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**Item No. 4 on the agenda: Ongoing legislative activities carried over from the
2020-2022 Work Programme**

(b) Bank Insolvency

(prepared by the Secretariat)

<i>Summary</i>	<i>Report on the Bank Insolvency project</i>
<i>Action to be taken</i>	<i>The Governing Council is invited to take note of the progress made by the Working Group on Bank Insolvency, and to consider authorising the Secretariat to commence a targeted consultation on the draft Legislative Guide</i>
<i>Mandate</i>	<i>Work Programmes 2020-2022 and 2023-2025</i>
<i>Priority level</i>	<i>High</i>
<i>Related documents</i>	<u>UNIDROIT 2019 C.D. (98) 14 rev. 2</u> ; <u>UNIDROIT 2021 C.D. (100) B.4</u> ; <u>UNIDROIT 2021 A.G. (80) 10</u> ; <u>UNIDROIT 2022 C.D. (101) 9</u> ; <u>UNIDROIT 2022 C.D. (101) 21</u> ; <u>UNIDROIT 2023 C.D. (102) 8</u> ; <u>UNIDROIT 2023 C.D. (102) 25</u>

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. It briefly recalls the background of the project (Section II), provides information on the Working Group on Bank Insolvency (Section III) and the draft Legislative Guide that has been developed over the course of six Working Group sessions (Section IV and Annexe I). As a next step, the Secretariat proposes to commence a targeted consultation on the draft Legislative Guide, which would be followed by at least one more Working Group session in November 2024 (Section V).

II. BACKGROUND

2. The Bank Insolvency project aims to develop international guidance covering the key aspects of liquidation frameworks for non-systemic banks, thereby complementing the international architecture in the area of bank failure management. Given the mix between matters of private law and regulatory law, the project is undertaken by UNIDROIT in cooperation with, and with the support of, the Bank for International Settlements' (BIS) Financial Stability Institute (FSI).

3. The project on Bank Insolvency was included in UNIDROIT's Work Programme for 2020-2022, following proposals from the Bank of Italy and the European Banking Institute ([C.D. \(98\) 14 rev. 2](#)).

After an Exploratory Workshop in June 2021 and a feasibility study conducted by the Secretariat, the project was assigned high-priority status in December 2021 ([C.D. \(100\) B.4](#); [A.G. \(80\) 10](#)). Accordingly, a Working Group on Bank Insolvency was established (see Section III).

4. During its 101st session in June 2022, the Governing Council received an update from the Secretariat regarding the development of the project and the first two Working Group sessions, which had been held in December 2021 and April 2022. On that occasion, the Governing Council recommended maintaining the project in the 2023-2025 Work Programme with the same high-priority level ([C.D. \(101\) 21](#)).

5. During its 102nd session in May 2023, the Governing Council received an update on the work conducted by the Working Group on Bank Insolvency since June 2022, which included two Working Group sessions, in October 2022 and March 2023, and intense intersessional work ([C.D. \(102\) 8](#)). The Governing Council took note of the impressive progress that had been made by the Working Group thus far and agreed to grant the Secretariat flexibility to continue the project until 2025 ([C.D. \(102\) 25](#)).

III. THE WORKING GROUP

A. Composition

6. The Working Group on Bank Insolvency is chaired by Governing Council Member Professor Stefania Bariatti and is composed of ten members selected for their expertise in the fields of insolvency law, bank crisis management and deposit insurance.¹ In addition, the Working Group benefits from the participation of 39 institutional observers, including international and regional bodies or organisations,² as well as banking supervisors, deposit insurers, and bank resolution authorities from all over the world. Overall, the Working Group consists of participants from 26 jurisdictions from across five continents.³

B. Working method

7. Considering the participation of a large number of financial regulators in the Working Group and the sensitive nature of the topics, the meetings are conducted under Chatham House Rule to encourage open discussion among all participants. Furthermore, two distinct reports are drawn up following each Working Group session: a detailed report that is shared, on a confidential basis, with the Working Group participants only, and a high-level summary that is made publicly available on the UNIDROIT website.

¹ The Working Group is composed of the following experts: (i) Stefania Bariatti (Chair, Italy), (ii) Anna Gelpern (United States), (iii) Christos Hadjiemmanuil (Greece), (iv) Matthias Haentjens (the Netherlands), (v) Marco Lamandini (Italy), (vi) Rosa Lastra (United Kingdom), (vii) Matthias Lehmann (Austria), (viii) Irit Mevorach (United Kingdom), (ix) Janis Sarra (Canada), and (x) Reto Schiltknecht (Switzerland). David Ramos Muñoz (Spain) and Marco Bodellini (United Kingdom) are advisors to the Secretariat for this project. Furthermore, Iacopo Donati, Chair holder of the UNIDROIT-Bank of Italy research Chair programme, and Shuai Guo (China) have provided assistance to the Secretariat since the last Governing Council session.

² International Association of Deposit Insurers (IADI), International Monetary Fund (IMF), International Insolvency Institute, United Nations Commission on International Trade Law (UNCITRAL), World Bank Group, European Commission, European Banking Institute.

³ Please see UNIDROIT's [Bank Insolvency webpage](#) for the full composition of the Working Group. In addition to the participants listed there, representatives of the following institutions have observed one or more Working Group sessions: the Chinese National Financial Regulatory Administration, the Chinese Deposit Insurance Corporation, the European Bank for Reconstruction and Development.

C. Working Group sessions

8. Between December 2021 and March 2024, the Working Group met six times:⁴

- First session: 13-14 December 2021 (Rome)
- Second session: 11-13 April 2022 (Rome)
- Third session: 17-19 October 2022 (Brussels, hosted by the Single Resolution Board)
- Fourth session: 29-31 March 2023 (Basel, hosted by partner organisation FSI)
- Fifth session: 17-19 October 2023 (Rome)
- Sixth session: 4-6 March 2024 (Rome)

9. In addition, nearly all Working Group participants were involved in intense intersessional work, through thematic Subgroups (point D), a stock-taking exercise (point E), and the work of the Drafting Committee (point E).

D. Thematic Subgroups

10. Following the first Working Group session, three thematic Subgroups were established to conduct work during the intersessional periods:

- Subgroup 1 on Scope and definitions, Objectives, Institutional models, and Procedural and operational aspects of the liquidation procedure (Co-Chairs: Elsie Addo Awadzi (Bank of Ghana) and Ruth Walters (FSI)).
- Subgroup 2 on Preparation, Grounds for opening bank liquidation proceedings, Tools, and Funding (Co-Chairs: Christos Hadjiemmanuil (University of Piraeus) and Rastko Vrbaski (FSI)).
- Subgroup 3 on Creditor hierarchy, Financial contracts, Banking groups, Cross-border aspects, and Safeguards (Co-Chairs: Anna Gelpern (Georgetown Law) and Irit Mevorach (University of Warwick)).⁵

11. In the first and second intersessional period, 12 virtual Subgroup meetings were held. In addition, Subgroup participants produced written input, and the Secretariat organised three meetings between the Co-Chairs of the Subgroups to discuss common issues and coordinate the work.

12. The Subgroups continued to play a role in the third intersessional period (for the analysis of survey responses – see point E), and in the fourth intersessional period (when the draft Chapters of the Legislative Guide were submitted to the Subgroups for comments).

E. Stock-taking exercise

13. During the second intersessional period, a stock-taking exercise was conducted to gather information from Working Group members and observers on bank liquidation regimes across the world. The Secretariat, in cooperation with the Subgroups, drew up a survey consisting of approximately 60 questions covering all the subtopics considered by the Working Group, as well as questions concerning the characteristics of each jurisdiction's banking sector and actual (non-systemic) bank failures and how they were dealt with under the applicable regime. The Secretariat received survey responses from Working Group members and observers from 22 jurisdictions.

⁴ The meeting documents and Summary Report for each session are available on UNIDROIT's [Bank Insolvency webpage](#).

⁵ After the second Working Group session, the Subgroup 3 topics "cross-border aspects" and "safeguards" were merged.

14. During the third intersessional period, the Subgroups produced an analysis of the survey responses, which was discussed during the fourth Working Group session. On that occasion, the Working Group discussed how the stock-taking exercise had been instrumental in gaining insight into the laws and practices regarding the liquidation of banks in different jurisdictions, as well as the potential strengths and weaknesses of different possible approaches to subtopics. At the same time, it was agreed that the final version of the Legislative Guide should not extensively refer to jurisdictions' current laws and practices to avoid the Guide becoming inaccurate or outdated as frameworks might change over time.

F. Drafting Committee

15. At its third session (October 2022), the Working Group decided that the instrument should take the form of a Legislative Guide, to assist legislators and policymakers seeking to reform or refine their bank liquidation regime. In addition, it was decided to establish a Drafting Committee to prepare a first draft of the Legislative Guide based on the discussions and input collected thus far.

16. Accordingly, the Secretariat established a Drafting Committee consisting of ten individual experts.⁶ The Chapters of the Legislative Guide were allocated among the members of the Drafting Committee, ensuring that at least two experts were responsible for each Chapter. The representatives of the IMF and the World Bank agreed to participate in the Drafting Committee as reviewers.

17. The full Drafting Committee held seven virtual meetings in 2023. In addition, the teams for each Chapter discussed their draft texts through virtual meetings and exchanges. The Drafting Committee produced a preliminary draft of the Legislative Guide for the fourth Working Group session (March 2023).

18. Following the fourth session, the Drafting Committee revised the Chapters in line with the outcome of the discussions. Between August-September 2023, the draft Chapters were submitted to the respective Subgroups for feedback. Subsequently, the drafters updated the Chapters in cooperation with the UNIDROIT Secretariat and the FSI, which resulted in a revised draft Legislative Guide that was discussed during the fifth Working Group session (October 2023). Following the fifth session, the Drafting Committee met three times and the updated draft Chapters were submitted to the full Working Group for comments in February 2024. During its sixth session (March 2024), the Working Group discussed the feedback received during the Working Group consultation. Where feasible, the Secretariat had already addressed the comments that were not expected to require extensive discussion during the session. Following the sixth session, the Drafting Committee met between 7-8 March 2024 to address the main feedback received from the Working Group during the session. The updated draft Legislative Guide was sent to the Working Group for fatal flaw review on 15 April 2024. Annexe I to this document contains the version of the draft Legislative Guide that was sent to the Working Group for fatal flaw review. Annexe II contains the comments that were received from Working Group participants during the review process. A redline version of the draft Guide showing the changes that were made after the review process will follow if required.

IV. DRAFT LEGISLATIVE GUIDE

19. At the close of its sixth session, the Working Group agreed with the Secretariat that the draft Legislative Guide – after revisions in line with the sixth session – would be sufficiently developed to undertake a targeted consultation, and referred the draft instrument to the Governing Council for consideration at its 103rd session (see Annexe I).

20. The draft Legislative Guide currently consists of ten Chapters:

⁶ Marco Bodellini, Anna Gelpert, Christos Gortsos, Christos Hadjiemmanuil, Marco Lamandini, Rosa Lastra, Stephan Madaus, Irit Mevorach, David Ramos Muñoz, Janis Sarra.

- Chapter 1: Introduction. This Chapter contains introductory remarks concerning the background, scope and purpose of the Legislative Guide; a Glossary that explains the intended meaning of frequently used terms; explanations concerning the design of legal frameworks for managing bank failures (distinguishing between “single-track” and “dual-track” regimes), and the broader legal and operational environment in which bank liquidation rules operate; and guidance on the key objectives of an effective bank liquidation framework.
- Chapter 2: Institutional Arrangements. This Chapter provides guidance on how the institutional arrangements in a bank liquidation framework may support an orderly exit of non-systemic banks from the market as the intended outcome of the liquidation process. It offers an empirical overview of different institutional models, which can be grouped broadly as (i) administrative, or (ii) court-based but with a role for relevant banking authorities at specific stages of the process. The Chapter sets out key factors and considerations that may help in designing the appropriate institutional model considering jurisdiction-specific aspects. It explains that an administrative model can have clear benefits, which may make it the preferred option for jurisdictions. At the same time, it provides legislative Recommendations for jurisdictions with a court-based model.
- Chapter 3: Procedural and Operational Aspects. This Chapter discusses an early notification duty of banks vis-à-vis their supervisor, which should in turn inform the resolution authority and liquidation authority of a bank’s approaching non-viability to ensure appropriate coordination and facilitate preparation. Furthermore, Chapter 3 provides guidance on the petition for opening a bank liquidation proceeding; a range of issues relating to the liquidator (including desirable qualities, the criteria and process for selection and appointment, compensation, transparency and accountability, personal liability and legal protection); explanations on modified creditor involvement in bank liquidation proceedings, considering the special nature of banks and the role of banking authorities; and the termination of bank liquidation proceedings.
- Chapter 4: Preparation and Cooperation. This Chapters provides guidance on how the legal framework can facilitate preparation for bank liquidation proceedings. It also discusses how cooperation is key to the success of a liquidation process, and how cooperation between all relevant actors could be enabled by the legal framework, both in jurisdictions with an administrative model and in jurisdictions with a court-based model.
- Chapter 5: Grounds. This Chapter explains why the grounds for opening a bank liquidation proceeding should be broader than traditional insolvency grounds and should ideally include a forward-looking element, recommending the concept of “(likely) non-viability” as a guiding principle. Chapter 5 also discusses the interaction between the revocation of a banking licence and the opening of bank liquidation proceedings.
- Chapter 6: Liquidation Tools. This Chapter provides guidance on the tools and powers that should be included in the legal framework to allow an orderly liquidation of non-systemic banks. The focus of Chapter 6 is on the sale of a non-viable bank’s assets and liabilities to another bank (a “sale as a going concern”). In addition, with regard to the “piecemeal liquidation” of a bank, the Chapter discusses how some adjustments from the general business insolvency framework are advisable to account for the specificities of banks and make the process as efficient and effective as possible. Chapter 6 also elaborates on the treatment of financial contracts in bank liquidation proceedings.
- Chapter 7: Funding. This Chapter explains why funding beyond a bank’s own available resources may be needed for orderly failure management. The focus of Chapter 7 is on the use of resources from industry-sourced deposit insurance funds, either to reimburse insured depositors or to fund measures that preserve depositors’ access to their funds as an alternative to payout.
- Chapter 8: Creditor Hierarchy. This Chapter provides guidance on the treatment and relative ranking of certain types of claims in bank liquidation proceedings. After discussing how rules

on creditor ranking may be introduced in jurisdictions' legislative framework, it provides guidance on: (i) the ranking of deposit claims, including interbank deposits and related party deposits; (ii) the subordination of claims, be it by means of a contract, statutory provision or a court order, including the subordination of related party claims; (iii) the ranking of shareholders; (iv) the ranking of resolution financing arrangements; (v) the ranking of post-liquidation financing; (vi) the treatment of secured creditors, including covered bondholders and central banks.

- Chapter 9: Group Dimension. This Chapter discusses how the legal framework could prevent the liquidation of an individual bank being hampered by impediments arising from its membership in a group (e.g., discussing how to deal with intra-group financing and dependencies). Furthermore, it discusses how cooperation between different liquidation authorities and liquidators of different group entities can be encouraged.
- Chapter 10: Cross-Border Aspects. This Chapter provides guidance on the design of the legislative framework for cross-border cooperation that takes into account different possible scenarios (e.g., the presence of subsidiaries and branches in different jurisdictions). It offers a framework for cooperation and coordination of liquidation authorities in a cross-border context; provides guidance on the recognition of foreign proceedings and support measures; and discusses safeguards that are critically important to creating a fair and effective cross-border regime.

21. Each Chapter contains a set of Recommendations for legislators and policymakers. The Recommendations as such do not constitute provisions that could be directly enacted in national law. Rather, they provide guidance on core issues that it would be desirable to address in an effective bank liquidation framework. The title of the Guide could be the "UNIDROIT Legislative Guide on Bank Liquidation" (alternatives would be the "UNIDROIT Legislative Guide on Effective Bank Liquidation Regimes" or similar).

V. PROPOSED NEXT STEPS

22. It is proposed that the Secretariat undertakes a four-month targeted consultation campaign (e.g., between June and September 2024). The consultation could be targeted to banking supervisors, deposit insurers, and bank resolution authorities that are not participating in the Working Group, as well as insolvency practitioners, law firms, and banking associations. Several key aspects of policy included in the instrument will also be presented in selected international conferences to receive feedback from experts attending those highly specialised events.

23. After the consultation period, at least one more session of the Working Group is envisaged in November 2024, to allow the Working Group to duly consider the comments received on the draft Legislative Guide during the consultation period, as well as additional work that may have been conducted by the Secretariat and experts from the Working Group concerning detailed legal aspects of the liquidation procedure. A second and final Working Group session may be necessary, to be held early in 2025.

24. The draft Legislative Guide would then be finalised and submitted to the Governing Council at its 104th session in 2025 for final evaluation and adoption.

VI. ACTION TO BE TAKEN

25. *The Governing Council is invited to take note of the progress made by the Working Group on Bank Insolvency and to consider the current draft Legislative Guide (Annexe I) and the comments received from Working Group participants during the fatal flaw review process (Annexe II). Furthermore, the Council is invited to consider authorising the Secretariat to commence a targeted consultation on the draft instrument.*