proceedings; Tools; Funding.](#)
 - [Report of Subgroup 3 on Creditor hierarchy; Financial contracts; Banking Groups; Cross-border aspects; Safeguards.](#)
5. [Annex I](#) to this paper provides links to relevant documents to assist the Working Group. [Annex II](#) sets out a preliminary structure for the prospective guidance document.
6. The Secretariat is grateful to the Co-Chairs of the three Subgroups and to Marco Bodellini (Queen Mary University of London) and David Ramos Muñoz (University Carlos III of Madrid) for their contributions to this document.

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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 liquidation frameworks, and accordingly the effectiveness of bank liquidation 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 willingness to provide 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](#)).

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

14. It is anticipated that the Working Group will prepare legal guidance and a set of best practices in the area of bank liquidation 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 Liquidation Proceedings'. Once the project has advanced sufficiently, the Governing Council's endorsement may be sought for an appropriate title.

C. Target Audience

17. As consistent with all UNIDROIT instruments, the prospective instrument should be relevant for countries irrespective of their particular legal tradition and would aim to help countries make their bank liquidation 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 Working Group

18. Consistent with UNIDROIT's established working methods, the Working Group is composed of members selected for their expertise in the field of bank liquidation, 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, University of British Columbia (Canada)
- Mr Reto Schiltknecht, Attorney-at-law (Switzerland)

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

20. UNIDROIT has also invited a number of intergovernmental organisations and public sector stakeholders with expertise in the field of bank liquidation, 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 instrument 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
- 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)
- 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](#)

21. UNIDROIT may invite industry associations and other private sector stakeholders to participate as observers in the Working Group, to ensure that the future instrument will address those stakeholders' needs. The latter may also assist in promoting the implementation and use of the Legal Guide. 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 undertakes its work in an open, inclusive and collaborative manner. As consistent with UNIDROIT's practice, the Working Group has not adopted any formal rules of procedure and seeks to make decisions through consensus. Working Group meetings are conducted under Chatham House rules in order to encourage open discussion.

23. The Working Group meets 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 Bank Insolvency Project 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 not feasible to complete the entire project during the current Work Programme. The following would be a tentative calendar.

(a) Development of the future instrument over five in-person (or, depending on the circumstances, hybrid) sessions of the Working Group in 2021-2023:

- (i) First session: 13-14 December 2021
- (ii) Second session: 11-13 April 2022
- (iii) Third session: October 2022
- (iv) Fourth session: March 2023
- (v) Fifth session: Summer 2023

It is envisaged that intense intersessional work is conducted in thematic subgroups.

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

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

F. Intersessional work

25. At the first Working Group session, in order to facilitate the organisation of the work, the Chair suggested setting up informal subgroups that would be active during the intersessional period. They would be structured as open-ended, and both experts and observers were to be invited by the Secretariat to express their interest in participating in one or more of them. Three thematic subgroups were set up accordingly.

26. Subgroup 1 is Co-Chaired by Ms Elsie Addo Awadzi and Ms Ruth Walters, and was assigned the following topics: (i) Scope and definitions; (ii) Objectives; (iii) Institutional models; (iv) Procedural and operational aspects. Subgroup 1 held virtual meetings on the following dates:

- SG 1 – First Meeting – 24 January 13:00 – 15:00 (CET)
- SG 1 – Second Meeting – 2 February 13:00 – 15:00 (CET)

27. Subgroup 2 is Co-Chaired by Mr Christos Hadjiemmanuil and Mr Rastko Vrbaski, and was assigned the following topics: (i) Preparation; (ii) Grounds for opening liquidation proceedings; (iii) Tools; (iv) Funding. Subgroup 2 held virtual meetings on the following dates:

- SG 2 – First Meeting – 1 February 12:30 – 13:30 (CET)
- SG 2 – Second Meeting – 8 March 13:00 – 14:00 (CET)

28. Subgroup 3 is Co-Chaired by Ms Anna Gelpern and Ms Irit Mevorach, and was assigned the following topics: (i) Creditor hierarchy; (ii) Financial contracts; (iii) Banking Groups; (iv) Cross-border aspects; (v) Safeguards. Subgroup 3 held virtual meetings on the following dates:

- SG 3 – First Meeting – 16 February 17:00- 19:00 (CET)
- SG 3 – Second Meeting – 17 March 13:45 – 15:15 (CET)

29. The Co-Chairs of the three Subgroups met three times (18 January, 21 February and 15 March 2022) to discuss progress and coordinate the intersessional work.

G. Relationship with existing international instruments

30. The future instrument will focus on the key aspects of liquidation procedures applicable to banks, for which there is currently a lack of international guidance. However, there are several international instruments that are relevant when developing the Legal Guide. It is suggested that the terminology and concepts used in the future instrument 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.

31. The publication *Orderly and Effective Insolvency Procedures: Key Issues* (1999) of the 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.

32. The joint IMF-World Bank publication *An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency* (2009) discusses the principal features of the framework that countries may put in place in order to deal effectively with cases of bank insolvency. The IMF's *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination* (2010)

advocates a framework for enhanced cross-border coordination regarding the resolution of international financial groups.

33. The *Core Principles for Effective Banking Supervision* (adopted originally in 1997, revised in 2011) of the Basel Committee on Banking Supervision (BCBS) are the *de facto* minimum standard for sound prudential regulation and supervision of banks and banking systems. Amongst others, it requires supervisors to cooperate with relevant authorities regarding the orderly resolution of a problem bank situation (Core Principle 11). The *Report and Recommendations of the Cross-Border Bank Resolution Group* (2010) of the BCBS sets out ten recommendations to address the challenges arising in the resolution of a cross-border bank, on the basis of a stocktaking exercise of legal and policy frameworks and lessons learned from the financial crisis.

34. 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*. The FSB *Key Attributes Assessment Methodology for the Banking Sector* (2016) sets out essential criteria to guide the assessment of the compliance of a jurisdiction's bank resolution framework with the *Key Attributes*.

35. 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, for identifying gaps in their deposit insurance practices and measures to address them. The *Core Principles* are also used by the 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.

36. UNCITRAL has developed a number of international instruments in the area of corporate 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.

37. 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.

38. The *UNCITRAL Legislative Guide on Insolvency Law* (2004, last addition 2021) 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. The *Legislative Guide* is divided into five parts. Part three addresses the treatment of enterprise groups in insolvency, both nationally and internationally. Part five was added most recently (2021),

and aims at assisting States with establishing a simplified insolvency regime to address the insolvency of individual entrepreneurs and micro and small businesses of an essentially individual or family nature with intermingled business and personal debts (collectively referred to as MSEs). Special considerations arising from the insolvency of banks are not specifically addressed in the *Legislative Guide*. UNCITRAL is currently conducting work on the topic of applicable law in insolvency proceedings.

39. 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.

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

41. 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*, is designed as a tool to assist countries in their efforts to evaluate and improve insolvency and creditor/debtor regimes. Lastly, 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.

II. STRUCTURE OF THE INSTRUMENT

42. At its first session, the Working Group discussed an initial list of aspects to be covered by the future instrument. It was proposed to add the topic 'safeguards' to that list. Accordingly, the following revised list of aspects is suggested for consideration by the Working Group at its second session:

- the scope of the instrument and a set of definitions;
- the objectives of bank liquidation proceedings;
- the institutional set-up;
- the procedural and operational aspects of the liquidation procedure;
- the preparatory phase;
- grounds for opening liquidation proceedings;
- tools;
- funding;
- creditor hierarchy;
- the treatment of financial contracts (and perhaps similar, e.g., set-off);
- group aspects;
- cross-border aspects;
- safeguards.

43. Based on the discussion during the first session and intersessional deliberations, a preliminary structure for the instrument was prepared and included in [Annex II](#) to this document for consideration by the Working Group.

Questions and recommendations for the Working Group:

- *The Working Group is invited to consider the revised list of aspects that should be covered in the future instrument.*
- *Should 'liquidity' be added as a separate subtopic, as was suggested by some participants during the first session? Or would this be covered by any of the other identified subtopics?*
- *The Working Group is invited to consider the preliminary draft structure for the future instrument and propose any additional contents that should be included as well as any rearrangement of chapters as appropriate.*
- *The Working Group is invited to reflect on the need to provide more specific indications on the format of the future instrument (see also Part I. B above), in order to harmonise the work of the Subgroups going forward. For instance, should each chapter of the future instrument contain: (i) explanations on the subtopics; (ii) a comparative analysis of approaches in different jurisdictions; and/or (iii) a description of different options; and (iv) a box with recommendations, where possible?*
- *Does the Working Group agree to conducting a cross-jurisdictional survey within the Working Group in order to collect information and data on relevant aspects of, and experiences with, bank liquidation regimes worldwide?*

III. CONTENT OF THE INSTRUMENT

A. Scope and Definitions

44. With regard to the scope of the instrument, the experts and stakeholders that participated in the Exploratory Workshop and the UNIDROIT Secretariat concluded that the initial focus 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.

45. At the first session of the Working Group, there was broad agreement that the scope of the future instrument needs to articulate appropriately with the scope of application of resolution regimes under the FSB *Key Attributes* in order to achieve a seamless international framework. It was also recognised that liquidation procedures may apply both to (i) banks that do not meet the conditions for the use of the applicable resolution framework; and (ii) parts of a bank that are liquidated within a resolution process.

46. However, there were different views as to which ‘banks’ should be included within the scope and according to which criteria. Subgroup 1 identified and discussed two possible approaches for consideration by the Working Group: (i) a ‘functional approach’, according to which the instrument would apply to all institutions performing specified activities (accepting deposits and granting loans), irrespective of their regulatory status in the jurisdictions where they operate; or (ii) an ‘institution-focused approach’, where the scope would be restricted to institutions with a banking license. The pros and cons as well as the consequences of each of these approaches (e.g., with regard to FinTechs and legacy institutions) are described in the Report of Subgroup 1.

47. As regards definitions, the Working Group discussed in its first session that ‘bank failure management’ may be considered as an umbrella term to encompass both bank resolution and liquidation proceedings. Subgroup 1 decided to postpone the work on developing definitions until work on the instrument is further advanced. However, it considers that, if the instrument is to focus on procedures for market exit, ‘liquidation proceedings’ may be the most appropriate terminology to be used in the future instrument.¹ Furthermore, it collected selected jurisdictional definitions of ‘bank’.

Questions for the Working Group:

- *Does the Working Group agree to using ‘bank liquidation proceedings’ as terminology in the future instrument?*
- *Should a ‘functional approach’ or an ‘institution-focused approach’ be followed to clarify the scope of the future instrument? I.e., should the future instrument: (i) cover all institutions that perform the functions of banks; or (ii) apply only to licensed banks? It is suggested to consider the consequences of both approaches for different categories of entities (e.g., FinTechs, legacy institutions and investment banks). A third option could be to grant jurisdictions flexibility to apply the future instrument beyond licensed banks.*
- *Does the Working Group agree to specifying that, in addition to banks/licensed banks, the instrument applies to (non-bank) parent companies?*
- *To further clarify the scope, does the Working Group agree to specifying in the instrument that it applies to banks/licensed banks and parent companies that would not be resolved, in their entirety, under the regime established by the Key Attributes*

¹ This paper therefore generally uses the term ‘bank liquidation’ (rather than ‘bank insolvency’).

(i.e., it would cover banks that are not systemic in failure and parts of a bank that are liquidated within resolution)?

- *Should the future instrument contain a definition of "bank" by reference to the two key functions generally performed by banks: (i) collecting deposits from the public; and (ii) granting loans on their own account?*

B. Objectives of a bank liquidation regime

48. At the first session of the Working Group, it was agreed that the key objectives of bank liquidation proceedings should be value maximisation and depositor protection. Views were split as to the scope of depositor protection and whether this should be articulated as a separate objective or subsumed with creditors in general. No consensus was reached regarding the extent to which the objectives of bank liquidation proceedings should be aligned with the objectives for resolution.

49. Subgroup 1 noted that the objectives are closely intertwined with other subtopics (e.g., grounds, tools and creditor hierarchy) and that coordination is essential to ensure consistency. It agreed that value maximisation and depositor protection are core objectives. However, it suggests to further consider how to frame depositor protection in relation to other objectives. The pros and cons of including a financial stability and/or continuity objective are described in the Report of Subgroup 1. Additional objectives or guiding principles suggested by participants in Subgroup 1 are the market exit of the insolvent entity within a reasonable timeframe and the need to reduce fiscal implications.

50. Subgroup 1 suggests that objectives should not be ranked, leaving discretion to the relevant authorities to balance the objectives depending on the circumstances of the case. Finally, it proposes that the objectives be the same, irrespective of the institutional model and irrespective of whether liquidation affects the entire entity or only a residual part of an entity.

Questions for the Working Group:

- *Does the Working Group agree to build a common understanding of the objectives included in bank liquidation regimes through a cross-jurisdictional survey?*
- *Does the Working Group agree to identifying value maximisation and depositor protection (separately) as the main objectives of bank liquidation proceedings?*
- *The Working Group is invited to consider different options for 'resolution-like objectives' in bank liquidation proceedings, in particular whether to include financial stability: (i) as an objective; (ii) as a consideration relevant for specific phases of the liquidation process (e.g., the grounds for opening bank liquidation proceedings); (iii) as a guiding principle or minimum safeguard to the conduct of the bank liquidation process.*
- *Does the Working Group agree to ask Subgroup 1 to further specify:*
 - *The concept of depositor protection, e.g., whether it should be limited to certain classes of depositors or deposits generally and whether its nature depends on the existence and mandate of a deposit insurance scheme (DIS)?*
 - *The concept of financial stability, e.g., whether it would be aligned with the concept in resolution or would be different.*

C. Institutional models

51. There are significant divergencies among jurisdictions in the institutional set-up for bank liquidation proceedings. Institutional models can either be: (i) predominantly administrative, where the procedure 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 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.

52. Depending on the institutional model, different actors may be involved in the management of the bank liquidation 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. In several jurisdictions with administrative-based models, the bank liquidation procedure is managed by the deposit insurer or the resolution authority.

53. At the first session of the Working Group, it was discussed that, generally, it would be beneficial if administrative authorities have an important role in the bank liquidation process. On the other hand, the current cross-border regime speaks in favour of a court-based system since most national frameworks provide for cross-border recognition of judgments only. Furthermore, it was discussed that differences among jurisdictions (e.g., in legal traditions, constitutional arrangements) should be duly taken into consideration.

54. Overall, the majority favoured an outcomes-based, modular approach by which the instrument would specify the outcomes that the institutional model should achieve and discuss how various arrangements and practices might do that. Subgroup 1 noted that the effectiveness of different models will depend to a material extent on the mandate of the authorities involved and the efficiency of the courts and the administrative authorities in the specific jurisdiction. It recommends identifying, for each phase of the bank liquidation procedure, which model would be preferable for the specific tasks required and suggesting possible solutions in case such model cannot be chosen due to national specificities.

55. For example, it is suggested that in the initial phase, the involvement of administrative authorities is preferable, e.g., to allow for speediness, a technical assessment of the bank's situation and an appropriate balancing of private and public interests. Should administrative involvement not be possible in the initial phase, the instrument could recommend 'corrective measures' such as the involvement of specialised judges and procedural rules that would allow decisions to be taken expeditiously. Conversely, it was argued that creditors' rights and claims might be better dealt with by court involvement. Further examples and considerations are included in the Subgroup 1 report.

Questions for the Working Group:

- *Does the Working Group agree to build a common understanding of the differences in approaches with regard to institutional models across jurisdictions' regimes (and strengths and weaknesses) through a cross-jurisdictional survey?*
- *Should the future instrument discuss the benefits of predominantly administrative proceedings/involvement of a centralised administrative authority, before turning to the modular, outcomes-based approach (i.e., the various phases of the liquidation process and relevant considerations)?*

- *Which are the main phases of the liquidation process to be considered in this context, e.g., preparation, opening of the liquidation procedure, conducting a sale process, establishing a distribution plan, etc. (see also the Subgroup 1 Report, para. 99)?*
- *Which are the outcomes to be achieved by the institutional model in the various phases of the process (e.g., speed, ability to take account of public interest considerations, due process etc.)?*
- *Should judicial review be dealt with under Institutional models (SG1) or under Safeguards (SG3)?*

D. Procedural and operational aspects of the liquidation procedure

56. 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 liquidation proceedings. For instance, the remuneration of an appointed liquidator may be 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 liquidation 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).

57. At the first Working Group session and in Subgroup 1, main aspects discussed were legal standing – in particular that of individual creditors – to file for a bank's insolvency², types of liquidators (e.g., the deposit insurer) and the legal protection of persons managing the liquidation process.

Questions for the Working Group:

- *Does the Working Group agree to build a common understanding of the differences in approaches across jurisdictions' regimes through a cross-jurisdictional survey, e.g., regarding legal standing, creditor involvement and legal protection?*
- *Should considerations regarding the involvement of a DIS as receiver or liquidator be included here or under Institutional Models?*
- *Regarding legal standing, should the future instrument recommend that, in principle, the right to petition for insolvency should be exclusively in the hands of the banking supervisor, while identifying possible solutions where this would not be possible (e.g., prior approval of the banking supervisor/resolution authority, confidentiality requirements)?*
- *To what extent should the liability of the person managing the liquidation process be limited (e.g., gross negligence, bad faith)? Should this be aligned with existing standards, e.g., for banking supervisors / deposit insurers / resolution authorities?*
- *Should Subgroup 1 consider possible protections from liability for the management of the bank? It is recommended to discuss this in conjunction with Subgroup 3 (which considers aspects of legal protection e.g., in case of intra-group support).*

² The Report of Subgroup 2 also contains considerations on legal standing, see paras. 37-39 and 93-95.

E. Preparation

58. 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.

59. At the first Working Group session, the importance of a seamless continuum between supervision and crisis management was underlined. It was further discussed that preparation, in the context of the liquidation of smaller banks, raises issues of proportionality since preparatory actions may create costs and stretch resources of both banks and authorities. There was agreement, however, that the involvement of deposit insurers would require at least some preparatory actions and collection of data to facilitate a pay-out or transfer.

60. Subgroup 2 noted that the need and extent of preparation will depend on several factors (e.g., institutional model, available time, whether it is a self-standing liquidation or liquidation as part of resolution). It contemplated several aspects that are relevant for preparation, such as to what extent bank liquidation planning is needed and how this relates to bank resolution planning. It considers that, in administrative systems, advance notice, consultations and coordination among authorities is crucial to ensure a swift pay-out or other actions (e.g., purchase and assumption (P&A)). If a court is involved, various mechanisms may be considered to ensure smooth cooperation (e.g., exploring synergies with the bank's efforts and appointing an administrator in the pre-liquidation phase). It may also be considered to identify requirements that would ensure that the bank duly cooperates and provides the necessary information.

61. Subgroup 2 discussed that some form of valuation may be needed, but this may not need to involve an independent expert. Furthermore, some consider it useful if the future instrument were to identify general criteria to carry out a marketing process as well as considerations on confidentiality and possible exemptions from public disclosure requirements. For more details on each of the mentioned aspects, reference is made to the Subgroup 2 report.

Questions for the Working Group:

- *Should the instrument identify factors that may be relevant to determine the need for and extent of preparation?*
- *Should the instrument distinguish between coordination in the preparatory phase among administrative authorities, on the one hand, and between courts and administrative authorities, on the other hand?*
- *Should the instrument identify best practices or recommendations regarding cooperation with the failing bank?*
- *Does the Working Group agree that the instrument should provide flexibility with regard to the valuation of the bank (i.e., not to prescribe an independent valuation)?*
- *Does the Working Group agree to ask Subgroup 2 to prepare a proposal on general criteria to conduct a marketing process, and confidentiality/exemptions from public disclosure requirements?*
- *It is recommended that Subgroup 2 and Subgroup 3 jointly consider the preparation that may be needed in group situations.*

F. Grounds for opening liquidation proceedings

62. 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).

63. Due to the special nature of banks, these grounds may be inappropriate as triggers to commence bank liquidation proceedings. In many jurisdictions, bank insolvency regimes therefore include a wider range of grounds for opening bank liquidation proceedings (e.g., forward-looking triggers and regulatory triggers).

64. At the first Working Group session, many participants favoured including prospective elements in the grounds for opening bank liquidation proceedings. Views diverged as to whether a negative condition should be included, such as lack of a private sector solution. Furthermore, different views were expressed as to the effects of insolvency on a bank's license. Participants generally agreed that the grounds for liquidation should in principle be aligned with the conditions for resolution.

65. A majority of Subgroup 2 members suggests aligning the triggers for resolution and liquidation to avoid 'limbo' situations, acknowledging, however, that this is mainly relevant for dual-track regimes. Furthermore, it suggests considering aspects such as: (i) the distinction between grounds related to the financial condition of a bank and non-financial grounds; (ii) the need for discretion by the relevant authority and how to balance diverging interests; (iii) the choice between resolution and liquidation; (iv) the relevance of a 'public interest test'; (v) the timing of the liquidation procedure, especially if it is part of a broader resolution process; and (vi) the interaction with license revocation.

Questions for the Working Group:

- *Does the Working Group agree to build a common understanding of the differences in approaches with regard to grounds for opening liquidation proceedings across jurisdictions through a cross-jurisdictional survey?*
- *Should the future instrument contain general considerations/recommendations regarding the opening of liquidation proceedings (e.g., the need for specific grounds as compared to corporate insolvency and the need to align the grounds for liquidation with the resolution triggers in dual-track regimes)?*
- *Should the future instrument distinguish between financial and non-financial grounds (and/or make any other distinction between different grounds for opening the liquidation process)?*
- *Should Subgroup 2 assess to what extent a public interest test may be relevant to triggering bank liquidation proceedings?*
- *Should the future instrument contain considerations to inform the decision whether to proceed with resolution or liquidation in dual-track regimes?*
- *Should Subgroup 2 describe different options for interaction between the opening of liquidation proceedings and license revocation (e.g., withdrawal of the license as a ground or as an outcome of the liquidation procedure; automatic withdrawal or discretion), and the consequences of such choices?*
- *Should the future instrument contain specific considerations regarding the opening of liquidation proceedings in cases where liquidation is part of a broader resolution procedure (e.g., mechanisms to ensure continuity of services to a failed bank in resolution)?*

G. Tools

66. 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.

67. In other jurisdictions, the liquidation 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.

68. 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.

69. The use of transfer tools in bank liquidation 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.

70. 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 H). 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).

71. Subgroup 2 discussed several aspects concerning liquidation tools, such as the advantages of having transfer options in liquidation (as opposed to atomistic liquidation only), the relationship with the tools under the FSB *Key Attributes* and creditor safeguards (e.g., whether a no-creditor-worse-off (NCWO) assessment would be needed). For further details, reference is made to the Report of Subgroup 2.³

³ One of the individual contributions included in the Report of Subgroup 1 also contains considerations on P&A, see para. 93 of the Subgroup 1 Report.

Questions for the Working Group:

- *Should the future instrument provide best practices for atomistic liquidation and for the use of transfer tools in liquidation? Does the Working Group agree to collect information and data on experiences in different jurisdictions through a cross-jurisdictional survey?*
- *Should bank liquidation 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?*
 - *For the bridge institution and asset management company specifically, should the future instrument identify pros and cons and recommend a cost-benefit analysis?*
- *Should the future instrument provide guidance on any other tools and/or powers that should be available to the person in charge of the liquidation process? E.g., the possibility to impose a moratorium, to temporarily continue the bank's business and/or claw-back powers?*
- *Should tools be available if and when the grounds for opening liquidation proceedings are established, or should certain tools be subject to additional conditions? Is there a need to establish a 'hierarchy' of tools (Subgroup 2 does not seem to be in favour of this)?*

H. Funding

72. 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.

73. 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).⁴ 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.

74. 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,

⁴ Article 11(6) of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes.

may face only limited costs in a pay-out scenario. When applying the least-cost principle in a manner 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.

75. Subgroup 2 considered the above aspects and the below questions, which the Working Group is invited to consider in conjunction with the Report of Subgroup 2.

Questions for the Working Group:

- *Should bank liquidation 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 (e.g., deposit insurance scheme) and who should decide on its use?*
- *The Working Group is invited to consider the relationship between the potential use of the deposit insurance scheme 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?*

I. Creditor hierarchy

76. 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. 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. Apart from these formal differences, great differences exist in the ranking of claims.

77. At the first session of the Working Group, it was agreed that the future instrument should not 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 liquidation proceedings. Views were more nuanced as regards a discussion of the various forms of depositor preference.

78. Subgroup 3 considered the topic in more detail and proposes that the future instrument covers the following aspects: (i) general principles on ranking; (ii) claims of depositors; (iii) secured creditors; (iv) liabilities arising from financial contracts; (v) subordinated claims. For a detailed description of the proposed scope and relevant considerations for each of these aspects, reference is made to the Report of Subgroup 3.

Questions for the Working Group:

- *Should the future instrument propose specific principles on ranking and hierarchy of claims for banks, or rely on existing insolvency principles, and provide limited exceptions?*

- *Should the future instrument focus on aspects of secured transactions (and their privileged status) of special importance for banks?*
- *Should the future instrument outline the different options for depositor preference (general, insured, tiered, no preference) and the treatment of claims by the DIS, or identify some emerging best practice and make a clear recommendation? Should it consider other financing practices (e.g., a debtor-in-possession financing preference)?*
- *What should be the treatment of temporary accounts, used for payment purposes? More generally, what should be the treatment of claims related to a participant's account in a payment/ settlement system/ clearing system? And of new phenomena, like stablecoins?*
- *Is there any emerging best practice with regard to the enforcement and/or statutory treatment of contractual subordination clauses (complete, partial subordination (or both), intercreditor/creditor-debtor agreements) that merits a specific recommendation?*
- *Should equitable subordination be dealt with separately, restricted to fraud and similar cases, assimilated within other types of subordination, or a combination of these?*
- *Is there any emerging best practice on the subordination of intra-group debt (direct subordination, subordination in case of over-indebtedness, equitable subordination)?*

J. Financial contracts

79. 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.

80. 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."⁵

81. 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.⁶

82. 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

⁵ UNIDROIT, Principles on the Operation of Close-Out Netting Provisions (2013), Principle 2 and par. 19.

⁶ UNCITRAL Legislative Guide on Insolvency Law (2004), Recommendations 7(g) and 101-107.

decide whether and how to resolve an ailing financial institution in an orderly fashion.⁷ Indeed, most significant banks have signed a specific resolution stay protocol and certain jurisdictions have introduced special rules regarding the treatment of close-out netting clauses in case of bank resolution.

83. Subgroup 3 invites the Working Group to discuss whether the stay should apply only in the area of resolution or in case of insolvency proceedings of any type of bank. Furthermore, Subgroup 3 suggests discussing and further exploring the calculation of the price of derivatives upon contract termination. Subgroup 3 also considered the general principles applicable to financial collateral, repos and securities lending and margin loans in corporate insolvency and suggests to follow the same approach in bank liquidation proceedings. Finally, it discussed the differences between centrally cleared and non-centrally cleared (over-the-counter) derivatives and invites the Working Group to consider whether these should be treated differently in the insolvency of a small or medium-sized bank. For a detailed analysis of each of these aspects, reference is made to the Subgroup 3 Report.

Questions for the Working Group:

1. Definitions

- *Should the future instrument adopt a general definition of "financial contract" as provided in the FSB Key Attributes Assessment Methodology for the Banking Sector (2016)⁸ and UNCITRAL Legislative Guide on Insolvency Law, Parts One and Two (2004), (para. 209, Recommendation 107 and Glossary)⁹? Or should it instead focus on specific contract terms, e.g., close-out netting clauses and financial collateral?*

2. Scope

- *Should the future instrument say that close-out netting clauses and financial collateral arrangements which involve banks as a party are valid and enforceable in accordance with their terms in case of insolvency? Or should we be more restrictive?*

3. Mutuality

- *The Working Group is invited to consider the suggestion by Subgroup 3 of a principle of mutuality: As long as close-out netting provisions can be invoked by banks in case of their counterparty's insolvency, the same should also apply for their counterparties in case of the bank's insolvency.*

⁷ FSB Key Attribute 4.2 and 4.3.

⁸ FSB Key Attributes Assessment Methodology for the Banking Sector (2016), p. 3: "Any contract that is explicitly identified under the legal framework of the jurisdiction as subject to defined treatment in resolution and insolvency for the purposes of termination and netting. Typically, financial contracts include contracts for the purchase or sale of securities; derivatives contracts; commodities contracts; repurchase agreements; and similar contracts or agreements."

⁹ UNCITRAL Legislative Guide, para. 209: "Financial contracts include, among other things, securities contracts, commodities contracts, forward contracts, options, swaps, securities repurchase agreements, master netting agreements and other similar contracts." Recommendation 107: "Financial contracts should be defined broadly enough to encompass existing varieties of financial contract and to accommodate new types of financial contract as they appear." Glossary, para. 12 point (r): "Financial contract: any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above."

4. Exceptions

- *Should the future instrument suggest an exception for resolution proceedings (e.g., stay of execution) for bank liquidation? Or should it disregard the resolution situation given its focus on small and medium-sized banks and liquidation?*
- *The treatment of close-out netting clauses under bank resolution has undergone substantial changes (e.g., the disapplication of termination rights and the introduction of temporary stays) in recent years. Given that the introduction of such changes means that the financial collateral would be treated differently in small bank insolvency/liquidation vs. large bank resolution, should the regime applicable to small banks be changed and follow the large bank resolution model?*
- *Should cleared and uncleared financial contracts be treated differently in small bank liquidation?*

5. Derivative valuation

- *The Working Group is invited to consider whether termination and calculation of theoretical prices, etc. are purely a matter of contract determination, or may be subject to certain requirements, taking also into account considerations beyond the ISDA Model.*

K. Group dimension

84. 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.¹⁰ Entities within a banking group may even be subject to different rules within a certain jurisdiction, depending 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.

85. The lack of international guidance¹¹ 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.

86. 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.

87. Subgroup 3 considered the group dimension of small and medium-sized banks in more detail and proposes that the future instrument covers the following aspects: (i) group insolvency plans (the Subgroup 3 Report describes the possible content of such plans and pros and cons of group planning); (ii) considerations on upstreaming of losses and downstreaming of funds within a banking group; (iii) special 'groups' such as cooperative banks and institutional protection schemes; (iv)

¹⁰ 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.

¹¹ 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.

considerations on ranking of intra-group measures (e.g., subordination of intra-group claims; a possible priority status for intragroup liquidity support in the twilight zone and in liquidation); (v) procedural consolidation and the option of substantive consolidation. For a detailed description of the proposed scope and relevant considerations for each of these aspects, reference is made to the Report of Subgroup 3.

Questions for the Working Group:

1. Preparation for liquidation

- *To what extent should insolvency plans be required? What should be the minimum content? Should they be subject to approval/revision by a court, a regulatory authority, both?*
- *What role should be given to resolution plans ("living wills") in an insolvency situation?*
- *Should assets be pre-positioned within the group?*

2. Conduct of the liquidation procedure

- *To what extent should pre-insolvency plans be respected in the proceedings? According to their letter? Or should there be some flexibility?*
- *Should bank groups be treated differently according to the specific sector they belong to (e.g. private, public or cooperative banks)? How should 'mixed' group structures (i.e., with elements from several of these sectors) be treated?*
- *What should be the status of the insolvency administrator of a group member in the insolvency of another group member? Which rights shall creditors of one group member have in the insolvency of another?*
- *Should bank structure regimes (e.g., ring-fencing) be an absolute bar to intra-group support measures in insolvency? Or should they not apply in certain situations (e.g. where they are not necessary for the protection of the ring-fenced entity)?*
- *To what extent should cash pooling arrangements be maintained in insolvency? Can group members continue to use common infrastructure in the event of insolvency of a group company, e.g., a common IT system?*
- *Should Subgroup 3 offer recommendations on possible solutions for procedural or substantive consolidation?*

L. Cross-border aspects

88. 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 liquidation proceedings.¹² 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, for instance with regard to: (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.

¹² 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.

89. 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.

90. 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 contractual¹³ 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 recognise or give effect to the measures taken by the authority in the jurisdiction that initiated the proceedings.

91. 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.

92. Subgroup 3 undertook a detailed analysis of the unique challenges in cross-border bank liquidation and concluded that existing international frameworks offer limited solutions. On the one hand, there is a coherent framework for enterprise cross-border insolvency¹⁴, which does not, however, fully address the unique challenges of banks. On the other hand, international frameworks specific to financial institutions¹⁵ tend to focus on large institutions and offer high-level principles rather than concrete rules for adoption.

93. Subgroup 3 advises formulating concrete recommendations to assist in creating a framework that minimises divergences between the private international law aspects of bank liquidation proceedings in different jurisdictions. It suggests focusing on recognition of foreign proceedings, orders, and tools, cooperation between authorities, and the giving of effect to such tools and assistance/support to home authorities in host jurisdictions. Furthermore, Subgroup 3 suggests considering the treatment of foreign branches and foreign subsidiaries, and differences in institutional models. For more details, reference is made to the Report of Subgroup 3.

Questions for the Working Group:

1. General relationship with frameworks on cross-border corporate insolvency

The Working Group is invited to consider the relationship between the future instrument and the general framework applicable to cross-border corporate insolvency. In particular, it is suggested to consider the following options: (i) a full carve-out from the general cross-border insolvency framework; (ii) a partial carve

¹³ 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.

¹⁴ E.g., the World Bank Principles, the UNCITRAL Model Law on Cross-Border Insolvency and the UNCITRAL Model Law on Enterprise Group Insolvency.

¹⁵ E.g., the FSB *Key Attributes* and FSB *Principles for Cross-Border Effectiveness of Resolution Actions*.

out, to the extent needed to achieve the necessary objectives; and (iii) a partial carve-out, with similar general principles, but specific rule-based exceptions, to account for, e.g., the role of administrative authorities, or the effectiveness of certain tools, like asset transfers; or are there other potential options that may not fit in these categories?

2. Concrete recommendations on the cross-border treatment of bank liquidation

The Working Group is invited to identify specific recommendations on cross-border bank liquidation. In particular, it is suggested to consider the desirability of:

- *Recommendations concerning cooperation and allocation of competences between home and host authorities, also taking into account the situation of branches and groups.*
- *Recommendations concerning recognition of foreign proceedings, cross-border actions and tools, and for assisting and giving effect to such tools. Concrete recommendations concerning the recognition/effectiveness of transfers of assets and liabilities and/or equity.*
- *Recommendations concerning non-discrimination of creditors based on the jurisdiction of nationality, or location, or payability of claims.*
- *Recommendations concerning the safeguards/grounds to refuse recognition/support/cooperation.*

M. Safeguards

94. If a bank liquidation instrument follows the example of bank resolution frameworks, it may entail significant powers for relevant authorities in order to protect depositors, and pursue other goals. This authority to act swiftly and somewhat unilaterally can be prejudicial to creditors and other stakeholders, and should be accompanied by “safeguards”, which are principles and mechanisms aimed at protecting the rights of creditors and other stakeholders and ensuring the overall fairness of the process. Safeguards are of special importance in a cross-border scenario, where they may play a key role in ensuring transnational fairness and fostering cross-border cooperation.

95. Following the first session of the Working Group, Subgroup 3 analysed the topic in more detail in order to provide an initial taxonomy of safeguards in bank insolvency processes for the Working Group to consider. It suggests covering the following aspects in the future instrument: (i) public policy safeguard; (ii) due process and procedural fairness; (iii) protection of legitimate expectations; (iv) protection of financial stability. Reference is made to the Subgroup 3 Report for considerations on each of these aspects, both from a domestic and from a cross-border perspective.¹⁶

Questions for the Working Group:

1. General considerations

- *Should safeguards be proposed separately, to signal their importance, or as part of “tools” or powers?*

¹⁶ The Report of Subgroup 1 also contains considerations regarding judicial review (paras. 94-96) and the *pari passu* principle (Annex 2 to the Subgroup 1 Report).

- *Given that the FSB Key Attributes were designed for financial institutions of all types that could be systemic in failure, what safeguards should align with the Key Attributes and what additional safeguards might be needed that recognise the small or medium nature of an insolvent bank?*
2. Public policy
- *What should be the threshold for a public policy exception in domestic proceedings?*
 - *Should the threshold test for refusing to recognise a cross-border proceeding in another jurisdiction be manifestly contrary to public policy, fraud and/or other grounds?*
 - *What relationship should the public policy exception bear with non-discrimination standards?*
3. Due process
- *What is the scope of access to judicial review of decisions made by the administrator/liquidator and what timing best protects creditor interests?*
 - *Which general principles should apply to any judicial review process in the context of bank liquidation proceedings, balancing creditors' rights with the need for efficiency and legal certainty?*
4. Protection of legitimate expectations – NCWO
- *Should deviations from rules on ranking and hierarchy (including pari passu) be contemplated? In particular, should there be any safeguard similar to NCWO, especially in cases where tools other than piecemeal liquidation are used? Is there an identifiable counterfactual to use as a baseline? What alternative could be used to protect creditors' legitimate expectations in such settings?*
 - *In cross-border settings, should the future instrument propose a standard of "adequate protection", or different?*
5. Other
- *How can assets be protected or placed in trust to be available to settle creditor claims if they are to be stayed until the resolution proceeding is completed?*

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 International documents

Basel Committee on Banking Supervision (BCBS), Core Principles for effective banking supervision, revised (2012) and integrated into the consolidated Basel Framework (version 2019)
https://www.bis.org/basel_framework/chapter/BCP/01.htm?inforce=20191215&published=20191215

BCBS, Report and Recommendations of its Cross-Border Bank Resolution Group (2010)
<https://www.bis.org/publ/bcbs169.pdf>

FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, revised (2014)
[Key Attributes of Effective Resolution Regimes for Financial Institutions \(fsb.org\)](https://www.fsb.org/wp-content/uploads/Key-Attributes-of-Effective-Resolution-Regimes-for-Financial-Institutions-(fsb.org))

FSB, Key Attributes Assessment Methodology for the Banking Sector (2016)
<https://www.fsb.org/wp-content/uploads/Key-Attributes-Assessment-Methodology-for-the-Banking-Sector.pdf>

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>

IADI Brief No 4, Depositor Preference and Implications for Deposit Insurance (2020)

<https://www.iadi.org/en/news/iadi-brief-on-depositor-preference-and-implications-for-deposit-insurance/>

IADI, Ways to Resolve a Financial Cooperative while Keeping the Cooperative Structure (2021)

<https://www.iadi.org/en/assets/File/Papers/Approved%20Guidance%20Papers/IADI%20Guidance%20Paper%20Ways%20to%20resolve%20a%20financial%20cooperative%20while%20keeping%20the%20cooperative%20structure.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>

IMF, Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination (2010)

<https://www.imf.org/external/np/pp/eng/2010/061110.pdf>

IMF Technical Guidance Note, The Case for Depositor Preference (2020)

<https://www.imf.org/en/Publications/TNM/Issues/2020/12/22/The-Case-for-Depositor-Preference-49766>

IMF and the World Bank, An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency (2009)

<https://www.imf.org/external/np/pp/eng/2009/041709.pdf>

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**PRELIMINARY DRAFT STRUCTURE**

Below, a suggested draft structure for the future instrument is set out for consideration. It takes into account the aspects to be covered proposed in Parts II and III of this paper. The text included under the Chapter titles in form of bullet points is not being proposed as headings, but merely as a prompt for the contents.

Recommendation for the Working Group:

- *The Working Group is invited to consider the preliminary draft structure for the future instrument on Bank Liquidation and propose any additional contents that should be included as well as any rearrangement of chapters as appropriate.*

Heading	Contents
Chapter 1. Preliminary Remarks	<ul style="list-style-type: none"> • Background and aim of the instrument • Legal frameworks (single v dual track regimes)
Chapter 2. Glossary	<ul style="list-style-type: none"> • Definitions of bank; liquidation; bank failure management etc.
Chapter 3. Scope	<ul style="list-style-type: none"> • Entities covered by the instrument • Relationship with FSB <i>Key Attributes</i>
Chapter 4. Objectives	<ul style="list-style-type: none"> • Key objectives • Relevant considerations/guiding principles
Chapter 5. Institutional model	<ul style="list-style-type: none"> • General considerations • Phases of the liquidation process
Chapter 6. Procedural and operational aspects	<ul style="list-style-type: none"> • Legal standing to file for insolvency • The person in charge of the liquidation procedure (appointment, supervision, remuneration, accountability, legal protection) • Role of the deposit insurance authority • Role of creditors in the procedure
Chapter 7. Preparation	<ul style="list-style-type: none"> • Proportionality • Planning, collecting information • Cooperation among banking authorities, and between authorities and courts • Valuation • Preparation for the transfer of assets and liabilities • Confidentiality and public disclosure

Chapter 8. Grounds for opening liquidation proceedings	<ul style="list-style-type: none"> • General considerations (e.g., concerning the relation with triggers for corporate insolvency and alignment with resolution triggers) • Financial grounds • Non-financial (regulatory) grounds • License revocation
Chapter 9. Tools	<ul style="list-style-type: none"> • General principles • Atomistic liquidation • Transfer to a private acquirer • Other tools (bridge bank, asset management company) • Safeguards
Chapter 10. Funding	<ul style="list-style-type: none"> • Sources of funding • Purposes of funding (pay-box, transfer) • General principles (least-cost principle) • Burden-sharing
Chapter 11. Creditor hierarchy	<ul style="list-style-type: none"> • General principles on ranking • Depositor claims • Secured creditors • Liabilities arising from financial contracts • Subordinated claims
Chapter 12. Financial contracts	<ul style="list-style-type: none"> • Close-out netting • Secured debt and financial collateral • Repos and securities lending • Margin loans • Ranking
Chapter 13. Group dimension	<ul style="list-style-type: none"> • Types of intra-group support (financial; operational) • Group insolvency plans • Upstreaming and downstreaming of losses and funds • Groups and other structures (cooperative banks; institutional protection schemes) • Procedural consolidation and cooperation • Substantive consolidation
Chapter 14. Cross-border aspects	<ul style="list-style-type: none"> • Challenges • Concrete recommendations (recognition; support; cross-border cooperation; safeguards)

	<ul style="list-style-type: none">• Foreign branches and foreign subsidiaries
Chapter 15. Safeguards	<ul style="list-style-type: none">• Public policy safeguard• Due process and procedural fairness• Creditor protection• Financial stability