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International Institute for the Unification of Private Law
Institut international pour l'unification du droit privé

(Draft) Legislative Guide on Bank Liquidation

**Single Resolution Board
Legal Conference
Brussels, 6 June 2024**

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UNIDROIT Project on Bank Liquidation

Context and need for international guidance

▶ **Global Financial Crisis**

▶ **Special nature and role of banks**

▶ **Business insolvency frameworks**

FSB Key Attributes of Effective Resolution Regimes for Financial Institutions (2011)

→ Financial institutions that are systemic in failure

UNCITRAL and World Bank instruments

→ Focus on 'regular' businesses

What about frameworks to deal with the failure of 'non-systemic' banks?

Working Group on Bank Insolvency

Form

- Proposals by the Bank of Italy and European Banking Institute
- Mix of private law and regulatory law
 - ▶ Partnership UNIDROIT – Financial Stability Institute (BIS/FSI)
- Working Group on Bank Insolvency:
 - ▶ 10 Members/ 39 Observers (international and regional organisations, bank supervisory authorities, resolution authorities, deposit insurance agencies)
 - ▶ Participants from 26 jurisdictions, from across five continents

A Legislative Guide addressing key aspects of bank liquidation frameworks, setting out options and providing recommendations, where appropriate

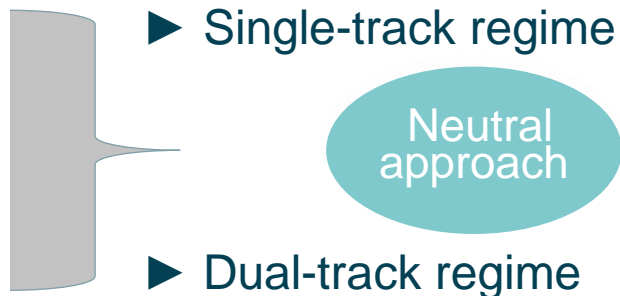
- Introduction
- Institutional Arrangements
- Procedural and Operational Aspects
- Preparation and Cooperation
- Grounds for Opening Bank Liquidation Proceedings
- Liquidation Tools
- Funding
- Creditor Hierarchy
- Group Dimension and Cross-border Aspects

The liquidation of:

1. Non-systemic banks that are not resolved pursuant to special resolution regimes
2. Parts of a bank following, or in the context of, a resolution action

→ Certain aspects of liquidation frameworks also relevant for the resolution of systemic banks

Design of legal frameworks for managing bank failures



- Bank liquidation and the broader legal and operational environment
- Flexibility for jurisdictions to tailor the scope of their framework



SELECTED TOPICS

I. Appropriate Institutional Set-Up

Overall, an administrative model might have benefits making it the preferred option for jurisdictions absent special circumstances

- ➔ E.g., the banking supervisor, resolution authority, or deposit insurer (subject to conditions)
- ➔ Well-positioned to pursue public interest objectives
- ➔ Capable of preparing for liquidation
- ➔ Expertise, efficiency, access to information; ability to take decisions swiftly

An administrative liquidation authority should have the power to appoint a liquidator, who would operate under its direction and oversight; regular reporting vis-à-vis the administrative authority

I. Appropriate Institutional Set-Up

Solutions for jurisdictions that do not adopt a fully administrative model

- ➔ Where a court order is needed to open bank liquidation proceedings, this should not impede a rapid and effective intervention. Intervention by banking authority in some manner
- ➔ It should be possible to adequately prepare for a bank's liquidation
- ➔ Granting a banking authority an important role throughout the proceeding, especially at beginning/transfer tool implementation
- ➔ Entrusting bank liquidation cases to judges with appropriate expertise and experience, and a role for intervention in appointment of liquidator by authority

The legal framework should envisage a strong role for banking authorities, especially in the opening of the proceeding and to prepare and execute a transfer of assets and liabilities

II. Effective Liquidation Tools

Drawbacks of ‘piecemeal liquidation’: destruction of value; disruption of access to deposits; possible broader adverse effects

The legal framework should allow and facilitate a ‘sale as a going concern’: transfer of a bank’s assets and liabilities – especially (insured) deposits – to another bank to allow continued operation

- ➔ Power for the liquidation authority / liquidator to transfer a non-viable bank’s assets and liabilities to a sound acquirer
- ➔ Without the need to individually notify, or obtain consent from, shareholders and creditors
- ➔ Enabling the liquidation authority / liquidator to prepare and execute the transfer

Why not Bail-in? Bridge bank? Asset Management Company?

Ordinary corporate insolvency tools?

II. Effective Liquidation Tools

Piecemeal liquidation: when a sale as a going concern is not feasible or desirable & to liquidate the residual estate following a transfer

« Need for bank-specific provisions »

- ➔ **Recognition of claims:** Allowing the liquidator to rely on a bank's records; no need for insured depositors to submit claims for amounts covered by deposit insurance
- ➔ **Contracts:** Allowing the continued provision of services to transferred business
- ➔ **Depositors:** Allowing advance payments to depositors
- ➔ **Avoidance:** Exceptions (resolution transactions); possibly stricter rules (related party transactions)

Financial contracts:

- Contractual early termination rights, including close-out netting, should remain enforceable
- Power for the liquidator to impose a temporary stay to facilitate a transfer, provided that substantive obligations continue to be met

III. Funding and Creditor Hierarchy

External funding to ensure an orderly liquidation should be envisaged, and the creditor ranking should facilitate the implementation of liquidation tools

External funding may be needed for prompt reimbursement of insured depositors or to enable deposit transfer to a sound acquirer ('filling the gap')

Use of industry-sourced deposit insurance funds (DIFs), subject to the safeguards in the *IADI Core Principles for Effective Deposit Insurance Systems*

Facilitating the provision of post-liquidation financing by private lenders

Depositor ranking (benefits of some form of depositor preference)

Depositors should not be treated differently based on their nationality, the location of their claim or the jurisdiction in which it is payable

The legal framework should provide the possibility to subordinate the claims of related parties

Shareholders should not be paid until the bank's creditors are fully repaid. In case of a transfer, equity interests could be left in the residual entity

Specific provisions may be needed to protect bank-specific secured creditors

IV. Adequate Safeguards

The legal framework should provide adequate substantive and procedural safeguards

- ➔ Independence of the liquidation authority
- ➔ Judicial and non-judicial accountability mechanisms; but limitation of remedies to monetary compensation (no reversal of measures)
- ➔ Respect for the *pari passu* treatment of creditors; deviations for reasons of value maximisation and provided that no creditor is worse off
- ➔ Other, e.g., provisions to avoid unwarranted benefits for related parties

V. Group dimension and Cross-border aspects

Cooperation and coordination between liquidation authorities and liquidators of different entities (in the same or different jurisdictions) must be envisaged

→ Rules governing intra-group financing and intra-group services

→ Procedural rights for administrative authorities when court is involved in the liquidation of one or more group entities

→ Cooperation between administrative authorities responsible for liquidation of group entities (including non-banks)

→ Cooperation between liquidators to the maximum extent possible; possible appointment of the same liquidator for entities of the same group

→ Encouraging the liquidation authority and liquidator to act to achieve a cooperative solution with foreign authorities and liquidators

→ Advance cooperation among banking authorities in jurisdictions with court-based models

→ Enable prompt effect to be given to foreign liquidation actions (recognition and support measures)

→ Refusal of recognition and support on clearly defined grounds (public policy; financial stability; material fiscal implications)



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Thank you for your attention!

Any Questions?