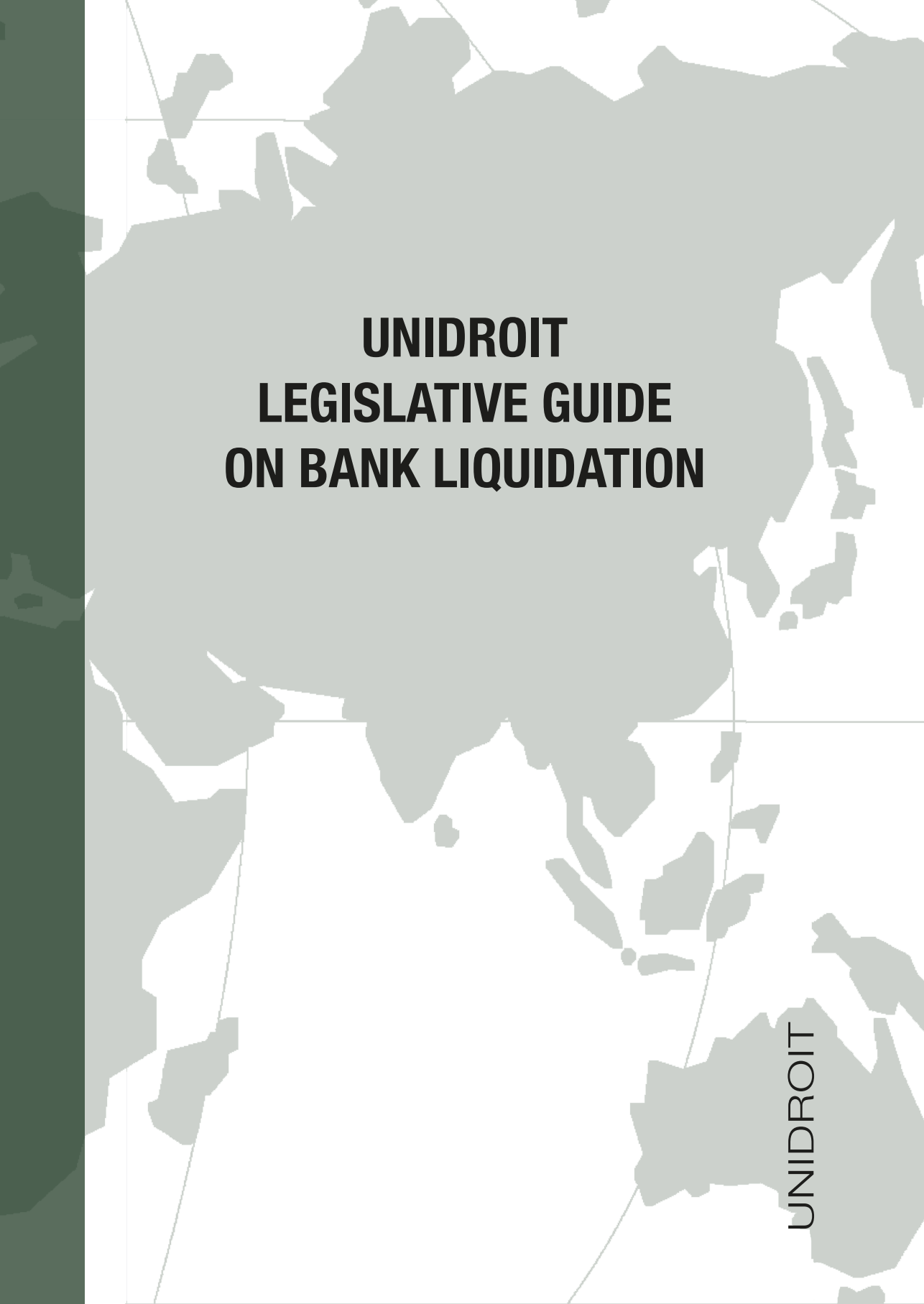
UNIDROIT LEGISLATIVE GUIDE ON BANK LIQUIDATION



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FOREWORD

At the dawn of the new millennium (2007-2015), the world was shaken by a deep, pervasive financial crisis that arose as a banking crisis, immediately expanded to the broader financial markets, quickly spread to the non-financial economy, and eventually brought many nations towards the brink of insolvency. The expansion of financial markets and their ever-enhanced interconnection caused the trouble to escalate at an unprecedented speed and to an unparalleled number of jurisdictions, irrespective of geographic location, thus redefining the concepts of systemic risk and financial stability. Both the institutional and legal frameworks of the existing international financial architecture had to be reshaped, bolstered, deepened and enlarged.

And so they were. Concerning banks, Basel's new, more rigorous and comprehensive standards, the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions (and other related instruments) and the International Association of Deposit Insurers' Core Principles for Effective Deposit Insurance Systems − alongside widespread legal reform at the domestic (e.g., the United States' "Dodd-Frank" Wall Street Reform and Consumer Protection Act) and regional level (e.g., the EU Bank Recovery and Resolution Directive) − created a substantially strengthened regulatory and institutional architecture to deal with systemic crises and to underpin financial stability.

But the regulatory landscape that emerged in the slipstream of the financial crisis did not quite finish the job. In the province of bank crisis management, at least two areas were left untouched: effective means of managing the failure of small (non-systemic at point of failure) banks, and the design of bank liquidation frameworks. These two loopholes bear great potential importance. Firstly, banks that are non-systemic at the point of failure constitute a very large portion of banking sectors across the globe. Secondly, experience has shown that, especially (albeit not only) in less developed financial systems, any bank, irrespective of size, might ultimately have disruptive effects for financial stability. Thirdly, a sound system to liquidate banks ought to be an essential part of every country's legal framework, for it represents the path to wind up and close down failed, insolvent banks − a critical task which could be undertaken from the beginning or as the final stage of a resolution process. The absence of international guidance on how to liquidate a bank is particularly grave given that many countries around the world either have no specific rules to liquidate banks and therefore apply a general business insolvency legislation that is most often inadequate for banks, or have existing models that are outdated, depend heavily on inefficient court systems, and result in a very fragmented cross-border scenario.

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UNIDROIT received a proposal to undertake work on the subject matter and close said loophole by the Bank of Italy, which was soon joined by the European Banking Institute. The proposal was accepted and included in the 2020-2022 Work Programme by the concurrent decisions of the Governing Council and the General Assembly, initially with medium priority. Pursuant to the Governing Council's mandate, the Secretariat conducted additional legal research, canvassed international support for the project, and sought cooperation in the main regulatory scene. Widespread confirmation that the initiative was deemed highly relevant − and urgent − was immediately apparent. Most importantly, we found a partner in the core of Basel, the Bank of International Settlements' (BIS) Financial Stability Institute (FSI). The FSI would purport to cover the regulatory side, while UNIDROIT would draw from its substantive track record in private law and the law of financial markets, forging what was to become an extremely synergic cooperation.

In June 2021, UNIDROIT and the FSI jointly organised an Exploratory Workshop, inviting experts and institutions from all over the world. Drawing from the conclusions of the Exploratory Workshop, the Governing Council, at its 100th session, upgraded the project to high priority, and late in 2021 a Working Group was established and started its activity. The composition and the level of engagement and thoroughness of the Working Group have been impressive, almost unparalleled. Masterfully − and firmly − chaired by Governing Council member Professor Stefania Bariatti, the Working Group was composed of leading experts from a varied range of legal systems, including around 40 institutional observers from all continents (amongst which central banks, banking supervisors, resolution and liquidation authorities, international financial institutions, deposit insurers and representatives of the insolvency industry), totalling over 120 accredited participants. This was perhaps the first time that regulatory experts sat in the same room with corporate insolvency experts to undertake a normative project, and it was no doubt the first time that such a formal dialogue was conducted outside of Basel − a rare honour, and a show of trust, that UNIDROIT proudly embraced.

The Working Group met seven times between December 2021 and November 2024. Due to the participation of a large number of financial regulators and the sensitive nature of the topics, the Working Group's meetings were held − exceptionally, given our usual methodology − under the Chatham House Rules, and benefited from substantial intersessional work conducted by three subgroups that met, formally and informally, well over 20 times, and, especially, by the Drafting Committee, whose members bestowed on the project an outstanding amount of effort and skill. In addition, a stock-taking exercise on bank liquidation regimes from around the world, with feedback received from 22 jurisdictions, and a technical survey jointly designed by the FSI, our Secretariat and the IMF on specific technical questions, were conducted. Moreover, following authorisation from the Governing Council, a public (and targeted) consultation was launched for a period of 18 weeks, with 22 responses

comprising 414 comments. After the consideration of all the relevant input, a final meeting of the Working Group decided on the content of the final text, which was submitted to UNIDROIT's 105th session of the Governing Council (23-25 May 2025), and approved with all praise.

* * * *

The instrument has been drafted as a legislative guide intended to be used by legislators and policymakers when designing effective bank liquidation regimes tailored to the special nature of banks and their role in a country's economy and society. It draws substantially on existing standards, with particular regard to the FSB's Key Attributes and IADI's Core Principles, texts which the Guide purports to complement, never to substitute or replace. It is divided into ten chapters containing an explanation of key issues, an analysis of possible approaches to such issues and, where appropriate, providing Key Considerations and Recommendations in a clear, discursive manner. A system consistent with all 105 Recommendations will feature a state-of-the-art, best practice system for the liquidation of banks.

The Guide seeks to tackle all the important items that a legislator would need to consider when designing a system to handle failed, unviable banks. To do that, different models are identified and discussed, and the instrument does not shy away from grappling with the difficult questions, providing a preferred solution where consensus was reached. A good example of the Guide's intention to confront complex questions can be found in its treatment of the key objectives of an effective bank liquidation framework, where reflections on how to deal with possible conflicts between the objectives, for example between the protection of depositors and the maximisation of the insolvency estate, are envisaged, discussed, and argued, and solutions are proposed.

Guidance was found to be particularly necessary in relation to the institutional arrangements in a bank liquidation framework, which is where a comparative analysis showed the highest level of fragmentation. Considering all the possible variations, the Guide provides a carefully-crafted analysis of the pros and cons of administrative models and court-based models. Instead of opting for the wholesale preference for one or the other, the Guide usefully underscores the essential role that administrative agencies (e.g., resolution or liquidation authorities, banking supervisors) must play in every system, and it identifies the features of models that a country opting to keep substantial court involvement (due to path dependency or constitutional constraints) should in any case not do without.

The analysis provides plenty of clear-cut examples where the usual corporate insolvency law solutions do not work for banks. A salient one concerns the grounds for opening a bank liquidation proceeding. Both the usual balance-sheet and cash-

flow tests are deemed inadequate, and recommendations are included to ensure the legislator opts for forward-looking grounds, in line with the FSB Key Attributes, drawing on the concept of "non-viability" as a guiding principle. It also discusses the interaction between bank liquidation and the revocation of a banking licence, as well as the interaction with triggers for resolution procedures. But perhaps the most useful part concerns the design and use of bank liquidation tools. The focus is on the transfer of a non-viable bank's assets and liabilities to another bank (a "sale as a going concern"), which is the preferred solution where feasible. In addition, with regard to the "piecemeal liquidation" of a bank, the Guide discusses how some adjustments to the general business insolvency framework are advisable to account for the specificities of banks and make the process as efficient and effective as possible.

Naturally, this aspect – along with others – would not be complete without an adequate analysis of funding beyond a bank's own available resources. Here, the focus is on the use of resources from industry-sourced deposit insurance funds. Explanations are provided as to why there are significant advantages to allowing the use of deposit insurance fund resources to support a sale as a going concern, which would ensure continued access to insured deposits as an alternative to a payout of insured depositors.

Perhaps the most thoroughly discussed topic regarded the treatment and relative ranking of certain types of claims in bank liquidation proceedings, with special attention to the ranking of deposit claims, including interbank deposits and related-party deposits. This is an area where a clear majority defended granting a preferred ranking for deposit claims, as opposed to no priority, which is the solution in a handful of highly relevant and developed jursidictions. The discussion in the Guide broaches the matter from a dynamic (funding) perspective, considering how "general depositor preference" may facilitate deposit book transfer as compared to "tiered depositor preference". The choice of the legislator regarding these items also has implications for banks that have cross-border activities or are part of a domestic group, for which detailed guidance is offered.

The foregoing are but a handful of examples of complex areas where the legislator must face intricate policy options, the solution to which – whatever the legislator's choice might be – must be internally consistent: indeed, the institutional decision-making process, the grounds to access proceedings, the use of a transfer tool and its funding, and the ranking of claims are all interdependent items, which must observe reciprocal consistency. Accordingly, the Guide is most useful when read in its entirety, rather than cherry-picking different parts.

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UNIDROIT would like to express its heartfelt gratitude to the experts and observers of the Working Group for their hard work, dedication, generosity, constructive spirit and collegiality. It was not only a reciprocal learning exercise, but a true pleasure, from beginning to end.

Institutionally, our first word of aknowledgement and recognition must go to the FSI, which shared the work and the cost of the project, hosted the Working Group in Basel and played a key role in the instrument's development and dissemination. Our partnership proved successful, our expertise complementary and synergic, and our joint work exemplary and enriching. We would like to thank the FSI Chair, Fernando Restoy, for his leadership and unwavering support throughout the project. Special gratitude is owed to Ruth Walters and Rastko Vrbaski, working with whom became an intellectually edifying exercise and a most rewarding personal interaction.

We would like to sincerely thank the Bank of Italy, which initially proposed the project, participated very actively throughout the negotiations, and helped the Secretariat by setting up a joint Bank of Italy-UNIDROIT Chair that significantly bolstered the Secretariat's human resources. Hardly 100 meters separate the entrances of Villa Aldobrandini (the seat of UNIDROIT) and Palazzo Koch (the seat of the Bank of Italy), but even such short distance has proven too far as a proxy for the extraordinary cooperation and synergy of our respective teams. Gratitude is indeed also in order to the Single Resolution Board, the European Banking Union's resolution authority, for its remarkable involvement in the project, for hosting one session of the Working Group in Brussels, and for offering us a privileged platform to discuss the instrument's draft during the consultation period through their Annual Conference. Special appreciation is also owed to the European Banking Institute, which was also an initial proponent of the project, and which lent the Working Group and Drafting Commmittee some of its key experts.

This time, the UNIDROIT Team (with a capital T) benefited from a deeper bench than usual. We gained from the generous and highly skilled work of Professors David Ramos and Marco Bodellini, who, apart from being Working Group members in their own right, worked hand in hand with the Secretariat. Immensely useful support was also received by the two Bank of Italy-UNIDROIT Chairs, Professors Iacopo Donati and Hossein Nabilou, and, due to a generous grant from the Chinese Government, by Professor Shuai Guo. The enormous administrative work of such a large project was borne, almost single-handedly, by Isabelle Dubois, who never failed to serve *éclat* with her usual kindness, generosity and humility. Finally, the real driving force of the project was Senior Legal Officer Myrte Thijssen, whose hard work, technical excellence, distinction and collegiality will be difficult, very difficult, to mirror.

The Legislative Guide on Bank Liquidation is already being used as a standard globally; its translation into Chinese and Japanese is almost complete, and other

translations are well underway. There was a need for this instrument. It was a challenge, but, *with a little help from [our] friends*, we rose to it. This instrument, halfway between banking and insolvency law, between private law and regulation, opens a new workstream for UNIDROIT and forges a new path, one where – now we know – other important services to the international legal community will arise.

Maria Chiara Malaguti
President

Ignacio Tirado
Secretary-General

Villa Aldobrandini, Rome, August 2025

CONTENTS

LIST OF ABBREVIATIONS

AMC	Asset management company
BCBS	Basel Committee on Banking Supervision
BRRD	Bank Recovery and Resolution Directive (EU)
CP	Core Principle
DI	Deposit insurer
DICJ	Deposit Insurance Corporation of Japan
EC	Essential Criterion
DIF	Deposit insurance fund
DIS	Deposit insurance scheme
EN	Explanatory Note
EU	European Union
FDIA	Federal Deposit Insurance Act (US)
FDIC	Federal Deposit Insurance Corporation (US)
FSB	Financial Stability Board
G-SIB	Global Systemically Important Bank
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund
ISDA	International Swaps and Derivatives Association
KA	Key Attribute
MLCBI	UNCITRAL Model Law on Cross-border Insolvency
MLEGI	UNCITRAL Model Law on Enterprise Group Insolvency
MoU	Memorandum of Understanding
NBFI	Non-Bank Financial Institution
NCWO	No Creditor Worse Off
P&A	Purchase and Assumption
TLAC	Total Loss Absorbing Capacity
UNCITRAL	United Nations Commission on International Trade Law
US	United States

CHAPTER 1. INTRODUCTION

A. Background and scope of the *Legislative Guide*

1. Banks provide services that are essential to the functioning of the real economy, such as deposit-taking (an activity that is typically restricted to authorised institutions), the granting of loans and the processing of payments. Banks also play a key role in the transmission of monetary policy. Banking supervision and regulation aim to ensure that banks operate safely and soundly. However, they are generally not intended to achieve a "zero failure" regime. Nevertheless, the failure of a bank of any size may have a significant impact on depositors and other creditors, and borrowers. Depending on the size of the bank, it may also have implications for the payment system, the inter-bank market and the financial system at large. An effective legal framework for dealing with non-viable banks is therefore a key building block of a jurisdiction's financial safety net.

2. Frameworks for dealing with non-viable banks need to reflect the special nature of banks and their role in society. General business insolvency regimes are not designed to address the particular risks and public policy concerns that arise when a bank fails. This is because core features such as the grounds for insolvency, the objectives of the proceeding, the tools available, the procedural roles and rights of creditors, and the institutional framework within which the process takes place are not tailored to the specific characteristics of banks and the public policy concerns typically associated with their failure.

3. Following the many bank failures during the global financial crisis that started in 2007, the international community developed a framework for the resolution of financial institutions that could be systemic in the event of failure in a way that maintains their critical functions and preserves financial stability without exposing taxpayers to loss. These efforts resulted in the adoption in 2011 of the Financial Stability Board's *Key Attributes of Effective Resolution Regimes for Financial Institutions* [1] (FSB Key Attributes), the international standard for "resolution regimes". They set out the core elements of frameworks that facilitate the orderly resolution of financial institutions without reliance on public funding. These include institutional arrangements; powers, tools and associated safeguards; sources of funding; requirements for recovery and resolution planning; and arrangements for cooperation and information sharing. This international standard is

[1] FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (revised 2024).

being implemented widely for banks and, in some cases, for other financial institutions, including by G20 jurisdictions which have committed to do so.

4. The *FSB Key Attributes* specify that any financial institution that could be systemic in the event of failure should be subject to a resolution regime that complies with this standard. This scope is broader than institutions that are designated in advance as systemically important since any bank, regardless of its size, may be systemic in failure depending on the circumstances.[2] Some jurisdictions extend that scope and apply their resolution regime to all banks.

5. However, limited attention has been given to regimes for managing the failure of banks that are not considered to be systemic at the point of failure for the purposes of the *FSB Key Attributes*. In this *Guide*, such banks are referred to as "non-systemic banks". Moreover, while the *FSB Key Attributes* specify that frameworks should include the power to "*effect the closure and orderly wind-down (liquidation) of the whole or part of a failing firm*",[3] guidance is lacking on effective liquidation procedures for any residual parts of banks that are to be wound up following resolution actions, such as the transfer of viable operations to an acquirer.

6. The purpose of this *Legislative Guide* is to complement the existing international standards. It therefore focuses on the orderly liquidation of (i) banks that are not placed under a resolution procedure compatible with the *FSB Key Attributes* and (ii) parts of a bank following, or in the context of, a resolution action (including the liquidation of individual banking subsidiaries of a banking group in resolution). This *Guide* does not cover reorganisation measures outside of liquidation or measures aimed at preventing a bank's failure.[4]

7. The liquidation proceeding described in this *Legislative Guide* ends with the market exit of the bank, even if parts of its business are continued by a different legal

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[2] See *FSB, Key Attributes Assessment Methodology for the Banking Sector* (2016), Explanatory Note (EN) 1(c), which explains that the determination that a bank is systemically significant or critical in failure may be made either at a point close to failure when resolution is being considered or in advance. In the latter case, there should be procedures to apply the resolution regime to banks that were not formerly designated as systemic if they are subsequently determined to be systemically significant or critical in the circumstances of their failure.

[3] See *FSB Key Attributes*, KA 3.2(xii). The provision further specifies that the process should include the timely payout or transfer of insured deposits and prompt access to transaction accounts and segregated client funds.

[4] For instance, measures taken by a deposit insurance scheme or institutional protection scheme to prevent the failure of a member institution are outside the scope of this *Guide*.

entity.[5] While the guidance is mostly aimed at facilitating the orderly liquidation of non-systemic banks, elements such as the guidance on creditor hierarchies (see *Chapter 8. Creditor Hierarchy*) are also relevant to resolution frameworks.[6]

B. Organisation and purpose

8. The *Legislative Guide* comprises ten chapters, including this introduction. Each chapter focuses on a specific thematic area of a bank liquidation framework and contains an explanation of key issues, an analysis of possible approaches to such issues and, where appropriate, a set of Key Considerations and Recommendations.

9. The guidance has been informed by a survey of experts in bank failure management about the nature of, and experience with, bank liquidation frameworks in 22 jurisdictions.[7] Where relevant, the *Guide* refers to those survey results to illustrate its discussion of specific aspects of bank liquidation.

10. The Recommendations have differing levels of detail, and 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. It is advisable to read the Recommendations together with the accompanying text in each chapter, since the latter provides detailed explanations and also discusses aspects not specifically addressed in the Recommendations.

11. The *Legislative Guide* was developed with due regard to relevant international instruments (see *Section F* below) and refers to them where appropriate. It aims to complement the existing international standards for managing bank failures. As such, aspects that are not covered by this *Guide* should be understood as dealt with under other international standards. Nothing in this *Guide* should be interpreted as revising, replacing or overriding any provisions and principles included in other international standards.

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[5] See the definition of "bank liquidation proceeding" (*Glossary, point (7)*). This contrasts with the possibility of "open bank" resolution under some resolution frameworks, whereby the legal entity is preserved and the bank continues to operate in the market following resolution.

[6] This is because the order of distribution in liquidation generally governs the allocation of losses in bank resolution proceedings.

[7] Argentina, Belgium, Brazil, Canada, China, Colombia, France, Germany, Ghana, Greece, India, Italy, Japan, Malaysia, Moldova, the Netherlands, Nigeria, Paraguay, South Africa, Spain, Switzerland, Ukraine.

12. The *Guide* is intended to be used as a reference by legislators and policymakers when designing effective bank liquidation regimes tailored to the special nature of banks and their role in society. It is expected to be particularly relevant for jurisdictions that do not yet have a dedicated bank liquidation framework or specific rules for the liquidation of non-systemic banks, although it may also be useful for jurisdictions that wish to reform their existing bank liquidation framework. It is not intended to serve as standard or code used in countries' assessment by international organisations. However, it may be used by international and regional organisations as appropriate in line with their policies to provide technical assistance to national authorities wishing to improve their legal framework for bank liquidation.

C. Glossary

13. This section explains the intended meaning of terms that appear frequently in the *Legislative Guide.* Many of these terms may be defined differently in other contexts. The definitions listed here are intended to ensure that the concepts are clear for the purposes of this *Guide*.

(1) "Administrative authority": a non-judicial public authority, with powers in the field of activity entrusted to it by law.

(2) "Bank": any entity that is authorised or licensed under the applicable legal framework to accept deposits or repayable funds from the public and grant loans. For the purposes of this *Guide*, "bank" includes any licensed deposit-taking institution (including cooperatives, credit unions, building societies, savings banks, or national legal forms such as *Cajas de Ahorro*, *Sparkassen* and others).

(3) "Banking authorities": the authorities responsible for exercising functions in the areas of bank supervision, bank resolution and bank liquidation. Such authorities would typically include the banking supervisor and resolution authority (which may, in either case, be a central bank or deposit insurer).

(4) "Banking group": two or more entities, of which at least one is a bank, linked by control or ownership.

(5) "Banking supervisor": the authority responsible for the prudential supervision or oversight of a bank.

(6) "Bank failure management": any measures that may be taken by the competent bodies within a jurisdiction to deal with the failure of a bank, irrespective of the cause of that failure and however classified under the applicable legislative framework.

(7) "(Bank) liquidation proceeding": a collective judicial or administrative proceeding, in which the assets and affairs of a bank are subject to control or supervision by a court or administrative authority for the purpose of a piecemeal liquidation or a sale as a going concern, and in any case ending with the exit of the bank from the market.[8]

(8) "Close-out netting provision": a contractual provision on the basis of which, upon the occurrence of an event defined in the provision in relation to a party to the contract, the obligations owed by the parties to each other that are covered by the provision, whether or not they are at that time due and payable, are automatically or at the election of one of the parties reduced to or replaced by a single net obligation, whether by way of novation, termination or otherwise, representing the aggregate value of the combined obligations, which is thereupon due and payable by one party to the other.

(9) "Contingency plan": a plan developed to prepare and facilitate a bank's liquidation in the run-up to its non-viability.

(10) "Deposit": any credit balance which derives from normal banking transactions and which a bank must repay at par under the applicable legal and contractual conditions, any debt evidenced by a certificate issued by a bank, and any other funds or obligations defined or recognised as deposits by the applicable legal framework.

(11) "Deposit insurer" (DI): the legal entity (or entities) responsible for providing deposit insurance, deposit guarantees or similar deposit protection arrangements.

(12) "Depositor preference": the preferential treatment of some or all deposits in a bank liquidation proceeding arising from their ranking in the creditor hierarchy above ordinary unsecured claims.

(13) "Financial contract": a contract that is identified in the legal framework of a jurisdiction as subject to specific treatment in insolvency for the purposes of termination and netting. Financial contracts include contracts for the purchase or sale of securities, derivatives contracts, commodities contracts, repurchase agreements, and similar contracts or agreements.

[8] See *point (24)* for the definition of "piecemeal liquidation" and *point (29)* for the definition of "sale as a going concern".

(14) "Home jurisdiction": the jurisdiction where the bank is authorised, licensed or incorporated and where a liquidation proceeding for the bank may be opened or centralised.

(15) "Host jurisdiction": the jurisdiction where a bank or banking group has operations in the form of one or more subsidiaries or branches or where it carries out activities that are regulated and supervised in that jurisdiction (which is not the home jurisdiction).

(16) "Institutional protection scheme" (IPS): a contractual or statutory liability arrangement for a group of member banks aimed at their protection and, in particular, ensuring their liquidity and solvency to avoid failure.

(17) "Insured deposits": deposits that fall within the scope of coverage of a deposit insurance scheme and do not exceed the maximum coverage level.

(18) "Interbank deposits": deposits made with a bank by another bank or by a financial institution, often for short-term periods (typically overnight).

(19) "Licence": official permit to undertake a regulated activity, which is also referred to as authorisation or charter in the context of banking.

(20) "Liquidation authority": administrative or judicial authority (or authorities) empowered by law to open or oversee a bank liquidation proceeding.

(21) "Liquidator": a natural or legal person authorised by a liquidation authority or applicable law to develop and implement a liquidation strategy for a bank in a liquidation proceeding or, in the absence of such person, the liquidation authority itself.

(22) "No Creditor Worse Off (NCWO) safeguard": the right of creditors of a bank to compensation where they do not receive in the bank's resolution at a minimum what they would have received in a piecemeal liquidation.

(23) "*Pari passu* principle": the principle according to which similarly situated creditors are treated and satisfied proportionally to their claim out of the assets of the estate available for distribution to creditors of their rank.

(24) "Piecemeal liquidation": a process of selling or disposing of assets piece by piece for the distribution of the proceeds to creditors in accordance with the applicable creditor hierarchy, as opposed to the sale or transfer of the whole business or parts thereof as a going concern.

(25) "Prospective liquidator": a person authorised by a liquidation authority or applicable law to be involved in the preparation of a bank liquidation proceeding, with the prospect of being appointed as the liquidator.

(26) "Public policy objectives": the liquidation objectives of depositor protection and, where applicable, financial stability as explained in this *Guide*.

(27) "Resolution": the process of managing the failure of banks and, depending on the scope of the regime, other financial institutions that are (or are likely to be) no longer viable and could be systemic in failure, through the exercise of resolution powers by a resolution authority.

(28) "Resolution authority": an administrative authority or authorities designated as such and conferred with resolution powers under a resolution regime.

(29) "Sale as a going concern": the sale or transfer of a business in whole or in part that allows its continued operation, as opposed to the sale or disposal of assets piece by piece for the distribution of the proceeds to creditors.

(30) "Subordination": the lower ranking, by virtue of statute, a court order or a contractual agreement, of one or more creditors' rights or claims in relation to other rights or claims, with the result that they will be paid later in the distribution of the proceeds than they would otherwise be paid.

(31) "Subordination agreement": a contractual agreement between two or more creditors of a single debtor, or a debtor and one or more creditors, by which one or more creditors agree that their rights or claims against a debtor will be subordinated to other claims.

D. Legal framework for managing bank failures

14. The design of legal frameworks governing bank failure management differs across jurisdictions. Broadly speaking, jurisdictions may either have a single framework for dealing with any bank failure (single-track regime), or they may distinguish conceptually between "resolution", on the one hand, and "liquidation" or "insolvency proceedings", on the other (dual-track regime).[9] In single-track regimes,

[9] A dual-track regime typically features a specific resolution framework that is distinct from the insolvency regime that would otherwise apply. Nevertheless, a single-track regime may incorporate distinct powers and procedures for different circumstances. For example, certain powers may only be available in cases where the non-viable entity is systemic or its failure entails a risk to financial stability. Such a regime incorporates distinctions similar to those that characterise dual-track regimes, but within a single

the legal framework governing bank failures is typically tailor-made for banks (and possibly, other financial institutions). In dual-track regimes, the "liquidation" track may be governed by the general business insolvency law (with or without bank-specific modifications), or by a bank-specific liquidation law.

15. For example, the European Union's (EU) framework for bank resolution, set out in the Bank Recovery and Resolution Directive (BRRD), distinguishes between "resolution" and "normal insolvency proceedings", and national implementation by EU Member States takes the form of a dual-track regime.[10] Under that framework, resolution action may be taken only if resolution is "necessary in the public interest",[11] and if there are no supervisory or private sector measures that can restore the bank to viability within a reasonable timeframe. If that threshold is not met, the failing institution will be dealt with under the applicable national insolvency law using whatever procedures and tools are available under that law.[12] The applicable national insolvency law also applies when a residual entity is wound up following a resolution transfer of the institution's viable activities. For EU Member States, the guidance provided in this *Legislative Guide* would be relevant for such national insolvency laws.

16. By way of comparison, the United States (US) Federal Deposit Insurance Act (FDIA) constitutes a single-track regime for bank failure management, and all failed US insured depository institutions are resolved or liquidated under that regime. The FDIA provides for several possible courses of action[13] and confers a range of powers on the Federal Deposit Insurance Corporation (FDIC) in the capacity as receiver of a failed insured depository institution, including powers to transfer assets and liabilities of the failed bank to an assuming institution in a "Purchase and Assumption" (P&A) transaction. It may also organise a bridge bank to continue the operations of the failed bank until it is sold or liquidated. Alternatively, under the same framework, the FDIC may use the broad statutory powers of a receiver to liquidate the assets of the failed institution and pay out depositors and other creditors.

framework that may not distinguish between "resolution" and "liquidation" as a matter of terminology.

10 The same is true for the Single Resolution Mechanism Regulation for the European banking union.

11 For the concept of "public interest", see Article 32(5) BRRD.

12 Since the nature of those regimes is not governed by EU law, they vary in form between (predominantly) administrative or judicial, bank-specific or modified versions of the general business insolvency framework.

13 The FDIC can be appointed as the conservator of a failed bank to carry on the business of the institution, pending a sale or other disposition, or as a receiver.

The FDIC also insures deposits and supervises depository institutions for safety, soundness and consumer protection.

E. Neutrality of the Guide

17. The *Guide* recognises that banking sectors and the legal frameworks for bank failure management differ across jurisdictions. It seeks to accommodate such differences and offer guidance that can be implemented in any jurisdiction in a way that takes account of local specificities. Key aspects of bank liquidation laws are discussed with the aim of helping users to evaluate different approaches and to choose the most suitable design and elements for the specific legal and institutional context.

18. This *Legislative Guide* recognises the benefits of an administrative regime for bank liquidation (see *Chapter 2. Institutional Arrangements*). Regarding the design of the legal framework, it does not prescribe or assume the existence of a specific type of regime (single-track or dual-track). However, not all parts of the *Guide* are equally relevant for single-track and dual regimes. In a single-track regime, the *FSB Key Attributes* will inform the design features of the overall bank failure management framework, including several aspects that are covered in this *Guide* such as the institutional model, which is necessarily administrative in a single-track regime; the objectives of a failure management procedure; preparation and cooperation; the grounds for opening failure management proceedings; the powers available, including the use of transfer powers; and cross-border cooperation. This means that some of the guidance offered in Chapters 1, 2, 4, 5, 6 and 10 is mainly relevant to the liquidation track of dual-track regimes.[14] Other aspects of the *Guide* are equally relevant to a single-track regime, especially those concerning provisions of general business insolvency law and advisable modifications thereto and guidance relating to the liquidation of a residual entity following resolution action.

19. This *Guide* does not prescribe the level at which bank liquidation rules should be incorporated in a jurisdiction's legal framework. Whether certain provisions fit better in primary legislation (statutory law) or in secondary (administrative) acts is a legal and policy choice and depends on jurisdiction-specific characteristics.

20. Nevertheless, most of the aspects discussed in the *Guide* would be expected to be part of primary legislation. Importantly, bank-specific modifications of generally applicable rules should be enacted at the same level as the general rules (e.g., a business insolvency statute). Accordingly, derogations from statutory rules

[14] While this provides a general indication, legislators and policymakers of jurisdictions with single-track regimes are advised to read all Chapters in order to carefully assess which specific aspects are already informed by the *FSB Key Attributes*.

of regulatory, corporate, capital markets and insolvency law should be clearly stated and adopted at the statutory level. Moreover, certain provisions, such as powers to deal with property rights or to adjudicate competing claims, may require primary legislation under a jurisdiction's constitutional arrangements.[15]

21. In a dual-track regime, the provisions governing bank liquidation should ideally be included in a dedicated bank liquidation law. Alternatively, they could be integrated in the banking law or general business insolvency law, provided they are clearly demarcated and readily identifiable. The enactment of a *lex specialis* contributes to legal certainty and procedural clarity. In a predominantly court-based regime, it may be sufficient to introduce bank-specific modifications, although some jurisdictions have a *lex specialis* for a court-based framework. In any case, if the general business insolvency law applies to banks, clear bank-specific provisions should be introduced, either in the banking law or in the general insolvency law.

22. This *Guide* explains the aspects that should be specifically addressed in a bank liquidation framework, irrespective of the chosen legislative approach. This includes the specificities compared to general business insolvency law. Illustration 1 provides a concise overview of the key features of bank liquidation laws.

Illustration 1. Key features of bank liquidation laws

Involvement of administrative authorities	A bank liquidation proceeding should be managed by an administrative authority (administrative model) or by a court with a strong involvement of the relevant banking authorities (court-based model with administrative involvement). Irrespective of the model, a strong role for the relevant banking authorities is needed, especially in the earlier phases of the bank liquidation process and in the preparation and execution of strategies that transfer some or all of the bank's business to another entity (see *Chapter 2. Institutional Arrangements*).

[15] By way of analogy, the *FSB Key Attributes Assessment Methodology for the Banking Sector* notes that resolution powers "*should be clearly set out in the legal framework applicable to the [resolution] authority*" (see EN 3(e)). The purpose of this is to ensure a sufficiently clear legal basis for those powers.

Procedural role and treatment of creditors	An administrative authority should have the right to initiate or petition for the opening of a bank liquidation proceeding. Where others also have such a right, the administrative authority should at least be heard before any order is granted in any proceeding initiated by a third party. The procedural rights of creditors should be modified under the framework where the exercise of those rights could materially undermine the objectives of the framework (see *Chapter 3. Procedural and Operational Aspects*).
Preparation and cooperation	The legal framework should enable an appropriate level of preparation and cooperation between the authorities. Transfer strategies are facilitated by advance preparation, to the extent possible, while for a piecemeal liquidation, preparation is needed to enable a swift payout of insured depositors (see *Chapter 4. Preparation and Cooperation*).
Grounds for opening liquidation proceedings	The grounds for opening a bank liquidation proceeding should be broader than those for other businesses and ideally include a forward-looking element to allow timely action, prevent unnecessary destruction of value and protect depositors. When the authority responsible for revoking a bank's licence is different from that responsible for opening the liquidation proceeding, the legal framework should clearly set out their interaction. The framework should enable a smooth liquidation of residual parts of the failed bank as part of a resolution process (see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*).
Liquidation Tools	Piecemeal liquidation of a bank will often destroy value and disrupt depositors' access to their deposits, which may have broader adverse effects. The legal framework should therefore allow the transfer of the non-viable bank's deposits and other suitable liabilities – with available assets – to another entity (see *Chapter 6. Liquidation Tools*).
Funding	Bank failure management in most cases requires funding in excess of the bank's own available liquid resources. Bank-specific sources of funding, in particular the deposit insurance fund, may play an important role in ensuring an orderly liquidation of non-viable banks (see *Chapter 7. Funding*).

Creditor hierarchy	The creditor hierarchy applicable in a bank liquidation proceeding should be clearly set out and reflect the specificities of banks. In particular, a privileged ranking for depositors facilitates transfer strategies, which protect depositors by providing continued access to their deposits (see *Chapter 8. Creditor Hierarchy*).
Group dimension	Banks often operate in a group structure and may be interconnected within the group, both financially and operationally. A bank's membership in a group should not impede its liquidation. The legal framework should clearly set out the treatment of pre- and post-liquidation intragroup financing and grant administrative authorities the appropriate means to ensure coordinated actions among liquidators for group entities (see *Chapter 9. Group Dimension*).
Cross-border dimension	Both single entities and banking groups may have cross-border activities. The legal framework should allow for effective cross-border cooperation, coordination and exchange of information. It should facilitate the recognition of foreign proceedings, with due respect for safeguards such as the non-discriminatory treatment of creditors (see *Chapter 10. Cross-Border Aspects*).

F. Bank liquidation and the broader legal and operational environment

23. The effectiveness of a bank liquidation framework depends not only on its design features but also on the broader legislative and regulatory environment in which it operates. While outside the scope of this *Guide*, that broader legal and regulatory environment, including the judicial system, affects the liquidation authority's ability to fulfil its mandate and perform its functions effectively. Shortcomings may lead to delays in decision-making and legal uncertainty, which can result in sub-optimal outcomes in bank liquidation. Bank liquidation is part of a jurisdiction's financial safety net. *Subsection 1* describes the other elements of the financial safety net. *Subsection 2* describes elements of the broader legal and judicial regime that might have an impact on the effectiveness of bank liquidation proceedings.

1. Robust financial safety net

24. Effective prudential regulation and supervision, in accordance with the relevant international standards, are critical for enabling supervisors to identify, assess and take action with respect to risks arising from individual banks or the

financial system as a whole. Where banks nevertheless fail, a timely assessment of non-viability helps to lower the costs associated with such failures.

25. To ensure a smooth continuum from supervision to bank failure management, jurisdictions should have a system of prudential regulation and banking supervision that meets the relevant international standards, especially the Basel international regulatory framework for banks (the Basel Framework) and the *Basel Core Principles for Effective Banking Supervision* (Basel Core Principles).[16] In accordance with the latter, it is important that the supervisory framework: (i) includes a forward-looking assessment of the risk profile of banks, (ii) provides for increased intensity of supervision of a bank that is encountering difficulties, and (iii) provides the supervisor with an adequate range of powers to bring about timely corrective action and address unsafe and unsound practices or activities that could pose risks to individual banks or to the financial system as a whole.

26. The supervisory framework should foster coordination and the exchange of information between a banking supervisor and a liquidation authority or (prospective) liquidator. In line with the *Basel Core Principles*, supervisors should be able to cooperate and collaborate with relevant authorities in deciding when and how to effect the orderly failure management of a problem bank, including its possible closure.[17]

27. An effective lender of last resort function constitutes an important component of the financial safety net. The discretionary provision of emergency liquidity assistance is typically exercised by the central bank.

28. Jurisdictions should have a deposit insurance system that is in line with the International Association of Deposit Insurers' *Core Principles for Effective Deposit Insurance Systems* (IADI Core Principles).[18] The deposit insurance system consists of the DI and its relationships with the financial safety net participants that support deposit insurance functions and resolution processes. Such system protects depositors up to a specified amount and contributes to financial stability.

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16 The *Basel Core Principles (2024)* provide a comprehensive standard (soft law) for establishing a sound foundation for the regulation, supervision, governance and risk management of the banking sector. The *Basel Framework* (https://www.bis.org/basel_framework/) is the full set of standards of the Basel Committee on Banking Supervision (BCBS), which is the primary global standard setter for the prudential regulation of banks.

17 See *Basel Core Principles,* Core Principle (CP) 11, Essential Criterion (EC) 8; CP 1, EC 6; CP 3, EC 6.

18 IADI, *Core Principles for Effective Deposit Insurance Systems* (revised 2014).

29. If a bank is liquidated, the default use of deposit insurance fund (DIF) resources is to reimburse insured depositors through payout of insured deposits. However, the *IADI Core Principles* envisage that DIF resources may also be used to fund measures that preserve depositors' access to their funds as an alternative to payout, subject to the mandate of the DI, appropriate governance arrangements and safeguards to protect the DIF against excessive depletion.[19]

30. Jurisdictions should have a bank resolution framework in line with the *FSB Key Attributes*. The bank liquidation framework specified in this *Guide* is not a substitute for a resolution framework, and the provisions and arrangements it recommends, taken together as a whole, are not tailored to deal with banks that are systemic in failure. Furthermore, the guidance provided in this *Guide* regarding the liquidation of banks following resolution action assumes that such action took place in accordance with the *FSB Key Attributes*.

2. An effective legal and judicial framework and an adequate system of support professionals

31. The broader legal and judicial regime also has an impact on the effectiveness of bank liquidation proceedings. A well-developed legal framework should incorporate a corpus of business laws, including corporate, contract, consumer protection, securities, property and conflict-of-law provisions that are clear and consistently enforced.

32. Depending on the design of the legal framework governing bank failures, general business insolvency law may be partially applicable to banks, in combination with bank-specific modifications (see *paragraph 21)*. Where the bank-specific framework relies on provisions of general business insolvency law to any extent, those provisions should meet relevant international standards. This includes, in particular, the World Bank's *Principles for Effective Insolvency and Creditor/Debtor Regimes* (World Bank Principles)[20] and the instruments of the United Nations Commission on International Trade Law (UNCITRAL) in the area of insolvency law, notably the UNCITRAL *Legislative Guide on Insolvency Law* (UNCITRAL Legislative Guide).[21] This *Guide* assumes that jurisdictions have implemented these insolvency instruments. It refers to relevant parts of these instruments where

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19 See *IADI Core Principles*, CP 9, EC 8. The use of the DIF to fund measures that preserve access to insured deposits, such as transfer transactions and the associated safeguards for the DIF is discussed further in *Chapter 7. Funding*.

20 World Bank, *Principles for Effective Insolvency and Creditor/Debtor Regimes* (revised 2021).

21 UNCITRAL, *Legislative Guide on Insolvency Law* (presently consisting of five parts adopted at different times between 2004 and 2021).

appropriate, and complements them by providing guidance designed for the liquidation of banks.

33. The legal framework should provide a mechanism for the fair and timely resolution of disputes. The judiciary should be independent, have appropriate expertise and experience, and should be able to take decisions swiftly. Furthermore, the ecosystem of support professionals (e.g., accountants, auditors, valuers, lawyers and liquidators) should be adequate and allow for effective cooperation with the liquidation authority. When such professionals are involved in the preparation and execution of a bank liquidation proceeding, they should be subject to appropriate accreditation and professional oversight, and the legal framework governing their work should be consistent with relevant international technical and ethical standards and guidelines.

G. Scope of a bank liquidation framework

34. This *Guide* focuses on "non-systemic" banks (see *paragraph 5*). The definition of the term "bank", and the entities that it covers, varies across jurisdictions and in different regulatory and legal frameworks. For the purposes of this *Guide,* the concept of a "bank" is based on the applicable regulatory definition: that is, the entities that are classified as banks for regulatory purposes, and thereby licensed or authorised to accept deposits and grant loans in the jurisdiction in question. For the purposes of this *Guide*, the term "bank" is the genus and the various types of deposit-taking institutions (cooperatives, credit unions and others) are species within that genus.[22]

35. The reason for this approach to scope in the *Guide* is that the regulatory perimeter is aligned with and already reflects policy decisions about which entities operating within a jurisdiction merit a specific regime. Following a "regulatory approach" when designing a bank liquidation framework has the advantage that it is clear which entities are covered by the framework and that these are within the scope of prudential supervision, which facilitates access to relevant information and enables a smooth continuum from ongoing supervision to failure management. Furthermore, it is generally expected that licensed banks fall within the scope of any scheme established to protect depositors in the event of a bank failure (deposit insurance scheme or DIS), and that deposit insurance funding is therefore available in liquidation – either to pay out insured depositors or to facilitate transfers of deposits to another entity.

36. Depending on the applicable regulatory framework, different types of licences may be required for different types of banks and other deposit-taking

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22 See the definition of "bank" in the *Glossary, point (2)*.

institutions (e.g., universal banks, payment banks, small finance banks, urban cooperative banks, regional rural banks, local area banks, rural cooperative banks, Islamic banks). If this is the case, different failure management regimes and DISs may apply.

37. The licensing and failure management regime for cooperative banks also varies across jurisdictions. In some, cooperative banks are licensed as banks and covered by a DIS (which may be a specific DIS set up for cooperative banks), while in others, they are subject to a separate regulatory and supervisory framework and their deposits may not be insured.

38. While the scope of this *Guide* is based on an entity's licence to perform banking activities, the guidance remains relevant after the licence has been revoked. Licence revocation may be a ground for opening bank liquidation proceedings (see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*) and a sale as a going concern may take place after the revocation of the licence. Similarly, in a piecemeal liquidation following licence revocation, bank-specific rules are necessary to ensure that the liquidation process achieve the objectives of bank liquidation (for instance, to swiftly reimburse depositors or to allow a residual entity to continue to provide services to another bank to which part of the non-viable bank's assets and liabilities were transferred).

39. This *Guide* covers banks irrespective of their legal form – joint stock company, mutual or cooperative – or their business model. While most banks are incorporated as joint stock companies (e.g., PLC, *Societé anonyme*, *Sociedad anónima*, *Aktiengesellschaft*), cooperative structures are important in several jurisdictions, especially among small- and medium-sized banks. Business models in banking range from the traditional to more innovative models that focus on specialised or niche services. Increasingly, business models also vary according to the extent to which services are delivered face to face (a "brick-and-mortar" business model), or through digital technology without a network of physical branches. Mixed models, combining physical and digital presence, are currently predominant, but the number of exclusively digital banks is growing, especially among small- and medium-sized institutions.[23] Furthermore, the *Guide* covers both single entity banks

[23] While the *Guide* covers banks irrespective of their legal form or business model, jurisdictions' legal frameworks may need specific provision to reflect the particular characteristics of different types of banks.

and banking groups.[24] Specific considerations relevant to the liquidation of a bank that is part of a group are covered in *Chapter 9. Group Dimension*.

40. While the *Legislative Guide* is designed for banks, jurisdictions may choose to tailor the scope of their bank liquidation framework to the specificities of their financial sector and regulatory framework. For example, the scope of the bank liquidation framework might be extended to cover regulated entities that are not licensed as banks but carry out bank-like activities (e.g., entities that are engaged in only one of the core activities of banks, such as lending or payment services) and entail similar risks in failure. Nevertheless, if the scope of the bank liquidation framework is extended beyond banks, certain parts of the *Guide* may not be fully applicable. For instance, the *Guide* assumes that the non-viable entity is a member of a DIS. If this is not the case, this reduces the funding options as described in *Chapter 7. Funding*.

H. Key objectives of an effective bank liquidation framework

41. This section elaborates on the objectives of an effective bank liquidation framework. The identification of key objectives, principles and outcomes is primarily meant to ensure that the overall design of a bank liquidation framework enables the procedure to deliver those objectives and outcomes. The objectives may be stated explicitly in the liquidation framework, or they may be derived from the legal and institutional mandate of the actors involved in the bank liquidation proceeding. For example, the institutional mandates of central banks and banking supervisors typically include objectives related to financial stability. Where such an authority is involved in a liquidation, that objective will also apply to that involvement unless specific other liquidation objectives are set out in the framework.

42. Even if they are not explicitly specified in the legal framework, objectives can still guide the broad goals and the policy choices made in bank liquidation laws. The discussion below sets out relevant objectives in the design of bank liquidation frameworks and/or the outcome of liquidation proceedings. It does not prescribe how each objective should be incorporated in the legal framework, since that may depend on the broader policy choices and design features of the bank liquidation framework at hand. Nevertheless, it does recognise that some of the objectives discussed are more in the nature of a guiding design principle while others might be more appropriate as an explicit objective for the liquidator.

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[24] Data provided by ten jurisdictions indicates that, in nearly all jurisdictions, at least 35% of bank entities operate within a banking group. In most jurisdictions, at least 50% of banks operate within a group rather than on a stand-alone basis. While it is more likely for large banks to be part of a group, smaller banks often operate within a group as well.

43. Different phases of the liquidation proceeding may be informed by different objectives. Specifically, financial stability concerns and depositor protection tend to play a more significant role in the first phase of a liquidation proceeding, whereas the objective of value maximisation gains more relevance as the proceeding advances. Accordingly, a stronger role for administrative authorities is needed in the earlier phase of the process, e.g., the decision to liquidate a bank, the choice of liquidation approach and the execution of measures to protect depositors (payout or transfer). This is because administrative authorities are well positioned to pursue public policy objectives, such as depositor protection. Conversely, the focus of a liquidator in realising residual assets and settling claims will be driven by value maximisation.

44. After describing the key objectives of an effective bank liquidation framework (*subsection 1* to *subsection 5*), options are provided on how legal frameworks could guide liquidation authorities and liquidators in balancing the liquidation objectives in case of friction (*subsection 6*).

1. Value preservation and maximisation

45. Value maximisation is a core objective of business insolvency laws.[25] The goal is to obtain the highest possible value from the liquidation estate, the principal benefit of which is that the creditors of the business in liquidation can expect the highest possible recovery rates. In some frameworks, for example, a liquidator has an explicit duty to wind up the affairs of the insolvent entity in a way that maximises the value of the assets of the estate.

46. Irrespective of whether the objective is included as an explicit statutory objective for the liquidator, if this is intended as an objective of bank liquidation, the framework should facilitate that outcome by conferring appropriate tools and powers. For example, powers to sell the business or parts thereof as a going concern, rather than disposing of assets piece by piece, may help to preserve value and achieve higher distributions to creditors whose claims were not transferred. The ability to open bank liquidation proceedings in a timely manner and to act swiftly may also help to minimise value destruction, and this will depend in part on the grounds for liquidation and in part on the capacity of liquidation authorities to act quickly under the institutional framework.

47. What maximises the value of the estate of a bank in liquidation requires a case-by-case assessment, as it depends not only on the composition of that estate, but also on the broader context in which it is being liquidated and the feasibility of

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[25] See, e.g., *UNCITRAL Legislative Guide*, Part One, Chapter I, para. 5; *World Bank Principles*, Principle C1.

potentially value-maximising options, such as a sale as a going concern. Depending on the circumstances, the objective of value maximisation may either require acting quickly (in case of a sale as a going concern) or acting slowly (e.g., to avoid fire sales at distressed prices in the liquidation of a residual entity).

2. Depositor protection

48. Depositors generally make up a significant percentage of the creditors of a bank, and that percentage is typically even greater in non-systemic banks. If access to their deposits is interrupted, this could cause considerable personal hardship for depositors and undermine general confidence in the banking sector. The objective of protecting depositors aims to reduce such negative impacts for individuals and businesses, and on the banking sector and economic activity more generally. Depositor protection is therefore closely connected to the objective of financial stability in that it aims at maintaining trust in the banking system and avoiding broader negative impacts on the economy.

49. Accordingly, depositor protection is a universal motivating objective for bank-specific liquidation frameworks, including bank-specific modifications to a general business insolvency regime. The design of bank liquidation regimes may promote depositor protection, for example by facilitating transfers of deposits to preserve uninterrupted access for depositors to their funds.

50. Depositor protection should ideally be an explicit statutory objective. Where jurisdictions impose a duty for the liquidator in relation to depositor protection, it typically takes the form of a procedural priority that requires depositors to be paid early in the proceeding[26] or that requires the liquidator to prioritise the interests of depositors by working first with the DIS to transfer the deposits or make a rapid payout.[27] A depositor protection objective for liquidation may also be derived from the mandate of the administrative authority in charge of bank liquidation

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[26] For example, the regime may provide for uninsured depositors to be paid at the first opportunity (Colombia). Insured deposits are protected by the DIS, where it exists.

[27] In some jurisdictions, a depositor protection objective empowers or requires the liquidator to prioritise finding solutions regarding the protection of depositors with the DIS first, before pursuing value maximisation. For instance, under the United Kingdom's Bank Insolvency Procedure (BIP), the liquidator has two objectives. Objective 1, which is specific to the BIP and is not an objective of the general business insolvency regime, is to *"work with the deposit insurer to ensure that, as soon as reasonably practicable, the accounts of protected depositors are transferred to another bank or that the insurer pays out the protected deposits"*. Objective 2, which is the sole objective of the general business insolvency regime, is to wind up the failed bank to achieve the best result for creditors as a whole. Objective 1 takes precedence over Objective 2, although the liquidator should start working on both immediately.

proceedings, either framed explicitly in terms of protecting depositors or as a facet of a broader financial stability objective.[28]

51. Depositor protection objectives are separately pursued through deposit insurance. DISs protect a specified set of insured depositors and support financial stability by helping to preserve public confidence in the banking sector and reducing the risk of contagion arising from bank runs.[29] The defined category of insured depositors varies among jurisdictions, reflecting policy choices about the nature of depositors that should benefit from DIS protection in the circumstances of the national banking sector. However, it generally covers deposits of individuals and possibly some corporates, typically up to a specified coverage limit. Depending on their mandate,[30] DIs protect the insured depositors either by paying out the insured depositors or by funding the transfer of their deposits to another entity that will maintain the accounts and thereby ensure that depositors can access their funds with no or minimal interruption. The role of the DI and the use of DIF resources in bank liquidation frameworks are discussed further in *Chapter 2. Institutional Arrangements* and *Chapter 7. Funding* of this *Guide*.

52. Depositor protection may also be pursued through depositor preference, which confers a preferred ranking for some or all depositors over other unsecured creditors in the creditor hierarchy. Granting all depositors a preferred ranking by means of general depositor preference may also support a depositor protection objective in liquidation since it facilitates transfer of the deposit book (for a full discussion of the implications of different forms of depositor ranking, see *Chapter 8. Creditor Hierarchy*).

3. Financial stability

53. Maintaining financial stability is generally an overarching objective of any framework for prudential regulation and supervision, and it is often an explicit part of the mandate of banking authorities and central banks. It is linked to banks' special nature (e.g., susceptibility to runs) and the interplay between banks, the financial

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28 For example, DIs with responsibilities for bank failure management will typically be required by their mandate to carry out those responsibilities in a way that protects depositors, while a financial stability mandate may explicitly or implicitly encompass depositor protection.

29 See *IADI Core Principles*, CP 1: "*The principal public policy objectives for deposit insurance systems are to protect depositors and contribute to financial stability*".

30 While "paybox only" DIs may only use their funds to pay out insured deposits, either directly or through an agent bank, DIs with broader mandates may fulfil their responsibilities to protect depositors by funding measures (such as transfer transactions) that preserve depositors' access to their funds, see *Chapter 2. Institutional Arrangements, Section E* for a discussion of the types of DI mandate.

system and the real economy. Although there is no uniform definition of this broad and flexible concept, and its meaning differs across jurisdictions and according to the context, one core meaning of financial stability relates to safe and sound banking.[31] Banking sector stability and financial stability are interrelated concepts. The presence of unsound banks or the disorderly exit of a bank in any economy can pose threats to financial stability. Trust and confidence in safe and sound banking are essential for well-functioning financial systems.

54. Financial stability is a core objective of resolution under the *FSB Key Attributes*. Accordingly, single-track regimes should contain a financial stability objective that is derived from the *FSB Key Attributes*, which will inform actions where a bank's failure risks a negative impact on financial stability. In dual-track regimes, failures with clear financial stability implications will be managed under the separate resolution framework. Nevertheless, certain financial stability considerations may be relevant in some circumstances in a bank liquidation, where financial stability considerations and depositor protection are closely linked. These considerations can play a role in aspects of liquidation that relate to prompt access to deposits, both by way of transfer-based strategies and through requirements imposed on the liquidator to support a DIS for the reimbursement of insured deposits. Generally, disruptions to depositors of a non-viable bank will be minimised and confidence in the banking sector better maintained by a sale as a going concern, compared with piecemeal liquidation. Furthermore, financial stability remains a potentially significant consideration in the liquidation of the residual entity of a bank in resolution following a transfer of critical functions to an acquirer. In such cases, the continuity of those functions may require the provision of certain services by the residual entity for a limited time until the acquirer makes substitute arrangements, or other actions from the liquidator to support the continuity of those services. It may also require the liquidator to refrain from taking legal actions to recover value that might unwind or put at risk the earlier resolution.

55. Financial stability is therefore an objective that informs the broader design of a bank liquidation framework and, in particular, features such as the institutional arrangements, tools and procedural aspects. However, financial stability may also be incorporated in a bank liquidation framework as an explicit objective for all or specific parts of the procedure and/or through the mandate of the authorities involved in the process. However framed, the relevance of financial stability in bank liquidation does not imply the availability of public funds in a way that exposes public funds to loss (see *subsection 4* below). The relevance of financial stability in bank liquidation is also an important reason for assigning administrative authorities a role in bank liquidation frameworks under a dual-track regime, whether as

[31] In a broader context, financial stability is also related to macroeconomic stability and the stability of government finances.

liquidation authority or in overseeing aspects of the liquidation where financial stability concerns may arise (for example, in the treatment of depositors). As discussed in *Chapter 2. Institutional Arrangements, Section C.1*, administrative authorities with a relevant mandate may be best placed to consider the public policy concerns that may arise due to the failure of a bank (see also *Recommendation 12*).

4. Avoiding loss to public funds

56. Following the global financial crisis that started in 2007, where public funds were used to prevent or mitigate the impact of a number of large bank failures, a primary aim of the *FSB Key Attributes* is to reduce loss exposure of the taxpayer by removing the reliance on public funding in managing the failure of financial institutions.[32] Public funds may only be used exceptionally in a resolution where there are no other feasible options for preserving a firm's critical functions. In such exceptional circumstances, it should be determined that private sources of funding have been exhausted or cannot achieve the objectives of an orderly resolution.[33] The *FSB Key Attributes* specify that any use of public funds should be accompanied by mechanisms for recovering those funds from the failed banks or the sector more broadly.[34]

57. The same objective should guide the design of bank liquidation frameworks. Funding for liquidation measures should derive primarily from the balance sheet of the failed bank, with equity absorbing losses first, followed by creditors in accordance with the creditor hierarchy. Providing public support to non-systemic banks is even more difficult to justify than for systemic banks. To minimise fiscal implications, legislators and policymakers should thus be guided by the principle that public funding will not be available for the liquidation of banks within the scope of this *Guide.* This does not prevent the use of DIF resources for measures such as transfers that preserve access to insured deposits since the use of those funds in accordance with the DI's mandate is considered as involving industry funds (see *Chapter 7. Funding*).

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[32] See *FSB Key Attributes,* e.g., Preamble. KA 6.1 also specifies that "*Jurisdictions should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms*".

[33] *FSB Key Attributes*, KA 6.4.

[34] *FSB Key Attributes,* KA 6.2 provides that where temporary sources of funding are needed to accomplish orderly resolution, any losses incurred should be recovered first from shareholders and unsecured creditors (subject to the NCWO safeguard) and, if necessary, from the financial system more widely.

5. Certainty and predictability

58. Certainty and predictability are important objectives in the design of any liquidation framework. The legislation should establish clear rules on, for example, the process, the competences of the actors involved in the process, the available tools, the creditor hierarchy, how to deal with banks that are part of a group and cross-border liquidations.

59. Predictability for creditors about the expected treatment of their claims in bank liquidation proceedings may have a positive impact on the cost of funding for banks. Clear and comprehensive provisions about the grounds for liquidation, the powers of the liquidation authority and conditions governing their use may also reduce risks of legal challenge of actions taken during a liquidation proceeding and increase legal certainty for stakeholders.

60. The principles of certainty and predictability may also inform the remedies available under the legal framework in the event that actions relating to the liquidation are challenged. For example, remedies may be limited, and some may be excluded, in order to avoid legal uncertainty about the status of action undertaken in the course of a bank liquidation proceeding and to strike an appropriate balance between the protection of private rights and broader public interests (see *Chapter 2. Institutional Arrangements*).

61. Nevertheless, certainty and predictability should be balanced with appropriate flexibility for the actors involved in a liquidation process to plan and execute the most appropriate liquidation strategy depending on the circumstances of the case. The level of detail and prescriptiveness of the legislative provisions will need to be weighed against such need, while ensuring as much transparency as possible (see *Chapter 2. Institutional Arrangements, Section C.7*).

6. Balancing the objectives of a bank liquidation framework

62. As outlined above, there are multiple objectives that an effective bank liquidation framework should seek to achieve. These objectives are commonly aligned in bank liquidation proceedings, with liquidation strategies serving various objectives at the same time.

63. However, there may be situations in which frictions arise. For example, public policy objectives may be in tension with maximising value for creditors (e.g., there could be circumstances in which the former may be better served by a fast transfer of at least insured deposits, while other creditors may have an interest in a longer liquidation process that might recover greater value for them). Value maximisation may also require discretion and flexibility, which may reduce the level of certainty and predictability present in the framework.

64. The extent to which objectives are complementary depends on the circumstances of the case. For instance, in liquidating a residual entity, it may be in the interest of financial stability to postpone the sale of certain assets or operations that are needed for the continuity of the transferred business, irrespective of whether it maximises value. This may be particularly pertinent in the context of the liquidation of the residual entity following a transfer of critical functions in a resolution.

65. Accordingly, it is helpful for the framework to include guidance for a liquidation authority or liquidator on how to balance the objectives, including in the case of friction, while preserving the flexibility of liquidation authorities and liquidators to respond to the circumstances of the case. This guidance should recognise the specific nature of banks and reconcile concerns about safety and soundness, and in particular the protection of depositors, with the objective of value maximisation. As a general principle, value maximisation should not compromise public policy objectives.

Key Considerations and Recommendations 1 – 2

Key Considerations

- The effectiveness of a bank liquidation framework depends on the broader legal and operating framework. The bank prudential supervision framework, deposit insurance system, bank resolution framework, lender of last resort function, and the broader legal and judicial framework and associated system of support professionals, should all be effective and consistent with applicable standards.

- A bank liquidation framework should be informed by the objectives of value preservation and maximisation, depositor protection, financial stability, avoiding loss to public funds, and certainty and predictability.

Recommendations

1. The provisions governing bank liquidation proceedings should be clearly set out in the legal framework. In a dual-track regime, this should ideally be done in a dedicated bank liquidation law. Alternatively, the provisions could be integrated in the banking law or general business insolvency law provided they are clearly demarcated and readily identifiable. Bank-specific modifications of generally applicable rules should be enacted at the same level as the general rules.

2. The design of the legal framework should be informed by the liquidation objectives. The legal framework should provide guidance to the liquidation authority and liquidator on how to weigh objectives should friction arise between them. As a general principle, value maximisation should not compromise public policy objectives.

CHAPTER 2. INSTITUTIONAL ARRANGEMENTS

A. Introduction

66. It is essential that the institutional framework facilitate the smooth and effective conduct of bank liquidation proceedings and the orderly exit of non-viable, non-systemic banks from the market as the intended outcome of the process. This Chapter discusses how the institutional arrangements and roles under a bank liquidation framework support that outcome. In addition to this Introduction, it comprises four sections that consider different aspects of institutional arrangements that are relevant to effective bank liquidation proceedings.

- *Section B* offers an overview of different institutional models for bank liquidation proceedings. These can be grouped broadly as: (i) administrative, where the proceedings are managed by an administrative authority (and the court's role is limited to specific functions, such as judicial scrutiny); or (ii) court-based, where the proceedings are managed by a court but with a role for relevant banking authorities at specific phases of the process, given the special nature of banks.
- *Section C* sets out key factors and considerations that may help in designing the appropriate institutional model. Those include arrangements that facilitate preparation, effective cooperation among banking authorities, timely action and access to relevant information, and qualities that liquidation authorities should have in order to be effective. It considers how these factors and considerations are met under the different institutional models.
- *Section D* explains that the role and relevance of these factors and considerations may change in the course of a bank liquidation proceeding and depending on the strategy pursued.
- *Section E* discusses the role of DIs in bank liquidation proceedings.

67. This Chapter explains that an administrative institutional model can have clear benefits, which may make it the preferred option for jurisdictions. It also emphasises that, irrespective of the institutional model that is chosen, relevant banking authorities should be appropriately involved in the proceeding. The analogy with bank resolution is relevant in this regard. The *FSB Key Attributes* specify that resolution frameworks should designate an administrative authority that is responsible for exercising resolution powers. This recognises the public interest objectives of resolution and the need for timely intervention and rapid action to stabilise a non-viable financial institution. While the *FSB Key Attributes* do not preclude a role for courts in resolution, any such role should not impede effective

resolution.[35] They also prescribe that the framework should include liquidation options and that the administrative resolution authority should have powers to "*effect the closure and orderly wind-down*" of the bank or parts thereof.[36] That wind-down may be executed directly by the resolution authority or through an appointed administrator. In any case, it implies that the resolution authority should have a role in the liquidation of banks within the scope of that regime.

68. If a fully administrative model for bank liquidation is not adopted, the legal framework should nevertheless ensure that relevant banking authorities have a clear role in the process. In particular, banking authorities should have a role in the decision to open a liquidation proceeding and in a liquidation strategy entailing the sale of all or part of a bank to a third-party acquirer.

B. Institutional models

69. Jurisdictions have different approaches to the nature and extent of administrative authorities' role in bank liquidation proceedings. This section describes two main institutional models, recognising that, in practice, the involvement of both administrative authorities and courts may create a "hybrid" institutional design.

70. The procedural steps of bank liquidation proceedings are, in principle, similar to those in business insolvency cases. Those steps include the imposition of a stay (moratorium) on the enforcement of claims, the appointment of a liquidator, the establishment of a table of verified claims, an inventory and appraisal of available assets, a decision on the best way to liquidate these assets and the organisation of the distribution of proceedings in accordance with a statutory ranking of claims (as discussed in more detail in *Chapter 3. Procedural and Operational Aspects* and *Chapter 6. Liquidation Tools*).

1. Administrative model

71. Under an administrative model, an administrative authority is responsible for managing bank liquidation proceedings. While courts may have a role, for

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[35] Resolution regimes should "*ensure that the time required for court proceedings will not compromise the effective implementation of resolution measures*" (KA 5.4).

[36] *FSB Key Attributes*, KA 3.2, item (xii). See also *FSB Key Attributes Assessment Methodology for the Banking Sector*, EC 3.15: *"The resolution authority has the power to effect the closure and orderly wind-down and liquidation of the whole or part of a failing bank, and in such event, has the capacity and practical ability to effect or secure both of the following: (i) the timely payout to insured depositors or the prompt transfer of insured deposits to a third party or bridge institution; and (ii) the timely transfer or return of client assets."*

example, in adjudicating legal challenges or judicial scrutiny, the actions of the administrative liquidation authority (including the actions of an appointed liquidator, where applicable) do not typically require prior court approval and judicial authorities are not involved in the general oversight of the process.

72. The nature of that administrative authority varies, depending on the broader institutional arrangements and allocation of relevant functions under a jurisdiction's legal framework and financial safety net. Accordingly, administrative bank liquidation proceedings may be led by the banking supervisor (which may be the central bank or another administrative authority), the DI and/or the resolution authority (these functions may overlap).[37]

73. Under an administrative model, the relevant banking authority selects and initiates the process and places the bank in liquidation by means of an administrative act. Such a decision is generally taken at its own discretion, although in some countries other persons may be entitled to make a request to the banking authority.[38] Subsequently, the relevant banking authority may act as liquidator or it may appoint an external liquidator who will act under its oversight.[39]

74. The same administrative authority may be in charge of several phases of the liquidation (e.g., opening the proceeding and overseeing the execution of the

[37] For instance, in Brazil, Ghana, Greece and Italy, the central bank is in charge of administrative bank liquidation proceedings, and combines the functions of banking supervisor and resolution authority. In Colombia, bank liquidation competences are shared between the banking supervisor or resolution authority and the DI. In Ukraine, the Deposit Guarantee Fund is both the bank resolution and deposit insurance authority and also entrusted with bank liquidation functions. Where a combination of supervisory, resolution, central bank and deposit insurance functions are colocated with liquidation functions in a single institution, this may require internal governance arrangements for decision-making to manage potential conflicts of interest that may arise (see *Section C.5* below).

[38] For instance, in Brazil, the decision to initiate a bank liquidation proceeding is generally taken *ex officio* by the Central Bank of Brazil but may also be triggered by a petition by the bank's management.

[39] For instance, in Ghana, the "receiver" appointed by the Bank of Ghana may be someone from the private sector or an official of the Bank of Ghana. In Ukraine, the DI acts as liquidator. In the US, the DI can be appointed as the conservator or the receiver of a failed bank. In several other countries with an administrative model (e.g., Brazil, Colombia, Greece, Italy), the relevant banking authority does not act as liquidator itself but is responsible for appointing a liquidator.

liquidation), but it is also possible that different authorities are responsible for managing different phases of the liquidation proceeding.[40]

75. Under an administrative model, the court has no direct role in the bank liquidation process, without excluding the general competence of courts to carry out judicial review. Given the significant impact of liquidation proceedings on all stakeholders involved, judicial scrutiny is important to meet due process requirements. The involvement of a court is also an important mechanism for accountability to ensure that administrative authorities act within their mandates. At the same time, however, the public policy concerns typically associated with a bank liquidation may require timely and rapid measures, which may be undermined by a standard judicial review process, particularly if carried out before actions in the context of the bank's liquidation can have effect. Accordingly, a balance needs to be struck between due process requirements, on the one hand, and public policy objectives, on the other. These considerations have led several jurisdictions to, for instance, limit the list of matters that can be reviewed, the interim measures available to the court (e.g., no suspension of the authority's decisions pending determination of the review), or the remedies it can award (e.g., only compensation rather than reversal of measures that were taken within the authority's legal powers).

2. Court-based model with administrative involvement

76. Under a court-based model, a court is primarily in charge of opening and overseeing the liquidation process. This may be a commercial court, an insolvency court or a general court. However, relevant banking authorities always retain a role in bank liquidation proceedings, for example, in the petition to open proceedings or in monitoring aspects of the liquidation. As indicated in *Section C* and *Section D* of this Chapter, a strong role for banking authorities is key in jurisdictions with predominantly court-based models.

77. The process starts with a petition to the court to open the liquidation proceeding, which is generally made by a banking authority.[41] The ability to file such a petition may be the exclusive competence of a banking authority, or it may be shared with other persons (e.g., the bank itself, its creditors, shareholders, the public prosecutor or a temporary administrator appointed by the banking supervisor). However, if other persons have the right to petition the court, the banking authority

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[40] For instance, in Colombia, the banking supervisor is responsible for initiating Administrative Forced Liquidation proceedings, while the DI appoints the liquidator and follows up on its activities.

[41] In all surveyed jurisdictions with predominantly court-based bank liquidation regimes, an administrative authority has the right to file a petition with the court to open bank liquidation proceedings.

must at least be consulted or must approve the initiation of the bank liquidation proceeding. For guidance on the initiation of bank liquidation proceedings, see *Chapter 3. Procedural and Operational Aspects*.

78. The opening of bank liquidation proceedings may be subject to additional requirements compared to general business insolvency law. In some jurisdictions, predominantly court-based bank liquidation proceedings may be opened only following the revocation of a bank's licence. In other countries, the revocation of the banking licence may be a ground, but not a necessary condition, for opening liquidation proceedings. It may also be possible that the licence be revoked simultaneously with, or shortly after, the commencement of liquidation proceedings. For guidance on the interaction between bank liquidation and revocation of the banking licence, see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*.

79. The degree of involvement of relevant banking authorities in a predominantly court-based bank liquidation proceeding varies. In addition to their role in the opening of the proceeding, banking authorities are often involved in the appointment of a liquidator.[42] In some jurisdictions, a banking authority may be appointed as liquidator, which significantly increases its role in the liquidation process.[43]

80. Furthermore, the relevant banking authority may be part of the committee conducting the liquidation process; it may have a role in monitoring the conduct of the liquidation, and may receive reports from liquidators to that end; it may be part of an oversight mechanism that can propose removing and replacing the liquidator; it may be involved in the determination of the liquidator's remuneration; and it may be recognised as a stakeholder in the process (e.g., with the right to be heard before a court decision and/or the right to appeal a liquidator's decisions).

C. Considerations in the design of institutional arrangements

81. This section sets out several key factors that may help facilitate the smooth and effective conduct of bank liquidation proceedings and inform the choice and

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[42] In Belgium, for instance, the liquidator is appointed by the court having heard the opinion of the banking supervisor. In South Africa and Spain, an administrative authority proposes candidates to be appointed by the court as liquidator. In France, a "judicial liquidator" is appointed by the court and a "banking liquidator" is appointed by the banking supervisor (these may be the same person).

[43] In Canada, for instance, the DI may act as liquidator, under court oversight. In India, the Reserve Bank of India (RBI) may be appointed as liquidator. In Nigeria, the Central Bank of Nigeria appoints the DI (NDIC) as provisional liquidator, which can subsequently file a petition for winding–up of the bank with the court.

design of institutional arrangements. Specific considerations on the suitability of administrative and judicial involvement are provided for each factor.

1. Objectives

82. The institutional arrangements should allow the objectives of bank liquidation to be achieved (see *Chapter I. Introduction, Section H*). Liquidation authorities should have experience in balancing private and public policy interests, which might diverge. Administrative authorities are well positioned to pursue public policy objectives to the extent that they are part of their mandates. Banking authorities are decisively placed to weigh public and private considerations in decisions related to, for example, a bank's non-viability, the liquidation strategy to pursue and which business units or assets and liabilities of the failing bank should be transferred. They also need to have some flexibility to decide on the most appropriate strategy depending on the circumstances of the case. Conversely, courts and insolvency practitioners are likely to have expertise in balancing potentially competing private interests, for example, between classes of creditors.

83. In jurisdictions that have a predominantly court-based model, the objectives of bank liquidation – and, in particular, the need to duly consider matters of public policy – demand that banking authorities have a strong role in the proceeding, and in particular at the initial phases of opening the proceeding and deciding on the liquidation strategy.

84. The legal framework should ensure that any financial stability issue that may arise during the conduct of liquidation is primarily assessed and decided by the relevant banking authority. To that end, the legal framework should allow the banking authority to give instructions to the liquidator in such cases or to ask the court to issue an appropriate instruction to the liquidator. Furthermore, the liquidator should consult with the banking authority in case of possible friction between public policy objectives and value maximisation during the liquidation process (see *Chapter 1, Section H.6* and *Recommendation 2*).

2. Preparation

85. Preparation may be crucial for the success of bank liquidation proceedings as certain strategies can be executed effectively only if they are prepared in advance, to the extent possible in the circumstances (see *Chapter 4. Preparation and Cooperation*). A banking authority has the capabilities needed to carry out such preparation owing to its technical expertise, knowledge of the bank and the broader sector (including entities that may be interested in buying parts of the non-viable bank's business) and its ability to cooperate with other authorities, including the DI. Courts, in comparison, are typically less able to prepare for a bank's liquidation since they will not normally have the institution-specific knowledge and will generally

have no standing to act until a petition for insolvency has been made. Regardless of the selected institutional model, but especially in jurisdictions with a predominantly court-based model, the legal framework should contain arrangements to ensure that adequate preparation can take place. Preparatory steps may include contingency planning, early cooperation by supervisory or resolution authorities with DIs or the early involvement of a prospective liquidator, if legally available, even before a liquidation proceeding is formally initiated (see *Chapter 4. Preparation and Cooperation*). However, despite such arrangements, the shortcomings of a predominantly court-based model to prepare for a bank's liquidation might not be fully overcome.

3. Expertise, efficiency, resources and access to information

86. The nature of banks and the potential impact of their failure on depositors and other clients mean that bank liquidation proceedings need to be opened in a timely manner[44] and conducted efficiently. The institutional arrangements should enable the actors involved to act swiftly, especially at an early stage, given that the financial situation of a bank may rapidly deteriorate, and quick action best serves the interests of stakeholders and reduces the risk of bank runs. Depositors need access to their funds without material interruption and measures need to be adopted to ensure the smooth conduct of payments. Once a liquidation proceeding is opened, the procedural steps should be followed without undue delay for the remainder of the process. Timely intervention and efficient conduct of the proceedings rely on the liquidation authority having relevant sectoral expertise, including an understanding of how banks function within the financial system and their role in the economy. For example, an assessment that a bank meets the grounds for opening bank liquidation proceedings is a complex matter that requires a thorough understanding of the business model of the bank and the developments that led to the deterioration of its situation, coupled with the ability to evaluate whether the situation may still be remedied and whether sufficient financing is available.

87. As important as technical expertise is the need for actors to have timely access to relevant information to inform their decisions. They will require detailed and accurate data and information about the non-viable bank (e.g., on its financial situation and its legal and operational structure) and knowledge of the banking sector to assess the availability of suitable acquirers and the impact of failure management options.

88. The need for expertise, efficiency and access to information to support timely intervention favours an administrative institutional model. Indeed, the need for timeliness was one of the considerations that motivated the requirement in the

44 See *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*.

FSB Key Attributes that jurisdictions designate administrative resolution authorities. In the area of bank liquidation, relevant banking authorities would generally have the expertise and experience to take into account the special characteristics of banks. Furthermore, such authorities are generally well-equipped to design and smoothly execute a transfer-based strategy (or oversee its execution), building on their knowledge of the specific bank, the banking sector and their existing channels of communication with other banking authorities or DIs.

89. Moreover, relevant banking authorities have access to extensive and often confidential information about the bank and the sector as a whole, either directly or through cooperation with other banking authorities. This facilitates preparation and swift decision-making and allows authorities to act promptly throughout the liquidation proceeding.

90. The efficiency and experience of courts and the business insolvency system are relevant considerations when designing the model. A lack of speed is a significant potential weakness of court-based models. Where the judicial system is over-burdened or there is no fast-track procedure to expedite proceedings, court proceedings may be slow and lengthy. In jurisdictions where this is the case, predominantly court-based liquidation proceedings for banks would not be appropriate. Moreover, in the absence of specialised judges or courts, relevant expertise and experience in bank failures may be lacking. In this event, courts might well be effective in winding up a residual entity, but will generally be less able than banking authorities to manage transfer-based strategies. The assessment may be different in jurisdictions with a capable judicial branch that is efficient and able to tap from a pool of appropriate experts.

91. In jurisdictions with predominantly court-based models, it is advisable that courts draw on judicial expertise developed in the fields of general business insolvency law and financial matters, if possible through specialised insolvency or commercial courts. However, it is recognised that some jurisdictions may have little or no judicial practice in business insolvency, let alone bank failures. The involvement of relevant banking authorities as appointed liquidators[45] or a special role for banking authorities in the process (e.g., allowing them to be part of the committee conducting the liquidation process and allowing them to provide specialist advice on relevant matters) is a means to mitigate a lack of specialist judicial expertise. Furthermore, banking authorities could be granted a monitoring

[45] Alternatively, the court could appoint a liquidator on the proposal of a banking authority or from a list of eligible liquidators maintained by or in cooperation with the banking authority.

role throughout the liquidation proceeding[46] and be given legal standing to appeal decisions of the liquidator and request the court to give an instruction to the liquidator. It is also important to ensure that any role of the court does not delay the proceedings. A requirement for *ex-ante* court approval to open bank liquidation proceedings should not impede rapid and effective intervention (see *subsection 6* below).[47]

92. The liquidation authority should have sufficient human resources and adequate funds to fulfil its functions effectively and independently.[48] In predominantly court-based proceedings, specific functions are usually assigned to a liquidator. In administrative proceedings, banking authorities should also be able to appoint external liquidators to operate under the authorities' oversight. Banking authorities that conduct the liquidation themselves should have the legal authority to delegate liquidation powers to a natural and/or legal person to ensure that sufficient persons with the necessary expertise are available throughout the liquidation proceeding. Such a delegation of powers has the additional benefit that persons with complementary expertise can be assigned tasks relating to the execution of the liquidation process (e.g., concerning claim admittance or dismissal, or the treatment of employees, on which banking authorities may lack expertise). The appointment of a liquidator or delegation of liquidation tasks should not, however, release the banking authority from its responsibility (see *Chapter 3. Procedural and Operational Aspects*).

4. Cooperation

93. Regardless of the institutional model, different authorities have a role during the period running up to liquidation and during the liquidation proceeding. Therefore, the framework should provide for appropriate coordination and exchange of information to allow these authorities to fulfil their mandates properly, including as part of the broader arrangements to prepare for and manage a bank failure.

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46 Regular reporting by the liquidator *vis-à-vis* the banking authority would allow the banking authority to fulfil such monitoring role, see *Chapter 3. Procedural and Operational Aspects*.

47 In the context of resolution, the *FSB Key Attributes* specify that in jurisdictions where a court order is required to apply resolution measures, it should be ensured that "*the time required for court proceedings will not compromise the effective implementation of resolution measures*" (*FSB Key Attributes*, KA 5.4).

48 In addition, the liquidation authority and liquidators should have adequate technical resources (e.g., IT systems) to manage the liquidation process effectively. Capacity building should take place in "peacetime" to ensure that the liquidation authority and potential liquidators are able to effectively respond to bank failures.

94. This is particularly relevant where supervision, resolution, liquidation and/or deposit insurance functions are carried out by different authorities. For example, at the domestic level, the banking supervisor will be involved in the preparatory phase, and coordination between the liquidation authority and the banking supervisor on matters such as the bank's non-viability and the identification of potential acquirers for part of the bank's business are key. Similarly, the liquidation authority will need to cooperate closely with the DI since the latter may need to pay out insured deposits or facilitate a transfer (see *Section E* below and *Chapter 7. Funding*). The institutional arrangements should also ensure coordination with the resolution authority, especially if the bank is liquidated following a resolution process or is otherwise connected to entities under resolution.

95. An administrative model significantly facilitates cooperation, given that relevant banking authorities may make use of existing coordination arrangements or develop new arrangements, as needed. Administrative regimes allow bank liquidation to be incorporated into existing coordination arrangements for crisis preparation and management, such as cooperation agreements or Memoranda of Understanding (MoUs) concluded under bank supervision and resolution frameworks. Building on existing arrangements for cooperation facilitates preparation, the exchange of information and effective action during the liquidation proceeding.

96. Such pre-existing cooperation mechanisms are unlikely to exist under a court-based model and effective cooperation and information sharing with administrative authorities is more difficult. A strong involvement of relevant banking authorities, both prior to the opening of the proceeding and during the liquidation process, could mitigate these drawbacks. For instance, if the court can appoint a banking authority as liquidator, this would allow that authority to make use of and build upon its existing cooperation arrangements with other authorities.

97. The need for coordination often extends to banking authorities in other jurisdictions since a failing bank may have foreign branches and/or subsidiaries. Cases where cross-border cooperation and coordination will almost certainly be needed include where resolution tools are applied to a cross-border banking group and a residual entity needs to be wound down under the liquidation framework, or where a sale as a going concern within a liquidation proceeding has a cross-border element. Administrative authorities may benefit from existing cross-border cooperation arrangements with their counterparts in other jurisdictions (e.g., cooperation agreements or cross-border cooperation fora) and may be mandated to give effect to foreign measures. A predominantly court-based model may benefit from any applicable cross-border insolvency law frameworks for the cross-border recognition of court orders or acts of liquidators. For recommendations regarding

cooperation in cross-border cases, irrespective of the institutional model, see *Chapter 10. Cross-Border Aspects*.

5. Independence

98. The independence of the liquidation authority is important for the integrity of the process and to minimise the risk that it may be influenced by considerations other than the objectives of bank liquidation. The requirement for independence can be met under both institutional models, in accordance with existing international standards and good practices. The independence of judges in their decision-making is a cornerstone of most legal frameworks and often guaranteed at the constitutional level. Furthermore, international technical and ethical standards and guidelines require liquidators to meet professional standards that include their independence (and insolvency laws specify the consequences of a lack of independence).[49] Administrative authorities are also subject to independence requirements under international standards,[50] while a liquidator appointed by such an authority would generally be subject to the authority's directions or guidance.[51] Standards on operational autonomy should therefore apply under any institutional structure to provide safeguards against undue influence from governments or any other public or private body. Furthermore, the liquidation authority should be well-governed and subject to sound governance practices. This means, for instance, that the liquidation authority should have proper internal checks and balances and organisational arrangements in place that promote sound and independent decision-making, especially where this authority is assigned multiple mandates, such as both supervision and liquidation.[52]

6. Accountability

99. The need for accountability follows from the independence of the liquidation authority. The institutional design must guarantee that the liquidation authority acts within its legal mandate. Means of accountability encompass both administrative structures and judicial scrutiny. For banking authorities, internal governance

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[49] See, e.g., *UNCITRAL Legislative Guide*, Part Two, Recommendations 115 and 116; *World Bank Principles*, Principle D8.

[50] See, e.g., the *Basel Core Principles* (CP 2) for banking supervisors, the *FSB Key Attributes* (KA 2.5) for resolution authorities, the *IADI Core Principles* (CP 3) for DIs.

[51] See also *Chapter 1. Introduction, Section F* (especially *paragraph 33*) for the relevance of international standards.

[52] Such governance requirements already apply to administrative authorities pursuant to existing standards, see *IADI Core Principles*, CP3, EC 4 (for DIs) and *FSB Key Attributes*, KA 2.5 and *FSB Key Attributes Assessment Methodology for the Banking Sector*, EC 2.3 and EN 2(d) (for resolution authorities).

structures may already provide internal procedures for reviewing and evaluating the authority's actions taken in the performance of its statutory responsibilities. Periodic publication of reports on its actions and policies may add a layer of public scrutiny (see *susbsection 7* below and *Chapter 3. Procedural and Operational Aspects*).[53] Furthermore, non-judicial accountability mechanisms for banking authorities, such as accountability to the executive and parliament, may require an authority to report how it has performed its liquidation functions and achieved its liquidation objectives, provided those mechanisms respect the often confidential and sensitive nature of specific information (see *subsection 7* below), and do not interfere with the operational decisions of the authorities.

100. Provision for judicial scrutiny is important to ensure due process and provide appropriate legal remedies to the bank and other stakeholders that have a legitimate interest in requesting such a review under the legal framework. It is also an important mechanism of accountability in circumstances where administrative authorities do not act within their legal powers. The legal framework should guarantee effective judicial protection to those with legal standing to seek relief against bank liquidation measures. This should encompass processes for legal review, effective access to a court and adequate remedies.

101. A liquidation consists of a variety of acts of the liquidation authority and any appointed liquidator. Such acts include the decisions to commence and terminate bank liquidation proceedings (*Chapter 3. Procedural and Operational Aspects*), the possible execution of a sale as a going concern and the piecemeal sale of remaining assets, the distribution of proceeds, and the production of documents and reports. While judicial scrutiny of any act is, in principle, important to meet due process requirements given the significant impact of a liquidation proceeding on all stakeholders involved, it should not undermine the objectives of bank liquidation, which may require timely and rapid measures. As a general rule, the ability to scrutinise the actions of the liquidation authority or liquidator should be balanced with the need for an efficient administration of the liquidation proceeding and the liquidation authority's autonomy to take decisions within its mandate and powers. In the design of bank liquidation frameworks, three key issues related to judicial scrutiny are relevant: (i) the scope and standard of a court's review, (ii) the

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53 See, e.g., the non-judicial accountability requirements for resolution authorities as indicated in the *FSB Key Attributes Methodology Assessment for the Banking Sector*, EC 2.4: *"The resolution authority is accountable through a transparent framework for the discharge of its duties in relation to its statutory responsibilities. This framework includes procedures for reviewing and evaluating actions that the resolution authority takes in carrying out its statutory responsibilities, and the periodic publication of reports on its resolution actions and policies, as necessary*" (for further explanations see EN 2(e) on accountability).

availability of a stay pending the court's decision or an appeal against it, and (iii) possible effects of successful remedies.

102. Regarding the scope and standard of scrutiny, a first distinction should be made between situations in which (a) an administrative authority's or liquidator's decision requires judicial approval before it is implemented, and (b) an administrative authority's or liquidator's decision is challenged after its implementation.

103. A requirement for prior judicial approval is undesirable where it risks causing material delay in the execution of a measure. That delay may be caused, for example, by the need to notify and involve other parties. Where measures require prior court approval, the legal framework should provide for expedited procedures with shortened timelines for filing, notice, hearing and appeal. In addition, the elements for review by the court should be limited. The statutory provisions could, in particular, require a court to concentrate on matters of law and procedure, while deferring to the relevant banking authority's view on complex technical aspects and matters of public policy. Absent a material deficiency in the decision-making process or a manifest error in the banking authority's appreciation, courts should not be able to override that authority's assessments by engaging in a *de novo* assessment.[54] Bearing in mind the considerations on expertise (*subsection 3* above), it is important to ensure, for instance, that the relevant banking authority has a margin of appreciation in assessing the bank's non-viability and that courts defer to that authority's expertise and discretion.[55]

104. When courts scrutinise acts of liquidation *ex post*, proceedings should also be expedited. Special considerations apply where an administrative authority made the decision. In many jurisdictions, special rules and principles apply to the challenge of administrative decisions. Under the principles of administrative law, the scope of judicial scrutiny is often already limited, with courts deferring to the technical expertise and discretion of banking authorities. The standard for assessing an administrative authority's decision in relation, for instance, to a bank's non-viability or the execution of a sale as a going concern, should follow the same principles. The statutory provisions could, in particular, require a court to concentrate on matters of

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[54] For instance, in the predominantly court-based proceedings in the Netherlands, a bank can dispute the supervisor's assessment that the requirements for opening liquidation proceedings are met. In such a case, the court can only rule in favour of the bank (i.e., deny the bankruptcy request) if it determines that the banking supervisor could not have reasonably reached the conclusion that the requirements were met.

[55] See also *Recommendation 17* advising to specify in the legal framework that the banking authority's approval is needed before a bank liquidation proceeding may be opened, or at least that this authority is heard before any proceeding is opened.

law and procedure, unless this is already clarified under the broader administrative law. At the same time, acts during the liquidation process may not be limited to administrative decisions concerning matters of general interest. Acts that are civil in nature, for instance regarding the verification of claims, may be subject to legal challenge before a different court (e.g., a civil or specialised insolvency court) with a different standard of review. The legal framework should clearly specify the process for legal challenge of different types of acts during the liquidation proceeding.

105. A second distinction should be made regarding stakeholder rights in relation to acts of the liquidation authority and any appointed liquidator. Where such acts are merely relevant for the conduct of orderly proceedings (e.g., reporting duties) or the preparation of transfers (e.g., appraisals or production of relevant documents), stakeholders may have no legal standing to challenge the act in court. Only as far as an act directly affects the value available for distribution to stakeholders, a right to legal challenge may be appropriate or, depending on the applicable constitutional framework, necessary. The remedies available may also be limited to reflect the fact that the interests of stakeholders in a (bank) liquidation proceeding may be limited to a monetary interest.

106. A power for the court to grant an interim stay pending its decision to approve a liquidation act or rule on an appeal against such a decision risks undermining legal certainty and the legitimate expectations of stakeholders affected by a liquidation action. Accordingly, it is undesirable that an individual application to a court should automatically suspend the liquidation act. This approach is in line with the *FSB Key Attributes,* which prescribe that the legislation establishing resolution regimes "*should not provide for judicial actions that could constrain the implementation"* of measures taken by resolution authorities (KA 5.5). In the same vein, appeal proceedings in predominantly court-based proceedings should not suspend the execution of the liquidation. Subject to their constitutional framework and broader legal system, jurisdictions may use different legal mechanisms to ensure that judicial actions do not constrain the implementation of measures taken during liquidation. To that end, some jurisdictions bar any suspension order or any other interim order. In others, any temporary suspension of liquidation measures pending judicial challenges is limited to narrowly defined grounds (e.g., of irreparable harm and *prima facie* illegality). Jurisdictions may also consider procedural safeguards (e.g., a presumption that suspension would be against public policy considerations).

107. The *FSB Key Attributes* also prescribe that the legislation establishing resolution regimes "*should not […] result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified*" (KA 5.5). Similarly, in bank liquidation proceedings, in the interest of legal certainty and

considering the near impossibility of returning to the *status quo ante*, it may be justified for the legal framework to prevent a court from reversing any decision of an administrative authority under the bank liquidation framework after such a decision has been executed (in whole or in part). In particular, third parties may have acquired assets, rights and liabilities in good faith and may therefore have legitimate expectations that the transaction will not be voided or reversed. To facilitate the feasibility of sale as a going concern, acquisitions made in good faith should be protected and the scope of potential remedies for individual creditors limited accordingly. Instead of providing for a claim of restitution of assets, rights and liabilities, remedies should be limited to monetary compensation with respect to such decisions.[56]

108. Even where remedies are limited to monetary compensation, legal actions could theoretically be directed against both the administrative authority and the individual issuing the decision or acting as a liquidator. Concerns about liability may lead to inaction or delayed actions and hamper the speed and efficiency of liquidation proceedings. This may be particularly acute where individuals are exposed to the risk of personal liability. At the same time, personal liability is a means of accountability of the liquidator in many business insolvency frameworks. A balanced approach is needed, as discussed in more detail in *Chapter 3. Procedural and Operational Aspects*.

7. Transparency

109. The bank liquidation process and the role of the relevant actors should be clearly set out in the legal framework. In the interests of predictability, efficiency and smooth cooperation, there should be a clear demarcation of the tasks and powers of each actor involved in the various phases of preparation, decision-making and implementation.

110. A key issue in bank liquidation proceedings is how to strike an appropriate balance between transparency and confidentiality, especially in relation to critical decisions such as those to open a liquidation proceeding or to execute a sale as a going concern. Since judicial processes are largely transparent, in predominantly court-based bank liquidation proceedings, the legal framework should ensure that part of the process can be conducted confidentially. In particular, it should not be publicly disclosed that a petition to open a liquidation proceeding has been made.

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[56] As under the *FSB Key Attributes*, this should apply to measures that are within the legal powers of the liquidation authority and taken in good faith; it should not limit statutory judicial remedies that may be available in relation to actions that are unlawful because they are taken in bad faith or otherwise outside the authority's legal power (see *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN 5(e) and *Chapter 3. Procedural and Operational Aspects*).

The public disclosure of sensitive information should be suspended or delayed until it no longer qualifies as such, as far as is consistent with market transparency (see *Chapter 4. Preparation and Cooperation*). In line with existing standards, the legal framework should impose obligations of confidentiality on the bank and the liquidator.[57]

111. Administrative authorities will already be subject to confidentiality rules.[58] While respecting such confidentiality rules, the need for transparency should require them to disclose as much as possible, provided disclosure does not jeopardise the objectives of the proceeding. This may be a matter of timing. For instance, the administrative authority's decisions should be duly reasoned and could be made public (with a delay where necessary and subject to confidentiality requirements) after a bank is put into liquidation. Transparency and accountability needs can be considered together, for instance by requiring the liquidation authority to produce *ex-post* reports on its activities (based on prior regular reporting received from the liquidator, see *Chapter 3. Procedural and Operational Aspects, Section D.4* and *Recommendation 23*). More generally, administrative authorities should conduct their bank liquidation work in line with standards of good administration and sound governance.

D. Establishing the most effective institutional framework

112. As illustrated in the previous section, an administrative model can have clear benefits for bank liquidation proceedings. If a fully administrative model is not adopted, the legal framework should ensure that administrative authorities nevertheless have a strong role in the process. The institutional model may then be a blend of an administrative and a court-based model. The effectiveness of any institutional model will depend on jurisdiction-specific factors, such as the legal tradition; constitutional protections; the efficiency, capacity and expertise of a jurisdiction's courts and administrative authorities; and the structure and level of development of the banking system.

113. The factors and considerations in *Section C* above may help in designing the appropriate institutional framework. The role and relevance of these factors and considerations may change during the course of the bank liquidation proceeding. Policymakers may conclude that a stronger role for banking authorities is only

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[57] See, e.g., *UNCITRAL Legislative Guide*, Part Two, Chapter III, paras. 28 and 52, and Recommendation 111.

[58] For confidentiality requirements applicable to resolution authorities, see the *FSB Key Attributes Assessment Methodology for the Banking Sector*, EC 12.3. Also see the *FSB Key Attributes* (KA 7.6, 7.7. and I-Annex 1) concerning confidentiality issues in cross-border cooperation.

required in the earlier phase of the process, i.e., the decision to liquidate a bank and hence to commence a liquidation proceeding, as part of their statutory tasks in the failure management system designed to safeguard financial stability. Such a role may also be warranted where the bank (or parts thereof) is to be sold as a going concern. In a piecemeal liquidation, public policy concerns may be more limited, albeit not entirely absent, and an ordinary court process may proceed subject to monitoring by banking authorities, which should be able to take appropriate actions if the course of the liquidation poses risks to its objectives. Irrespective of the chosen institutional design, the legal framework should clearly set out the functions and responsibilities of the actor(s) involved in managing bank liquidation proceedings.

E. The role of deposit insurers[59]

114. In jurisdictions that have a deposit insurance system, DIs play an important role in bank liquidation proceedings since they administer the use of (industry-sourced) DIFs. The principal public policy objectives for deposit insurance systems are to protect depositors and contribute to financial stability.[60]

115. DIF resources should be used in a manner consistent with the DI's mandate and the conditions and safeguards specified in the *IADI Core Principles* (see *Chapter 7. Funding*). The *IADI Core Principles* classify DI mandates into four categories.[61] A DI with the narrowest mandate (a "pay box") may only use its funds to pay out insured deposits, directly or through an agent bank. A DI with a broader mandate, which can range from the limited "pay box plus" to the broadest "risk minimiser" mandate, may use its funds for purposes other than payout where those purposes achieve the objective of protecting insured deposits. A "pay box plus" DI may use its funds to enable transfer transactions that preserve access to deposits, in addition to payout. A "loss minimiser" DI may fund a broader range of strategies and actively engages in the selection of the one that is least costly to the DIF. A "risk minimiser" DI may choose from among the broadest range of early intervention and bank failure strategies, has additional risk-management functions and may also have responsibilities for prudential oversight.

116. The role of the DI in a liquidation may be multi-faceted. If it has paid out to insured depositors and taken over their claims (through subrogation, see *Chapter 8. Creditor Hierarchy*), it is likely to be a major creditor. Depending on its mandate, it

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59 Where an IPS assumes the role of DI in accordance with the applicable legal framework, the guidance in this *Guide* applies to such IPS in its function as DI, including caveats relating to its institutional nature and governance practices and appropriate safeguards.

60 See *IADI Core Principles,* CP 1.

61 See *IADI Core Principles*, Section II. Definitions of Key Terms, under "Mandate".

is also a potential external source of funding for transfer transactions that include insured deposits. However, the DI may have a broader institutional role in bank liquidation proceedings under the legal framework. Legislators and policymakers may consider assigning the role of liquidation authority or liquidator, or other key functions in a bank liquidation process, to the DI provided that this is in line with the DI's mandate, that the DI adheres to good governance practices[62] and that sufficient safeguards are in place to protect confidential information and to address potential conflicts of interest with its role as a major creditor (see *Chapter 3. Procedural and Operational Aspects, Section E.2*). Of particular relevance in this regard is the institutional nature of the DI. Where the DI is a private entity, assigning liquidation functions to such entities poses significant legal and policy challenges that may be insurmountable.

117. Subject to the same conditions, the DI could be assigned a role in predominantly court-based liquidation proceedings, such as the right to nominate a liquidator or membership of the committee conducting or supervising the liquidation process. Alternatively, the DI could have a role in the proceeding as an authority on matters within its competence, whose specialist advice may be sought by the court.

118. In any case, irrespective of its mandate and nature, the DI, in its capacity as creditor, should have the right to receive information from the liquidator, in line with the *IADI Core Principles*.[63] Furthermore, to facilitate preparation and cooperation, information sharing arrangements should be in place between the DI and other financial safety net participants, subject to appropriate confidentiality safeguards.[64]

Key Considerations and Recommendations 3 – 15

Purpose of legislative provisions

The purpose of provisions on institutional arrangements in bank liquidation proceedings is:

(a) To ensure that the institutional set-up for bank liquidation proceedings facilitates the timely and effective conduct of the proceedings and serves the objectives of the bank liquidation regime;

62 See *IADI Core Principles*, CP 3 and CP 14.1.

63 See *IADI Core Principles*, CP 16, EC 3.

64 See *IADI Core Principles*, CP 4.

(b) To specify the functions and responsibilities of the actors involved in managing bank liquidation proceedings; and

(c) To provide clarity to the debtor and the creditors on the process and available remedies.

Key Considerations

➢ An administrative institutional model for bank liquidation proceedings can have clear benefits, which may make it the preferred option for jurisdictions.

➢ In jurisdictions with a predominantly court-based model, a strong role for relevant banking authorities is needed, especially in the earlier phases of a bank liquidation proceeding where the specific technical expertise of banking authorities supports effective preparation and cooperation, and timely action to achieve the bank liquidation objectives. Banking authorities should also play a key role in the preparation and execution of transfer-based strategies.

➢ The following factors and considerations may help inform the design of institutional arrangements for bank liquidation.

(a) Objectives: The institutional set-up should serve the objectives of bank liquidation, and actors involved in the process should be able to pursue and balance the interests of different stakeholders to the extent consistent with the objectives of bank liquidation.

(b) Preparation: The institutional set-up should allow adequate preparation to take place before bank liquidation proceedings are opened, subject to the speed of the deterioration or failure.

(c) Timeliness: The institutional set-up should enable bank liquidation proceedings to be initiated and continued in a timely and speedy manner.

(d) Expertise, efficiency, resources and access to information: The actors involved in bank liquidation proceedings should have the necessary technical expertise, experience and human, financial, and technical resources to carry out their functions effectively. They should also have access to all information regarding the bank, and other affiliated entities as appropriate, that is relevant to their decision-making.

(e) Cooperation: The framework should facilitate close cooperation between the actors involved in bank liquidation proceedings and the banking authorities, at home and abroad.

(f) Independence: The actors involved in bank liquidation proceedings should be independent and their decisions impartial. To this end, any institutional structure should be aligned with international standards and good practices on operational autonomy and good governance.

(g) Accountability: While judicial scrutiny available under the domestic framework remains relevant, such provisions should be designed in a way that promotes legal certainty, avoids delays in the proceedings and does not jeopardise the objectives of the liquidation. Banking authorities may be subject to non-judicial accountability mechanisms deriving from their founding statutes, and these should also apply to the discharge of their duties under liquidation frameworks and their pursuit of liquidation objectives.

(h) Transparency: The rules and the process, and the role of relevant actors therein, should be clearly set out in the framework. The need for transparency should be balanced against the need to respect the confidentiality of sensitive information.

Recommendations (irrespective of the institutional model)

3. The legal framework should clearly set out the functions and responsibilities of the actor(s) involved in managing bank liquidation proceedings.

4. The legal framework should provide effective judicial protection to those that are directly affected by bank liquidation proceedings. It should specify the processes for legal scrutiny, ensuring effective access to a court and adequate remedies.

5. The legal framework could specify that the court should defer to the banking authority's assessment about the non-viability of a bank and other technical aspects within that authority's judgment, limiting its review to assessing whether there was a material deficiency in the decision-making process or a manifest error in the banking authority's appreciation.

6. The legal framework should provide that judicial actions should not constrain the implementation of, or result in a reversal of, measures taken by liquidation authorities and liquidators acting within their legal powers

and in good faith. Likewise, third parties that have acquired assets, rights and liabilities in good faith should be protected. Jurisdictions should provide for redress in justified cases by awarding monetary compensation rather than the restitution of assets, rights and liabilities.

7. The non-judicial accountability mechanisms that apply to banking authorities should provide for oversight of how those authorities perform their functions and achieve their objectives in relation to their role in bank liquidation proceedings.

8. The liquidation process should be free from undue political or industry influence.

Recommendations for jurisdictions with an administrative model

9. The *ex-post* judicial review of an administrative decision should not have automatic suspensive effect.

10. The legal framework should provide a legal basis for the relevant banking authority to delegate, at its own discretion, liquidation powers to a liquidator, who would operate under the oversight of the banking authority in all phases of the liquidation where public policy objectives are relevant.

Recommendations for jurisdictions with a court-based model with administrative involvement or in which a court order is required to open bank liquidation proceedings

11. In jurisdictions with a predominantly court-based model, the timely and effective conduct of bank liquidation proceedings may be facilitated by a legal framework that provides for:

(a) Arrangements to ensure that adequate preparation can take place. For instance, the legal framework could allow a prospective liquidator to be involved in the preparation of a liquidation where feasible.

(b) A strong role for the relevant banking authority in the opening of bank liquidation proceedings.

Where a court order is required to open bank liquidation proceedings, this should not impede a rapid and effective intervention:

(i) Relevant banking authorities should take this into account in their planning so as to ensure that the time

required for court proceedings will not compromise the effective implementation of liquidation measures.

(ii) The legal framework could provide for expedited procedures (for example, with shortened timelines for notice, filing, hearings and appeals).

(c) A strong role for the relevant banking authority during bank liquidation proceedings. To this end, the legal framework could adopt one or more of the following options:

(i) Provide for the banking authority to be appointed as liquidator, or require the appointment of a liquidator nominated by the banking authority, or require the court to appoint the liquidator from a list of persons with technical expertise and experience, established by or in cooperation with the banking authority.[65]

(ii) Allow the banking authority to be involved in the proceeding as an authority on matters within its mandate whose specialist advice may be sought by the court.

(iii) Allow the banking authority to be part of the committee conducting the liquidation process and any oversight mechanism, where applicable.

(iv) Assign a monitoring role to the banking authority.[66]

(v) Give the banking authority legal standing to request a relevant instruction to the liquidator by the court or to appeal decisions made by the liquidator.

12. The legal framework should ensure that any financial stability issue that may arise during the conduct of liquidation is primarily assessed and decided by the relevant banking authority. To that end, the legal framework should allow the banking authority to give instructions to the liquidator in such cases or to ask the court to issue an appropriate instruction to the liquidator.

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65 See also *Chapter 3. Procedural and Operational Aspects, Section D.2*.

66 Regular reporting by the liquidator *vis-à-vis* the banking authority would allow the banking authority to fulfil such monitoring role, see *Chapter 3. Procedural and Operational Aspects*.

13. The legal framework should enable bank liquidation cases to be entrusted to judges with appropriate expertise and experience, benefiting from specialisation within the judiciary where available.

14. Appeal proceedings should not suspend the execution of liquidation measures.

Recommendation concerning the role of deposit insurers

15. Where consistent with their mandate, deposit insurers that perform a public function and adhere to good governance practices may be given a strong role in bank liquidation proceedings, including as liquidation authority or liquidator.

For jurisdictions with a predominantly court-based model, the legal framework could allow such deposit insurers to be involved in bank liquidation proceedings in line with the options provided in *Recommendation 11(c)(i) to (iii)*.

CHAPTER 3. PROCEDURAL AND OPERATIONAL ASPECTS

A. Introduction

119. This Chapter discusses procedural and operational aspects pertaining to the following aspects of bank liquidation.

- The notification duties of banks' management in the period approaching liquidation, appropriate legal consequences in case of non-compliance, and coordination among banking authorities (*Section B*).
- The petition for opening a bank liquidation proceeding (*Section C*).
- A range of issues relating to the liquidator, including desirable qualities; the criteria and process for selection and appointment; remuneration; oversight, transparency and accountability; and personal liability and legal protection (*Section D*).
- Creditor involvement, considering the special nature of banks and the role of banking authorities (*Section E*).
- The termination of a bank liquidation proceeding (*Section F*).

120. While some jurisdictions have a bank-specific liquidation framework with provision for a special bank liquidator, in others a failed bank is liquidated under general business insolvency law. As discussed in *Chapter 1. Introduction*, the latter is not designed to address the public interest dimension of managing bank failures, unless it has been modified for application to banks. Procedural elements are an area in which general business insolvency law may not be suitable for banks. Accordingly, effective bank liquidation should be supported by procedural elements, such as the selection, remuneration and liability of liquidators, or the role of creditors, that differ from those that apply in a jurisdiction's business insolvency framework. This Chapter focuses on key aspects where legislators may consider such different provision.

B. Notification duties of the bank's management or Board of Directors in the period approaching liquidation

121. Under the *Basel Core Principles*, banks are required to notify the banking supervisor in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any "material adverse

developments", including breach of legal or prudential requirements.[67] Since jurisdictions should have a bank prudential regulatory and supervisory framework that meets the relevant international financial standards, requirements for banks to notify their supervisor of relevant changes should already be included in the legal framework. In addition to that early notification requirement under the *Basel Core Principles*, the framework could require banks to notify all the relevant banking authorities (banking supervisor, resolution authority, liquidation authority, as applicable) of approaching non-viability.[68]

122. The triggers for banks' obligation to notify relevant banking authorities, and the action(s) required of the authority following such a notification, should be clearly specified in the legal framework. The triggers could be aligned with a jurisdiction's grounds for opening bank liquidation frameworks based on the concept of "(likely) non-viability" (see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*). Furthermore, depending on possible disclosure requirements under other laws (for example, securities regulation or market rules), legislators and policymakers should consider whether confidentiality safeguards are needed to avoid destabilising effects and support the successful implementation of the liquidation strategy (see *Chapter 4. Preparation and Cooperation, Section D* and *Recommendation 37*).

123. The legal framework should provide for appropriate legal consequences for a bank and its management of a failure to comply with a notification obligation. The type of consequences depends on the jurisdiction's broader legal framework. These may include personal liability of directors for damages and/or criminal penalties. Administrative consequences may include, e.g., administrative fines or penalties.[69]

C. Initiation of bank liquidation proceedings

124. This section discusses which actor(s) should be able to initiate bank liquidation proceedings. Due to its expertise and knowledge of the bank, this should be, in the first place, a banking authority. The banking authority could be granted an exclusive right to initiate bank liquidation proceedings (directly or by petitioning the court, depending on the institutional model). If the legal framework also allows

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67 *Basel Core Principles*, CP 9, EC 10.

68 For ways to promote effective cooperation between administrative authorities in the preparatory phase, see *Chapter 4. Preparation and Cooperation, Section D.1*.

69 For instance, Article 57(1)-(b) of the Ghana Act 930 (Banks and specialised deposit-taking institutions act, 2016) requires the Board of Directors of a bank to report in writing to the Bank of Ghana if there is sufficient reason to believe that a bank is not likely to meet its obligations in the near future. Bank directors who do not comply with this obligation may be liable to pay an administrative penalty or may no longer be considered fit and proper to perform their functions.

others to file a petition for the opening of bank liquidation proceedings, appropriate safeguards should be in place to avoid destabilising effects. The next paragraphs discuss this in more detail.

125. Business insolvency law typically requires a company's management (directors) to file for insolvency in a timely manner, with potential personal liability and criminal penalties in the event of non-compliance.[70] Such an obligation could, in principle and *mutatis mutandis*, also apply to the management of a bank. However, the legal framework should stipulate that the relevant banking authority should approve (or not oppose)[71] the initiation of a bank liquidation proceeding or at least be heard before the liquidation process is opened.

126. If a requirement to file for insolvency in a timely manner applies to bank management, the consequences of non-compliance under the business insolvency framework should also apply.[72] This may include compensation for damages (e.g., a claim of the bank against its (former) management may be brought by the liquidator and form part of the estate). In addition, culpable management of the failed bank could be held accountable for the bank's failure in accordance with relevant insolvency law.

127. In most jurisdictions, general business insolvency law grants creditors the right to initiate involuntary insolvency proceedings, individually or collectively, as one of the options for enforcing their claims. In order to exercise this right, frameworks often impose substantive conditions, such as requiring creditors to have a legitimate interest in collective proceedings, a minimum claim amount or a minimum headcount or percentage of creditors, or require creditors to meet specific formal requirements, such as filing a preliminary proof of claim.

128. However, a similar right for bank creditors is not straightforward. Since banks are subject to prudential supervision and supervisory reporting, the banking supervisor is better placed than individual creditors to evaluate a bank's viability and initiate a liquidation proceeding where necessary. In jurisdictions in which banks are subject to a resolution framework, there may also be a case for the resolution

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70 See, e.g., *UNCITRAL Legislative Guide*, Part Four, Section One, p. 11. Pursuant to Recommendation 255, in short, the insolvency law should contain an obligation for directors in the period approaching insolvency to have due regard to the interests of creditors and other stakeholders and to take reasonable steps to: (a) avoid insolvency; and (b) where this is unavoidable, to minimise the extent of insolvency.

71 The legal framework may require the non-objection of the administrative authority, rather than its affirmative consent.

72 In addition, non-compliance may have regulatory consequences (e.g., disqualification from holding management positions in other financial institutions).

authority to be responsible for initiating liquidation proceedings.[73] In any case, the legal framework should grant a banking authority the right to open bank liquidation proceedings (in jurisdictions with an administrative model) or to petition the court for the opening of bank liquidation proceedings (in jurisdictions with a predominantly court-based model or when a court order is needed to open administrative bank liquidation proceedings).[74]

129. This approach gives rise to two further options. Under the first, the legal framework would preclude individual creditors from filing an application for the liquidation of a bank and limit the right to one or more banking authorities. Under the second, the legal framework would allow other persons (e.g., individual creditors or the bank itself) to request the opening of bank liquidation proceedings but with appropriate safeguards to avoid destabilising effects. Such safeguards should include: (a) making the application for liquidation subject to confidentiality requirements,[75] and (b) requiring that a banking authority must approve (or not oppose) the initiation of bank liquidation proceedings or at least be heard before any proceedings are opened.[76] In particular, in a predominanty court-based model, a right for the relevant banking authority to be heard before proceedings are opened would function as a minimum safeguard and ensure that the authority's assessment of the bank's viability is taken into account, and that the court is apprised of other possible (supervisory or resolution) measures that could be taken.

130. However, such safeguards may not be watertight. Even if disclosure of a petition is prohibited, breaches of secrecy can occur and rumours that a creditor petition is pending risk accelerating a run on that bank and possibly undermining confidence in other parts of the banking sector. The growth of social media and its

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[73] That case may be particularly forceful where liquidation is one of the possible outcomes when decisions about resolution are taken, e.g., under the EU framework for bank resolution.

[74] The right to petition may also be given to a public prosecutor (e.g., in case of AML issues).

[75] As an alternative to keeping the petition for liquidation confidential, some jurisdictions with a predominantly court-based model provide for an urgent hearing to be held on the petition. Such approach would be a valid alternative only in jurisdictions with a judicial branch that is able to act swiftly and has the appropriate expertise and experience (see *Chapter 2. Institutional Arrangements*). In any case, coordination is required with the bank and between relevant administrative authorities, including the securities regulator (see *Chapter 4. Preparation and Cooperation, Section D*).

[76] E.g., in China and South Africa, individual creditors may apply for the liquidation of a bank, but the consent of a banking authority is needed to open bank liquidation proceedings. Similarly, under EU law, "normal insolvency proceedings" against institutions under resolution or institutions meeting the conditions for resolution may only commence at the initiative of the resolution authority or with its consent.

ability to amplify rumour and misinformation make those risks more acute and arguably impossible to mitigate effectively.

131. Accordingly, the right to petition the court for the opening of a bank liquidation proceeding could be reserved to a banking authority, accompanied by a right for others (e.g., the bank and its creditors) to request that authority to assess whether the grounds for bank liquidation are met, with a concomitant duty on the authority to make that assessment unless there is a good reason not to. This would better safeguard against the potentially destabilising consequences of misuse by individual creditors and mitigate the risk that a bank could be put into liquidation at a time when its banking supervisor may wish to take (additional) supervisory or early intervention measures, or the resolution authority may prefer to put the bank into resolution.

132. Similarly, in an administrative system, the framework could give creditors an explicit right to request the relevant administrative authority to assess whether the grounds for opening the procedure are met. That authority would then carry out an assessment. A request by creditors should not affect the banking authority's exercise of discretion in undertaking its functions.

133. Irrespective of whether the framework is administrative or predominantly court-based, there are strong arguments for the relevant banking authority to have effective control of the timing of when a bank is put into liquidation. The grounds for bank liquidation should include those that are forward-looking, objective and clearly defined (see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*). If a bank is likely to be no longer viable (but still technically solvent), an authority may need to take immediate action rather than wait until the situation deteriorates further. Conversely, there may be circumstances in which, although a forward-looking ground is met, the authority considers that the bank still has reasonable prospects of recovery. Allowing creditors to file for bankruptcy in those cases may not be in the public interest and may also impede cross-border cooperation.

134. Since the focus of this *Guide* is on compulsory bank liquidation proceedings, it does not elaborate on the initiation of voluntary liquidation proceedings. However, also in case of voluntary liquidation proceedings, a banking authority should be duly involved in the process.[77]

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[77] For instance, in some jurisdictions, the legal framework specifies that voluntary liquidation proceedings cannot commence without the authorisation of the banking supervisor, after certifying that the bank is able to meet its obligations to its depositors and

D. The bank liquidator

1. Desirable qualities

135. As follows from *Chapter 2. Institutional Arrangements*, the liquidator in a bank liquidation proceeding may be an administrative authority or one or more appointed natural or legal persons. Under an administrative model, the legal framework could allow the liquidation authority to conduct the liquidation itself (possibly with the assistance of external persons acting as agent of the liquidator) or give it the power to appoint a liquidator (e.g., a person from the private sector) that would perform the tasks of liquidation under its oversight. In jurisdictions with a predominantly court-based model, the court could appoint a person from the private sector or a banking authority as liquidator, which would conduct the liquidation under the oversight of the court.

136. In all cases, the liquidator(s) in a bank liquidation proceeding should possess certain personal qualities, expertise and experience. The minimum qualifications and qualities should be set out in the legal framework or guidance, or be specified by the relevant administrative authority. In line with existing international guidance on general business insolvency laws, such requirements as to personal qualities should include integrity, independence and impartiality.[78] In addition, the liquidator should have appropriate knowledge and technical expertise in insolvency cases and the functioning of banks. Maintaining a list of liquidators with the required qualities

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other creditors. The legal framework might also envisage the transition from a voluntary liquidation proceeding to a compulsory liquidation proceeding if, in the course of the proceeding, the banking supervisor considers that the bank is unable to meet its obligations to depositors or creditors in full.

[78] The *UNCITRAL Legislative Guide* recommends that business insolvency laws "*specify the qualifications and qualities required for appointment as an insolvency representative, including integrity, independence, impartiality, requisite knowledge of relevant commercial law and experience in commercial and business matters. The insolvency law should also specify the grounds upon which a proposed insolvency representative may be disqualified from appointment"* (Recommendation 115, see also Part Two, p. 174 and further). In addition, it recommends that the insolvency law requires the disclosure of "*a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest or lack of independence*" (Recommendation 116). The *World Bank Principles* indicate that the system should ensure that *"(i) Criteria as to who may be an insolvency representative should be objective, clearly established, and publicly available; (ii) Insolvency representatives be competent to undertake the work to which they are appointed and to exercise the powers given to them; (iii) Insolvency representatives act with integrity, impartiality, and independence; and (iv) Insolvency representatives, where acting as managers, be held to director and officer standards of accountability, and be subject to removal for incompetence, negligence, fraud, or other wrongful conduct"* (Principle D8). See also *Chapter 2. Institutional Arrangements, Section C.5*.

could facilitate the rapid appointment of a liquidator. The liquidation authority and the liquidator should also be able to seek the assistance of third parties with specific expertise (see *Chapter 4. Preparation and Cooperation, Section C* and *Recommendation 40(c)*) and make use of the technical tools available to them.

2. Selection and appointment procedure

137. The selection of the liquidator should take into account the specific circumstances of the case, including the nature of the failing bank (type, size, location, activities), in order to ensure the appointment of a liquidator with an appropriate profile. The procedure for selecting and appointing the liquidator is closely linked to, and is likely to depend on, a jurisdiction's institutional model. In jurisdictions with an administrative model, the legal framework for bank liquidation should confer the competence to select and appoint a liquidator exclusively on the administrative liquidation authority, if the authority itself does not carry out the role of liquidator.

138. In jurisdictions with a predominantly court-based model, the liquidator would be selected, appointed and overseen by the court, and possibly acts as an officer of the court. Although as a general rule under court-based frameworks the court has the power to select and appoint a liquidator as it deems fit, that rule could be modified for bank liquidation, as it is recommended that a banking authority be involved in the process. Under a modified rule, the framework could specify either that the court should appoint a banking authority as liquidator or should be guided in its selection and appointment by the banking authority, which may make a proposal to the court, or by a list of eligible liquidators maintained by or in cooperation with the banking authority (see *Recommendation 11(c)(i)*).

3. Remuneration

139. The liquidator should be entitled to recover its liquidation expenses, including where an administrative authority acts as the liquidator, and the basis for calculating those expenses should be set out in law (e.g., statute or rules).

140. Where natural or legal persons from the private sector act as liquidators, rules or principles about appropriate remuneration are recommended to avoid creating perverse incentives in the conduct of the liquidation (e.g., incentives to prolong the procedure if that would increase the remuneration). Principles may have the advantage of permitting flexibility to tailor the remuneration to specific cases. Civil enforcement and business insolvency laws offer a variety of models for the regulation of the remuneration of receivers or liquidators. They include a fixed remuneration based on the size of the estate, hourly rates, a combination of both, and a bonus system for quick(er) liquidations of more complex cases. In bank liquidation proceedings, the remuneration of liquidators is generally based on the size of the

bank's balance sheet, the nature and expected complexity of the proceeding and/or the proceeds of the liquidation of the bank's assets. Bank-specific characteristics (such as the generally large amount of assets) should be taken into account as appropriate, to ensure that the liquidator's remuneration is not excessively low or high.

141. In jurisdictions where bank liquidators are appointed by an administrative authority, it is advisable that the legal framework indicate that the terms of the liquidator's remuneration should be determined by the administrative authority (based on any rules or principles set out in the legal framework or developed by that authority).

142. Where the liquidator is appointed by the court, the legal framework should allow the banking authority to be involved in the determination of the liquidator's remuneration. For instance, the banking authority could be required to provide information to the court on the size of the bank and the complexity of its liquidation, the court could be required to hear the banking authority before determining the liquidator's remuneration, or the banking authority could be part of a committee responsible for determining the liquidator's remuneration.

143. The method for determining remuneration may be adapted to encourage particular outcomes.[79] For example, even if the remuneration policy is not time-based, the compensation payable may be tailored to reward liquidators who close the process in a timely manner or to reduce the standard compensation in the event of undue delays.[80] If part of the remuneration is calculated by reference to the proceeds of the liquidation of assets, the likelihood that the market value of those assets will decrease with the passing of time may also act as an incentive for the liquidator not to unjustifiably prolong the process.[81] The remuneration of any appointed liquidator should be paid from the liquidation estate and have a priority ranking in the creditor hierarchy.

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79 The remuneration method may also differ depending on the phase of the liquidation proceeding.

80 For example, in Italy, the Bank of Italy in its capacity as the liquidation authority appoints the liquidator of a bank and sets the remuneration. Although the remuneration is generally based on the amount of assets and liabilities, it may be tailored in a way that rewards a timely conclusion to the proceedings.

81 For example, in South Africa, where liquidators are appointed by the court, their remuneration is commission-based to create incentives for the liquidator to realise the greatest achievable value. The percentage of such commission is set out in law.

4. Oversight, transparency and accountability

144. Liquidators in general business insolvency proceedings enjoy wide discretion in administering the estate. However, for the sake of oversight, transparency and accountability, they are commonly obliged to report their activities to a supervising (insolvency) judge, an administrative authority overseeing the process, and/or a creditor committee (or other body representing creditors in insolvency proceedings).[82] Observed best practices suggest that certain general principles on transparency and/or accountability mechanisms should be set out clearly. The details of those mechanisms may be tailored as appropriate to judicial and administrative frameworks.

145. If an administrative liquidation authority itself acts as liquidator under an administrative framework for bank liquidation, it should draw up regular reports on the conduct of the liquidation proceeding. These reports or selected pieces of information included therein should be made available to all creditors. The reports may also be published; where appropriate, publication could be limited to certain information (e.g., in aggregated form or by means of a non-confidential version of the report).[83] In the event that creditors are dissatisfied with the conduct of the liquidation, they may be able to challenge certain actions, and the authority may make changes to the staff members who are running the liquidation, if appropriate. However, under an administrative framework, the authority itself cannot be replaced as liquidator.

146. Liquidators appointed by an administrative liquidation authority should conduct their work under the direction and oversight of that authority. To this end, the legal framework could specify that the liquidator should act in accordance with the directions, instructions and guidance provided by the administrative authority in the course of the liquidation process, without prejudice to the liquidator's operational autonomy and liability within the scope of delegated powers. The framework may also require a liquidator to obtain the approval of the administrative authority for specified actions. The liquidator should be accountable to the administrative authority for the performance of its tasks as liquidator. Furthermore, the legal framework could require the liquidator to report regularly (e.g., monthly) to the

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82 The *UNCITRAL Legislative Guide*, Part Two provides that: (a) the insolvency representative may have notice, reporting or other duties *vis-à-vis* the court or creditors (p. 178); and (b) a duty of confidentiality towards third parties may be appropriate (Recommendation 111, and p. 180). The *World Bank Principles* provide that *"[a]n insolvency and creditor rights system should be based upon transparency and accountability. Rules should ensure ready access to relevant court records, court hearings, debtor and financial data, and other public information."* (Principle D4).

83 Publication could be a means of substituting individual creditor notifications, where jurisdictions' legal frameworks allow this and deem it appropriate.

administrative authority to ensure that the latter is duly informed about the performance of the liquidator's tasks and the progress of the proceedings. Such a regular reporting requirement could be complemented by an obligation for the liquidator to provide additional information if requested by the administrative authority. In the event of a just cause as prescribed in law, regulation or contract, such as mismanagement, performance failure or conflict of interest, it should be possible to replace the liquidator and/or reduce the remuneration commensurately.[84]

147. In jurisdictions with a court-based model with administrative involvement, similar requirements will generally be in place. The liquidator may be required to report to the court on a regular basis or in respect of certain activities, and the court's approval may be required at certain phases of the liquidation proceeding. Given the need for the relevant banking authority to have a role in bank liquidation proceedings, as discussed in *Chapter 2. Institutional Arrangements*, the legal framework could allow such authority to be part of any oversight mechanism; reporting to the appointing court and the administrative authority should take place in parallel, to enable both to monitor the process.

5. Personal liability and legal protection[85]

148. It is common under general business insolvency law for a receiver or liquidator to be personally liable to compensate creditors or other parties for any loss or damage caused by an unlawful act or omission during the liquidation. This may be the case for both private sector insolvency practitioners and administrative authorities (and, potentially, their employees).[86] If the threshold for liability is too low or the standard for liability is not clear, there is a risk that liquidators' activities may be impeded or that the pool of persons willing to carry out those functions be limited. Accordingly, the legal framework should clearly specify the standard of liability in a way that is well-understood under the jurisdiction's broader legal framework, and limit liability to prevent a liquidator from being exposed to

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84 In some jurisdictions, it might also be possible for the administrative liquidation authority to replace the liquidator at different phases of the liquidation proceeding (e.g., it might appoint a legal person as liquidator for the initial phase, and replace it with a natural person once the liquidation proceeding reaches its final phase, where the activities might be less demanding).

85 This section provides guidance on the civil liability of liquidation authorities and liquidators. It does not address possible criminal liability.

86 By comparison, the court overseeing the insolvency proceeding is not subject to a liability regime except for general rules of wilful misconduct.

potentially costly claims for damages for legitimate or justifiable actions or omissions.[87]

149. When developing legislative provisions on the appropriate standard of liability for liquidation authorities and liquidators, a number of considerations are relevant. If a framework gives insufficient protection to liquidators, this could expose them to frivolous claims, or claims filed or threatened by shareholders and creditors who may use litigation to exert pressure on the conduct of the liquidation. Insufficient protection may also lead to inaction: a liquidator may prefer not to sell an asset than to sell it in uncertain market conditions and risk being sued. However, if the scope of a liquidator's protection is too wide, this can also lead to suboptimal outcomes, especially in countries with weaker arrangements for accreditation and oversight.

150. National frameworks vary widely in the nature and extent of legal protection conferred on liquidators. For example, liability may be limited to gross negligence, actions undertaken in bad faith or a similar concept under the jurisdiction's legal framework, or the liquidation regime may establish a "safe harbour" that provides legal protection for acts carried out with a good business reason. Conversely, in some countries, the threshold is low and liquidators may be held liable for acts or omissions found to be negligent under ordinary standards of liability, for shortcomings in respect of legal obligations or duty of care.[88] A comparable standard applies in jurisdictions where the threshold for liability is formulated as a failure to meet a professional standard of care, skill or diligence in performing functions in the course of the liquidator's office.[89] A higher bar applies in other jurisdictions where only gross negligence or wilful misconduct is actionable, and liquidators are shielded against actions for ordinary negligence. In some jurisdictions, liquidators enjoy

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87 The *UNCITRAL Legislative Guide* recommends that insolvency laws *"specify the consequences of the insolvency representative's failure to perform, or to properly perform, its duties and functions under the law and any related standard of liability imposed"* (Recommendation 121). It refers to various possible standards of care for the insolvency representative, e.g., to observe at least the same standard as would be expected to apply to the debtor in undertaking its normal business activities or to act in good faith for proper purposes (Part Two, Chapter III, paras. 60-61).

88 For example, in Belgium and France, liquidators are subject to ordinary legal standards of liability for negligence in actions taken or omitted in the execution of their mandates.

89 For example, in Canada, a liquidator is not liable if it exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on financial statements of the bank represented to the liquidator by bank officers or auditor reports of the bank fairly reflecting the financial condition of the bank, or a report of a person whose profession lends credibility to a statement.

broad statutory protection for acts carried out in good faith in accordance with their professional functions. In cases where a liquidator or receiver acts under the instruction of a public authority, legal protection may be extended to all acts undertaken in accordance with a direction from that authority.[90] Where the liquidators are officials of an administrative authority, legal protection often applies to any action undertaken in pursuance of their official functions and they are only exposed to liability if they acted in bad faith or in wilful misconduct.

151. Where an administrative authority or any of its officials acts as liquidator, they should benefit from adequate legal protection. Such protection is already advocated by international standards for banking supervisors, resolution authorities and DIs for action taken and omissions made while discharging their duties in good faith and within their powers.[91] While jurisdictions may differ in the exact formulation of the standard for liability (e.g., bad faith, gross negligence, malicious intent), these standards set a high bar for the liability of the authority and its officials.

152. This high level of protection is motivated by the fact that these authorities are required by the framework to carry out their functions pursuant to explicit statutory public policy objectives. It is designed to facilitate rapid action that is not inhibited by a high exposure to risks of institutional and personal liability where that action is within the powers of the authority and taken in good faith in a high-pressure environment of imperfect information.

153. For administrative authorities and their officials, in principle, the legal framework should thus at least ensure that existing provisions on legal protection extend to their involvement in bank liquidation proceedings.

154. For liquidators that are not public officials, but natural or legal persons from the private sector appointed by the liquidation authority (court or administrative), some form of liability may function as an incentive for them to appropriately discharge their functions and as a protection for creditors, whose recoveries may depend on the efficiency of the liquidation. However, a balance needs to be struck between a standard that will promote competent and effective performance of the duties of the liquidator and a standard that is so stringent that it invites lawsuits against the liquidator and raises the costs of its services. A robust and effective

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90 For example, in Ghana, a receiver has legal protection for actions taken under the direction of the central bank or, in the exercise of a power or a discharge of duty authorised or required under any other enactment, for any action or omission in good faith in the implementation of his or her duties, unless this constitutes intentional wrongful conduct or gross negligence.

91 See *IADI Core Principles*, CP 11, EC 2; *Basel Core Principles*, CP 2 and EC 9; and *FSB Key Attributes*, KA 2.6.

framework for accreditation and oversight of professional standards is required to complement an adequate degree of legal protection. Where these components of the broader legal framework are in place, a fair balance between facilitating rapid and decisive action within the liquidation and protecting the rights of creditors and third parties could limit legal protection to acts taken as instructed by the liquidation authority (court or administrative) or a creditors' body (e.g., the creditor committee).[92] Acts of discretion should be measured by applicable professional standards for liquidators.

155. Irrespective of the standard of liability or the existence of "safe harbours", liquidators will be exposed to the risk of claims for damages, and creditors have a right to financial remedies where liquidators have acted in breach of their duties and professional standards. Professional liability insurance is commonly available, at least up to a certain amount, and protects both the liquidator that is sued and creditors that have a valid claim. Where the legal framework sets out a liability regime, mandatory insurance for private sector liquidators could therefore be considered, if available in the jurisdiction. Without professional liability insurance, damages will not, in practice, be an effective remedy in cases where the liquidator does not have the funds to pay them.

E. Creditor involvement in the liquidation process

1. General aspects

156. The outcome of a liquidation proceeding has direct economic implications for creditors. The amount they recover on their claims is determined by the outcome of the collection, administration and realisation of the debtor's assets, and by the costs of the liquidation if these are borne by the estate (as is the standard practice).

157. Business liquidation frameworks typically provide mechanisms for creditor involvement in the form of creditor meetings and, where it exists, a creditor committee, and some categories of creditors participate in those (although, as general practice, many do not). In business liquidations, those arrangements may be used for consideration of issues that are subject to a creditors' vote of approval or veto. These include (but are not confined to) the following: selection or substitution of the receiver or liquidator, approval of their remuneration, approval of an auction process, and/or challenges to a distribution scheme.

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92 For aspects of the liquidation where public policy objectives are relevant, natural or legal persons from the private sector would act under the instruction of a banking authority (see *Chapter 2. Institutional Arrangements*) and a high level of legal protection is justified. The applicable legal protection of the banking authority and its officials may already extend to such person in his/her capacity as agent of the authority.

158. The public policy objectives, the role of administrative authorities in bank liquidation proceedings and efficiency considerations justify a different degree of creditor involvement compared to general business insolvency proceedings, combined with appropriate safeguards.[93] Considering the large number of depositors and other creditors, typical rules on creditor involvement under general business insolvency law might be practically challenging to implement and could cause delays that affect the efficiency of the bank liquidation process. Administrative authorities with a relevant mandate may be best placed to assess public policy objectives. Therefore, where a creditor committee exists, it should be ensured that the relevant banking authority/ies are allowed to participate and that they in any case have a primary say in the earlier phase of the liquidation process, e.g., the decision to liquidate a bank, the choice of liquidation approach and the execution of measures to protect depositors (payout or transfer).[94] Creditors should not be able to interfere with decisions that involve a public policy objective, including a decision about, and execution of, a transfer-based strategy.[95] They should, however, have the right to challenge such decisions *ex post*, although remedies may be limited to financial compensation. In a piecemeal liquidation of a bank or a residual entity following a transfer of assets and liabilities to another entity, public policy concerns may be more limited, albeit not entirely excluded, and creditor involvement could be similar to that under general business insolvency law provided that the efficiency of the bank liquidation process is not compromised. This means that creditors should be able to challenge decisions of the liquidator, e.g., regarding the admission of claims, and that they should receive reports or at least selected information from the liquidator (see *Section D.4* above).

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93 The extent of creditor involvement greatly varies under existing liquidation frameworks that apply to banks. In some jurisdictions, creditors have no role in bank liquidation, and there is no provision for creditors' meetings or creditors' agreements. In others, the potential for involvement is much more significant and may include, variously, powers to participate in the recognition of claims, propose a creditors' agreement, participate in creditors' meetings to approve or reject such an agreement, propose amendments to a liquidation plan before its approval by the court, and appeal against resolutions adopted in the liquidation proceeding. Generally, however, creditor involvement is more restricted in jurisdictions with an administrative model for bank liquidation.

94 See also *Recommendation 11(c)* and *Recommendation 12*. For instance, in the United Kingdom, the liquidation committee is composed only of banking authorities until protected deposits have been paid out or transferred.

95 See *Chapter 6. Liquidation Tools*, which explains that the liquidation authority or liquidator should have the power to transfer a non-viable bank's assets and liabilities to another entity without the creditors' consent (*Recommendation 46*).

2. Involvement of the deposit insurer as a creditor

159. A main difference compared to general business insolvency proceedings is the involvement of the DI, which (usually) will have a substantial claim against the liquidation estate. Where the DI pays out insured deposits of a bank in liquidation, it is subrogated to the rights of insured depositors against the failed bank in the liquidation proceeding and participates therein as a creditor.[96] As one of the largest creditors – if not *the* largest creditor – in the liquidation, its special interest may be reflected in a right to appoint a representative to the creditor committee – where such committee has been established. Where the DI is also the liquidation authority or liquidator, its status as a significant creditor of the bank in liquidation may raise concerns of potential (material) conflicts of interest. The existence and extent of a conflict would depend on various factors, such as the internal separation of the DI's functions, its mandate in liquidation, and the existence and type of depositor preference. To the extent that there is such a conflict, it can be mitigated by requirements that as liquidator, the DI serves the interests of all creditors together with governance arrangements to ensure that it acts independently for all parties involved, in accordance with principles of fairness and neutrality as regards all creditors. Those arrangements could be supported by an appropriate transparency and accountability framework (e.g., where creditors can appeal decisions of the DI as liquidator).

F. Termination of bank liquidation proceedings

160. General business insolvency laws adopt different approaches to the manner in which a liquidation proceeding is to be concluded or terminated.[97] The liquidator could be required to call a meeting of creditors and present final accounts to be approved by the creditors. In some jurisdictions, it is sufficient to then file the accounts and a report of the final creditors' meeting with the administrative authority responsible for the registration of business entities in order to remove the company from the business register. In other jurisdictions, an application to the court might be required to dissolve the debtor.

161. In line with general business insolvency law, a bank liquidator should be required to submit final accounts and a final report concerning the bank's liquidation to the creditors. Where appropriate, these documents should be adjusted to remove any confidential information. In jurisdictions with an administrative model, the liquidator should also submit the final accounts and a final report (which may be

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96 The *IADI Core Principles* specify that, where the DI has paid out insured deposits of a failed bank, it should be clearly recognised as a creditor of that bank by subrogation and have at least the same creditor rights or status as a depositor (CP 16, EC 1 and 2).

97 See *UNCITRAL Legislative Guide*, Part Two, Chapter VI (paras. 16-17).

confidential) to the administrative liquidation authority. The legal framework should specify that the bank liquidation proceeding ends following the approval of these documents by the administrative authority. In jurisdictions with a predominantly court-based model, the final accounts and a final report should be submitted to the creditors (where appropriate, in non-confidential form), the appointing court and the banking authority involved in the liquidation proceeding. In such a case, the proceeding should be terminated by the court, following its approval of these documents and after hearing the banking authority or receiving its consent (or non-objection).

162. Irrespective of the institutional model, following the termination of a bank liquidation proceeding, the liquidation authority should take the necessary steps to remove the former bank from the business register.[98] The former bank should also be removed from any other public register concerning companies with ongoing business operations (e.g., a register of authorised or supervised entities maintained by the banking supervisor). The legal framework should clarify whether the liquidation authority and any appointed liquidator are subsequently relieved of any further responsibility in connection with the liquidation of the former bank.

Recommendations 16 – 35

Purpose of legislative provisions

The purpose of provisions on procedural and operational arrangements in bank liquidation proceedings is to ensure that:

(a) The notification duties of the bank in the period approaching non-viability and the related legal consequences of non-compliance are clearly set out;

(b) The liquidator is appropriately qualified and accountable, and subject to adequate protection from personal liability for decisions and actions in the liquidation;

(c) The nature and extent of creditor involvement in bank liquidation proceedings takes into consideration the special nature of banks, the specific role of banking authorities and efficiency considerations; and

[98] Following the liquidation of limited liability companies, the law generally provides for the dissolution of the legal entity. If creditors have not been paid in full, they will no longer have an outstanding claim against the debtor (see *UNCITRAL Legislative Guide*, Part Two, Chapter VI (para. 3)). The same should apply in a bank liquidation proceeding (i.e., the issue of "discharge" of the shareholders of the bank would not arise).

(d) A procedure is in place for the termination of bank liquidation proceedings.

Recommendations

Notification requirements for the bank's management or Board of Directors in the period approaching liquidation

16. In line with the *Basel Core Principles*, the legal framework should require banks to notify the banking supervisor as soon as they become aware of any material adverse development, including breach of legal or prudential requirements.

The legal framework could also require the bank to notify all the relevant banking authorities of its approaching non-viability.

The legal framework should clearly specify the terms of this notification requirement and the obligations of the administrative authority on receipt of such a notification. The framework should also provide for appropriate legal consequences of non-compliance by the bank.

Initiation of bank liquidation proceedings

17. In jurisdictions with an administrative model, the legal framework should grant the right to initiate bank liquidation proceedings to a banking authority.

In jurisdictions with a predominantly court-based model, or when a court order is needed to open bank liquidation proceedings, a banking authority should have the right to petition the court. If the banking authority does not have an exclusive right, the legal framework should contain appropriate safeguards to avoid destabilising effects from the exercise of such rights by other persons. In particular, the legal framework should stipulate that the petition be kept confidential, unless the court hearing can be held on an expedited basis, and that the banking authority's approval is needed before a liquidation proceeding may be opened – or at least that this authority is heard before any proceeding is opened.

Bank liquidator

Desirable qualities

18. The minimum qualifications and qualities required of bank liquidators should be set out in the legal framework, in guidance or specified by the relevant administrative liquidation authority. Such required qualities

should include integrity, independence and impartiality. In addition, the liquidator should have appropriate knowledge and technical expertise in insolvency cases and the functioning of banks. For the sake of efficiency, the liquidation authority could be required to establish and maintain a list of liquidators meeting the required qualities.

Selection and appointment procedure

19. In jurisdictions with an administrative model, the competence to select and appoint a bank liquidator should be conferred exclusively upon the administrative liquidation authority. The administrative liquidation authority may also act as liquidator itself.

20. In jurisdictions with a predominantly court-based model, it is recommended that a banking authority be involved in the selection and appointment of the liquidator by the court, in line with *Recommendation 11(c)(i)*.

Remuneration

21. The legal framework should establish a method for determining the remuneration of the liquidator that encourages the timely and efficient conduct of the liquidation. This may draw on models from business insolvency proceedings, adapted as appropriate to take into account bank-specific characteristics.

In jurisdictions with an administrative model, the legal framework should specify that the terms of the liquidator's remuneration be determined by the administrative liquidation authority.

In jurisdictions with a predominantly court-based model, the banking authority should be involved in the determination of the liquidator's remuneration.

22. The liquidator's remuneration should be paid from the liquidation estate and have a priority ranking in the creditor hierarchy.

The liquidator should be entitled to recover its liquidation expenses, including where an administrative authority acts as the liquidator, and the basis for calculating those should be set out in the legal framework.

Oversight, transparency, and accountability

23. The legal framework should require a liquidator to regularly report on its activities to its appointing liquidation authority. In jurisdictions with a predominantly court-based model, the legal framework should require the

liquidator to report both to the court and to the relevant banking authority. In jurisdictions with an administrative model, the administrative liquidation authority should draw up regular reports if it conducts the liquidation itself.

Appropriately tailored reports that omit confidential information should be made available to all creditors and may be published.

24. The legal framework should require the liquidator to provide the liquidation authority with additional information upon request.

25. In jurisdictions with an administrative model, the legal framework should require liquidators to act in accordance with the directions, instructions and guidance provided by the administrative liquidation authority in the course of the liquidation proceeding, without prejudice to the liquidator's operational autonomy and liability within the scope of delegated powers. The liquidator should be accountable to the administrative authority for the performance of its tasks as liquidator and subject to adequate oversight.

26. In case of a just cause, such as mismanagement, performance failure or conflict of interest, the legal framework should allow for replacement of any appointed liquidator and/or a commensurate reduction of its remuneration.

Personal liability and legal protection

27. Where the liquidation authority or liquidator is an administrative authority or public official, the legal framework should ensure that existing provisions on legal protection for the authority and its officials extend to their involvement in bank liquidation proceedings in line with international guidance.

28. Where the liquidator is a person from the private sector, the legal framework should specify an appropriate standard of legal protection for actions taken or omissions in the conduct of the liquidation. There should be a safe harbour for actions taken by such a person in accordance with instructions from the liquidation authority. In jurisdictions with an administrative model, it should be assessed whether the legal protection of the administrative authority and its officials extends to persons from the private sector engaged by it, in their capacity as agents of the authority.

29. Mandatory insurance for liquidators in relation to their liability could be considered, if available in the relevant jurisdiction.

Creditor involvement during the liquidation process

30. The legal framework should ensure that creditors do not interfere with decisions that involve a public policy objective, including decisions about, and the execution of, a transfer-based strategy. In a piecemeal liquidation, public policy concerns may be more limited, and creditor involvement could be similar to that under general business insolvency law provided that the efficiency of the bank liquidation process is ensured.

31. In bank liquidation proceedings that include a payout of insured deposits, the legal framework should recognise the DI as creditor in the proceeding (e.g., allowing it to appoint its representative to the creditor committee where such committee exists). Where the DI is also the liquidation authority or liquidator, appropriate governance arrangements and transparency and accountability mechanisms should be in place to mitigate the risk of conflicts of interest arising from its status as creditor.

Termination of bank liquidation proceedings

32. In jurisdictions with an administrative model, the legal framework should:

(a) Include a requirement for the liquidator to submit final accounts and a final report to the administrative liquidation authority and to the creditors (where appropriate, in non-confidential form). If the administrative liquidation authority itself conducts the liquidation, it should draw up the final accounts and a final report;

(b) Specify that the liquidation proceeding is terminated by the administrative liquidation authority, after its approval of the documents under (a).

33. In jurisdictions with a predominantly court-based model, the legal framework should:

(a) Include a requirement for the liquidator to submit final accounts and a final report to the appointing court, the relevant banking authority, and to the creditors (where appropriate, in non-confidential form);

(b) Specify that the liquidation proceeding is terminated by the court, after its approval of the documents under (a) and after hearing the banking authority or receiving its consent (or non-objection).

34. Following the termination of a bank liquidation proceeding, the liquidation authority should take the necessary steps to remove the company from the business register.

35. The legal framework should clarify whether, following the termination of a bank liquidation proceeding, the liquidation authority and any appointed liquidators are relieved of any further responsibility in connection with the liquidation of the bank.

CHAPTER 4. PREPARATION AND COOPERATION

A. Introduction

163. A key task for resolution authorities is to maintain resolution plans for, at a minimum, banks that could be systemic in failure. This is a requirement under resolution frameworks.[99] Conversely, planning for liquidation purposes in normal times is typically limited. If such planning takes place, it might be restricted to deposit insurance related functions (e.g., ensuring that banks can supply the necessary information about insured deposits for purposes of a payout or transfer), or possibly ensuring that banks have the capabilities to support a transfer. Liquidation planning as part of business-as-usual activities is, however, different from the preparation of a liquidation strategy and plan in the run-up to a bank's non-viability (so-called "contingency plans"). Contingency plans are often crucial for the success of a bank's liquidation. Piecemeal liquidation is typically a suboptimal solution (see *Chapter 6. Liquidation Tools*) and a sale as a going concern, which may often achieve better results, can be thwarted if there is insufficient preparation. Preparation in the run-up to a bank's non-viability is also needed to enable a swift payout of insured depositors in a piecemeal liquidation.

164. This Chapter provides guidance on how the legal framework can facilitate preparation for bank liquidation proceedings and covers the following aspects.

- *Section B* discusses the need for preparation and provides examples of actions that may be useful to undertake before bank liquidation proceedings are opened.
- *Section C* provides guidance on enabling provisions that may be included in the legal framework to facilitate preparatory actions, and considerations on timing.
- *Section D* explains how cooperation among all relevant actors in the preparatory phase is key to the success of a liquidation process, and how this can be enabled by the legal framework, irrespective of a jurisdiction's institutional model.

B. Need for preparation

165. Ongoing planning is well established in the context of bank resolution, and is carried out by resolution authorities, with the cooperation of the banks in question, during business as usual. The *FSB Key Attributes* require jurisdictions to put in place "*an ongoing process for recovery and resolution planning, covering at a minimum*

99 *FSB Key Attributes,* KA 11.1.

domestically incorporated firms that could be systemically significant or critical if they fail".[100] In some jurisdictions, resolution plans are required for all banks, irrespective of their size, while other jurisdictions have limited the scope of resolution planning to systemically relevant banks.

166. Conversely, jurisdictions generally do not require authorities to maintain such plans for liquidation purposes. However, where resolution planning is undertaken for all banks, the plans for non-systemic banks may be based on liquidation rather than the use of resolution tools.

167. In contrast, contingency planning needs to be undertaken in the run-up to a bank's non-viability. Where a piecemeal liquidation is envisaged, such contingency planning would mostly be focused on enabling a swift payout of insured depositors by the DI, where such body exists.[101] Preparatory actions and cooperation among authorities are needed to facilitate a timely and smooth payout (see *Section D*). Preparation in the run-up to the bank's non-viability may also be needed to ensure that the necessary day-to-day operations of the bank (e.g., IT systems) may be continued in liquidation. For instance, it should be ensured that the liquidator maintains access to the infrastructure that is necessary for a payout of insured depositors.

168. Developing a contingency plan in the run-up to a bank's non-viability in order to prepare for the liquidation facilitates the swift and effective application of bank liquidation tools. It allows for the development of a precise and up-to-date description of the business activities of the bank and may improve the ability of the liquidator to sell assets and liabilities during liquidation. For instance, a separability analysis examining how parts of the bank's business could be operationally, legally and financially separated from the remainder of the legal entity, would allow a liquidator to swiftly sell high-quality business units and maximise value. At the same time, proportionality should be a key guiding principle in the extent of contingency planning and preparatory actions undertaken in each individual case.

169. A sale as a going concern in a bank liquidation proceeding ideally needs to be completed almost simultaneously with the opening of the proceeding and therefore requires a significant amount of preparation. A range of actions might need to be taken *before* the opening of the liquidation proceeding, as discussed in the next paragraph. This is different from general business insolvency regimes, where little,

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100 *Ibid*.

101 See *IADI Core Principles,* CP 15, requiring the deposit insurance system to reimburse depositors' insured funds promptly. According to accompanying EC 1, the DI should be able to reimburse most insured depositors within seven working days.

if any, preparation is envisaged prior to the opening of an insolvency proceeding, unless it is envisaged to transfer the debtor's business in whole or substantial part.[102]

170. A sale as a going concern in bank liquidation proceedings is usually preceded by a valuation of assets and liabilities of the non-viable bank; the calculation of the potential "funding gap" (i.e., the difference in value between the assets and liabilities to be transferred); open and transparent marketing, to the extent permitted by the circumstances and confidentiality requirements, involving the identification and the exchange of information with potential acquirers; a bidding process during which potential acquirers undertake due diligence; the drafting of contractual documentation; and, where applicable, the involvement of the DI in providing funding to facilitate the transfer strategy (see *Chapter 6. Liquidation Tools* and *Chapter 7. Funding*). All this requires full and timely access to up-to-date information on the state of the bank's affairs and the banking sector, where potential acquirers may be found.

171. Where the liquidation takes place as part of a resolution process, for the purpose of liquidating residual assets on a piecemeal basis, the planning and advance preparation that took place for the resolution may minimise the need for separate preparation for the liquidation of the residual entity, since the bank's business lines for which a transfer was feasible have already been transferred by the resolution authority.[103] Furthermore, where an authority has taken measures in relation to the bank with a view to preparing for the possible use of resolution tools, this may also facilitate the preparation of alternative options, including piecemeal liquidation.

172. The extent of preparation that the liquidation authorities are able to undertake may also depend on the institutional arrangements. Preparatory actions can be more easily taken in an administrative model, since banking authorities have the required technical expertise, access to and knowledge of the bank and the broader sector, and can cooperate with other authorities. They can also take measures once the bank's situation deteriorates but before a failure management proceeding is commenced. Among other things, the banking supervisor might appoint a temporary administrator (or similar) with a view to preventing a bank's failure. Preparatory actions for failure management may take place in parallel or build on such supervisory actions (e.g., by preparing appropriate contingency plans, should the

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[102] For instance, in case of a "pre-pack" sale of the business, i.e., a sale that is arranged before an administrator is appointed. Where a "pre-pack" is agreed in advance, the assets and business included in the agreement are sold immediately by the administrator when the entity enters the insolvency proceeding. Preparatory steps are also common in reorganisation proceedings.

[103] This consideration applies even if the resolution process did not result in the use of a resolution tool.

actions adopted by the temporary administrator be insufficient to prevent the bank's failure). In predominantly court-based models, preparation would crucially depend on the preparatory actions by banking authorities and the reliance by the court on such actions. Furthermore, some jurisdictions contemplate the appointment (by the court or by a banking authority) of a prospective liquidator, who is authorised to be involved in the preparation of a bank liquidation proceeding, with the prospect of being appointed as liquidator once the liquidation proceeding is opened.[104]

C. Provisions to support preparation and mitigate delay

173. The legal framework should vest banking authorities with powers to prepare a liquidation strategy, including through contingency plans. To do so, those authorities should be able to cooperate in advance with other authorities and the bank (see *Section D*).

174. Irrespective of the institutional model, the legal framework should require the bank to cooperate with the banking authority in the preparatory phase. If the bank fails to cooperate, the legal framework should allow the authority to take appropriate remedial measures (e.g., by appointing a person to cooperate with or replace the bank's management or to ensure that information is transmitted to the relevant authorities). Jurisdictions should assess whether their legal framework already provides for a power to remove non-cooperative management of the bank prior to failure management proceedings. The legal framework should also vest the authority with intervention powers to prevent asset stripping.[105]

175. Furthermore, in jurisdictions with predominantly court-based models, the legal framework could allow the court or a banking authority to appoint a prospective liquidator (see *Chapter 2. Institutional Arrangements* and *Recommendation 11(a)*).[106] Preparation would be further facilitated if the prospective liquidator were a banking authority. Where jurisdictions allow both the appointment of a temporary administrator (or similar) and the appointment of a prospective liquidator, and these have different mandates (and can therefore not be the same person), the legal

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104 A prospective liquidator should be distinguished from a "provisional" liquidator with a limited mandate focused on the protection of assets in the period approaching insolvency.

105 For the type of measures banking supervisors should be able to take at an early stage, see *Basel Core Principles*, CP 11.

106 E.g., in the Netherlands, the court appoints a liquidator on the day that the liquidation proceeding is opened. However, in practice, before that, the court may indicate the person who will be appointed as liquidator, so that such prospective liquidator can prepare and possibly take preparatory actions (e.g., for a sale). Similarly, in the United Kingdom, the Bank of England can appoint a prospective liquidator, who could be involved in contingency preparations and is subsequently proposed to the court for appointment as liquidator.

framework should allow for cooperation and exchange of information between these persons, subject to appropriate confidentiality safeguards and under the oversight of the banking authority. The legal framework should, in any case, not impede banking authorities from taking preparatory actions.

176. In some cases, it may be sufficient if the legal framework vests the liquidation authority and/or the liquidator under its supervision with the power to transfer all or part of the bank's assets and liabilities to another institution (see *Chapter 6. Liquidation Tools*), since this may implicitly also confer the power to prepare for such a transfer. In other cases, however, it may be appropriate to include in the legal framework an explicit power for the liquidation authority or liquidator to take any other action necessary for the orderly liquidation of the bank (which would include preparatory action), and/or the power to seek the assistance of third parties, including the power to hire any specialists, experts or professional advisors.

177. While the preparatory phase by definition precedes the formal declaration of a bank's failure, it is not possible to identify a precise moment when preparatory actions should start since this is contingent on the circumstances of the case. Legal frameworks for bank failure management typically do not define a time when preparations for liquidation should be started. Frameworks for Prompt Corrective Action are an exception to this, where they provide for time-bound interventions, ultimately concluding with liquidation or resolution.[107] In predominantly court-based models, the legal framework should enable the timely involvement of banking authorities to facilitate as much preparation as possible.

178. Where there may be a delay between the grounds for liquidation being met and the formal opening of a liquidation process – for instance, when the commencement of a liquidation proceeding needs to be approved by a court – banking authorities need to take this into account in their planning. Where this is the case, to reduce the length of any such delay, the legal framework could provide for expedited procedures and require the court to defer to the banking authority's assessment of the facts (see *Chapter 2. Institutional Arrangements*, *Section C.6* and *Recommendation 11(b)*). To mitigate the risk of harm during that period, the banking authority could be given the power to remove the management of the bank or take other measures in order to prevent its disorderly default and/or any asset stripping (if such power is not already part of a jurisdiction's legal framework). Alternatively, the

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[107] E.g., in the US, the FDIA (Section 38) provides for mandatory and discretionary supervisory actions linked to different capital categories. If a bank is "*critically undercapitali[s]ed*", after a specific period (maximum 90 days), a receiver should in principle be appointed.

same result can be achieved by providing for the power or duty of the competent court to adopt an interim measure, pending its decision on the petition.

D. Cooperation between all actors in the period approaching liquidation

179. The bank liquidation process typically involves a multiplicity of actors. Apart from the liquidation authority (which may be an administrative authority or court) and any appointed liquidators, it involves the bank, the banking supervisor, the DI, and possibly the resolution authority. These actors may be subject to differing mandates and take decisions and measures under different legal frameworks. Enhanced coordination between these actors, supported by consistent provisions in their governing frameworks, is key to the success of the liquidation process.

180. It is also important to ensure that, if the failing bank is an issuer of securities listed or traded on a stock exchange or alternative trading facilities, there is cooperation with the relevant market authority. That authority should be notified in a timely and confidential manner of the bank's situation so that it may determine whether or not to suspend the trading of the bank's securities. Coordination between the bank, the banking authority and the market authority is also needed in relation to disclosure requirements under the applicable securities law.

181. The public disclosure of "material adverse developments" or a bank's approaching non-viability (see *Chapter 3. Procedural and Operational Aspects, Section B*) might accelerate a bank's failure, increase asset stripping risks, and affect the successful implementation of the liquidation strategy. On the other hand, delaying disclosure of such information would prevent creditors from making informed decisions about whether to continue transacting with the bank, and uncertainties among investors could also have destabilising effects. Similar considerations apply in relation to possible other disclosure requirements in the applicable laws (e.g., company law). Jurisdictions should consider these trade-offs when designing their bank liquidation framework. The legal framework should enable coordination between the bank, the banking authority and other relevant authorities in order to achieve a mutually acceptable solution.

182. Securities laws usually allow, under strict conditions, the relevant market authority to consent to a delay in the disclosure of relevant information following a request by the issuer. In this specific context, the consent of the market authority should be coordinated with the role of the banking authority. A possible approach could be for the legal framework to allow the relevant market authority to authorise a delay in a bank's disclosure obligations relating to its approaching non-viability for a period strictly necessary to complete the preparation of the liquidation, provided that (i) the market authority is informed in advance and has consulted with the

banking authority, and (ii) the information can be kept confidential during that period.

183. The legal framework should also ensure that the securities regulator and/or the market operator operating a trading facility where the securities of the failing bank are traded is informed promptly so that it can suspend the relevant securities from trading when necessary, unless such suspension would be likely to cause significant damage to investors' interests or the orderly functioning of the market.

184. Cooperation between banking authorities and with the bank is crucial in the period when the bank's situation is deteriorating and its liquidation is possible. Legal frameworks do not always explicitly address cooperation in the pre-liquidation phase. Indeed, there may be different ways of ensuring that such cooperation take place. Cooperation arrangements between the authorities involved vary across jurisdictions. In some jurisdictions, an MoU is in place between the banking supervisor and the liquidation authority. In countries with administrative institutional frameworks, relevant functions may be located within the same authority (e.g., the banking supervisor may also be in charge of resolution and liquidation, subject to structural separation between supervision and failure management functions).

1. Cooperation among administrative authorities

185. To the extent that the liquidation process is of administrative character, international standards on cooperation between authorities for bank failure management purposes, as set out in the *Basel Core Principles*, the *FSB Key Attributes* and the *IADI Core Principles,* and elaborated through good practices in associated guidance, remain relevant.[108] These would apply, in particular, to any communications, advance notice, consultations and coordinated actions between authorities that enable relevant actors to be ready for an anticipated liquidation process. Such coordination can be critical, for example, for the readiness of the DIS to pay out insured deposits rapidly or for the prompt implementation of transfer-based strategies. Bank liquidation frameworks should be consistent with cooperation arrangements under those standards, and obstacles to such cooperation should be removed.

186. Apart from legislative provisions, cooperation may also be furthered by concluding MoUs or similar agreements. Such agreements provide an operational framework within which parties commit to cooperate while exercising their specific competences and powers. Ideally, they would specify arrangements for data and

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[108] For instance, *IADI CP* 4 requires an information sharing arrangement between DIs and other financial safety net participants, formalised through legislation, regulation or memoranda of understanding.

information sharing and set out the respective operational duties of the parties in the phase preceding the opening of the liquidation process. While the authorities may not need a specific legislative provision related to liquidation to conclude such agreements with domestic counterparts, such provision may still be useful in encouraging coordination, and the legal framework should allow the sharing of confidential information (subject to adequate safeguards). The formalisation of relations between authorities should not preclude flexibility for the parties to respond as appropriate when managing a bank failure. Existing (institution-specific) multilateral coordination arrangements related to the preparation and management of bank failures could also be a forum for coordination among relevant authorities.

187. There should be a smooth continuum between supervision and bank failure management. Accordingly, the bank should notify the relevant banking authorities of approaching non-viability (see *Chapter 3. Procedural and Operational Aspects, Section B* and *Recommendation 16*) and close cooperation should take place between those banking authorities. The liquidation authority will need to provide sufficient and timely information to the banking supervisor and the resolution authority and keep them informed of its intentions and the progress of its preparation.[109]

2. Cooperation between administrative authorities and the court

188. Coordination challenges may arise where the institutional set-up for bank liquidation involves courts and court-appointed liquidators. The court typically first becomes involved at the formal filing for a liquidation proceeding. As such, it will have no, or a very limited, role in the preparatory phase.

189. In jurisdictions with a predominantly court-based model, it is likely that the preparatory work will have to be carried out by the relevant banking authority/ies. This raises questions concerning the ability of the banking authorities to make commitments to potential acquirers with regard to planned transactions and the willingness of courts to validate the preparatory steps. The judicial actors will lack prior knowledge of the situation and the process for court approval may cause delays. This should be taken into account in the preparatory phase (see also *Chapter 2. Institutional Arrangements*).

190. Nevertheless, cooperation between banking authorities and the court can and should be enabled by the legal framework and the arrangements adopted under it. As noted in *Chapter 2. Institutional Arrangements*, in almost all jurisdictions with

[109] In jurisdictions with a dual-track regime, the choice between resolution or liquidation is made by the resolution authority. Therefore, if the liquidation authority is distinct from the resolution authority, appropriate coordination between these authorities should take place and any preparatory actions by the liquidation authority should not hamper the preparation for resolution.

predominantly court-based models, banking authorities have a role in the selection and appointment of liquidators. Where this is the case, one option for facilitating preparation and cooperation between the court and banking authorities is to involve the prospective liquidator in the preparatory process. Appointing a banking authority as liquidator would also help ensure a smooth continuum from pre-liquidation to liquidation and effective cooperation between the court and banking authorities (see *Recommendation 11(a)* and *Recommendation 11(c)*).

191. While cooperation between banking authorities and the court is crucial, the framework may need to incorporate constitutional constraints pertaining to the independence of authorities and confidentiality of some information. Nevertheless, it may set out high-level principles about the need for the authorities to cooperate in good faith to achieve the objectives of the framework. A precise and well-defined allocation of functions, along with safeguards limiting the scope for judicial review of technical decisions made by banking authorities, particularly in the pre-liquidation phase, might further such cooperation.

3. Cooperation with the bank

192. Banking authorities may already have access to the data required for preparatory actions due to prior information-gathering (e.g., reporting and investigations). The sharing of such information with an administrative liquidation authority is discussed under *subsection 1* above. If additional information (including more timely and/or more granular financial data) is required, the liquidation authority should have the power to require the bank to provide it directly or request the banking supervisor to gather the relevant information in the run-up to the opening of liquidation proceedings.

193. In either case, provisions enabling the flow of information to the authority in charge of the preparation of liquidation should be in place. The obligation for the bank to notify the banking supervisor and other relevant authorities of any material adverse development, including its actual or imminent non-viability, is also an aspect of cooperation and may help reduce the authority's risk of legal challenge concerning the grounds for liquidation (see *Chapter 3. Procedural and Operational Aspects, Section B* and *Recommendation 16*).

194. Furthermore, the legal framework should not prevent the liquidator from retaining bank staff that is deemed necessary for the conduct of the liquidation process (e.g., security personnel, IT staff, loan officers). As part of preparatory activities, authorities should be able to identify key personnel and resources.

Key Considerations and Recommendations 36 – 40

Key Considerations

➢ Preparation for liquidation in the run-up to a bank's non-viability is useful and should be possible, taking due consideration of the specificities of the bank and the circumstances of its failure. Preparation is especially relevant for the effective implementation of a sale as a going concern.

➢ In jurisdictions with an administrative model, timely access to adequate information and effective preparation and cooperation among administrative authorities are supported by the *Basel Core Principles* and the *FSB Key Attributes.* Cooperation with deposit insurers should be in line with the *IADI Core Principles*. Jurisdictions should assess whether existing legal provisions already provide the powers recommended here.

➢ In jurisdictions with a predominantly court-based model, the legal framework should contain arrangements to ensure that adequate preparation can nevertheless take place (see *Chapter 2. Institutional Arrangements, Section C.2, Recommendation 11(a)*).

Recommendations

36. The legal framework should facilitate, in the run-up to a bank's non-viability, the timely and effective preparation for a liquidation proceeding and encourage, or at least not impede, such cooperation and preparatory actions as the relevant authorities deem appropriate and proportionate in the circumstances. The relevant authorities for this purpose are the liquidation authority and/or the liquidator and any other actors whose functions require them to be involved in the preparatory phase, including the banking supervisor, resolution authority and deposit insurer.

37. The legal framework should enable coordination between the bank, the banking authorities and other relevant authorities as regards the application of disclosure requirements under securities regulation and market rules in the period in which the bank is approaching non-viability. If the bank is an issuer of listed or traded securities, the legal framework could allow a delay in the public disclosure of the information that the bank is approaching non-viability for the period strictly necessary to complete the preparation of the liquidation.

38. The legal framework should ensure that the securities regulator and/or the market operator operating a trading facility where the securities of the

failing bank are traded is informed in a timely and confidential manner of a bank's expected failure so that it may determine whether or not to suspend the trading of the bank's securities.

39. The legal framework should require banks to cooperate with the banking authority prior to bank liquidation proceedings to facilitate preparation. If the bank fails to cooperate, the legal framework should ensure that the banking authority can take all necessary remedial supervisory actions. Jurisdictions should assess whether their legal framework already provides a power to remove non-cooperative management of the bank prior to failure management proceedings.

40. The legal framework should vest the banking authorities – including an administrative liquidation authority – a temporary administrator (or similar) if appointed, and any appointed liquidator, including a prospective liquidator if the relevant jurisdiction so contemplates, with sufficiently broad powers to adequately prepare the liquidation process. This may include, *inter alia*, the powers to:

(a) Exchange information, subject to appropriate confidentiality requirements, among themselves and with the deposit insurer, before liquidation actions are undertaken;

(b) Obtain all the relevant information for the preparation of liquidation from the bank, if such information cannot be obtained by means of (a); and

(c) Hire third parties, such as specialists, experts or professional advisors.

CHAPTER 5. GROUNDS FOR OPENING BANK LIQUIDATION PROCEEDINGS

A. Introduction and general considerations

195. The grounds that justify the opening of liquidation proceedings are an essential element of a bank liquidation framework, and these should be clearly specified. As a general principle, the legal framework should provide a consistent structure for all failure management decisions. Policy decisions about the nature and form of the statutory grounds for liquidation should also have regard to the interaction with the grounds for revoking the banking licence, since both result in the bank's exit from the market.

196. In single-track regimes, there is likely already a single set of grounds for the opening of failure management proceedings, which should reflect the relevant provisions of the *FSB Key Attributes*. Accordingly, this Chapter is primarily focused on dual-track regimes. One notable feature of dual-track regimes is that a finding of non-viability is accompanied by a decision as to whether to put the bank into resolution or liquidation. Since there should be seamless continuity between the resolution and liquidation regimes, the opening of a liquidation proceeding in respect of a non-viable bank should follow the decision of the resolution authority not to take resolution action or to take resolution action which leaves certain residual parts of the bank to be wound up.

197. This Chapter covers the following aspects:

- *Section B* offers an overview of the types of grounds that could justify the opening of bank liquidation proceedings. It explains why such grounds should be broader than the traditional grounds for business insolvency, and why they should ideally contain a forward-looking element to allow for timely action, prevent depletion of assets and protect depositors. In line with the *FSB Key Attributes*, the concept of non-viability or likely non-viability should be a guiding principle.
- *Section C* discusses the interaction between licence revocation and the opening of bank liquidation proceedings. Attention should also be paid to the interplay between administrative and judicial decision-making in this context. The guidance for bank resolution regimes in the *FSB Key Attributes* on coordination with judicial actions[110] should also apply, *mutatis mutandis*,

[110] The *FSB Key Attributes* in KA 5.4 specify that "*[t]he resolution authority should have the capacity to exercise the resolution powers with the necessary speed and flexibility,*

to bank liquidation proceedings (see *Chapter 2. Institutional Arrangements*). For predominantly court-based liquidation proceedings, in particular, the respective roles of the banking authorities and the court in ascertaining whether the statutory grounds are met must be clearly specified.

- *Section D* highlights the need for consistency between the conditions for resolution and the grounds for opening bank liquidation proceedings, to avoid "limbo" situations and facilitate a smooth liquidation of the residual entity as part of a resolution action.

B. Types of grounds

1. Financial and non-financial grounds for liquidation

198. The survey undertaken in preparation of this *Guide* showed, across jurisdictions, a variety of grounds for initiating bank liquidation proceedings. These can be classified into two general categories: (i) financial grounds, relating to the non-viable financial condition of the bank concerned; and (ii) non-financial grounds, which encompass a wide range of considerations, such as evidence of criminal activities, systemic violation of requirements relating to anti-money laundering or countering the financing of terrorism (AML/CFT), or other serious and/or persistent legal or regulatory infractions which justify the closure and dissolution of the bank in the public interest. Practically all jurisdictions rely on financial grounds of one sort or another (such as insolvency, lack of capital adequacy or sufficient liquidity, non-viability, credit weakness), while many jurisdictions complement the financial grounds with non-financial ones. Also, in several jurisdictions, the revocation of the banking licence on financial and non-financial grounds is itself a trigger for opening a bank liquidation proceeding (see *Section C*).

199. While a distinction between financial and non-financial grounds can help to conceptualise and map possible grounds, an integrated approach should be taken to identifying the grounds to be included in the statutory framework. This is because financial and non-financial problems in a bank are often interconnected. Non-financial weaknesses may easily translate into a loss of confidence by markets and clients, and this, in turn, can cause financial distress, eventually leading to the bank's non-viability.

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subject to constitutionally protected legal remedies and due process. In those jurisdictions where a court order is still required to apply resolution measures, resolution authorities should take this into account in the resolution planning process so as to ensure that the time required for court proceedings will not compromise the effective implementation of resolution measures."

200. The general classification of grounds for opening bank liquidation proceedings overlaps with the distinction between those specifically linked to breaches of banking regulation ("regulatory grounds") and other possible grounds. To the extent that regulatory grounds involve non-compliance with quantitative prudential requirements (e.g., the maintenance of the bank's capital ratio above a specified threshold), they constitute financial grounds. However, regulatory grounds may also be of a non-financial nature. Qualitative regulatory infractions (e.g., serious and systematic breaches of regulatory standards justifying the revocation of the banking licence, organisational or governance failures, or violations of AML/CFT requirements) also serve as non-financial grounds for liquidation proceedings in many jurisdictions.

2. Difference between the financial grounds for bank liquidation and the traditional financial grounds in general business insolvency law

201. Under business insolvency law, liquidation proceedings are generally opened if: (i) a company is unable to pay its debts as they fall due (illiquidity or cessation of payments); and/or (ii) a company's liabilities exceed its assets (balance-sheet insolvency).[111] Due to the special nature of banks, these grounds may be ill-suited to dealing with bank failures. Therefore, the grounds for opening bank liquidation proceedings should not be limited to or overly reliant on traditional insolvency grounds, but include additional ones.

202. In particular, illiquidity – as conceptualised and applied in the general business insolvency framework – may not be an appropriate ground, given banks' function in maturity transformation and their high reliance on on-demand deposits. The latter implies that, in the case of banks, it is not possible to focus on the maturity of the liabilities as such: that is, on the theoretical ability of the bank to repay all liabilities currently due, including all demand deposits, simultaneously and immediately, as distinct from their practical ability to retain the confidence of depositors and access to market funding. Furthermore, banks may have access to refinancing in interbank money markets, as well as to a central bank's regular monetary policy refinancing operations where available and provided that they comply with eligibility requirements and other safeguards as per central bank policy. Moreover, provided that the necessary conditions are met, the central bank may also provide liquidity assistance on a discretionary basis (including as emergency liquidity assistance to solvent banks). In contrast, other companies typically lack

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111 The *UNCITRAL Legislative Guide*, Part Two, Chapter I, para. 23 formulates it as *"[a] standard that is used extensively for commencement of insolvency proceedings is what is variously known as the liquidity, cash flow or general cessation of payments tests. This requires that the debtor has generally ceased making payments and will not have sufficient cash flow to service its existing obligations as they fall due in the ordinary course of business.*"

comparable sources of liquidity. Conversely, when a bank's failure is likely, it is not reasonable to defer official intervention until cessation of payments has actually occurred. Instead, decisions should be based on an assessment of the actual and projected development of outflows (or claims for repayment) and the availability of realistic sources of refinancing in the near future. Thus, in some cases, a bank's illiquidity can be a transitory problem, which can be addressed in ways that would not justify its forcible exit from the market.[112] On the other hand, banks' liquidity problems can escalate at a much higher speed and affect a much larger part of the liability side of the balance sheet in comparison to the liquidity problems of ordinary companies (e.g., due to a run by short-term liability holders, including depositors).

203. With regard to balance-sheet insolvency, the book value of a bank's assets might not fully and immediately encapsulate every impairment in the quality of assets and the losses that are likely to accrue as a result. More generally, it is not easy to value assets with great precision and within a very short timeframe, so as to know exactly if and when a financially weak bank has finally crossed the threshold into balance-sheet insolvency. More importantly, waiting for the bank's net financial position to actually turn negative before intervening may lead to an undesirable destruction of value in the run-up to liquidation (due to the accumulation of additional predictable losses and, potentially, to the incentive of bank managers to "gamble for resurrection"); produce inequitable results (e.g., by providing insiders and sophisticated investors with opportunities to withdraw value from the bank and engage in asset stripping, to the detriment of less informed investors and depositors which would be left behind); and increase the risk of contagion.[113]

204. Accordingly, it is important that the legal framework enable intervention at a relatively early stage once a bank presents signs of profound financial distress (that is, before it is balance-sheet insolvent) and that such interventions can be implemented in a speedy and timely manner.[114] The financial grounds for

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[112] Moreover, observed illiquidity in the sense of an actual cessation of payments (as distinct from the existence of underlying refinancing problems) will typically result, due to its exceptionally strong signalling effect, in the immediate and disorderly collapse of the bank.

[113] Also, before reaching the point of balance sheet insolvency, the bank would have breached regulatory capital requirements, and compliance with such requirements is a condition for continued authorisation.

[114] From a procedural perspective, in predominantly court-based systems, it is essential that the opening of a liquidation proceeding by the competent court take place rapidly upon the submission by the banking authority of the relevant petition, since any delay or participation of third parties in the process may lead to the bank's immediate and disorderly collapse (see *Chapter 2. Institutional Arrangements*, *Recommendation 5* and *Recommendation 11(b)* and *Chapter 3. Procedural and Operational Aspects*, *Recommendation 17*).

compulsory official intervention leading to the resolution and/or liquidation of banks are, therefore, typically set at a level of low but nonetheless positive net worth,[115] and are expressed in the form of quantitative supervisory thresholds of critical undercapitalisation (as defined by reference to regulatory capital requirements) or illiquidity, and/or more evaluative assessments of non-viability, which include forward-looking estimations indicating that the bank is likely to continue on a downward path and cannot reasonably be expected to return to soundness within a relatively short timeframe.

205. The *FSB Key Attributes* provide that resolution for financial institutions that could be systemic in failure should be initiated "*when a firm is no longer viable or likely to be no longer viable*".[116] In a similar vein, the concept of "(likely) non-viability" could usefully inform the design of the grounds for opening bank liquidation proceedings, even though jurisdictions may prefer to use more specific descriptions and criteria in their legislation. In line with the *FSB Key Attributes*, a jurisdiction's legal framework should already contain clear standards or suitable indicators of non-viability, which could be replicated or referenced in the legal framework governing bank liquidation. With regard to the criteria for non-viability, the existing guidance in the *FSB Key Attributes Assessment Methodology for the Banking Sector* should be taken into account.[117]

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115 Similarly, in business insolvency, reorganisation procedures may be initiated at an earlier point in time compared to liquidation.

116 See *FSB Key Attributes*, KA 3.1, which stipulates that *"[r]esolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so. The resolution regime should provide for timely and early entry into resolution before a firm is balance-sheet insolvent and before all equity has been fully wiped out. There should be clear standards or suitable indicators of non-viability to help guide decisions on whether firms meet the conditions for entry into resolution."*

117 Clarifying what these indicators could include, the *FSB Key Attributes Assessment Methodology for the Banking Sector* provides the following examples: *"(i) regulatory capital or required liquidity falls below specified minimum levels; (ii) there is a serious impairment of the bank's access to market-based funding sources; (iii) the bank depends on official sector financial assistance to sustain operations or would be dependent in the absence of resolution; (iv) there is a significant deterioration in the value of the bank's assets; or (v) the bank is expected in the near future to be unable to pay liabilities as they fall due. Exclusive reliance on criteria for non-viability that are closely aligned with insolvency or likely insolvency would not meet the test for timely and early entry into resolution (although it should always be possible to apply resolution measures to an insolvent bank)."* See also the definition of non-viability in the IADI Glossary, where two further points are added to the FSB list, namely: *"(vi) the Bank's business plan is non-viable; and/or (vii) the Bank is expected in the near future to be balance-sheet insolvent."*

206. It is up to the banking authority to assess on a case-by-case basis whether a bank is considered no longer viable or likely to be no longer viable. The opening of a bank failure management procedure typically requires a holistic assessment of the situation, involving technical evaluations and the exercise of discretion in order to balance competing considerations. For instance, while it is necessary to address bank failures in a timely and decisive manner, at the same time, a bank's non-viability should be sufficiently substantiated so as to justify the interference with shareholders' and creditors' property rights. To a certain extent, potential conflicts can be addressed by framing the grounds for intervention in precise terms in the legal framework. However, grounds that require some degree of evaluation (e.g., requiring breaches of regulatory requirements to be "very serious" or "material", or particular financial outcomes to be "likely to occur") are unavoidable. Moreover, the legal framework may intentionally include a measure of flexibility in the definition of the grounds, implicitly leaving certain matters for discretionary determination in light of the specific circumstances.

207. Technical evaluations and/or discretionary judgments may thus play a significant role in the assessment that a bank is no longer viable and the decision about the appropriate responses to a finding of non-viability (including, in dual-track regimes, whether to put the bank into resolution or liquidation). For this reason, if any court involvement is required to open a bank liquidation proceeding, it should not be possible for the court to substitute its own assessment of the situation for that of the banking authority (see *Recommendation 5*).

3. "Negative" condition

208. The *FSB Key Attributes* include a "negative" condition that needs to be met before a bank may be placed in resolution. This requires that, as well as being *"no longer viable or likely to be no longer viable"*, the bank should also have *"no reasonable prospect of becoming [viable]."*[118] A negative condition can be seen as a necessary feature of a system based on flexibility and proportionality and that contains forward-looking grounds. Liquidation, as a procedure that leads to the exit of the bank from the market, has to be considered as an *ultima ratio*; in this sense, it would not be justified if other less intrusive measures appear to be capable of addressing the bank's problems. The relevant authority should therefore be satisfied that liquidation is necessary, and that other measures have no reasonable prospect of success. This means that the authority should have regard to the ability of private

[118] *FSB Key Attributes*, KA 3.1. In the EU, the formulation is somewhat different, and essentially requires that there is no reasonable prospect that any alternative measures could prevent the bank's failure within a reasonable timeframe.

interventions, or market-based solutions, and/or supervisory actions to address the problems and restore the bank to viability within a reasonable timeframe.[119]

209. However, there are different ways to implement this "negative" condition. One option would be to include it in the statutory framework as part of the grounds for opening bank liquidation proceedings. The framework could also specify that a negative condition should not include any potential use of public funds as an alternative to liquidation. As noted in *Chapter 1. Introduction, Section H*, a primary objective of bank failure management frameworks should be to avoid loss to public funds, including through bail-out to prevent a failure. A properly circumscribed negative condition should thus be limited to the inability of other forms of intervention by authorities or available private sector solutions to rectify the problems of the bank within a reasonable timeframe.

210. However, a negative condition may also be implicit in the principle of proportionality (or any functionally equivalent principle of public law) that the banking authorities are often subject to in administrative decision-making. Indeed, a decision to liquidate is taken in the context of the overall framework for supervisory intervention and bank failure management, and will likely be made when alternative supervisory actions do not appear to be sufficient and no private solution seems to be feasible in a reasonable timeframe, thus leaving the bank in a position of persistent financial distress and/or imminent failure. A statutory negative condition may thus be redundant, as the authorities would already need to assess it under public law.[120]

C. Interaction with licence revocation

211. A jurisdiction's legal framework must not only specify the substantive grounds that justify a bank's mandatory exit from the market, but also how they interact with other elements of a bank failure management framework. Unlike

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[119] Including, in some jurisdictions, measures taken by an IPS to which the bank belongs.

[120] It may be difficult to prove that a negative condition is met, since this would require the provision of sufficient reasons to establish that alternative measures were available and could have restored the bank to viability with a reasonable prospect of success. To address this problem, a solution could be to frame the absence of alternatives as a factual question. Under this approach, rather than requiring the liquidation authority to positively establish and support with reasons that alternatives were not available, the opening of liquidation could be prevented if sufficient evidence were adduced that an alternative was reasonably available. In this context, the principle of deference to the relevant banking authority's assessment on a bank's non-viability is key (see *Recommendation 5*).

ordinary companies, banks can only operate on the basis of a licence.[121] In every jurisdiction, the serious and/or persistent breach of regulatory requirements may lead to the revocation of a bank's licence, forcing it to terminate its banking activities. Subject to some exceptional cases discussed below (see *paragraph 217*), the revocation of the banking licence will also affect a bank's actual or legal ability to survive, leading inexorably to its liquidation and dissolution. This implies that the legal framework may secure a bank's mandatory exit from the market either through the supervisory procedure of licence revocation and/or through a liquidation process. The same financial and non-financial grounds can be the basis for either process.

212. The revocation of the banking licence and the opening of a liquidation proceeding are thus closely linked in most cases, although the sequence and timing differ across jurisdictions. A key difference is whether the two procedures take place in parallel, without formal connections between them, or as a continuum, whereby one procedure precedes and is a ground for the other. In the latter case, licence revocation can be a trigger for opening bank liquidation proceedings or, conversely, the consequence of such proceedings.

213. The following paragraphs explain the different options, concluding that ensuring the alignment of the two procedures presents clear advantages. The legislative framework can achieve this result by establishing that the revocation of a bank's licence is in itself a sufficient ground for the opening of compulsory liquidation proceedings or, conversely, by providing that the revocation of the licence constitutes a direct consequence of the opening of liquidation proceedings. This section does not consider the voluntary surrender by a bank of its banking licence, for instance, with a view to changing its business activities. Such situation does not strictly speaking relate to liquidation and is not the subject of this *Guide*.

1. Licence revocation as a ground for opening liquidation proceedings

214. In most jurisdictions, the revocation of an entity's banking licence means that it can no longer fulfil its corporate purpose. Since this is a compulsory ground for the entity's dissolution, licence revocation can be a trigger for liquidation.

215. In several jurisdictions, the two procedures are explicitly linked and sequenced, with the revocation of a bank's licence preceding and leading ineluctably

[121] See *Basel Core Principles*, CP 5 and Essential Criteria – especially EC 3, according to which "*[t]he criteria for issuing licences [must be] consistent with those applied in ongoing supervision*". When a bank no longer meets the criteria for a banking licence, this prevents the bank from continuing to operate as such and, therefore, the licence is revoked.

to its liquidation.[122] In this scenario, the financial and non-financial grounds justifying a bank's mandatory exit from the market are set out in the banking supervisory framework as events triggering the (administrative) revocation of the bank's licence, so that, strictly speaking, the legal basis for the subsequent opening of liquidation proceedings does not consist in the occurrence of the substantive grounds as such, but in the supervisory act of revoking the licence.

216. There are clear benefits to including licence revocation as a ground for opening bank liquidation proceedings. Importantly, this approach leaves little room for conflicting assessments of whether the grounds are met. Where licence revocation is a ground for liquidation, the legal framework should support the swift initiation of liquidation proceedings following the decision to revoke the licence.

217. However, while this approach has the advantage of legal certainty, a couple of refinements are recommended. Importantly, the legislation should allow the authorities to permit a bank to continue operations for a short period following a decision to revoke its licence, if necessary to facilitate the execution of a transfer (see *Chapter 6. Liquidation Tools, Section D.2*). Furthermore, a potential disadvantage of licence revocation triggering a rapid opening of liquidation proceedings is that, in certain exceptional cases, the liquidation and dissolution of the entity in question may appear unnecessary and disproportionate.[123] If the framework permits exceptions in such cases, they should not apply in cases where the entity is insolvent or illiquid in the narrow sense of general business insolvency law, or in cases where the licence was revoked in response to serious wrongdoing (e.g., serious violations of AML/CFT requirements or facilitation of or engagement in criminal activities) so that the dissolution can be pursued in the public interest.

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122 E.g., Greece, Ghana, India, Japan, and Nigeria. In several of these jurisdictions, the revocation of the banking licence is one of several grounds for opening bank liquidation proceedings. In certain jurisdictions (e.g., Greece, Ghana), the revocation of the banking licence constitutes the sole ground for opening bank liquidation proceedings.

123 For example, in certain circumstances, an entity may breach the regulatory conditions for authorisation while still being solvent and viable as a going concern – albeit no longer as a bank. In this situation, its liquidation and dissolution may appear unjustifiable. For such cases, the legal framework could leave open the possibility of consensual surrender of the entity's banking licence without commencement of compulsory liquidation proceedings, provided that the entity's form and corporate purpose permit the change of business activity and that it is able to transfer to another bank or liquidate on a voluntary basis its portfolios of deposit liabilities and other regulated activities rapidly and in full compliance with its contractual obligations to its liability holders.

2. Parallel licence revocation and liquidation proceedings

218. In certain jurisdictions, licence revocation and liquidation proceedings are not articulated as consecutive steps of a single sequence but as parallel proceedings, each based on distinct legal grounds. In this case, liquidation proceedings may be initiated for substantive grounds which may coincide with, diverge in certain respects from, or be framed independently of, the grounds for licence revocation. For example, the persistent failure to comply with quantitative prudential requirements may be a ground for the revocation of a bank's licence under banking legislation but not a ground for liquidation in the bank liquidation framework.

219. However, such separation of licence revocation and the opening of liquidation is inadvisable, both on substantive grounds and in the interests of a coherent legal framework. It is instead recommended that the statutory grounds for the opening of liquidation proceedings be aligned with those already in place for revocation of the licence in the specific jurisdiction. Ideally, if the grounds for revocation of the licence are met, this should be a sufficient ground for opening a liquidation proceeding. Alternatively, jurisdictions should ensure consistent drafting of equivalent grounds across the supervisory, resolution and liquidation frameworks where these are set out in separate statutes.

220. Even when nearly identical grounds are used, the assessment of whether they are met may need to be made separately for each procedure, possibly by different decision-makers. For example, the banking supervisor may be responsible for the decision on licence revocation, while the liquidation authority (which may be an administrative authority or a court) is responsible for opening a liquidation proceeding. In this case, the liquidation framework should be designed in a manner that minimises the potential for inconsistent assessments and, in any case, avoids "limbo" situations.[124]

221. In predominantly court-based models, attention should be paid to the role of the court in assessing a banking authority's petition for opening liquidation proceedings based on a bank's non-viability. To avoid limbo situations, the preferred option would be to qualify the revocation of a bank's licence in the legal framework as a self-standing ground for liquidation. Should this not be the case, a procedural safeguard could be introduced, requiring the court to concentrate on matters of law and procedure, while deferring to the banking authority's expertise and discretion on technical matters and on policy issues (see *Recommendation 5*). The legal framework

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[124] In this context, a limbo situation refers to a scenario in which a bank is not put into an insolvency procedure and therefore continues to operate despite having been found to be non-viable by a banking authority.

should address how a limbo situation is avoided in cases where the court nevertheless departs from the banking authorities' technical assessment.

3. Impact of opening liquidation proceedings on the bank's licence

222. If a jurisdiction's legal framework allows liquidation proceedings to be opened independently of, and even prior to, the supervisory decision on the revocation of the licence, the latter should be one of the necessary outcomes of the former. Accordingly, the revocation of the licence should follow shortly after the opening of the liquidation proceedings. In certain exceptional situations, permission to carry on specific regulated activities (such as maintaining deposits [125] and performing payment transactions) for a limited period after the opening of the liquidation proceeding may be granted to the extent that this is considered necessary for the efficient conduct of the liquidation and/or the effective completion of a transfer (see also *Chapter 6. Liquidation Tools, Section D.2*). Jurisdictions could establish coordination rules enabling the liquidation authority to cooperate with the banking supervisor on this matter.

D. Interaction with triggers for resolution

223. In some jurisdictions with dual-track regimes, different triggers are used for resolution and liquidation. However, for reasons of legal certainty and economic rationality, the framework should prevent limbo situations in which a bank is found to be non-viable based on the criteria of the resolution framework, but the financial grounds for opening liquidation proceedings are not yet met.[126] Accordingly, where bank failures are managed either through resolution or by way of liquidation, the legal framework should ensure that one of those procedures must be applied whenever non-viability has been established (or the bank's licence has been revoked). A liquidation proceeding must necessarily follow swiftly if the non-viable bank is not placed in resolution. For this purpose, the alignment of the financial grounds for opening bank liquidation proceedings with the non-viability criteria for resolution could be beneficial. There are different ways to achieve such alignment. For example, the liquidation framework may refer to the non-viability criteria for resolution or formulate the grounds for opening bank liquidation proceedings in the same terms, or it may use a different formulation that nevertheless aligns with the resolution conditions. In any event, the decision of the resolution authority that a bank determined as non-viable should not be placed under resolution should be a sufficient ground for opening a bank liquidation proceeding, while a decision to

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125 Specifically, the temporary continuation of the licence would enable the bank to continue to service existing deposits. A bank would typically not be able to accept new deposits during this period.

126 A situation of this type occurred in the EU in the case of ABLV Bank (2018).

resolve the bank should preclude liquidation except with reference to a residual entity, if any.

224. Where the partial transfer of a failed bank's assets and liabilities in resolution is followed by the liquidation of the residual entity, it should be possible to proceed with that liquidation based on the existing non-viability assessment, without need for assessment of any further grounds.[127] This should not prejudice, however, the flexibility of the authorities to keep the residual bank outside liquidation for a short period of time for the continuation of critical functions transferred, while also having regard to the impact of such delay on the remaining creditors.

Key Considerations and Recommendations 41 – 44

Purpose of legislative provisions

The purpose of provisions on grounds for opening bank liquidation proceedings is to enable timely action and help achieve the objectives of bank liquidation.

Key Considerations

- In general terms, the grounds for opening bank liquidation proceedings should reflect the specificities of banks, including the maturity mismatch between their assets and liabilities, the opacity of their assets and banks' particular exposure to liquidity problems. Considering these specificities and the need for a timely intervention to meet the bank liquidation objectives, the grounds for opening bank liquidation proceedings should not be limited to, or overly reliant on, traditional insolvency grounds, and should include forward-looking grounds.

- The design of the legal framework should minimise the risk of limbo situations, whereby a bank continues to operate on the financial market despite having been found to be non-viable by a banking authority. In jurisdictions with a dual-track regime, liquidation proceedings should be opened following a decision by the resolution authority not to take resolution action in respect of a non-viable bank or to take resolution action which leaves certain parts of the bank to be wound up.

[127] As is the case, e.g., in Italy, where, following a partial transfer under the bank resolution framework, the residual entity must be subject to compulsory administrative liquidation proceedings. In some jurisdictions, the liquidation of a residual entity is governed by a distinct legal framework.

- To ensure alignment of the procedures, licence revocation can be a trigger for opening bank liquidation proceedings or, conversely, the consequence of such proceedings.

- Where licence revocation is a ground for, or a consequence of, opening bank liquidation proceedings, the legislation should enable a discretionary postponement of certain effects of the revocation decision for a short period, if this is necessary in order to ensure the efficient conduct of the liquidation and/or to provide the necessary time for the implementation of transfer-based strategies following the initiation of such proceedings.

Recommendations

41. The legal framework should clearly set out the grounds for opening bank liquidation proceedings, providing meaningful guidance to relevant decision-makers, in the interest of legal certainty and accountability. The way such grounds are formulated should leave sufficient margin for an assessment of the particular circumstances of each case.

42. Beyond the traditional insolvency grounds of balance-sheet insolvency and cessation of payments, the grounds for opening bank liquidation proceedings should include forward-looking elements and not exclusively financial grounds that would justify the bank's exit from the market. In line with the *FSB Key Attributes*, the concept of non-viability should be a guiding principle.

43. The grounds for opening bank liquidation proceedings should be aligned with the provisions of the legal framework relating to the revocation of the banking licence, and the substantive and procedural relationship between the two types of proceedings should be clearly set out.

44. In jurisdictions with a dual-track regime, the grounds for opening bank liquidation proceedings should be aligned with the non-viability conditions for resolution. The legal framework should enable the smooth liquidation of a residual entity of a bank under resolution, without imposing additional grounds.

CHAPTER 6. LIQUIDATION TOOLS

A. Introduction

225. This Chapter provides guidance on the tools and powers that should be included in the legal framework to allow for an orderly liquidation of banks which are not placed in resolution, or whose resolution leaves a residual part to be liquidated. It is structured as follows:

- *Section B* discusses traditional business insolvency strategies and explains why a bank liquidation framework should provide for additional tools. The focus of this Chapter is on the sale of a failed bank's assets and liabilities[128] to a private acquirer, which is referred to as "sale as a going concern" for the purposes of this *Guide*. *Section E* also touches upon other transfer-based tools, but does not recommend the use of such tools for the liquidation of a single non-systemic bank.
- *Section C* discusses the role of transfer-based tools in bank liquidation frameworks, the discretion for the liquidator to choose the most appropriate tool and general legal prerequisites.
- *Section D* discusses preparatory actions that could facilitate the implementation of a sale as a going concern, relevant enabling provisions and safeguards for creditors.
- *Section F* focuses on the piecemeal liquidation of a bank or residual parts thereof, explaining that certain adjustments to general business insolvency law are advisable.
- *Section G* discusses rules that seek to preserve the liquidation estate and ensure operational continuity.
- *Section H* discusses the treatment of funds in temporary settlement accounts.
- *Section I* elaborates on the treatment of financial contracts in bank liquidation proceedings.

B. Traditional insolvency tools and the need for transfer-based tools for banks

226. Liquidation pursuant to general business insolvency law generally implies a piecemeal liquidation. This entails the immediate and complete cessation of the insolvent enterprise's operations and the discontinuation of all its customer

[128] For the purposes of this *Guide*, "assets and liabilities" include any rights or obligations of the failed bank.

relationships, followed by the liquidation of the assets, typically according to a protracted timeframe and at prices which tend to be significantly lower than the assets' original accounting value.

227. In many cases, the insolvency law also enables the liquidator to sell sets of similar assets as a single pack. Such a sale may be possible, for example, for real assets, such as fixed assets and inventories, or financial claims, such as pools of receivables, and often encompasses operationally related assets and contracts that can function together with a certain level of autonomy, such as branches or business units of the insolvent enterprise. Such "pre-packing" and collective sale of assets has certain advantages. It is often easier to estimate the risk of a portfolio of similar assets than the risk of individual assets, thus improving marketability and pricing. Moreover, "functioning" pools, such as branches or business lines, allow for immediate use and avoid destruction of value, to the benefit of creditors, while preserving productive capacity and employment, to the benefit of the economy.

228. Such collective asset sales are to be distinguished from the reorganisation of the insolvent enterprise, which focuses less on the disposition of its assets and more on the restructuring of its liabilities with a view to restoring its financial condition and enabling it to continue as a legal entity. They are also distinct from (i) the sale of the insolvent legal entity itself to a new shareholder, and (ii) the transfer of the whole business or part thereof as a going concern, without interruption of its activities and business relations. The latter necessitates the joint transfer of the assets and liabilities that constitute the business. General insolvency law may accommodate this possibility,[129] although it traditionally tends to treat the insolvent enterprise's asset and the liability sides separately.

229. Accordingly, general business insolvency law and practice traditionally distinguish between the realisation of assets and the discharge of liabilities. Furthermore, they distinguish between pre- and post-insolvency liabilities. These distinctions are consistent with the logic of collective proceedings, which are aimed at the orderly satisfaction of claimholders (or the readjustment of their claims in the context of the enterprise's financial restructuring), thus preventing uncoordinated

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[129] A sale as a going concern in liquidation is possible under the modern business insolvency frameworks of certain jurisdictions. For instance, in the Netherlands, a "pre-pack" procedure makes it possible to prepare the sale of all or part of an enterprise prior to the declaration of insolvency, to increase the chances of creditors being paid in full. The sale is prepared by a prospective liquidator and a prospective supervisory judge, both appointed by the competent insolvency court. The preparations by these persons allow for a swift transfer of all or part of the entity's business following the declaration of insolvency. "Pre-pack" sales should generally prevent the destruction of value that businesses tend to suffer once a liquidation process starts.

legal actions that could cause further destruction of value and lead to an inequitable distribution of the proceeds.

230. For banks, a special regime is warranted because it is the liability side, specifically the deposit base, that characterises an entity as a "bank". The principal question of substance for bank liquidation relates to the possibility of preserving the banking operation, or parts thereof, where this better achieves the liquidation objectives. Continuity can be achieved through the transfer of part of the bank's assets and liabilities, while the residual part is left behind to be liquidated on a piecemeal basis, ending with the dissolution of the legal entity. A bank's stable client base is often valued at a premium by acquirers. The preservation of client relationships through the wholesale transfer of the insolvent bank's existing deposit accounts together with some or all of its assets may thus enhance value. The bank liquidation framework should, accordingly, enable and facilitate such transfers.

231. A lengthy process of asset realisation in a piecemeal liquidation can have dramatic impact in the case of banks, since many shortcomings of the process become more acute. The value of individual bank assets cannot be easily realised in secondary markets, while the rundown of portfolios of loans by a liquidator without an ongoing credit operation and the expertise and organisational capacity needed for servicing those assets can be particularly difficult and costly. The process therefore risks further dissipation of the estate's value and heightened administration costs. More generally, the benefits of a close operational link between a bank's deposits and its lending activity would be lost. Even performing assets can depreciate rapidly, if no longer serviced as part of an ongoing bank-client relationship. The joint disposition of assets and liabilities can avoid these impacts. The preservation of a bundle of assets and liabilities constituting the failed bank's business as an operating unit will usually better serve the objective of value preservation and maximisation (see *Chapter 1. Introduction, Section H*) than piecemeal liquidation.

232. In addition, there may be reasons to preserve the bank's depositor base that are not linked to assets. Unlike ordinary commercial enterprises, a bank's liability side is generally valuable *per se* as long as it remains part of a going concern. A transfer makes it possible to salvage franchise value by realising (i) the economic value for potential acquirers of a readily available branch network and client-depositor base; and (ii) the client-specific information that the bank uses on the credit side of its business, but which is derived from the liability side – that is, information that the bank acquires through its long-term relationships with clients, by servicing their accounts and observing their cash-flows.

233. For these reasons, a bank liquidation framework should include a tool that enables the continuation of a failed bank's business, as a whole or in part, through

its swift transfer to a financially sound and suitable private acquirer.[130] In this *Guide*, that tool is referred to as a "sale as a going concern". Its use entails the separation of specific liabilities, including deposits, from the failed bank's other liabilities for the purpose of transferring them, alongside specific assets, to an acquirer.

234. Bank resolution frameworks confer on the resolution authority the power to transfer all or some assets and liabilities of a failed bank to a third party.[131] However, sales as a going concern, when justified on grounds of value maximisation and the protection of depositors, can be beneficial irrespective of whether an individual bank is systemic in failure. The failure of a small bank that results in losses to uninsured depositors and other counterparties (e.g., families and businesses relying on overdraft lines of credit) can reduce confidence in the wider banking system and lead to contagion. To the extent that a transfer shields depositors from disruption of access to their deposits, accounts and payment facilities, it can meet the public policy objectives of bank liquidation (see *Chapter 1. Introduction, Section H*).

235. Most jurisdictions that participated in the survey undertaken in preparation of this *Guide* confirm that it is possible to transfer assets and liabilities under their bank liquidation framework. Some jurisdictions also provide for the use of bridge banks to temporarily take over parts of a failed bank's business (see *Section E* below). Jurisdictions may use different terms to describe their transfer-based tools.[132] This can create an impression of divergence where in fact the tools are functionally equivalent. Conversely, jurisdictions may use the same terminology for functionally different procedures. None of the Recommendations in this Chapter should be construed as requiring the abrogation of existing tools and powers in jurisdictions' legal frameworks that are functionally equivalent to those discussed here, irrespective of the terminology used in those frameworks.

236. If a jurisdiction's statutory framework currently only provides for piecemeal liquidation, it is recommended that transfer tools be adopted through explicit provision to ensure a clear legal basis. This should be accompanied by provisions enabling their swift and effective implementation.

237. A key consideration with regard to timing of transfers is the timeframe in which the DI is required to reimburse insured deposits. Under the *IADI Core Principles*, this should be carried out promptly, ideally within seven working days.[133]

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130 Following the transfer, the residual part of the bank is liquidated on a piecemeal basis; and the process ends in the dissolution of the legal entity.

131 See *FSB Key Attributes*, KA. 3.2 (vi) and KA 3.3.

132 E.g., "P&A transaction" in the US and "sale of business tool" in the EU resolution framework.

133 See *IADI Core Principles*, CP 15.

A transfer of assets and liabilities therefore needs to be executed before that deadline for depositor payout. If this is not the case, that payout will eliminate one of the key sources of value for third-party acquirers (namely, the existing portfolio of depositor relations), thus undermining the business interest of the transaction.

C. Transfer-based tools: nature and applicability

1. Types of transfer-based tools

238. Bank failure management regimes containing transfer-based tools differ as to the range of the types of transactions that they envisage and the conditions that apply to them. A sale as a going concern, as envisaged here, can be accomplished through the direct transfer of assets and liabilities to an acquirer. Some frameworks also enable the liquidation authority to first transfer certain parts of the bank's business for which no licence is required to a special purpose vehicle (SPV), with a view to transferring the shares of the SPV to the acquirer shortly thereafter.[134] In some cases, the sale as a going concern may involve the transfer of the shares of a viable subsidiary of the failed bank (which are assets of the latter).

239. The transfer of shares in an SPV or viable subsidiary as a means of executing a sale as a going concern should be distinguished from "share deals" involving the mandatory sale of the failed bank's shares to an acquirer. The essential difference between a sale as a going concern and share deals is that, while the former preserves certain operations of the failing bank but not its legal entity, which is dissolved, share deals preserve the legal entity itself. Share deals are more likely to be a resolution tool (and as such, to be included in single-track regimes), but are less likely to be available in the separate liquidation proceedings of dual-track regimes. There are various reasons why share deals are unlikely to be particularly useful in bank liquidation. They make it difficult to exclude unattractive parts of the failing bank's business or hidden and contingent liabilities from the transfer perimeter, thus depressing prices or increasing the complexity of the transfer transaction (for example, because the acquirer may require some form of guarantee). Furthermore, to the extent that they enable the survival and continuation of the legal entity, they may be inconsistent with legal provisions that characterise liquidation as the orderly winding up of the failed bank.

240. Sales as a going concern and share deals must be differentiated from two other types of transfer-transaction, namely, bridge banks and asset management companies. These are discussed in *Section E* below.

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[134] The use of SPVs as an insolvency tool is more common in the context of reorganisation than liquidation owing to potential costs and operational complexity.

2. Tools in the procedural organisation of the bank failure management regime

241. In dual-track regimes, the inclusion of transfer-based tools as part of the liquidation framework will ensure that, in cases where the bank is not deemed to be "systemic" at the point of failure, the authorities have the power to transfer (part of) the bank's business that has a franchise value, even though it does not involve a "critical" function. This would not blur the boundaries between the processes of resolution and liquidation, since they differ in terms of the objectives pursued, the applicable safeguards and constraints, and the availability of external funding. In single-track regimes, a single toolbox applies in principle, and it is not meaningful to distinguish between transfer-based tools in resolution and in liquidation. The design of the framework in single-track regimes is informed by the *FSB Key Attributes*. However, the technical details of implementing and executing a transfer strategy set out this *Guide* may nevertheless be helpful to jurisdictions with a single-track regime. In any event, the guidance on the liquidation of the residual entity, or the preservation of the estate, are equally relevant to both single-track and dual-track regimes.

3. Discretion in the choice of tools

242. In order to enable the authorities to achieve the objectives of bank liquidation, both sale as a going concern and piecemeal liquidation should be available. The framework should empower the liquidation authority and/or the liquidator[135] to select, at its discretion, the most appropriate tool depending on the circumstances of each particular case. It should not prescribe a hierarchy of tools or a default option. For example, a liquidation authority or liquidator that is required to prove that piecemeal liquidation is unsuitable in a specific case, may prove reluctant to pursue a sale as a going concern. While discretion in the choice of tools allows for the optimisation of the liquidation strategy, it should be accompanied by adequate safeguards (see below *Section D.6*).

4. Legal and other prerequisites

243. The successful use of any transfer-based tool within the scope of this *Guide* depends on both financial considerations and the existence of an enabling legal framework.

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[135] In jurisdictions with an administrative model, the tool would be selected by the administrative liquidation authority, while in a predominantly court-based model, the liquidator might play a role in the selection of the tool (with, in any case, a strong role for the banking authority).

244. With regard to the financial considerations, a shortfall in the value of assets compared to liabilities for transfer and/or uncertainties in valuation may make it difficult to execute a transfer without external funding, as discussed in *Chapter 7. Funding*. The sources of, and limits on, available funding affect the feasibility and relative appeal of transfer-based strategies.

245. The legal framework should enable the transfer of assets and/or liabilities of a failed bank without the consent of third parties, including creditors and shareholders, and there should be no requirement to notify creditors individually of a transfer. Legal obstacles to such a transfer should be removed and, when necessary to achieve public policy objectives, any authorisations required in relation to the transfer should be expedited where possible (see *Section D.8* below). Furthermore, the legal framework should ensure that transfers are final and irreversible, unless otherwise provided in the act of the transfer (e.g., if it provides that the effects of the transfer for certain assets or liabilities will be deferred, or be subject to a separate transfer act or contract, or if it is agreed with the acquirer that some assets or liabilities may be transferred back).[136]

246. The legal framework will also need to address the potential need for a continuation of the activities of the failed bank until the transfer has been finalised, so as to avoid the interruption of contracts and customer relationships and preserve the franchise value. If under the applicable framework the transfer can only be decided following the opening of the bank liquidation proceeding, or it is only completed after the bank's entry into liquidation, it will be necessary to provide either for a stay on enforcement actions by creditors (see *Section G*), as necessary for the completion of the transaction, or for the liquidator to have the power to continue the failed bank's business for the short time needed to finalise the transfer. More generally, continuity requires that the formal declaration of insolvency should not automatically result in the dissolution, by operation of law, of all pre-existing legal relationships (see *Section G*).

247. From a procedural viewpoint, the framework should specify (i) the timing of the decision to apply transfer tools (i.e., whether it must be taken prior to the formal commencement of the liquidation, even though the transfer will be executed subsequently, or within the liquidation process), and (ii) the allocation of responsibility for that decision and its implementation.

136 See also *Chapter 2. Institutional Arrangements* and *Recommendation 6*.

Recommendations 45 – 48

Purpose of legislative provisions

The purpose of transfer-based tools in bank liquidation proceedings is to facilitate the orderly exit of the failed bank from the market in a manner that recognises the special characteristics of banks and seeks to achieve the objectives of bank liquidation.

Recommendations

45. The legal framework should not prescribe a hierarchy of tools. The liquidation authority and/or the liquidator should have discretion to choose the most appropriate liquidation tool, guided by the objectives of bank liquidation and the circumstances of each case.

46. The legal framework should provide the liquidation authority and/or the liquidator with an explicit power to transfer a failed bank's assets and liabilities, wholly or partially, to a viable acquirer, without individually notifying, or obtaining the consent of, third parties.

47. The provision for transfer powers should be accompanied by provisions that enable the swift and effective implementation of the transfer. In particular, the legal framework should enable transfers to be implemented quickly following the opening of liquidation proceedings and within a very tight timeframe, to preserve the operational and transactional continuity of the banking business and uninterrupted access to deposits.

48. The legal framework should ensure the legal certainty and irreversibility (finality) of the outcomes of the transfer, unless otherwise provided in the act of transfer.

D. Sale as a going concern: process and safeguards

1. General approach and preparatory steps

248. The successful implementation of a sale as a going concern depends not only on market conditions but also on a conducive and technically adequate legal framework. For sale as a going concern to be an effective liquidation tool, a number

of legal and transactional factors need to be taken into account when designing the legal framework and applicable safeguards.[137]

249. At a minimum, the legal framework should provide the power to order and/or effectuate a sale as a going concern without need to give individual notice to, or obtain the consent or approval of, third parties (see *Recommendation 46*), if that power cannot already be deduced from the provisions of general business insolvency law – where applicable.

250. Some jurisdictions may choose not to introduce further substantive or procedural detail in their statutory framework, preferring instead to simply vest the liquidation authority and/or the liquidator with a broad discretionary power to design and execute the liquidation strategy that it considers fit, subject to certain safeguards. However, further provisions may be necessary to ensure a rapid and effective transfer. For instance, the process for evaluating the acquisition from a prudential and governance perspective may need to be accelerated, without compromising the intensity of the supervisory assessments. If other authorisations are needed to complete the transfer, provisions on cooperation between the liquidator and the relevant authorities may be warranted (see *Section D.8* below and *Chapter 4. Preparation and Cooperation*). Greater detail may also be appropriate in order to enhance legal certainty if, e.g., the jurisdiction lacks a well-established transfer practice, or past practice has proven to be problematic, or the safeguards are likely to apply in an unpredictable and retrospective manner.

251. This Chapter does not prescribe the level at which rules regulating the transfer process should be included in a jurisdiction's legal framework, or the form that these should take. Some jurisdictions may choose to codify the transfer process in primary law (statutory provisions). Others may prefer to use statutory provisions for the general powers and safeguards, leaving the more detailed aspects of the process to be specified in secondary acts or regulatory rules, or even in practice manuals.

252. The level of prescriptiveness must take into consideration the characteristics of the overall bank failure management regime, the structure of the market in which a transfer may need to take place and the applicable safeguards, in order to strike a balance between authorities' autonomy of action and their accountability.

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137 For further detail, see IADI, *Purchase and Assumption*, research paper (2019); David C. Parker, *Closing a Failed Bank. Resolution Practices and Procedures,* International Monetary Fund (IMF) (2011), especially Chapter 5. The US offers a long-standing practice of P&A transactions, see FDIC, *Resolutions Handbook* (2014), and FDIC, *Crisis and Response, An FDIC History, 2008-2013* (2017), Chapter 6. Bank Resolutions and Receiverships.

253. The success of transfer strategies depends on the amount and accuracy of the information available to the banking authorities, liquidation authority and/or liquidator responsible for preparing the transfer, the existence of suitable and willing potential acquirers, the determination of the transfer perimeter, and the adequacy of the sale process, all of which should benefit from pre-liquidation preparation and contingency planning (see *Chapter 4. Preparation and Cooperation*). More generally, success depends on the broader legal and operational environment, which should include an effective legal and judicial framework, a robust financial safety net and access for the liquidation authority and liquidator to appropriate professional support, where necessary (see *Chapter 1.Introduction, Section F*).

2. Perimeter of the transfer, licensing and funding

254. The legal framework should grant the liquidation authority or the liquidator discretion and flexibility to determine the assets and liabilities to be transferred (transfer perimeter), including through negotiation with the potential acquirer(s), with a view to maximising the estate's value and serving the other liquidation objectives. The legal framework should permit, and should not hamper, any of the following options: (i) the transfer of the banking operation in its entirety, i.e., substantially all assets and liabilities of the failed bank; (ii) the separation and transfer of the viable part of the banking operation, including deposits, liquid assets, and performing assets, leaving behind other assets and liabilities, including contingent liabilities; (iii) the transfer of the bank's deposit base (whether solely the insured deposits, or other deposits too) together with liquid assets; and (iv) the sale or assignment of assets to, and the assumption of liabilities by, prospective acquirers, separately from the bank's deposits or main business (including by way of securitisation). It should also be possible to transfer particular branches or units.[138] The transfer will typically exclude certain assets (e.g., illegal loans, assets necessary for the payment of senior claims) or liabilities (e.g., for employee benefits, loan loss reserves, reserve accounts for tax liabilities, deferred gains).[139] The legal framework may indicate that the acquirer will only acquire the assets and liabilities stipulated in the act of transfer, and/or may include a presumption against the transfer of contingent liabilities, or at least should not include a presumption in favour of their transfer, since this may deter potential acquirers. The liquidation authority and the liquidator should also be empowered to conclude more than one act of transfer. The discretion of the liquidation authority and liquidator in determining the transfer perimeter is subject to limited constraints concerning the transfer of financial contracts (to which the "no cherry-picking" rule applies, see *Recommendation 66(d)*)

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138 Compared to business insolvency proceedings, it is less likely that the acquirer would be interested in fixed assets and infrastructure.

139 IADI, *Purchase and Assumption* (2019), p. 22.

and liabilities secured by collateral (which should in principle be either transferred or left behind together, see *Recommendation 53*).

255. The implementation of a sale as a going concern should not be hindered by provisions on licensing. Providing the supervisory authority with some flexibility, for example to postpone for a short period the effects of a decision to revoke the licence of the bank in liquidation, accompanied by the necessary waivers of its regulatory requirements, can facilitate a going concern transfer and ensure the continuity of deposits and payment services. However, such a postponement and waivers, even if brief, should be regarded as exceptional and there should be a clear time limit (see also *Chapter 5. Grounds for Opening Bank Liquidation Proceedings, Section C*).

256. To facilitate the implementation of transfers that include insured deposits, jurisdictions may provide for the use of DIF resources, subject to certain limits and conditions (see *Chapter 7. Funding*). In such case, it might be preferable that the enabling provision does not prescribe or restrict the form of the contribution (e.g., by confining it to a cash payment), but is generally worded so as to allow the DI to design the funding arrangements in a way that is consistent with its mandate and its capacity, including by entering into more complex funding arrangements, such as loss-sharing or risk-sharing agreements, or by providing guarantees for the value of assets transferred.

3. Non-bank acquirers

257. In every sale as a going concern, it will be necessary to identify potential acquirers and ultimately select the acquirer. To this end, the liquidation authority and/or the liquidator should have discretion to employ the services of market researchers or other specialist private entities, always subject to strict confidentiality requirements. The process may be facilitated through adequate preparation (see *Chapter 4. Preparation and Cooperation*).

258. Jurisdictions must decide whether potential acquirers should be limited to banks (either existing banks or a specially constituted bridge bank, see *Section E* below) or extended to other entities, such as non-bank financial institutions (NBFIs) and non-financial corporations.

259. Whenever the transfer perimeter includes deposits, the acquirer should be a licensed bank, able to legally carry on the deposit-taking business from the moment the transfer takes effect. While in some jurisdictions it is possible to grant a banking

licence to a non-bank acquirer on the basis of special pre-approval procedures and "shelf" charters,[140] such an approach may not be practicable for most jurisdictions.

260. Similarly, if the transfer consists of assets that are subject to specific licensing requirements, the potential acquirers (including NBFIs) should already have the required licence at the time of the bidding process. If jurisdictions allow entities that do not yet have the required licence to participate in the bidding process, it should be assessed whether the licensing procedure is compatible with the time constraints of the sale, or whether the concerns underpinning the licensing requirements can be safeguarded by other means. Those means may include an adequate vetting process and/or the use of a specifically licensed SPV as the conduit for managing, servicing, and collecting the assets.

4. Disclosure of information to potential acquirers, due diligence and bidding process

261. To enable a sale as a going concern, the legal framework should allow the banking authorities, the liquidation authority and/or the prospective liquidator to take action before the initiation of the liquidation proceeding to "market" the bank (see *Chapter 4. Preparation and Cooperation*), or at least not impede it. It should be possible to grant potential acquirers access to the failing bank's proprietary information. To this end, the legal framework could include an obligation for banks facing an immediate prospect of non-viability to disclose proprietary information to potential acquirers or allow their access to such information, if so requested by the banking authorities, the liquidation authority and/or the (prospective) liquidator, as the case may be. The relevant provision should require that the disclosure of confidential information be kept to the necessary minimum and that potential acquirers be strictly bound by confidentiality requirements. Special rules may apply in case of IPSs, where the parties involved in the bidding process and the disclosure of confidential information may be restricted.

262. Potential acquirers should be allowed to conduct due diligence, within the applicable time constraints. A due diligence process allows potential acquirers to assess the situation of the bank and/or the quality and economic value of the portfolios of assets and liabilities within the transfer perimeter. In the run-up to its liquidation, the authorities should be able to require the failing bank to set up the necessary facilities, such as a virtual data room, to give potential acquirers access to detailed information about the bank. In situations where time constraints prevent potential acquirers from conducting adequate due diligence, or there are concerns about the availability or quality of data, it should be possible to offer appropriate assurances to potential acquirers, in case the transferred business turns out to be of

140 FDIC, *Crisis and Response, An FDIC History, 2008-2013* (2017), p. 198.

lower quality than anticipated or if certain unforeseen risks materialise. To this end, external funding may be required on a contingent basis, e.g., in the form of guarantees against potential future losses (see *Chapter 7. Funding*). Furthermore, the legal framework should allow the relevant authorities, when assessing the acquirer's liability for legal or regulatory infractions, to take into account the information available to it and the time constraints to which it was subject.[141] In any event, the acquirer should not bear liability for breaches preceding its acquisition of the failed bank's assets and liabilities.

263. The legal framework should enable the liquidation authority and/or the liquidator to design the bidding process in a manner that is fair and non-discriminatory and allows the transfer to take place on commercial terms, always having regard to the prevailing market conditions and confidentiality requirements.

264. The selection of the winning bid must be based on clearly established criteria.[142] Jurisdictions should develop such criteria, for instance through secondary instruments, policy documents or the decision to launch the sale process, and incorporate them in the tender documentation (invitation to bid). Depending on the circumstances, an open bidding process may be impracticable, inefficient, excessively burdensome or likely to lead to loss of market confidence. Therefore, the legal framework should not preclude closed bidding processes in which only a selected group of potential acquirers is invited to participate, or direct solicitation of interest by a specific bank, provided that the decision to proceed in this manner is duly justified and that the process is fair within the selected group.

5. Valuation

265. In bank failure management, it is common for the relevant authorities, often supported by external experts, to estimate the value of a bank's assets and liabilities using valuation models. In bank resolution frameworks, valuations are generally required to inform, *inter alia*, the initiation of resolution, the choice of resolution tool and decisions about its application.

266. A similar practice in bank liquidation could help to inform the decision-making process of the authorities in the interest of good governance, considering that key decisions are adopted without creditor involvement, and to support the choice of liquidation tool. In the context of a sale as a going concern, it could also provide a basis for estimating the possible funding gap, inform price setting and the assessment of the bids of potential acquirers and determine whether creditors would be treated

141 E.g., infractions may arise from inadequate internal procedures or incomplete or inaccurate data "inherited" from the failing bank.

142 FDIC "Bank Resolutions and Receiverships", pp. 208-209, 215.

fairly. This last aspect may be even more important in cross-border cases, since cooperation may be refused in case of unfair treatment (see *Chapter 10. Cross-Border Aspects*).

267. A valuation should be seen as an instrument to serve the liquidation objectives. The legal framework should thus enable such valuation if deemed necessary for the transfer process. The valuation should in principle be conducted by an independent expert. The liquidation authority should be able to prescribe the valuation standards and procedures, taking into account existing guidance in international instruments.[143]

268. At the same time, the provisions on valuation should not be overly prescriptive or hinder swift and effective action. Rather, they should allow a certain amount of flexibility with a reasonable forward-looking perspective. Preparatory steps, including a valuation, often take place under time constraints. The legal framework should provide safeguards if a full valuation by an independent expert is not possible in the circumstances. For example, it could allow the valuation to be provisional, to not include every asset (but to rely instead on sampling), or to be performed by the relevant banking authority rather than by an external expert. The price obtained through the bidding process should, in any event, trump the valuation price unless, owing to the criteria for the selection of the participants and the winning bid (see *paragraph 264*), the marketing and transfer process did not take place under fair and competitive conditions, as applicable in the circumstances of the case.

6. Safeguards: creditor treatment

269. Although the discretion to choose between sale as a going concern and piecemeal liquidation allows the liquidation authority or liquidator to pursue the optimal liquidation strategy, the transfer tool should be accompanied by adequate safeguards. In particular, a sale as a going concern should only be chosen if it benefits creditors as a whole or enhances the protection of depositors and none of the creditors receives less than it would in a piecemeal liquidation of the failed bank. To ensure this condition is met, the net value realised from the sale as a going concern and the

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143 See, e.g., *UNCITRAL Legislative Guide*, Part Two, Chapter II (paras. 66–69, on the valuation of encumbered assets), acknowledging the possibility of using a pre-commencement valuation, the relevance of valuation shortly after commencement for preparing a net balance of the debtor's position, and, for encumbered assets specifically, determining how much to provide to a secured creditor as relief against the possible diminution of the value of the encumbered asset during the proceedings, and determining the amount of the secured portion of the claim. The *UNCITRAL Legislative Guide* also recognises that a valuation of assets by neutral, independent professionals (especially in the case of real estate and specialised property) may function as a procedural protection to ensure that the sale of assets in insolvency proceedings is fair (para. 82).

liquidation of a possible residual entity should exceed the estimated net proceeds of a piecemeal liquidation of the whole estate (pursuant to the valuation under *subsection 5* above).

270. A well-functioning sale as a going concern will tend to be value enhancing, leaving the liquidation authority and/or the liquidator in a position to show that it benefited the failed bank's creditors and that it did not involve any transfer of wealth between classes of creditors. This consideration, however, should not affect the liability standard for liquidation authorities and liquidators, which should seek to ensure a fair balance between protecting the rights of the failed bank's creditors and facilitating rapid and decisive action on the part of the liquidation authority and the liquidator (see *Chapter 3. Procedural and Operational Aspects, Section D.5*).

271. The partial transfer of assets and liabilities may result in a departure from the principle of equal treatment of creditors since the claims of some creditors, including claims arising from the bank's contingent liabilities, may be left behind in the residual entity while other equally ranking claims are transferred to a sound acquirer. Deviations from the *pari passu* treatment of creditors of the same class should be permitted in liquidation only when the transfer maximises value for the benefit of creditors as a whole, or achieves the objective of depositor protection, and at the same time no creditors are financially disadvantaged by receiving less than their estimated dividend from a piecemeal liquidation of the whole estate. If, as a result of such partial transfer, some creditors are better off than they would have been in a piecemeal liquidation of the whole estate, the transaction should be deemed to maximise value for the benefit of creditors as a whole, provided that no creditors are worse off.[144]

272. The relative treatment of creditors, and thus the practical operation of this safeguard, depends in important part on jurisdictions' relative ranking of depositors. Other things being equal, a general depositor preference would reduce potential recoveries for non-deposit unsecured creditors, while facilitating the transfer of the entire deposit base to potential acquirers (see *Chapter 8. Creditor Hierarchy*).

7. Transfers and related parties

273. Transfers of related party claims entail the risk that the persons who might have been responsible for the bank's failure may benefit from the failure management process. For this reason, the legal framework may prohibit the transfer of liabilities owed to related parties altogether, or allow the liquidation authority or the liquidator to exclude them from the transfer. Any such restrictions may be further

[144] The same applies in bank resolution proceedings, see the *FSB Key Attributes Assessment Methodology for the Banking Sector*, ENs for KA 5.1.

supported by the rules on creditor hierarchy, which may exclude related party deposits from preferential treatment and, in some cases, subordinate related party claims (see *Chapter 8. Creditor Hierarchy, Section D.4*).

274. Furthermore, there should be restrictions on the acquisition by a related party of the banking business or, in the event of piecemeal liquidation, assets of the estate. The legal framework should enable the liquidation authority and/or the liquidator to exclude related parties as acquirers if the risk of collusion is too high, or to subject the possible transfer of assets and liabilities to a related party to intense scrutiny, including by means of an independent valuation and disclosure of business ties.

8. Execution aspects

275. In addition to vesting the liquidation authority or liquidator with a general power of transfer, jurisdictions need to consider the legal nature of the act (or acts) by which the transfer is executed. This is relevant for the transfer's domestic effectiveness and its cross-border recognition (see *Chapter 10. Cross-Border Aspects*). In general terms, the transfer may take place by means of an administrative act and/or a court decision or order, which may authorise or directly execute the transfer, usually accompanied by a contract between the acquirer and the failed bank (represented by the liquidation authority or the liquidator), which executes the transfer or determines its specific conditions. The legal framework should be clear about the legal nature and effect(s) of the act(s) of transfer, including, in particular, the ability to effect the transfer of assets and assumption of liabilities in bulk at the time specified therein without the need for separate acts of transfer for each item (see *paragraph 278*). The conditions of the transfer should be clearly set out in a contract with the acquirer. The legal framework should also be clear about the act(s) that may be challenged, and before which courts, e.g., administrative, civil or commercial. This should not affect considerations about the irreversibility of the transfer (see *Section C.4* above).

276. Jurisdictions should also consider the practical conditions for the effectiveness of the transfer. This does not necessarily require the legislation to confer explicit and detailed powers on the liquidation authority and the liquidator. Provided that the general power to transfer assets and liabilities of the failed bank is framed sufficiently broadly, the effectiveness of the transfer may primarily depend on the prior identification of legal issues that may arise in the process. This should enable banking authorities to develop in advance suitable models or templates for the transfer contract or act that deal with potential obstacles. In developing such transfer templates, the authorities may draw on experience with corporate transactions involving business transfers, so as to ensure a reasonable and clear allocation of risks. For example, preconditions for the effectiveness of the transaction (conditions precedent) may be included, covering matters such as the valid

appointment and powers of representation of the liquidator, the existence of all necessary authorisations or approvals (e.g., by the acquirer's Board of Directors), or the acquirer's holding of a licence. Indemnities may be used to protect the acquirer from certain liabilities or claims, etc. To allow the liquidation practice to be adapted to the specificities of each case, the authorities should be empowered to negotiate the precise terms of the sale with the prospective acquirer, including the transfer perimeter, the allocation of risks and the time at which it becomes effective.

277. Jurisdictions need to assess in advance whether their legal provisions create obstacles to the transfer of a banking operation as a whole, or of specific assets or rights. If the obstacles arise from the need for prior administrative approvals, e.g., under competition law or merger control regimes, or the regime applicable to foreign direct investment, the legal framework should seek to streamline the relevant procedures, if needed to achieve the public policy objectives of liquidation. Authorisation procedures may relate to specific assets, e.g., tax assets may need to be recognised by tax authorities. In such cases, appropriate cooperation arrangements may be needed. Where the obstacles to the transfer of specific assets arise from private law, the legal framework should minimise formalities. For instance, it may consider the permits, approvals and consents necessary for the transfer to have been granted, and exclude requirements for notarisation which may otherwise apply to certain asset transfers (and which would be replaced by the intervention of the liquidation authority). Pre-emption rights to acquire certain assets, based on either contract or law, should be excluded where possible.

278. The legal framework should recognise the transfer of assets and liabilities in bulk, thus avoiding the need for specific transfer procedures for individual assets. To this end, the legal framework may draw on generally recognised forms of universal succession in business transfers, such as mergers. In the case of assets such as real estate, securities or claims protected by security interests, which may be subject to registration and for which changes of ownership may require specific formal acts, the legal framework should empower the liquidator to execute such acts unilaterally (accompanied, if needed, by a confirmation from the acquirer) and expeditiously, and any deadlines or formalities in the rules that regulate the registries that may hinder such transfers should be revised accordingly. Where the transfer comprises secured liabilities, the transfer should not require the consent of secured creditors, but the legal framework should ensure their protection, including by providing for the transfer of the collateral assets together with the secured liabilities. The legal framework may provide for exemptions from this constraint where that is necessary for an orderly liquidation, and the regime otherwise provides adequate protection for counterparties of the contractual benefits. For this purpose, examples of adequate protection might include substituting collateral, the provision of a credit support

agreement, or financial compensation to counterparties.[145] In order to avoid restrictions on the transfer of bank records based on considerations of privacy (e.g., data relating to former employees) or confidentiality (e.g., records relating to non-transferred parts of the business), the transfer practice should seek to ensure compliance with the relevant requirements. The legal framework should, in any event, enable the transfer to take effect on a deferred basis, subject to any conditions indicated by the liquidation authority in the act of transfer, or by means of more than one act of transfer.

279. Specific considerations may arise with regard to the continuation of business activities, the assumption of liabilities, or the novation of contracts. Where the transfer is intended to ensure the continuous provision of certain financial services, the liquidation authority should be able to require the acquirer to commit to the continuation of banking activities in general or in specific areas or lines of business. Employees can also present relevant considerations, including non-bank-specific ones (e.g., pensions or health care plans) or bank-specific ones (retention of employees who perform specific functions, or allocation of responsibility for breaches of regulatory obligations committed by the failed bank's employees). These considerations are without prejudice to the rules for the continuity of contracts (see *Section G* below).

280. Specific attention should be given to the transfer of deposits and the acquirer's obligations in relation to transferred depositors. For example, the legal framework may address matters such as the accrual of interest after the transfer and the applicable rates, the acquirer's obligations regarding payment services and orders, or the novation of other servicing obligations resulting from the original deposit contracts or related agreements. If, in addition to any notification by the DI, the acquirer is required to notify the transferred depositors about the transfer and their right to claim their deposits, this should be clearly set out in the transfer contract, if it is not already specified in the legal framework or the transfer order. Special rules may be needed in relation to the verification of the claims of depositors (see *Section F*).

281. The legal framework should protect the acquirer from liability for actual or contingent claims relating to any items not included in the transfer.

282. Most of these technical aspects may be clarified in secondary acts, regulatory rules, practice manuals and templates, without specific provisions in the primary statute. However, jurisdictions should give due consideration to them and adjust or clarify their legal frameworks as appropriate.

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145 See *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN 3(n).

E. Other transfer-based tools: bridge bank and asset management company

283. Other types of transfer strategy include the transfer of a failed bank's assets and liabilities to a bridge bank or to an asset management company (AMC). Both structures must be distinguished from the use of an SPV as a means of executing a sale as a going concern (see *Section C.1* above). A bridge bank is a bank specially set up and licensed by public authorities for the purpose of taking up and continuing, in whole or in part, the business of a failing or failed bank, if a transfer to a private acquirer is not immediately feasible or value-preserving. The bridge bank operates temporarily under public ownership and control, thus allowing continuity of the bank's business – without interruption of the depositors' access to their deposits – and preserving franchise value until a private acquirer is found. In the case of a partial transfer of assets and liabilities, the residual (bad) assets and liabilities (e.g., non-performing assets and other assets of dubious quality and non-transferred liabilities) are left behind in the failed bank to be wound up.

284. An AMC is an entity established for the purpose of taking over and managing portfolios of failed banks' assets, including non-performing loans and other low-quality assets. Depending on the legal framework and economic and financial circumstances, AMCs may be set up under public or private ownership and control, and range from the limited management of the bad assets of a single bank to the management of bad assets originating from a number of banks (or even a country's whole banking industry).

285. Depending on the circumstances, bridge banks and AMCs can improve the outcome of a failure management process. However, the considerable complexities and drawbacks relating to their set-up, ownership, governance, licensing regime, sources of capital and operating costs generally render their use inappropriate for the liquidation of single non-systemic banks.[146]

286. Specifically, the immediate and prospective costs of capitalising and running a bridge bank, including the funding and organisational resources which must meet the usual prudential standards for banks, can be a major impediment to the use of this tool. Accordingly, the tool is mainly only available for bank liquidation in single-track regimes. Moreover, in practice, the feasibility of the bridge bank tool depends on external funding being available and the ability to keep costs low through proper

[146] Bridge banks and AMCs also involve costs for the liquidation authority. If the latter recovers those costs from the estate, the tools may not improve the financial outcome for creditors. Overall, the complexities and costs mean that bridge banks and AMCs tend to be used for reasons other than value maximisation.

preparation in normal times.[147] It should be noted in this regard that public financial support in liquidation proceedings cannot be justified in the absence of financial stability implications of the failure.

287. Different considerations apply to AMCs, which are created to manage the non-performing assets of often multiple institutions on a system-wide basis. AMCs can present special issues with regard to their constitution, funding and governance, and their precise configuration must be adapted to a jurisdiction's particular circumstances. Since the rationale for such AMCs is directly linked to the management of system-wide crises, as distinct from individual bank failures, the matter falls outside the scope of this *Legislative Guide*.

Recommendations 49 – 53

Purpose of legislative provisions

The purpose of including provision for sale as a going concern tool (and other transfer-based tools, if any) in the bank liquidation framework, together with associated safeguards, is:

(a) To enable the successful and prompt implementation of the tools;

(b) To ensure that the process will achieve the best possible financial outcome, having regard to the circumstances;

(c) To ensure the smooth transfer of assets and liabilities in a way that best serves the bank liquidation objectives; and

(d) To ensure accountability and the fair and non-discriminatory treatment of creditors.

147 In the past, Japan used pre-established bridge banks for the resolution of small and medium-sized banks. Under the framework of orderly resolution measures for systemically important financial institutions, to which not only banks but also holding companies, securities firms and insurance companies are now subject, the Deposit Insurance Corporation of Japan (DICJ) has established in advance shell companies, which upon the failure of a systemically important financial institution can promptly be vested with the necessary permits and licences, allowing them to be used as bridge institutions. As for small- and medium-sized banks, the Resolution and Collection Corporation, a subsidiary of the DICJ and an industry-level AMC holding a banking licence, is able to function as a bridge bank in the event of a bank failure under the amended Deposit Insurance Act. By using existing organisations, a bridge bank as a tool of bank failure management becomes available at low cost. Moreover, in case of bank failures, bridge banks are expected to use staff from failed banks.

Recommendations

49. Jurisdictions should choose the level of specificity and prescriptiveness with which to regulate the transfer process, taking into account factors such as pre-existing practice, market conditions, and the need for legal certainty.

50. The legal framework should ensure that the general power to transfer assets and liabilities (see *Recommendation 46*) results in a swift, effective and final transfer under terms that are fair, reasonable and consistent with the bank liquidation objectives. In particular, the legal framework should:

(a) Facilitate the coordination of the transfer process with supervisory procedures, including by providing for the cooperation of the liquidation authority with the banking supervisor, if different, with regard to the postponement of the effects of the revocation of the failed bank's licence and any accompanying regulatory waivers, and supervisory approval requirements necessary for the transfer;

(b) Enable the authority/ies preparing a transfer to conduct or request a valuation where this appears necessary in order to decide on the application of the transfer strategy and the terms and conditions for such transfer;

(c) Enable the authority/ies preparing a transfer to engage, under strict confidentiality safeguards, in communications with market participants for purposes such as gauging market interest and conducting due diligence;

(d) Enable the authority/ies preparing a transfer to design the bidding process and determine the conditions of sale, with a view to executing the transfer in a fair and commercially effective manner;

(e) Enable the liquidation authority and/or the liquidator to decide on the perimeter of assets and liabilities to be transferred;

(f) Not impede the use of DIF resources, if permitted pursuant to the DI's mandate, for the purpose of loss-sharing agreements, or agreements that otherwise limit the risk exposure of the acquirer in connection with the transferred assets and/or liabilities, as long as all the conditions and safeguards to the DIF's contribution are fully respected;

(g) Not restrict the ability of the bank in liquidation to continue certain activities necessary for supporting business transferred in a sale as a going concern, subject to the prior approval of the relevant authority;

(h) Facilitate the selection of the best offer pursuant to clear and objective criteria;

(i) Clearly define the legal nature and effect of the act(s) of transfer, including, in particular, the ability to effect the transfer of assets and assumption of liabilities in bulk at the time specified therein without the need for separate acts of transfer for each item;

(j) Protect the acquirer from liability for actual or contingent claims relating to any items not included in the transfer;

(k) Address any potential obstacles to a transfer, including by streamlining the procedures to obtain administrative authorisations, where feasible, and minimising the formalities under private law; and

(l) Enable the liquidation authority to develop an appropriate transfer practice, identifying the legal and practical steps that may be needed to ensure a successful transfer of the different elements of the bank's business and addressing legal issues that may arise, in the form of secondary acts, practice manuals, and/or contract templates.

51. The legal framework should require that the transfer tool be used in a way that respects the rules on creditor hierarchy. Transfers that benefit certain creditors should only be permissible if they enhance value for creditors as a whole or ensure depositor protection, and do not result in financial disadvantage to any creditors or claims in comparison to the treatment under a putative piecemeal liquidation of the failed bank in its entirety.

52. The legal framework should provide for safeguards with regard to transfers involving related parties, which may include:

(a) Restrictions on the transfer of liabilities owed to related parties; and

(b) Restrictions on the acquisition by related parties of assets and liabilities.

When there is a risk of collusion, the legal framework should enable the liquidation authority and/or the liquidator to exclude related parties as

acquirers, or subject a transfer to related parties to specific requirements with regard to valuation and the disclosure of business ties.

53. The legal framework should specify that where liabilities are secured by collateral, the liabilities and associated collateral must either be transferred or left behind together. The legal framework may provide for exemptions from this constraint where that is necessary for an orderly liquidation, and the regime otherwise provides adequate protection for counterparties of the contractual benefits. Examples of adequate protection might include substituting collateral, the provision of a credit support agreement, or financial compensation to counterparties.

F. Piecemeal liquidation

288. Piecemeal liquidation will be necessary when a sale as a going concern is not feasible or desirable, or when it does not cover all assets, in which case the residual estate will have to be liquidated in this manner. Moreover, the hypothetical piecemeal liquidation of a failed bank's total estate serves as a baseline for comparisons when a sale as a going concern is contemplated or implemented.

289. The legal provisions on the piecemeal liquidation of banks could in principle draw on the business insolvency framework and its concepts in many respects. However, some adjustments are necessary to account for the specificities of banks and make the process as efficient and effective as possible.

290. To ensure the effectiveness of piecemeal liquidation, the legal framework should empower the liquidator to identify the failed bank's assets, take steps necessary to protect and preserve those assets, make arrangements for the lodging of claims by the failed bank's creditors, verify the liabilities, and realise assets by collecting them or by selling individual assets or packs of assets in a commercially reasonable and accountable manner. If these powers are already included in the general business insolvency law, there may be no need for additional provisions (if the general business insolvency law applies with only bank-specific modifications) or it may suffice to refer to them (in a dedicated bank liquidation framework). The legal framework should further ensure that the net proceeds from the realisation of assets be distributed to the failed bank's creditors in the order of priority of their claims and *pro rata* (see *Chapter 8. Creditor Hierarchy*).

291. An important aspect of piecemeal liquidation is to establish the exact financial position of the insolvent estate, based on an opening balance sheet, including all assets and liabilities. To that effect, the liquidator should prepare an inventory of the assets and properties of the bank as soon as possible. Liabilities

should be deemed due and payable. In general business insolvency proceedings, the recognition and enforcement of the differing rights of creditors are hallmarks of an effective system.[148] In bank liquidation, the procedure for determining the validity and priority of claims should be specified in the legal framework, which for this purpose can draw on general business insolvency requirements. However, some adjustments may be needed. For example, the usual system of individual submission by creditors of their respective claims[149] may be excessively burdensome in light of the strong record-keeping requirements for banks (and the recognition of banks' book entries as evidence by national systems of civil procedure) and the special position of depositors. It is thus preferable to allow the liquidation authority and the liquidator to rely on the bank's records, at least with regard to bank deposits, when determining the creditors' claims, unless the reliability of those records is in doubt (e.g., due to indications of financial crime or substandard controls). In jurisdictions with a DIS, insured depositors should be exempt from the requirement to submit claims in relation to amounts covered by deposit insurance. Specific rules may be required if financial intermediaries hold custodial deposits in their name, but on behalf of investors, and these deposits are subject to deposit insurance and depositor preference. In such cases, evidence may be required that the deposits are held as an agent, together with the clients' names, and principal amounts for each client. Furthermore, jurisdictions should consider whether specific provision in the legal framework is needed for dealing with possible claims of debtors based on agreements that are not included in the bank's records.

292. The legal framework should enable the liquidator to make advance payments to uninsured depositors in a piecemeal liquidation. This is desirable to minimise disruption for affected depositors, especially in jurisdictions without a DIS.[150] The legal framework could indicate that depositors are entitled to withdraw a limited amount from their account as specified in the legal framework or based on the discretion of the liquidation authority, subject to available liquidity. Any funding solutions to facilitate an orderly liquidation should ideally also be set out in the legal framework *ex ante*.

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148 *UNCITRAL Legislative Guide,* Part One, Chapter I, Key Objective 8 (para. 13). Key Objective 8 also includes clear rules on ranking. These are addressed in *Chapter 8 Creditor Hierarchy*.

149 *UNCITRAL Legislative Guide,* Part Two, Chapter V, paras. 2 et seq.

150 In jurisdictions with a DIS, the legal framework should also allow advance payments to uninsured depositors. For instance, if only insured depositors are transferred by means of a sale as a going concern, there might be a need to minimise disruptions for uninsured depositors through advance payments.

Recommendations 54 – 56

54. The legal framework should require the liquidator to promptly establish a balance sheet for the bank, based on the estimated liquidation values of the bank's assets, in order to determine its net financial position.

55. The legal framework should prescribe the procedures for determining the validity and priority of claims, and for the liquidation of assets, following general business insolvency rules with appropriate modifications. In particular, when determining the validity of deposit claims, the liquidation authority and the liquidator should be allowed to presume that the bank's records are accurate, unless there are doubts about the reliability of such records. Insured depositors should be exempt from the requirement to submit claims in relation to amounts covered by deposit insurance, although special rules might be required for financial intermediaries holding deposits as custodians.

56. The legal framework should facilitate advance payments to uninsured depositors in a piecemeal liquidation. The legal framework could entitle depositors to withdraw a limited amount of money soon after the bank enters into liquidation, when the process does not involve the transfer of their deposits. The relevant amount should be specified in the legal framework or be determined by the liquidation authority, subject to available liquidity.

The liquidator may make available for withdrawal by depositors or payment to other creditors such amounts as in its view may appropriately be used for that purpose, provided, however, that all depositors or other creditors who are similarly situated shall be treated in the same manner.

G. Protection of the liquidation estate: stay on enforcement, contract termination and transaction avoidance

293. The preservation of the insolvency estate is a key objective of an effective and efficient general business insolvency framework.[151] The need to stabilise business operations, ensure their continuity and prevent the early termination of contracts is even more acute for banks. Thus, the legal framework for bank liquidation should incorporate (either directly or by reference) the norms of general

[151] *UNCITRAL Legislative Guide*, Part One, Chapter I, Key Objective 6 (para. 10); *World Bank Principles,* C1.

business insolvency law relating to the preservation of the estate and the safeguarding of operational continuity, subject to appropriate adjustments.

294. General business insolvency laws typically seek to prevent a disorderly run against the insolvent estate's assets. To this end, the court may take provisional measures between the time an application to commence an insolvency proceeding is made and the commencement of the proceeding. On the commencement of the insolvency proceeding, a stay or suspension of enforcement actions by creditors applies, including a stay on the attachment of assets by secured creditors.[152]

295. These principles should also apply in a bank liquidation. For this purpose, the legal framework for bank liquidation may draw on the relevant provisions of general business insolvency law, including special provisions for a stay as an automatic consequence of the commencement of bank liquidation proceedings. In jurisdictions with an administrative model, the legal framework should empower the liquidation authority to adopt equivalent provisional measures. The legal framework should clearly specify the scope, duration, limitations and safeguards applicable to any stay on contract enforcement in bank liquidation proceedings. This general stay should not affect financial contracts that are subject to specific rules (see *Section I*).

296. General business insolvency law also includes rules concerning contract termination, which, in the case of contracts where counterparties have not fully performed their obligations ("executory contracts"), make it possible to take advantage of the contracts that are beneficial, and reject those that are too burdensome.[153] The ability to maintain contracts that are essential for the operational continuity of key services, systems and processes is of special importance in bank liquidation. The legal framework may provide that no contract is terminated, accelerated or modified solely because the bank has been placed in liquidation, and that contractual clauses stipulating the acceleration or termination of such contracts on those grounds are null and void. The legal framework could also adopt a more limited approach by identifying *ex ante* certain types of executory contracts as essential and providing for their continuity. If jurisdictions opt for a general rule of contract continuity, some exceptions should be provided, e.g., in relation to certain financial contracts (see *Section I* on the enforceability of early termination and close-out netting) or special rules for vulnerable counterparties, such as the failed bank's employees, who should not be forced to continue performing the contract. Jurisdictions could also apply the general rules of business insolvency law in cases of piecemeal liquidation, with special rules to ensure that contracts essential for

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152 *World Bank Principles* C5.1, C5.2, C5.3; see also *UNCITRAL Legislative Guide*, Part Two, Recommendations 39-51.

153 *UNCITRAL Legislative Guide*, Part Two, Chapter II, para. 109; *World Bank Principles*, C10.1-C10.3.

operational continuity are not disrupted when a transfer tool is used. In any event, the circumstances in which acceleration or termination may take place should be clear. In cases of piecemeal liquidation and for non-essential contracts, the legal framework should empower the liquidator to decide whether to continue the performance of a contract that is deemed beneficial to the estate, or to reject it when this better serves the liquidation objectives. Damages resulting from the liquidator's decision to terminate the contract should rank as regular unsecured claims.

297. The legal framework may also provide a power for the liquidator to modify certain types of executory contracts, with the authorisation of the liquidation authority and subject to adequate safeguards (see *Section D.6*, which should apply *mutatis mutandis* to counterparties of the bank). Even if the power to modify contracts is broad, some exceptions may be warranted, e.g., for contracts protected by security interests and, in any event, for certain types of financial contracts (see *Section I* below). The legal framework should set a deadline for the liquidator to decide on whether to continue, modify or reject the contracts.

298. Preventing the dissipation of assets is particularly important for banks. The liquidator's general powers should ensure that it has sufficient control over the bank's business, assets, offices, operational systems and records to prevent dissipation of assets by theft or other improper action, with the aid of law enforcement when necessary. This should include the powers to limit access by changing locks, codes, authorisations and/or identification passes. The liquidator should also have the power to suspend the payment of capital distributions or payments to directors, subject to the payment of reasonable compensation to bank directors, senior managers and staff for services rendered to the bank at the request of the liquidator. To the extent that members of the management bodies of the bank continue to perform some of their functions, the liquidator should have the power to remove them or control their actions.

299. General business insolvency laws also provide for mechanisms for the avoidance and setting aside of transactions outside a debtor's ordinary course of business, including, in particular, fraudulent or preferential transactions concluded after the debtor was insolvent, or during a "suspect" period preceding that insolvency.[154] Best practices under business insolvency law suggest that avoidance encompasses transactions "*intended to defeat, hinder or delay creditors from collecting their claims; transactions at undervalue; and transactions with certain creditors that could be regarded as preferential.*"[155]

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154 *UNCITRAL Legislative Guide*, Part Two, Chapter II.F; *World Bank Principles* C11.

155 *UNCITRAL Legislative Guide*, Part Two, Chapter II, paras. 170-184, Recommendation 87.

300. Bank liquidation rules for the avoidance and setting aside of transactions should be based on clear criteria that draw on best practices of business insolvency law. Jurisdictions should decide whether to grant the power to avoid or set aside transactions to the liquidator, or to the liquidation authority, following an application by the liquidator. For this choice, the accountability regime applicable to the liquidator's actions should also be taken into account (*Chapter 3. Procedural and Operational Aspects, Section D.5*).

301. Legal frameworks may provide for exceptions from the application of the rules of business insolvency law on avoidance to ensure the operational continuity of key services, systems and processes. Where the failed bank went through a resolution process prior to the liquidation of its residual estate, the transactions undertaken in the resolution should be respected in the liquidation. Another exception should apply to certain types of financial contracts (see *Section I*) if the same result is not already assured under the general business insolvency framework. Conversely, there may be reasons for special bank rules to be stricter in certain cases. For example, if transactions with related parties constitute a concern, they may be subject to stricter avoidance rules – e.g., to a longer "suspect period", or to a reversal of the burden of proof, whereby related parties would need to demonstrate that the transaction was conducted in the ordinary course of business.[156] If, however, certain forms of intra-group support in the "twilight zone" are considered desirable, from a policy perspective, for orderly liquidation, any exemption from avoidance rules for such transactions or any other modification to a similar effect should be defined narrowly and be subject to strict conditions and safeguards (see also *Chapter 9. Group Dimension*).

Recommendations 57 – 61

57. The legal framework should provide for a stay or suspension of enforcement actions by creditors in accordance with the usual principles of business insolvency law. Exceptions should apply in relation to specific financial contracts.

58. The legal framework should ensure, by means of express provisions or by reference to general business insolvency law, that:

(a) Contracts which ensure the operational continuity of key services, systems and processes are not terminated, accelerated or

[156] Central bank financing is expected to be enforceable even if it was extended during the suspect period. To ensure this result, jurisdictions with strict avoidance rules may need to include an explicit "safe harbour" in their legal framework.

modified solely because the bank has been placed in liquidation. This outcome may be achieved by different approaches, including a general rule of contract continuity with certain exceptions; providing for the continuity of certain types of executory contracts that have been identified as essential *ex ante*; or applying rules of general business insolvency law, with special rules to ensure that contracts essential for operational continuity are not disrupted when a transfer tool is used. The circumstances in which acceleration or termination may take place should be clear, as should any exceptions or special rules, as in the case of financial contracts (see *Section I*).

(b) The liquidator has the power, exercisable within a period specified in the legal framework, to reject a contract when this better serves the liquidation objectives. The legal framework may contemplate exceptions for the determination of damages resulting from such termination.

59. The liquidator should have clear powers and control over the bank's business, assets, offices, operational systems and records to prevent dissipation of assets by theft or other improper action, with the aid of law enforcement when necessary.

The liquidator's powers should include the power to limit access by changing locks, codes, authorisations and/or identification passes, and to suspend the payment of capital distributions, or payments to directors, subject to the payment of reasonable compensation to bank directors, senior managers and staff for services rendered to the bank at the request of the liquidator. The liquidator should have the power to remove members of the bank's management bodies or control their actions.

60. The legal framework should establish clear rules, drawing on the principles of general business insolvency law, for the determination of the transactions that can be avoided or set aside, and should specify the procedure for achieving this result. Jurisdictions should decide whether to grant a power to avoid or set aside transactions to the liquidator, or to the liquidation authority, following an application by the liquidator to this effect. The following transactions should be exempted from the rules on avoidance:

(a) Measures adopted by the authorities as part of a resolution process prior to liquidation; and

(b) Specific types of financial contracts, which should be subject to their own rules.

Exemptions from the avoidance rules for forms of intra-group support should be defined narrowly and be subject to strict conditions and safeguards (for example, approval by the supervisory authority).

61. Stricter avoidance rules may be warranted for transactions with related parties. This may include a longer suspect period, or a reversal of the burden of proof, whereby related parties would need to demonstrate that the transaction was conducted in the ordinary course of business.

H. Temporary settlement accounts

302. One of the primary functions of banks is to enable clients to use the balances in their bank accounts to make payments. When a bank is placed in liquidation, it will often be the case that certain payments are "underway", in the sense that the relevant sums have been debited from the clients' accounts but not yet credited to those of the payees.

303. To preserve the smooth functioning of the payment system and protect the intended beneficiaries of payments, many jurisdictions provide for the special treatment of accounts where funds in transfer are (temporarily) placed in accordance with the rules governing payment systems after being withdrawn from the payer's account and before being placed in that of the payee. Jurisdictions use different names for such accounts, including "transit accounts", "temporary settlement accounts", or "suspense receipt accounts".[157] In this *Guide*, the term "temporary settlement accounts" is used.

304. There are different ways in which funds in temporary settlement accounts may be protected, and this may depend on their function and characterisation. Country practices include (i) segregating the funds in transfer and excluding them from the insolvency estate,[158] (ii) qualifying or treating the funds as deposits[159] in

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[157] For instance, in Japan, when a payer requests a bank to make a funds transfer to a payee's account with another bank, the funds are first debited from the payer's bank account and transferred temporarily to a transit account, which may be called "separate deposits" or "suspense receipts" until interbank settlement for those funds transfers takes place.

[158] E.g., in Brazil. In the EU, according to Article 4 Directive 98/26/EC (Finality Directive), "*Member States may provide that the opening of insolvency proceedings against a participant shall not prevent funds or securities available on the settlement account of that participant from being used to fulfil that participant's obligations in the system on the day of the opening of the insolvency proceedings. Furthermore, Member States may also provide that such a participant's credit facility connected to the system be used against available, existing collateral security to fulfil that participant's obligations in the system*."

[159] E.g., in Colombia, Malaysia, Moldova, Ukraine.

jurisdictions with some form of depositor preference, or (iii) allowing the DIS to contribute to transfer-based strategies to protect these funds.[160]

305. Jurisdictions should determine the treatment of temporary settlement accounts in bank liquidation proceedings depending on their broader legal framework – especially the definition and treatment of "deposits" and rules and practices concerning payment and settlement systems. In the interest of legal certainty for the payee, operators of payment systems and other market participants, the legal framework should not hinder the continued operability of payment and settlement systems and the protection of money in transit.

Recommendation 62

62. The legal framework should protect money in transit, ensuring that transactions that entered into the payment system before the opening of bank liquidation proceedings be completed, in the interest of legal certainty.

I. Limited stay on enforcement of certain financial contracts

306. A legal framework for managing bank failure should include clear, transparent and consistent provisions for the treatment of financial contracts that incorporate close-out netting terms. Such contracts include derivatives (e.g., swaps, options, and forwards), securities financing, and sale and repurchase transactions, which are typically documented using master agreement structures and standard terms published by the relevant financial industry associations. Counterparties to master agreements generally manage bilateral transactions between them on an aggregate basis. Master agreements commonly permit non-defaulting counterparties to initiate close-out netting upon the opening of a bank failure management process.

307. Close-out netting terms in a financial contract (typically, a master agreement) provide for a procedure whereby multiple obligations between the parties

[160] In Japan, funds held in transit accounts are fully protected as "settlement obligations" under the Deposit Insurance Act. The completion of the payment process (i.e., the transfer of the funds from one account to another) is ensured by a loan from the DICJ to the failed bank, which loan becomes a claim in the liquidation proceeding. Such protection is granted (i) because the smooth name-based aggregation of depositors by returning the funds from the transit account to the payer's demand deposit account would be practically difficult, particularly for large banks, and (ii) to avoid negative effects on the party that is to receive the funds as much as possible.

are terminated and replaced by a single net payment obligation. Close-out netting terms specify, *inter alia*, events that would allow a non-defaulting party to initiate the procedure and the method for determining the value of the single net payment obligation. Events that could give rise to early termination and close-out netting typically include the commencement of insolvency, liquidation, or similar proceedings that may stay or otherwise impede contract enforcement.

308. Frequently, when an entity enters an insolvency procedure, a stay on debt collection prevents individual creditors from enforcing claims against the entity's assets (see *Section G* above). This allows all claims to be dealt with in the collective insolvency proceedings, in accordance with the creditor hierarchy. Enforceability of close-out netting terms in financial contracts is an exception to such applicable insolvency law and practice; this exception is part of existing international standards.[161] This "safe harbour" from the normal treatment is based on the premise that applying the same stay on enforcement to all of the entity's contracts can pose a risk to financial market stability when the stay affects certain financial contracts.[162]

309. The *FSB Key Attributes* modify the close-out netting exception for financial institutions in special resolution regimes to restrict counterparties' ability to exercise early termination rights under financial contracts. That modification has two elements. First, it provides that counterparties should not be able to invoke statutory or contractual set-off, early termination, contractual close-out netting, acceleration, and similar provisions if substantive contractual obligations continue to be performed notwithstanding the firm's entry into resolution proceedings and the exercise of resolution powers. Legislation should not enable counterparties of a firm in resolution to initiate early termination and close-out netting solely by reason of

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[161] See the *World Bank Principles* (Principle C10.4); *UNIDROIT Principles on Close-Out Netting* (Principles 6 and 7); *UNCITRAL Legislative Guide* (Recommendations 101-107).

[162] See the *World Bank Principles*, C.10.4: "*Exceptions to the general rule of contract treatment in insolvency proceedings should be limited, clearly defined, and allowed only for compelling commercial, public, or social interests, such as in the following cases: […] Upholding (subject to a possible short stay for a defined period) termination, netting and close-out provisions contained in clearly defined types of financial contracts, where undue delay of such actions would, because of the type of counterparty or transaction, create risks to financial market stability*". Footnote 9 to this Principle notes that "*The operation of termination, netting, and close-out provisions would not preclude the application of a short stay for a defined period under the national law governing bank resolution, or of a similar stay that the national insolvency law may provide, particularly to accomplish the orderly transfer of the contracts to a solvent counterparty. Such stay should be subject to appropriate safeguards. Early termination rights would be suspended, provided that the substantive obligations of the debtor under the relevant contracts continue to be performed in full*."

such proceedings, provided that substantive contractual obligations continue to be performed.[163]

310. Secondly, it provides that where a counterparty retains the ability to exercise its rights under early termination and similar provisions solely by reason of the firm's entry into resolution, the resolution authority should have the power to stay the counterparty's exercise of such rights for a strictly limited time period (for example, for a period not exceeding two business days), subject to adequate safeguards.[164]

311. Continued performance of contractual obligations – including payment, delivery of securities, margin posting and collateral provision – is essential for market and broader financial stability, including the proper functioning of financial market infrastructure such as clearing and settlement systems. The narrowly circumscribed stay power in the *FSB Key Attributes* reflects experience in the global financial crisis that started in 2007, including concerns that, in some cases, early termination and netting can prompt asset fire sales and market instability and can undermine the success of the resolution process and the continuity of essential functions.

312. Since 2014, the International Swaps and Derivatives Association (ISDA) has published, and most systemically important financial firms have entered into, resolution stay protocols that give contractual recognition to temporary and limited stays on close-out netting and early termination rights imposed under specified national resolution frameworks to ensure the efficacy of resolution. The purpose is to ensure that counterparties outside the home jurisdiction of a bank in resolution (and therefore outside the territorial scope of resolution powers under that jurisdiction's legal framework) are nevertheless bound contractually by a resolution stay imposed by that jurisdiction's resolution authority. In addition, regulatory authorities in some jurisdictions require systemically important financial firms to accede to such ISDA protocols or enter into bilateral contractual arrangements with their systemic and non-systemic counterparties alike, to ensure that statutory resolution tools and widely used standard-form contract terms do not present a conflict for the firms or undermine effective failure management. Corresponding measures have been put in place for securities financing and sale and repurchase transactions.

313. The *FSB Key Attributes* address the resolution of financial firms that could be systemic in failure and are silent as to the desirability or appropriateness of stays on early termination rights in the context of any other type of failure management proceeding. Similarly, ISDA documentation was developed in response to the *FSB*

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163 *FSB Key Attributes*, KA 4.2.

164 *FSB Key Attributes*, KA 4.3.

Key Attributes to give effect to resolution stays.[165] The *World Bank Principles*[166] do not restrict the possibility of a limited stay on close-out netting to special resolution proceedings or systemically important firms.

314. Such a stay may be appropriate in bank liquidation proceedings for non-systemic banks in limited circumstances. Expanding the possibility of stay powers beyond special resolution regimes potentially introduces additional uncertainty about the pay-offs of derivative instruments in certain cases, which could reduce the efficacy of derivative instruments in risk management. Balancing this risk against the risk of undermining the effectiveness of bank failure management militates in favour of a targeted and clearly drawn power to stay close-out netting only where this is necessary for the effective implementation of a transfer of assets and liabilities to another entity (not in a piecemeal liquidation of the entire bank) and provided that the substantive obligations under the contract continue to be performed.

315. In line with the *FSB Key Attributes*, the duration of any stay should be strictly limited – e.g., not exceeding two business days. It should be taken into account that the feasibility of applying such a short stay will depend on the efficiency and procedural requirements of the wider bank liquidation framework, including, in the case of predominantly court-based models, the timing of the courts' assessment of the insolvency petition and the request to sanction a transfer and/or impose the stay, and in all cases, the ability of relevant authorities to implement transfer-based tools swiftly.

316. Furthermore, safeguards similar to those under the *FSB Key Attributes* should apply. In particular, a "no cherry-picking" rule should apply, so that the liquidation authority and/or the liquidator, as the case may be, is not permitted to select for transfer some, but not all, of the contracts with the same counterparty that are covered by the same netting agreement. It is important that by the expiry of the stay it is clear which liabilities are with a performing counterparty (for example, because they have been transferred to a financially sound third party) and which remain in the liquidation estate. Where financial contracts are not transferred, any early termination rights that have been stayed should be exercisable immediately after the expiry of the stay or, where the counterparty is notified before the expiry of

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165 See https://www.isda.org/a/K16gE/ISDA-Resolution-Stay-Matrix-7.29.2019.pdf.

166 The *World Bank Principles* are open to a "*possible short stay for a defined period*", which is not necessarily restricted to resolution – reference is specifically made to "*a similar stay that the national insolvency law may provide, particularly to accomplish the orderly transfer of the contracts to a solvent counterparty*" (see previous note) – but ask that the "*identification of relevant types of financial contracts should be determined in advance in accordance with existing international instruments*".

the stay that they will remain in the liquidation estate, immediately after such notification.

Recommendations 63 – 66

63. Contractual early termination rights under financial contracts, including close-out netting procedures that operate by reference solely to the commencement of bank liquidation proceedings, should remain in effect, and the bank's counterparties should be able to exercise these rights as an exception to general business insolvency law and practice, subject to *Recommendations 64-66*. The types of financial contracts covered by this exception should be clearly defined in the legal framework, including, for example, derivatives, securities financing, and sale and repurchase contracts.

64. To ensure effective implementation of transfer-based tools, the liquidation authority and/or the liquidator should have the power to stay temporarily the exercise of early termination rights, including the right to pursue close-out netting, arising solely out of the commencement of bank liquidation proceedings or the exercise of administrative or judicial powers with respect thereto, and provided that the substantive obligations under the contract, including payment, delivery, and collateral provision, continue to be performed.

65. The legal framework should specify the scope and strictly limit the duration of any such stay, for example, for a period not exceeding two business days.

66. The following additional safeguards and conditions on the operation of a stay on close-out netting should be explicitly set out in primary or secondary legislation:

(a) Early termination rights and close-out netting procedures that do not arise solely out of the commencement of bank liquidation proceedings, or the exercise of administrative or judicial powers with respect thereto, should remain in effect and should not be subject to a stay.

(b) The stay should be imposed at the discretion of the liquidation authority and/or the liquidator only where it is considered necessary to facilitate the execution of transfer of some or all of the operations of the bank in liquidation to a financially sound entity.

(c) The legal framework should clearly specify the process for imposing and lifting the stay.

(d) The liquidation authority and/or the liquidator should only be permitted to transfer all of the eligible contracts with a particular counterparty to a new entity and should not be permitted to select for transfer individual contracts with the same counterparty and subject to the same netting agreement ("no cherry-picking" rule).

CHAPTER 7. FUNDING

A. Introduction

317. The primary source of funding for bank failure management should be the bank's own resources. However, in some cases those resources may not be sufficient and additional funding from external sources ("external funding") may be needed to achieve liquidation objectives such as depositor protection and to preserve public confidence in the banking system (see *Chapter 1. Introduction*). Where they arise, such needs for external funding give rise to a tension between policy objectives. On the one hand, financial support associated with bank failure management entails a potential for moral hazard and risks shifting bank failure costs away from the bank's creditors and shareholders. On the other hand, a lack of credible financing arrangements to support bank failure management can harm vulnerable depositors and potentially undermine confidence in other banks. In some circumstances, those impacts could ultimately result in higher costs to the public.

318. Funding needs and arrangements may vary with the choice of tools for managing a given bank failure; the mandates of the potential sources of funding, such as the DI; and market structures. Funding decisions also tend to be politically sensitive to the extent that they entail distribution of limited resources. As a result, the design of funding arrangements for failure management is informed by policy on how the financial burden should be shared between the shareholders and creditors of failed banks and the industry more broadly. These factors are recognised in the international standards applicable to funding for bank failure management: the *IADI Core Principles* (CP 9) and, where bank failure can be "systemic or critical", the *FSB Key Attributes* (particularly KA 6).[167]

319. Against this background, this Chapter provides guidance on funding in bank liquidation proceedings, as follows:

- *Section B* explains why external funding is likely to be needed for orderly liquidation, for example, to facilitate deposit transfer to a sound acquirer.
- *Section C* discusses the type of measures a DI may be able to finance depending on its mandate and the safeguards to protect the DIS.

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[167] The *FSB Key Attributes* specify that, *inter alia*, jurisdictions should have credible arrangements to provide temporary financing to support the use of resolution powers, and that public funds should only be used if necessary for financial stability and private sources have been exhausted or would not achieve the financial stability objectives. See KA 6, and EC 6.1 of the *FSB Key Attributes Assessment Methodology for the Banking Sector*.

- *Section D* covers the form of DIS financing transaction (e.g., a cash contribution or loss-sharing arrangement).
- *Section E* discusses emergency backstop funding for the DIS and the principle that the use of public funding should be avoided.

B. Need for external funding

320. Banks' own loss-absorbing capacity has improved with regulatory reforms. Building it was a key element of internationally coordinated post-crisis financial reforms. However, specific requirements aimed at ensuring sufficient "gone concern" loss absorbency beyond minimum regulatory capital have predominantly focused on systemically important institutions, with the objective of facilitating resolution as envisaged by the *FSB Key Attributes*.[168]

321. For non-systemic banks, external funding may be required for orderly liquidation. The extent of that funding will depend on a range of factors, including the bank's business model, organisation, position in the financial system, and the risks associated with its failure; the failure management options available; and the wider circumstances.

322. In bank liquidation proceedings, the depositor protection objective can be achieved if insured depositors are promptly reimbursed or deposits are transferred to a healthy bank, which also strengthens public confidence in the banking system. However, the feasibility of a sale as a going concern may depend on external funding. Although potential acquirers often put a premium on the value of a bank's stable client base, there may still be a shortfall between the value of deposits and that of bank assets available for transfer. Accordingly, there may be few or no willing acquirers without external funding to fill the gap.

323. External funding may also be needed on a contingent basis when the circumstances of a bank failure limit potential acquirers' ability to perform due diligence and fully assess the risks involved in the acquisition (e.g., owing to extreme time constraints). Such funding may take the form of guarantees against potential

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168 For example, the FSB standard on Total Loss-Absorbing Capacity (TLAC) requires Global Systemically Important Banks (G-SIBs) to maintain increased levels of loss-absorbing capacity (LAC) consisting of regulatory capital or other debt instruments that meet specific eligibility criteria is designed to ensure sufficient available loss absorbing and recapitalisation capacity to support the resolution strategy. Where resolution-related LAC requirements apply or are contemplated for other banks, relevant considerations include the impact on business and funding models.

future losses on specified assets for which full due diligence was not possible (see also *Chapter 6. Liquidation Tools, Section D.2* and *Recommendation 50(f)*).

C. Use of deposit insurance funds

1. Non-payout measures

324. In jurisdictions that have a DIS, industry-sourced DIFs are a potential source of external funding. The default use of DIF resources, which is available to all DIFs, is the reimbursement of insured deposits. However, the *FSB Key Attributes* and the *IADI Core Principles* recognise the use of DIF resources to fund measures that preserve depositors' access to their funds as an alternative to payout ("non-payout measures"). Typical of such measures is the transfer of a non-viable bank's business, including but not necessarily limited to insured deposits, to another bank. DIF resources may be used to facilitate such a transfer by helping to meet a funding shortfall, where consistent with the DI's mandate, which may differ across jurisdictions (see *Chapter 2. Institutional Arrangements, Section E*), and the conditions and safeguards specified in the *IADI Core Principles*.

325. Pursuant to the *IADI Core Principles,* a legal framework that contemplates the use of DIF resources for non-payout measures requires additional features and safeguards that apply in any case where the DI is not the authority managing the bank failure.[169] These safeguards are designed to ensure accountability and to protect the DIF against excessive depletion. They include, *inter alia*, ensuring that the DI is appropriately informed and involved in the decision-making process;[170] that the use of its funds is transparent, documented, and clearly and formally specified; that the failure management process is designed to limit DIF exposure to contribute additional funding in respect of the same obligation; and that the amount of DIF resources contributed is limited to the costs the DI would otherwise have incurred in a payout of insured depositors in a liquidation net of expected recoveries.

326. There are significant advantages to facilitating the use of DIF resources to support the transfer of deposits to an acquirer during liquidation and thereby ensure

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169 *IADI Core Principles,* CP 9, EC 8 refers to "*resolution of member institutions other than liquidation*". In the CP, the term "resolution" is defined in a broad manner. It does not necessarily imply measures under a special resolution regime; it also covers the sale as a going concern in the context of bank liquidation proceedings as discussed in this *Guide*.

170 The extent to which information may be shared depends, *inter alia*, on the nature and governance arrangements of the DI.

continued access to insured deposits.[171] A DI mandate not limited to payout is more likely to preserve continuity of bank functions, limit externalities and advance the objectives of orderly bank failure management.[172] In particular, a bank liquidation regime that includes powers to carry out a sale as a going concern may be able to secure a higher value for the bank than the "gone concern" value that is generally realised in a piecemeal liquidation. A lack of funding arrangements for non-payout measures could in practice limit the liquidation options available to authorities, irrespective of their liquidation powers. This risks in turn that authorities might resort to public funding on an *ad hoc* basis to protect depositors and manage the impacts of the failure.

2. Amount of DIS funds that may be contributed

327. The *IADI Core Principles* specify that, where the DI is not the authority in charge of failure management but the framework authorises the use of its funds for non-payout measures, contributions should be restricted to the costs the DI would otherwise have incurred in a payout of insured depositors net of expected recoveries.[173] This "payout counterfactual" constitutes a quantitative constraint on the contribution of DIF resources for non-payout measures. In some jurisdictions, this restriction also applies where the DI is the authority in charge of failure management, for example by requiring the authority to adopt the failure management option that represents the least cost to the DIF. These restrictions aim at reducing the risk of excessive depletion of DIS resources in the failure management of an individual bank.

328. In practice, the safeguard against excessive depletion is implemented in different ways. Where it is applied on a "net" basis, the contribution from the DIF to a non-payout measure must not exceed the costs of a payout counterfactual that takes into account the DI's expected recoveries in liquidation (i.e., expected recoveries are subtracted from the costs of payout, thus reducing the amount that the DI could contribute to a non-payout measure).[174] Some jurisdictions, by contrast, calculate the

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171 In addition, the legal framework should facilitate the provision of post-liquidation financing by private lenders as an external source of funding, see *Chapter 8. Creditor Hierarchy, Section G*.

172 The use of DIF resources for non-payout measures is advancing globally. In 2021, only around 20% of DIs had a "pay box" mandate, compared to around 40% in 2011 (see *IADI Annual Survey* 2021).

173 *IADI Core Principles*, CP 9, EC 8, point (d).

174 The *IADI Core Principles* provide that where the DI has paid out insured deposits, it should become a creditor of the failed bank by subrogation to those claims, and have at least the same status as insured depositors with respect to the failed bank's estate. This means

counterfactual on a "gross" basis, meaning that the amount the DIF can contribute to a non-payout measure is benchmarked against the costs of paying out insured depositors *without* subtracting liquidation recoveries, provided that the latter are recovered by the DI at a later stage (e.g, in the context of the liquidation of the residual entity).[175]

329. The methodology for calculating the limit is therefore a key factor that determines the amount with which the DI would be able to support non-payout measures, such as transfers. Bank liquidation frameworks may address such funding limits in general terms, setting the principles and parameters. A detailed methodology (e.g., on the range of costs that should be taken into account or assumptions about recovery levels when calculating the costs the DIF would incur in a payout) could then be clarified, for example, in published policy statements or administrative guidance.

330. The capacity of the DI to contribute funds for measures involving the transfer of insured deposits during liquidation is also affected by jurisdictions' choices with respect to depositor preference, since this is an important factor in the recoveries the DI can expect in liquidation. For this reason, jurisdictions should pay close attention to potential interactions between safeguards such as quantitative constraints on DIF funding and other aspects of the bank liquidation regime, such as creditor hierarchy (see *Chapter 8. Creditor Hierarchy*).

D. Design of DIF financing transactions

331. The form of DIF support for transfer transactions in bank liquidation proceedings depends on the DI's mandate, its functions and capacity, and its role in the overall design of the bank failure management regime, among other factors. In the simplest case, the DI may contribute cash to help fund a transfer.[176] More complex forms of support could include providing a guaranteed floor on the value

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that it can expect to recover at least some of the funds it has paid out to insured depositors, depending on their ranking (see *Chapter 8. Creditor Hierarchy*). Where a "net" contribution approach is followed, the DI contributes to the transfer while taking into account the expected recoveries in the payout counterfactual. If, in such case, the DI were entitled to also file a claim against the residual entity, it would effectively receive a more beneficial treatment than what would result in piecemeal liquidation.

175 If the claims of insured depositors are transferred to another entity, the DI would not have a legal claim against the residual entity based on subrogation. In order to receive a "net" result, the DI would therefore need a separate legal basis to file a claim in the liquidation of the residual entity.

176 Such payments are ultimately made for the benefit of the acquiring bank and may thus be made either to the liquidation authority to forward to the acquirer or to the acquirer directly.

of transferred assets, entering into loss-sharing agreements with acquirers, or undertaking other forms of contingent commitment. Funding transactions may provide for *ex-post* adjustments to reflect valuation changes. Such forms of support are more complex to design and implement, require more staff resources and expertise, and may be more suitable to frameworks where the DI has a supervisory role or has close coordination arrangements in place with the banking supervisor that facilitates ongoing monitoring of, for example, the implementation of a loss-sharing agreement.

332. Ordinarily, details about the ways that funding can be provided would be set out only at a high level in the legal framework, if at all. Transaction design for DIF funding would be highly case-specific and would depend on specific factors relating to the circumstances and characteristics of each individual bank failure, including the transfer options available at the time. General corporate powers, such as the power to enter into contracts, could suffice in most transfer transactions.[177]

E. Backstops and recovery mechanisms

333. Although most DIFs are pre-funded through industry assessments,[178] their available funds may be limited. DIF funding levels and assessments are usually calibrated to cover a fraction of the total of the deposits they insure. While constraints on the use of DIF resources in a single case help to protect against excessive depletion, multiple failures or interventions in a larger bank could exhaust the DIF's pre-paid resources. The *IADI Core Principles* address this risk through a requirement that emergency funding arrangements, including pre-arranged and assured sources of liquidity, are in place for any DI.[179] Jurisdictions should specify the arrangements for back-up liquidity for the DI.

334. *Ex-post* industry assessments may be used to replenish the DIF when the costs to the DI of a bank failure exceed the recoveries it received from the liquidation. Such *ex-post* assessments impose the costs of bank failure on the surviving banks, and could help to enhance market discipline compared to a situation where there are no *ex-post* industry assessments or where public funding is used to replenish the DIF.

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177 Where the DI is not the liquidation authority, its contribution to a transfer is generally based on a decision of the DI's management (Board), which is recalled (and may be further specified) in the contract between the failed bank (represented by the liquidation authority or the liquidator) and the acquirer. In some jurisdictions, the DI may be a party to the contract (e.g., as guarantor).

178 Pursuant to *IADI Core Principles*, CP 9, EC 1, funding for the deposit insurance system should be provided on an *ex-ante* basis.

179 *IADI Core Principles,* CP 9, EC 4. Sources may include a funding agreement with the government, the central bank or market borrowing.

Some DIFs also have authority to borrow in private or public financial markets pending replenishment by the industry.

335. Public funding should not be available for the liquidation of non-systemic banks. The *FSB Key Attributes* apply to banks that are "systemic in failure", irrespective of whether such banks had been qualified as systemic for prudential or other purposes prior to their failure. As such, they also apply where the failure of a bank (or multiple banks) that had not been considered systemic poses a systemic risk, and where failure management requires external funding in excess of what may be provided by the DIF or outside the DI's mandate.

Key Considerations and Recommendation 67

Purpose of legislative provisions

The purpose of provisions on funding in bank liquidation proceedings is:

(a) To ensure that funding arrangements facilitate the effective conduct of the proceedings and serve the objectives of the bank liquidation regime;

(b) To specify at a high level the source, possible use and conditions of funding, and the governance arrangements for the use of funds.

Key Considerations

➢ The cost of a bank's failure should be primarily borne by its shareholders and its other loss-absorbing resources. Public funds should not be used to manage the liquidation of a failed bank.

➢ In jurisdictions that have a DIS, there are significant advantages to allowing the DI to authorise the use of DIF resources in bank liquidation proceedings to support a transfer of assets and liabilities to another entity that would ensure continued access to insured deposits, as an alternative to payout. Permitting such use of DIF resources is more likely to achieve the objectives of the bank liquidation regime and to minimise losses.

➢ Where DIF resources are used for non-payout measures, the conditions and safeguards should be consistent with the *IADI Core Principles.*

➢ The design of the legal framework should consider the interaction of the DI's mandate and funding arrangements with other aspects of the bank liquidation framework, including available tools and the position of deposits in the hierarchy of claims.

Recommendation

67. The legal framework should provide for the availability of external sources of funding that are additional to the internal resources of the failed bank so as to facilitate orderly liquidation, including by the use of transfer-based tools. It is recommended that the legal framework allows the DI to authorise the use of DIF funds as such an external source and specifies conditions applicable to the use of DIF funds, depending on the DI's mandate and in line with the *IADI Core Principles*.

CHAPTER 8. CREDITOR HIERARCHY

A. Introduction

336. The hierarchy of creditor claims applicable in bank liquidation proceedings establishes the order in which creditors should be paid from the assets of a failed bank. Such an order of distribution is followed strictly in the context of piecemeal liquidation. The creditor hierarchy is also relevant where other bank failure management strategies are used. For banks that are systemic in failure, the *FSB Key Attributes* prescribe that resolution powers should be exercised in a way that respects the hierarchy of claims.[180] The same applies where transfer powers are used in bank liquidation proceedings. In addition, the recoveries of creditors in a hypothetical piecemeal liquidation are the counterfactual for the purposes of the NCWO safeguard in bank resolution proceedings and play a similar function in bank liquidation proceedings where the liquidator or liquidation authority needs to assess whether a sale as a going concern maximises value for the benefit of creditors as a whole (see *Chapter 6. Liquidation Tools, Section D.6*). Distribution rules in insolvency thus function as a yardstick for the allocation of losses during bank failure management proceedings and can have a direct bearing on the ability to achieve the objectives in these proceedings.

337. Appropriate and transparent rules on creditor ranking are essential to facilitating the smooth implementation of bank failure management strategies, while ensuring the fair treatment of creditors, which is a prerequisite for cross-border recognition. Clear rules on ranking in liquidation allow creditors to price in and manage risks when entering into a relationship with a bank, which creates certainty in the market and facilitates the provision of credit.

338. While equality among creditors is a general principle, there may be compelling policy reasons for departing from absolute equality in loss allocation, for example when it would be inequitable or where there are significant differences in the legal or economic nature of certain claims. Therefore, insolvency laws may contemplate differential treatment of certain claims, including instances of preferential treatment (e.g., secured claims) and less beneficial treatment (e.g., subordinated claims).

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[180] Within the creditor hierarchy, resolution powers may be exercised in a way that departs from the principle of equal (*pari passu*) treatment of creditors of the same class if necessary to contain the potential systemic impact of a firm's failure or to maximise the value for the benefit of all creditors as a whole. See *FSB Key Attributes*, KA 5.1.

339. In principle, similarly situated creditors are treated and satisfied proportionately to their claim out of the assets of the estate available for distribution to creditors of their rank ("*pari passu* principle").[181] The *pari passu* principle and its exceptions are covered in frameworks by the World Bank[182] and UNCITRAL[183] and figure in the *FSB Key Attributes*.[184] This Chapter provides guidance on the treatment and relative ranking of certain types of claims in bank liquidation proceedings while taking into consideration these well-established frameworks and public policy concerns related to the special nature of banks.

- *Section B* discusses how rules on creditor ranking in bank liquidation proceedings may be introduced in jurisdictions' legislative frameworks.
- *Section C* provides guidance on the ranking of deposit claims, including interbank deposits and related party deposits.
- *Section D* discusses the subordination of claims, be it by means of a contract, statutory provision, or court order. It provides specific guidance on the subordination of related party claims.
- *Section E* covers the ranking of shareholders.
- *Section F* discusses the ranking of resolution financing arrangements.
- *Section G* contains guidance on the ranking of post-liquidation financing.
- *Section H* provides guidance on the treatment of secured creditors, including covered bondholders and central banks.

B. Establishing rules on creditor ranking

340. Approaches to the establishment of rules on creditor ranking in bank liquidation proceedings vary across jurisdictions. In some jurisdictions, the general business insolvency rules on ranking and priority fully apply to bank failure management proceedings (Option 1). The ability to depart from the *pari passu* treatment of creditors of the same rank in certain jurisdictions may allow authorities to reach an outcome that is functionally similar to bank-specific modifications (see next paragraph) – although this may weaken creditor safeguards (see *Chapter 6.*

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181 See *Glossary point (23)*. See also *UNCITRAL Legislative Guide*, Parts One and Two, Glossary.

182 *World Bank Principles*, C12.

183 See, e.g., *UNCITRAL Legislative Guide*, Recommendation 191 and Part Two, Chapter V, paras. 51-79 on priorities.

184 *FSB Key Attributes*, KA 5.1. See also, e.g., *IMF, Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination* (2010), and Dobler *et al*, *The Case for Depositor Preference* (IMF Technical Note and Manual, 2020) ("The Case for Depositor Preference").

Liquidation Tools, Section D.6), reduce predictability, and complicate cross-border cooperation during failure management proceedings.

341. Several jurisdictions have introduced limited, bank-specific modifications to the general insolvency rules on ranking and priority (Option 2). In most cases, such modifications pertain to the ranking of deposits (including that of the DIS or similar funding schemes). Some jurisdictions introduced bank-specific provisions on subordinated or non-preferred claims to facilitate loss absorption and recapitalisation in bank failure management proceedings.

342. Other jurisdictions provide for distinct, bank-specific rules on creditor ranking (Option 3). In several jurisdictions, the bank failure management framework provides separate and sometimes relatively detailed bank-specific rules on the ranking of claims.

343. Options 2 and 3 represent good practices. Transparency demands that the hierarchy of claims in bank liquidation be clearly stated in the legal framework.[185] This may take place through a separate regulation of creditor hierarchy in the bank liquidation law or, if general business insolvency rules apply to some extent to bank liquidation, by introducing clear, tailored modifications for banks, either in the banking law or in the general business insolvency law.

344. The legal framework should clearly determine which creditors will be affected by the liquidation proceeding and their treatment in terms of priority and distribution, including exceptions to the general rules on ranking and hierarchy. Indeed, there may be reasons that justify a differentiated treatment for particular bank-related claims, e.g., granting claims of depositors a preferred ranking (see *Section C* below). Conversely, the existence of a multiplicity of differentiated creditor classes without clear reasons may undermine the effectiveness of bank liquidation proceedings. In line with existing international guidance, the number of priority classes should be kept to a minimum.[186]

345. There should be no material difference between the order of loss allocation to creditors in bank resolution and in liquidation.[187] Significant divergences between

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185 See also *FSB Key Attributes*, KA 7.4, which states that "*The treatment of creditors and ranking in insolvency should be transparent and properly disclosed to depositors, insurance policy holders and other creditors*." The liquidation authority should therefore not have the discretion to define the relative ranking of claims.

186 See *World Bank Principles*, C12.3; *UNCITRAL Legislative Guide*, Recommendation 187.

187 *The Case for Depositor Preference*, p. 4.

creditor treatment in resolution and liquidation increase the risk of legal challenges and compensation claims under the NCWO safeguard.

346. In line with existing international guidance, the legal framework should ensure that the rights of creditors and the priorities of claims established prior to the commencement of bank liquidation proceedings be upheld throughout the proceedings to preserve the legitimate expectations of creditors and promote predictability.[188] Deviations from the *pari passu* treatment of creditors of the same class in the liquidation of a non-systemic bank should occur only to maximise value for the benefit of all creditors as a whole or to protect depositors, while in any case no creditor is financially disadvantaged with respect to piecemeal liquidation of the entire bank (see *Chapter 6. Liquidation Tools, Section D.6*).[189] In the context of resolution, deviation from *pari passu* treatment may be justified for other reasons, which fall outside the scope of this *Legislative Guide*.[190]

Key Consideration and Recommendations 68 – 70

Key Consideration

➢ When designing the creditor hierarchy applicable to bank liquidation proceedings, the potential impact of that ranking on the ability to achieve effective bank resolution should be considered.

Recommendations

68. The legal framework should clearly set out the creditor hierarchy applicable in bank liquidation proceedings. This should be done either in a dedicated bank liquidation law or, where the general business insolvency rules on ranking apply to bank liquidation, by introducing clear bank-specific provisions.

69. The number of creditor classes should be kept to a minimum. In principle, creditors should be treated as a single class unless there are

188 *World Bank Principles*, C12.1.

189 For instance, deviations from the *pari passu* principle may arise if contingent liabilities are left behind with the residual entity, when equally-ranking claims are included in the transfer perimeter (See *Chapter 6. Liquidation Tools, Section D.6*).

190 In resolution, departure from equal treatment is permitted if necessary to contain the potential systemic impact of a firm's failure or to maximise the value for the benefit of all creditors as a whole. Where such deviation takes place, creditors are protected by the NCWO safeguard which confers a right to compensation. See *FSB Key Attributes*, KA 5.1.

fundamental differences in the legal and economic nature of their relationship with the bank or compelling reasons of policy for distinguishing between them.

70. Subject to bank-specific liquidation rules, as stated in *Recommendation 68*, the legal framework should ensure that the rights and priorities of creditors established prior to insolvency proceedings under commercial or other laws be upheld in bank liquidation proceedings to preserve creditors' legitimate expectations and ensure predictability.

C. Ranking of depositors

347. Depositors tend to make up a significant percentage of a bank's creditors. When a bank fails, the inability of depositors to access their deposits could be disruptive and damaging to the general confidence in the banking sector. The objective of depositor protection is to reduce such negative impacts (see *Chapter 1. Introduction, Section H.2*). The DIS is key to depositor protection and avoiding bank runs. Depositor preference, i.e., ranking deposit claims ahead of ordinary unsecured claims, is another means of pursuing that objective.[191]

348. Rules concerning the ranking of deposit claims differ across the world. Depositor preference is present in a majority of jurisdictions that have deposit insurance[192], although several jurisdictions do not contemplate it.[193] The form of depositor preference – "general", "insured" and "tiered" – varies across jurisdictions.

349. "General depositor preference" grants an equal preference to all depositors regardless of their status (e.g., insured and uninsured, eligible and not eligible) and the amount of the deposit; "insured depositor preference" grants preference only to deposits that are insured by the DIS (and insurance coverage limits vary significantly across jurisdictions); and "tiered depositor preference" grants preference to insured deposits over uninsured deposits, and some or all of the latter over ordinary

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191 The scope of depositor preference is linked to the definition and legal qualification of instruments as "deposit", which differs across jurisdictions and falls outside the scope of this *Guide*. For the purposes of this *Guide*, "deposit" means any credit balance which derives from normal banking transactions and which a bank must repay at par under the applicable legal and contractual conditions, any debt evidenced by a certificate issued by a bank, and any other funds or obligations defined or recognised as deposits by the applicable legal framework (see *Glossary point (10)*).

192 According to IADI (2023 Annual Survey), 82% of DIS operate under legal frameworks with some form of depositor preference.

193 E.g., Brazil, Canada, Japan, and South Korea do not have depositor preference at the time of writing of this *Guide*.

unsecured claims (see Illustration 2). In jurisdictions with a DIS, the DI enjoys preference through subrogation under each form of depositor preference.

Illustration 2. Relative ranking of depositors' claims[194]

<table>
<tr><th>No depositor preference</th><th>Insured depositor preference</th><th>Tiered depositor preference</th><th>General depositor preference</th></tr>
<tr><td rowspan="4">All deposits (and DI's subrogation claims) rank equally with ordinary unsecured claims</td><td>Insured deposits (those that are eligible and within the deposit insurance limit) and DI's subrogation claims enjoy preference</td><td>Insured deposits and DI's subrogation claims enjoy preference</td><td rowspan="3">All deposits and DI's subrogation claims enjoy preference</td></tr>
<tr><td rowspan="3">Uninsured deposits (including any portion of eligible deposits that exceed the coverage level) rank equally with ordinary unsecured claims</td><td>Uninsured deposits meeting specified criteria (typically, portions of eligible deposits that exceed the coverage level) enjoy a more junior preference</td></tr>
<tr><td rowspan="2">Uninsured deposits not meeting the criteria for preference rank equally with ordinary unsecured claims</td></tr>
<tr><td>Ordinary unsecured claims</td></tr>
</table>

[194] The result of insured and tiered depositor preference can be replicated in jurisdictions without a DIS by creating cascades based on certain thresholds. Instead of "insured deposits", the legal framework could refer to deposit claims up to a certain limit, while "uninsured deposits" would refer to deposit claims exceeding that limit.

350. Based on past experience, there are compelling reasons for a preferential treatment of bank deposits. Reasons in favour include deposits' distinct legal features,[195] and policy reasons (reducing runs and contagion, protecting the payment system, reducing DIS costs, aligning the treatment of deposits with the protection granted under resolution).[196] There may also be some potential disadvantages (e.g., potentially higher cost of bank funding, regulatory arbitrage or increased encumbrance of bank assets as other creditors take a "flight to quality" to protect themselves).[197]

351. It is generally recommended that the legal framework adopt some form of depositor preference.[198] In any event, jurisdictions should make their own choice weighing the potential advantages of depositor preference against the potential disadvantages, including the impact on other unsecured funding sources and their costs, the role of uninsured deposits (i.e., their importance in the payment system as working capital rather than financial investments), moral hazard, the ability of institutions to absorb potential changes in funding structures, and the liability structure of their banking industry, in the context of their legal and judicial framework and financial system structure.

352. The ranking of deposits shapes how other claims can be treated. It also determines the recoveries of the DI in a piecemeal liquidation, as the DI subrogates to the rights of insured deposits.[199] The higher the subrogating DI's ranking, the more it can expect to recover from the failed bank's assets in piecemeal liquidation after a payout.[200]

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195 See *The Case for Depositor Preference*, p. 5.

196 *Ibid* p. 11. See also Kumudini Hajra *et al*, *Depositor Preference and Implications for Deposit Insurance, IADI Briefs* (2020), p. 4.

197 *Ibid* pp. 11-12; p. 5.

198 *The Case for Depositor Preference*, p. 15. Insured depositor preference may provide insufficient depositor protection when the level of deposit insurance coverage is low, or where deposits of small- and medium-sized enterprises are not eligible for protection.

199 *See IADI Core Principles,* CP 16. None of the surveyed jurisdictions contemplates a difference in treatment between the ranking of claims of deposits and the claims of the DI subrogated to such depositors.

200 With a high-priority ranking, the role of the DI in a piecemeal liquidation would be akin to a liquidity provider given that it would be expected to have high recoveries. Asset encumbrance also influences the recoveries for the DI. Creditors with a security interest on assets of the bank must generally be satisfied first (see *Section H*), which reduces the pool of assets available to satisfy the other, unsecured creditors. Furthermore, the recovery rate of the DI is influenced by the timing of the intervention. As indicated in *Chapter 5. Grounds*

353. The treatment of the subrogating DI's claim can also affect the DI's ability to fund transfers. Rules often limit the use of DIF resources to fund non-payout measures such as transfers by stipulating that the resources used may not exceed the costs the DIF would incur in a payout ("payout counterfactual", see *Chapter 7. Funding, Section C.2*). If the payout counterfactual is calculated "net" of liquidation recoveries, a DI that is expected to recover more in a piecemeal liquidation may be able to contribute less (or nothing) to non-payout measures, e.g., to support a transfer strategy.

354. The form of depositor preference and the relative ranking of the class applicable to insured deposits are key determinants of the DI's liquidation recoveries. They affect the feasibility of transfer strategies,[201] as explained in the following paragraphs. However, in addition to the impact of depositor ranking on the use of transfer tools, legislators should also consider all the policy implications of the various options (see paragraph 350).

355. In the absence of depositor preference, the DI, upon subrogation to the claims of insured depositors, ranks equally with all other ordinary unsecured creditors. This reduces the share of DIS recoveries in a piecemeal liquidation and, correlatively, by increasing the net costs to the DI in the payout counterfactual, creates greater scope for the DI to contribute funding for transfer-based strategies. However, it might be difficult to respect the *pari passu* principle where insured (and possibly uninsured) deposits are transferred while equally ranking claims of other creditors are left behind in the residual entity.[202] While a sale as a going concern is generally expected to increase value, depending on the case this may not be sufficient to ensure that the creditors left behind in the residual entity are not worse off than in a piecemeal liquidation.

356. In the case of insured or tiered depositor preference, the DI has, through subrogation, a priority claim to the assets in the liquidation over uninsured depositors and all other ordinary unsecured creditors. Insured and tiered depositor preferences are likely to lead to similar levels of recoveries for the DI, but under tiered depositor preference the recovery levels for ordinary unsecured creditors are lower since (at least some) uninsured deposits are preferred over such claims. Insured or tiered

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for Opening Bank Liquidation Proceedings, a timely initiation of bank failure management proceedings is crucial – and is beneficial for DI recovery rates.

201 The contribution of the DI also depends on the methodology for calculation of the costs the DIS would incur in the payout counterfactual.

202 In Japan, the DICJ addresses this issue by extending its financial assistance to the failed bank as well as the assuming bank, and adjusting the amounts of the financial assistance between both banks so that *pari passu* treatment between the insured depositors transferred to the assuming bank and other creditors left at the failed bank can be achieved.

depositor preference reduces the costs of bank failures to the DIS and reduces the constraints of the *pari passu* principle on a transfer strategy, as long as the only deposits being transferred are those with a higher ranking than ordinary unsecured creditors. By contrast, the flexibility to pursue transfer strategies may be constrained in a system of insured depositor preference since a transfer of uninsured deposits alongside insured deposits, in whole or in part, while ordinary unsecured creditors with the same ranking are left behind in the residual entity, will deviate from the *pari passu* principle. A similar problem arises if the preference is capped at a certain amount, and it is impractical to transfer deposits only in part. In any event, insured or tiered depositor preference may make it difficult for the DI to contribute funding to a transfer-based strategy depending on the ranking of deposits relative to other preferred claims and the limits and safeguards applicable to the DI's contribution.

357. In the case of general depositor preference, the DI has, through subrogation, a claim above ordinary unsecured creditors but equal to all other deposit liabilities. As a result, the share of recoveries for the DIS in liquidation following a payout will be lower than under a system of insured depositor preference, but higher than under a system of no depositor preference. General depositor preference facilitates a greater contribution by the DI to a transfer strategy compared to other forms of depositor preference, while not affecting in any way the level of protection of insured depositors by the DI. Furthermore, general deposit preference facilitates transfers comprising all deposits, since the special treatment of all deposits would be justified by their ranking ahead of ordinary unsecured creditors. As indicated in *Chapter 6. Liquidation Tools, Section D.2*, the legal framework should not limit transfers to insured deposits only, but instead allow transfers involving other deposits if this serves the bank liquidation objectives.

358. Some form of depositor preference is generally recommended, but the ranking of depositors will be informed by a range of policy considerations. However, whatever type of depositor ranking is chosen, the legal framework should reflect this clearly and transparently.

359. The legal framework should not treat depositors differently based on their nationality, the location of the deposit claim, or the jurisdiction in which the claim is payable.[203] Such discriminatory treatment could undermine effective cross-border coordination, and should be avoided. For example, preferring deposits in the bank's home jurisdiction over deposits at its foreign branches may diminish the willingness

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[203] See, similarly, *FSB Key Attributes*, KA 7.4; *IADI Core Principles*, CP 8.7 and 14.7. In the case of deposits held through branches, the law determining deposit treatment is normally that applicable to the legal entity in the home jurisdiction, although there may be exceptions. The law applicable to deposits held through a subsidiary is normally that of the jurisdiction of the subsidiary. For further guidance, see *Chapter 10. Cross-Border Aspects*.

of authorities in the host jurisdiction to cooperate and may incentivise ring-fencing. Instead, harmonisation of creditor hierarchies through depositor preference – which avoids any form of discrimination, as noted above – would help to align incentives for cooperation across jurisdictions.

360. Depositor preference should not, in any case, be seen as a substitute for deposit insurance. Depositor preference alone does not reduce the risk of contagion and bank runs to the same extent as when combined with deposit insurance.[204] Where depositors lose access to their funds, the DIS is needed to carry out a swift reimbursement, up to the applicable coverage level. Deposit insurance can also help fund non-payout measures where consistent with the DI's mandate. Jurisdictions increasingly combine deposit insurance and depositor preference.[205] In jurisdictions with a DIS, legislative provisions on depositor preference and deposit insurance should be coordinated. Particularly, the ceiling for depositor preference, if any, should not be lower than the ceiling for deposit insurance,[206] and the DI and insured depositors should be granted the same ranking.[207]

361. As indicated above, pursuant to the *IADI Core Principles*, the DI should have the right to recover its claims after a payout and therefore subrogate to the rights of insured deposits. If a jurisdiction grants some form of depositor preference, the

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204 Depending on the type, depositor preference could partially mitigate the likelihood of contagion by providing depositors with a higher probability of recovering their claims in a bank failure. However, it does not address the speed with which uninsured depositors will recover their funds. Therefore, although depositors will have a preferred status, given that they will lose access to their funds pending settlement of claims in the liquidation, depositors' fears of a bank failure may persist.

205 IADI (2023) *Annual Survey*.

206 If the legal framework sets a specific ceiling for depositor preference that is lower than the ceiling for DIS coverage, the DI would enjoy a preference only for a portion of the claims to which it has been subrogated. Where the ceiling for depositor preference is disproportionately low, the DI will rank *pari passu* with other senior unsecured creditors for a large portion of its subrogated claims when seeking reimbursement. This is problematic as it could put DIF resources at risk. Setting the ceiling for depositor preference at the same or at a higher level than the limit of the DIS coverage provides better protection for the DI.

207 See *The Case for Depositor Preference*, p. 13, noting that in some jurisdictions, preference is given to DI claims only, presumably on the assumption that insured depositors will be protected in any case as they will be paid out by the DI. However, this approach is not recommended since it can make it difficult to protect insured deposits in cases when no DI payouts are made – such as using transfer tools in liquidation (or bail-in or transfers in resolution). A preferential treatment of insured deposits in the application of such tools in the absence of a preferred ranking may lead to litigation and successful compensation claims.

DI's subrogation claims resulting from a deposit payout will enjoy the same priority.[208]

362. The legal framework may, for policy reasons, allow advance payments to depositors (e.g., retail clients and micro-, small- and medium-sized enterprises) after the bank is placed into liquidation and provided that the deposits are not transferred to another bank (see *Chapter 6. Liquidation Tools, Section F* and *Recommendation 56*). Such withdrawals need to be considered as on-account payments for the purpose of the treatment of creditors generally. This means that the amount payable to those depositors in the liquidation should be reduced to take into account the advance payments. In a case where deposits up to a certain level (e.g., the insurance threshold) are transferred, the amount already provided as an advance payment needs to be deducted.

363. Jurisdictions should also consider the ranking of related party deposits. Such deposits may be excluded from deposit insurance protection.[209] It is recommended that the legal framework also specify that related party deposits do not benefit from depositor preference. As a result, related party deposits could rank *pari passu* with, or be subordinated to, ordinary unsecured claims.

364. Finally, jurisdictions should carefully consider the treatment of interbank deposits. Interbank deposits are often excluded from deposit insurance and typically exceed the coverage level offered by deposit insurance.[210] However, the policy considerations need to be weighed. On the one hand, the inclusion of interbank deposits within the scope of depositor preference appears less justified than for individuals and smaller corporate depositors, because banks are in a better position to monitor the activities and risks of other banks. Awarding interbank deposits a preferential treatment might therefore weaken market discipline. On the other hand, that very circumstance makes interbank deposits particularly prone to runs.[211] In the

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208 See *IADI Core Principles*, CP 16, EC 1.

209 See *IADI Core Principles*, CP 8, EC 1 and footnote 16 thereto ("*[…] some specific types of deposits may be excluded or considered ineligible for protection. These may include: […] deposits of individuals who are regarded as responsible for the deterioration of an institution, including deposits belonging to the directors, managers, large shareholders*").

210 *Ibid* ("*[…] some specific types of deposits may be excluded or considered ineligible for protection. These may include: interbank deposits […]*"). According to the IADI Annual Survey 2022, only 8% of jurisdictions cover interbank deposits. See also World Bank Policy Research Working Paper 3628, "*Deposit Insurance around the World: A Comprehensive Database*" (2005), p. 7. At the time, only 13 out of 80 countries extended coverage to interbank deposits (p. 12).

211 See, e.g., IMF Occasional Paper 197, "*Deposit Insurance: Actual and Good Practices*" (2000), p. 4.

case of general depositor preference, all deposits – including interbank deposits – would rank above ordinary unsecured claims, which may help to reduce the risk of runs. Where policy reasons justify treating interbank deposits differently, jurisdictions may consider granting interbank deposits a ranking above ordinary unsecured claims but below deposits of retail clients and micro-, small- and medium-sized enterprises, to reflect the difference in the level of sophistication and capabilities of risk management between banks on the one hand, and individuals and smaller corporate depositors on the other.

Key Considerations and Recommendations 71 – 74

Key Considerations

- The choice about the ranking of depositors and the DI's claims should serve the objectives of orderly and cost-effective bank failure management processes and facilitate the use of resolution and liquidation tools, including a possible transfer of assets and liabilities to another entity. From a funding perspective, general depositor preference facilitates deposit book transfer as compared to tiered depositor preference, and it eases the transfer of both insured and uninsured deposits.

- Jurisdictions considering introducing some form of depositor preference, or changing their existing depositor preference arrangements, should weigh the advantages and disadvantages in the context of their legal and judicial framework and financial system structure.

- Depositor preference should not substitute for deposit insurance. Deposit insurance is needed to ensure a quick reimbursement of insured deposits and may facilitate continued access to such deposits through transfer to another entity.

Recommendations

71. The legal framework should clearly specify the chosen type of relative depositor ranking.

72. Jurisdictions should consider granting deposit claims a preferred ranking, bearing in mind the Key Considerations above when choosing between different forms of depositor preference.

73. The legal framework should clearly set out the substantive scope of any form of depositor preference. Related party deposits, at least if

excluded from deposit insurance, should not benefit from any preferential treatment granted to other deposits. The legal framework should clarify the treatment of interbank deposits.

74. The legal framework should not discriminate between depositors based on the nationality of the depositor, the location of the deposit claim, or the jurisdiction in which the claim is payable.

D. Subordinated claims

365. Claims may be subordinated by contractual agreement (contractual subordination), statutory provision (statutory subordination), or court order.

1. Contractual subordination

366. Contractually subordinated claims result from an agreement between one or several creditors and the debtor or between creditors, by which some creditors agree that their claims will be paid only after other creditors' claims have been satisfied.[212] This is normal practice in business insolvency, since creditors may wish to subordinate their claims to ensure that the debtor continues to have access to liquidity. In the case of banks, debt instruments may include a subordination clause to ensure loss absorbency in resolution or liquidation.

367. Subordinated debt fulfils important functions for banks, and thus the legal framework should enforce subordination agreements in the context of liquidation and resolution. It is recommended that the legal framework include an express recognition of contractual subordination clauses in the context of liquidation if the combined effect of contract law and business insolvency law casts some doubt over such recognition. It is also recommended that such express recognition encompass both "total subordination" clauses, which, e.g., subordinate the claim to "the claims of all ordinary unsecured creditors", and "partial subordination" clauses, which subordinate the claim of a specific creditor to the claims of other, specific creditors.

Recommendation 75

Contractually subordinated claims

75. The legal framework should enforce subordination agreements in the context of liquidation and, where appropriate, include an express

212 *UNCITRAL Legislative Guide,* Part Two, Chapter V, para. 57.

recognition of the enforceability of subordination clauses in the context of bank liquidation. Such express recognition should encompass both "total" and "partial" subordination clauses.

368. As a general exception to the enforceability of subordination agreements, however, the result of the agreement cannot be to provide to the claim a ranking higher than would otherwise be accorded to the particular creditor under the applicable law.

369. The rules on contractual subordination should be coordinated with any special rules on the validity or enforceability of intra-group support arrangements (see below, and also *Chapter 9. Group Dimension*).

2. Statutory subordination

370. In general, ranking and priorities should follow the general rules applicable to liquidation proceedings under the legal framework, including on statutory subordination. If the legal framework makes express provision for the subordination of certain types of claims, these provisions should govern the subordination of those claims, and contractual subordination provisions should apply in light of the statutory provisions.

371. One specific instance where statutory subordination may be warranted is related party claims, including intra-group debt (see below *subsection 4*).

3. Equitable subordination

372. Equitable subordination may occur when a creditor has gained an advantage over other creditors by committing fraud, illegality or unfairly using its special access to the debtor. In such cases, the court or administrative liquidation authority should have the power to change the priority of payment of claims to prevent that creditor from benefitting from such advantage.

373. The term "equitable subordination" has a specific meaning, referring to the "equitable powers" of courts, which is normally associated with some common law jurisdictions. Indeed, the results of the survey undertaken in preparation of this *Guide* showed that the concept of "equitable subordination" did not exist in most

jurisdictions, and where it did, it was used mainly in the context of subordination of intra-group or related party claims.[213]

4. Related party claims

374. In a group context, the privileged position of a sole shareholder, parent or affiliated company gives rise to the risk that the financing may not be concluded at arm's length, and may result in unfair treatment to other creditors. This makes it desirable for the legal framework to provide for a form of subordination for related party claims, in order to deter wrongdoing, or remedy clear situations of injustice.

375. Business insolvency best practices recommend that claims by related parties be subject to scrutiny, including the possibility of subordination.[214] It is generally recommended that business insolvency laws include mechanisms for identifying types of conduct or situations in which claims will deserve such additional attention.[215] In many jurisdictions, the legal framework explicitly contemplates the subordination of intra-group or related party claims (directly, or subject to conditions). In others, this is possible through the application of other provisions in the legal framework.[216]

376. When designing the legal framework on bank liquidation, jurisdictions should pay special attention to the treatment of related party claims and ensure that they are subject to greater scrutiny.[217] The legal framework should also facilitate the

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213 For instance, equitable subordination is possible in Ghana but is unused in practice there. China contemplates the possibility of equitable subordination and has applied it in practice to shareholder claims.

214 *UNCITRAL Legislative Guide*, Part Two, Chapter V (para. 48, Recommendation 184).

215 *Ibid.* See also *UNCITRAL Legislative Guide*, Part Three, Chapter II (para. 85; and paras. 86-87 for some examples).

216 Some frameworks contemplate the subordination of debt between related parties, including intra-group claims. Among these, some provide for an automatic subordination, others apply a reasonableness test (i.e., subordination in cases where it would have been more reasonable to provide an equity injection) or an arm's length test (i.e., subordination of shareholders' loans not provided under arm's length terms). Other frameworks do not explicitly contemplate intra-group subordination. However, intra-group subordination may result in practice as a result of the configuration of the debt instruments' loss-absorption, the fact that it results from transactions not conducted at arm's length or the adoption of reorganisation plans. Competent authorities may also be able to achieve it through exercise of their powers, which may include drastic remedies such as substantive consolidation.

217 Jurisdictions with a DIS typically consider related party deposits ineligible for insurance, and some jurisdictions have subordinated them to avoid moral hazard issues. See

identification of situations that deserve special attention. In any event, related party deposits should not benefit from any form of depositor preference, at least if they are excluded from deposit insurance (see *Recommendation 73*). Furthermore, jurisdictions should consider subordinating related party claims and specify their legal approach to subordination accordingly, taking into account the benefits of subordination as a rule and other policy implications (e.g., the cost of intra-group financing). The legal framework may take different approaches to subordinating related party claims. These can be broadly categorised as "principles-based", "mixed" and "rules-based".

377. Under a principles-based approach, the legal framework vests the liquidation authority with the power to subordinate the claims of creditors who have obtained an advantageous treatment by means of fraud or inequitable conduct, and this would result in an unfair treatment towards other creditors. These powers should also allow the authority to annul the security granted by the debtor to the creditor.

378. Under a "mixed" approach, the legal framework provides for the subordination of claims by related parties, defined in line with the definition included in the applicable banking law (e.g., directors, shareholders holding more than 10%, etc.), when certain conditions are met. Those conditions might include, for example, that the debt financing was granted in a situation where the company receiving the assistance is undercapitalised or in financial difficulties; that it masks what would otherwise be an equity contribution; that there is evidence of self-dealing; and/or that the related party claim results in unfair treatment of other creditors.

379. Under a rules-based approach, the legal framework automatically subordinates the claims from loans granted by certain related parties, defined precisely in line with the banking law. The framework could allow creditors to present evidence that the financing was granted on market-like terms, with a legitimate business purpose (rather than to disadvantage other creditors), and without self-dealing.

380. An analysis of current laws and practices across jurisdictions does not suggest a preferred approach. However, it is recommended that the legal framework at least recognise that related party (including intra-group) debt may be subordinated as a rule or in certain circumstances, in order to mitigate the risk of such related parties obtaining an unfair advantage, or even engaging in fraudulent conduct.

381. Each jurisdiction should choose its approach to subordination of related party claims. However, statutory subordination offers various advantages, including

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The Case for Depositor Preference, p. 14. Banking laws typically specify the categories of persons with sufficient connection to the bank to be treated as related persons.

facilitating resolution and certain liquidation strategies (e.g., transfers) and reducing litigation risk; mitigating moral hazard risks; impeding asset stripping; and supporting prudential rules on transactions with related parties. Given the specific nature of the banking business, international prudential principles are relatively strict, requiring banks to enter into transactions with related parties on an arm's length basis, and supervisors to monitor these transactions.[218] The legal framework governing bank liquidation can reinforce this by providing for the statutory subordination of intra-group claims that are not concluded at arm's length. Also, when related party transactions are not monitored regularly, or there is special concern about related party abuses, the automatic subordination of certain related party claims may be appropriate. In general, it may be recommended to introduce statutory subordination where the application of other forms of subordination under the legal framework (e.g., equitable subordination) is uncertain, or unlikely to apply to banks.

382. Regardless of the approach chosen, the legal framework should ensure that the rules on subordination of related party claims are fully aligned with the rules on post-liquidation financing and the rules on banking groups, as applicable to banks receiving funding from their parent or another group company. The legal framework should be especially clear about the treatment of post-liquidation financing (*Section G* below) when this is provided from within the group. Where jurisdictions, for reasons of policy, provide for any special rules or exceptions to the subordination of intra-group financing granted in the "twilight" pre-liquidation phase, this should be subject to strict conditions and safeguards (see *Chapter 9. Group Dimension*).

Recommendations 76 – 77

Subordination of related party claims

76. The legal framework should specify that claims by related parties should be subject to greater scrutiny in bank liquidation proceedings. Jurisdictions should consider subordinating the claims of related parties, including companies within the same group, taking into account any provisions in the banking law that specify the categories of persons with sufficient connection to the bank to be treated as related persons.

77. The legal framework should clearly specify the approach to subordination of related party claims. Jurisdictions should choose the approach that better aligns with their general legal framework, and considering policy implications such as the effect on moral hazard,

218 See *Basel Core Principles*, CP 20.

alignment with the arm's length principle in prudential rules, asset stripping risks, and the effectiveness of bank failure management strategies. Statutory provision for the subordination of related party claims is recommended, especially if the possibility of subordinating such claims under the general business insolvency law is uncertain and/or remote.

5. Claims for post-liquidation interest

383. Business insolvency laws take different approaches to the accrual and payment of interest on claims during liquidation proceedings. [219] In some jurisdictions, interest ceases to accrue on unsecured debts once liquidation proceedings are opened. In others, interest may accrue but payment is given a low priority (e.g., after the payment of all unsecured creditors).

384. In bank liquidation proceedings, a stay should in principle apply from the moment the proceedings are opened (see *Chapter 6. Liquidation Tools, Section G*).[220] This entails that the bank's debt obligations are frozen and that creditors are unable to enforce claims for interest that might be accrued during the liquidation proceeding. At the same time, the liquidation estate will continue to profit from the interest on its outstanding loans, to the extent these are not terminated. This might ultimately, after a lengthy process, result in a positive account where all creditors – including subordinated creditors – can be paid in full, while creditors with a more senior ranking might only receive interest payments *after* the termination of the proceedings. In economic terms, this means that senior, non-preferred creditors with interest claims provide finance to subordinated creditors: subordinated creditors can be paid in full *during* the bank liquidation proceeding because the interest claims of senior, non-preferred creditors are deferred to *after* the termination of the proceeding.

385. This result is undesirable for several reasons: (i) it is contrary to the normal, statutory hierarchy of creditors in which senior, non-preferred creditors trump junior, i.e., subordinated, creditors; (ii) it reduces the extent to which subordinated debt claims can be written down or converted into equity in resolution; and (iii) if subordinated claims are made subject to bail-in in resolution, it increases the risk that holders of such debt will have a claim for compensation based on the NCWO safeguard.

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219 See *UNCITRAL Legislative Guide*, Part Two, Chapter V (para. 49).

220 As explained in *Chapter 6 . Liquidation Tools, Section I*, special rules should apply for financial contracts in a sale as a going concern.

386. To avoid this, unsecured creditors should be allowed to file their interest claims (where appropriate, on a *pro memoria* basis[221]) and, in the creditor hierarchy, subordinated creditors should rank lower than ordinary unsecured creditors, including as regards any claims for interest accrued by those ordinary unsecured creditors during the liquidation proceeding.

Recommendation 78

Ranking of subordinated creditors below senior unsecured creditors, including interest claims

78. The legal framework should ensure that subordinated creditors rank lower than ordinary unsecured creditors, including any claims of those ordinary unsecured creditors for interest accrued during the liquidation proceeding. If creditors are required to file their claims as of the opening of bank liquidation proceedings, they should be allowed to file their interest claims *pro memoria*.

E. Ranking of shareholders

387. Under business insolvency law, shareholders generally rank behind all creditors in the distribution of the proceeds from the liquidation estate with respect to their equity interests. In other words, equity interests or the owners of the business are not entitled to a distribution of proceeds from the liquidation estate until the creditors have been fully repaid (including claims of interest accrued after the opening of liquidation proceedings).[222] As such, shareholders will rarely receive any distribution from the estate. If there are remaining assets after distribution to creditors, any distribution to shareholders is normally proportionate to the shares they hold in the failed entity.

388. The same should apply in bank liquidation proceedings. This would also ensure alignment of treatment of equity holders in bank liquidation proceedings and in bank resolution proceedings pursuant to the *FSB Key Attributes*, since KA 5.1 specifies that equity should absorb losses first, in line with the hierarchy of claims in liquidation. If a transfer tool is used, this result may be achieved by leaving the equity interests behind in the residual entity.

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221 This would mean that the claim is filed but the value thereof is determined at a later stage.

222 *UNCITRAL Legislative Guide*, Part Two, Chapter V, para. 76.

389. Shareholders may also have claims arising from loans provided to the bank. Such debt claims are not always subordinated in business insolvency laws.[223] The ranking of shareholder loans in bank liquidation proceedings is covered in *Section D.4* above.

Recommendation 79

Ranking of equity holders

79. The legal framework should ensure that holders of equity in the bank rank below creditors, with the result that holders of equity are not paid until the bank's creditors have been fully repaid.

The same principle should apply where a transfer tool is used.

F. Ranking of resolution financing arrangements

390. Pursuant to the *FSB Key Attributes*, jurisdictions should have in place privately-financed deposit insurance or resolution funds, or another funding mechanism that allows *ex-post* recovery from the industry if temporary financing is used to facilitate the resolution of a bank.[224] The ranking and status of the DIS are discussed above (see *Section C* above). Jurisdictions with distinct resolution financing arrangements should clearly specify the ranking of claims of such financing arrangements in the liquidation of the residual entity.[225] Similarly, the legal framework should specify the ranking of government claims, to the extent that public funding has been used in the bank resolution.

G. Ranking of post-liquidation financing

391. In business insolvency, the continuation of a debtor's business after the commencement of a liquidation proceeding is critical when the business is sold as a going concern. This requires that the debtor have access to funds to cover operating expenses and maintain the value of assets.[226] These considerations are also relevant for banks, where transfer of the business as a going concern is key for the

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223 *Ibid*.

224 *FSB Key Attributes*, KA 6.3.

225 Jurisdictions follow different approaches. In some, resolution financing arrangements enjoy a preferential ranking (e.g., as a liquidation expense) while no special treatment is foreseen in others.

226 *UNCITRAL Legislative Guide*, Part Two, Chapter II, paras. 94-95.

preservation of value (see *Chapter 6. Liquidation Tools, Section B*) and access to funding is essential to ensure an orderly exit. In the case of banks, funding is likely to be needed to cover a funding gap, most commonly when there is a difference in value between the assets and liabilities to be transferred. Funding to continue the entity's business may be less relevant for bank liquidation, given that a transfer needs to take place swiftly and, following a transfer, the necessary funding will come from the acquirer. As explained in *Chapter 7. Funding*, DIF resources are an important potential source of external funding in bank failure management. However, it cannot be excluded that a private lender is willing to facilitate a bank's liquidation strategy. The legal framework should enable the provision of post-liquidation financing by acknowledging it, when necessary, in the rules on creditor ranking. When establishing the conditions for treatment as post-liquidation financing, jurisdictions should follow general principles of business insolvency law.[227]

392. The legal framework can grant a preference by treating post-liquidation financing as a form of administrative expense, i.e., ranking ahead of ordinary unsecured creditors and other statutory priorities, but not ahead of secured creditors with respect to their security interest; or, if that is insufficient to make post-liquidation financing available, even granting a "super-priority", i.e., ranking it ahead of other administrative expenses.[228] When post-liquidation creditors demand security, this may be granted over unencumbered assets, or as a junior or lower security over already encumbered assets when their value is sufficient. The legal framework should not allow creditors to improve their position by demanding that a portion of the post-liquidation financing be used to pay off their pre-petition claim (so-called "roll up").

393. Given the urgency of the situation, the authorisation process for post-liquidation financing should not be excessively cumbersome. In jurisdictions with an administrative model, the provision of post-liquidation financing should be subject to the approval of the liquidator and/or the administrative liquidation authority. In jurisdictions with a predominantly court-based model, the general business insolvency law may in principle apply.[229] However, in the interest of speed, it may be sufficient to make the provision of post-liquidation financing subject to the approval of the liquidator. The banking authority should be heard before any authorisation of post-liquidation financing is granted. Jurisdictions should consider

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227 *Ibid.* paras. 96-107.

228 *Ibid.* paras. 101-102. Some jurisdictions also grant priority/super-priority to litigation funding, subject to adequate safeguards, in the understanding that it may increase recoveries.

229 *UNCITRAL Legislative Guide*, Part Two, Recommendation 63.

whether there are instances where, owing to the significance of the funding, the effects on other creditors or other risks, the authorisation of the court is needed.

Recommendations 80 – 82

Treatment of post-liquidation financing

80. The legal framework should facilitate the provision of post-liquidation financing for the continued operation of the bank's business or the preservation or enhancement of the value of the estate, by providing adequate protection for its providers. That protection should be balanced with the interests of the parties whose rights may be affected by the provision and treatment of post-liquidation financing.

81. The legal framework should establish the ranking of claims related to post-liquidation financing. This may consist of their treatment as an administrative expense, ahead of ordinary unsecured creditors and other priority claims, but not ahead of secured creditors with respect to their security interest; or as a special administrative expense, ranking ahead of other administrative expenses.

82. The urgency of the situation requires that the time for approving post-liquidation financing be minimised. In jurisdictions with an administrative model, the legal framework could specify that post-liquidation financing be subject to the approval of the liquidator and/or the administrative liquidation authority. In jurisdictions with a predominantly court-based model, the power to authorise post-liquidation financing could be granted to the liquidator, after hearing the relevant banking authority.

H. Secured creditors

394. One of the hallmarks of a system that protects security interests are "*clear rules of ownership and priority governing hierarchy of competing claims or rights in the same assets, eliminating or reducing priorities over security rights as much as possible*". [230] Secured creditors' rights are enforceable in business insolvency proceedings, often subject to a temporary stay of enforcement (*see* *Chapter 6. Liquidation Tools, Section G*). The same should apply in bank liquidation proceedings.

230 *World Bank Principles*, A2, A3.

395. Security interests are particularly relevant in bank financing. Certain types of financing, such as covered bonds, are dependent on it, and interbank lenders (including central banks) frequently hold interests in securities as collateral. These and other types of bank financing may not be available if the legal framework does not protect them through the creditor hierarchy, as most insolvency laws already do. This may be achieved by means of appropriation, a priority claim on the proceeds of the sale of collateral, or over the general proceeds of the insolvency estate (up to the value of the secured claim). Claims in excess of the value of the encumbered asset are generally treated as ordinary unsecured claims. However, some specificities in the case of central bank financing may be warranted, as discussed below.

396. The priority granted to secured creditors may be an absolute priority, which seems warranted as a general rule, or they may rank after the general costs of the liquidation proceeding[231] and/or some other specific claims (e.g., unpaid wage claims or deposit claims[232]) if there are strong reasons to do so. In some jurisdictions, the amount that can be recovered in priority over the collateral is limited to a certain percentage.[233] Distributions to secured creditors should be made as promptly as possible.[234]

397. Moreover, beyond the preferential treatment applicable to secured creditors in general, or to secured creditors of bank debtors, the legal framework may include specific provisions for certain types of bank transactions. One example is covered bonds.[235] These are widely used in some jurisdictions, and enable banks to grant mortgages to consumers and businesses or finance public debt. While covered bonds' regulation is beyond the scope of this *Legislative Guide,* the treatment of bondholders' claims in the creditor hierarchy may incentivise their use. Some jurisdictions contemplate some form of segregation of the cover assets, or some form

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231 In some jurisdictions, secured creditors contribute to the general costs of the liquidation proceeding, directly or due to the higher ranking of such costs. In other countries, this may depend on whether the general costs of the liquidation process contributed to the safeguarding, realisation and delivery of the secured asset. Other jurisdictions in principle do not contemplate any contribution by the secured creditors to the general liquidation costs. Nevertheless, secured creditors may indirectly contribute to such costs if they retain a residual claim after the sale of the collateral which ranks *pari passu* with ordinary unsecured creditors.

232 E.g., in Colombia and Nigeria.

233 E.g., in Spain, the priority claim is limited to 90% of the reasonable value of the secured asset.

234 See *World Bank Principles*, C12.2.

235 Covered bonds are debt obligations issued by banks and secured against a ring-fenced pool of assets, generally referred to as the "cover pool" or "cover assets". The cover pool comprises high-quality assets, typically mortgage loans and public sector debt.

of security to ensure bondholders' protection.[236] Jurisdictions should consider whether existing general rules on secured creditors suffice, or whether explicit provision for their preferred treatment is desirable.

398. Central banks are another type of secured creditor that is of specific relevance in bank liquidation. In most jurisdictions, central banks provide liquidity through monetary policy operations and may also lend bilaterally to institutions that are experiencing liquidity stress. All such lending is collateralised. If a jurisdiction grants preferential treatment to secured creditors in insolvency, this should normally suffice to protect the central bank as a creditor. However, jurisdictions should examine whether additional provisions are needed to ensure the protection of the central bank as a secured creditor.[237]

Recommendation 83

Treatment of secured creditors

83. The legal framework should uphold the priority claims of a bank's secured creditors in relation to their collateral, and those claims should not be subordinated to other priorities granted during the bank liquidation proceeding (unless the secured creditor explicitly consents). Distributions to secured creditors should be made as promptly as possible. The legal framework should ensure that secured claims are paid to the extent of the realised value of the security or that the security be delivered to the secured creditor for sale or appropriation, if permitted under the legal framework.

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236 For instance, in the EU, minimum harmonised rules for covered bonds were introduced by Directive (EU) 2019/2162 (Covered Bond Directive). Bondholders have preferential rights and are entitled to "dual recourse" through a claim against the cover pool, where bondholders enjoy priority, and a claim against the insolvency estate of the issuing bank as ordinary unsecured creditor, for any deficit resulting from applying the proceeds of the cover pool to meet all liabilities. The cover pool assets must be segregated from the bank's estate, they may remain on balance sheet, or a special purpose vehicle may be used. In case of liquidation of a bank, covered bond investors continue to be repaid in accordance with the contractual schedule, i.e., there is no acceleration of payment obligations ("bankruptcy remoteness").

237 In some jurisdictions, the central bank enjoys an unconditional preferential right to satisfy each of its claims, from any cash balances, securities and other assets that it holds for the account of the debtor (distressed bank). This is more akin to set off, or a statutory lien.

CHAPTER 9. GROUP DIMENSION

A. Introduction

399. Irrespective of their size, banks operate within group structures in most jurisdictions. Banking groups tend to represent a majority of total banking assets. Banking groups may be located in a single jurisdiction or – typically for larger banks – may have cross-border operations through subsidiaries established in host jurisdictions (see *Chapter 10. Cross-Border Aspects*).

400. The most common structure for banking groups is a corporate structure; however, cooperative structures are also of special importance in many jurisdictions. While banking groups may be headed either by a bank or by a non-bank holding company, group structures with an operating bank as the parent company are common.

401. Banking groups' practical relevance and their specific consideration under prudential and bank resolution regimes contrast with their traditionally limited treatment under insolvency rules.[238] The entity-centric nature of national company laws and the lack of a uniform company law approach to groups have long been reflected in insolvency rules.[239] This trend changed recently, however, with some emphasis in international, regional and national provisions on procedural coordination or consolidation, or group-wide corporate restructuring.[240] Most notably, the *UNCITRAL Model Law on Enterprise Group Insolvency* (MLEGI) now promotes a group-oriented approach, including coordination and cooperation, and

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238 This Chapter draws on existing international standards and guidance concerning insolvency and resolution with group-related aspects (including the *FSB Key Attributes*, UNCITRAL Model Laws and the *UNCITRAL Legislative Guide*, *World Bank Principles*, and IMF papers).

239 E.g., the *UNCITRAL Model Law on Cross-Border Insolvency* (1997), the Credit Institutions Winding Up Directive 2001/24/EC and the European Insolvency Regulation No 1346/2000 are entity-centric.

240 The *UNCITRAL Legislative Guide* included, as of 2010, Part Three (Treatment of enterprise groups in insolvency), which informed national developments. The European Insolvency Regulation Recast of 2015 included provisions on groups, as did domestic legislation following national reforms in Belgium, Germany, Italy, and Spain. The *UNCITRAL Legislative Guide*, Part Three, defines "procedural coordination" as "*coordination of the administration of two or more insolvency proceedings in respect of enterprise group members. Each of those members, including its assets and liabilities, remains separate and distinct*". This is to be distinguished from "substantive consolidation", which is defined as "*the treatment of the assets and liabilities of two or more enterprise group members as if they were part of a single insolvency estate*".

"group insolvency solutions" resulting from group-level "planning proceedings",[241] which seek to preserve going concern value at the level of an integrated group to protect and maximise the combined value of the assets and operations of the group as a whole and avoid disintegration, to the advantage of all creditors.[242] The *UNCITRAL MLEGI* does not capture the specificities of banking groups, but it shows the importance of addressing group implications in reorganisation proceedings and also, to some extent, in liquidation. In the banking context, this is relevant when all or part of the banking group is subject to liquidation and coordinated solutions in the liquidation process can better preserve value to the benefit of all creditors. It may also offer guidance where there are subsidiaries in the banking group that are not subject to special insolvency proceedings as deposit-takers or other regulated financial service providers.

402. The *FSB Key Attributes* cover the resolution of both single financial institutions and financial groups as a whole. Their scope includes holding companies of an in-scope financial institution (irrespective of whether a holding company itself carries on regulated financial activities), local branch operations of foreign banks, and non-regulated operational entities within a financial group or conglomerate, although the nature of the powers exercisable in respect of those different types of entity may vary.[243] It is recognised that the abrupt withdrawal of essential services (e.g., treasury services, IT, etc.) provided by non-regulated operational entities within the group could jeopardise resolution objectives. Resolution authorities should therefore have the power, *inter alia*, to require entities in the group (irrespective of whether they are regulated) to continue to provide services needed to support the continuity of critical functions to a bank in resolution or any successor or acquiring entity (see also *Chapter 6. Liquidation Tools, Section G*).[244]

403. Against this background, this Chapter discusses:

- How the legal framework could prevent the liquidation of an individual bank from being hampered by impediments arising from its membership in a

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241 See *UNCITRAL MLEGI (2019)*, Article 2(f) for the definition of "group insolvency solution"; Article 2(g) for the definition of "planning proceeding"; Articles 9-18 on cooperation and coordination; and Articles 19 *et seq.* on the conduct of planning proceedings. It follows from the definition of "group insolvency solution" that such solutions are not limited to reorganisation proceedings.

242 See also *UNCITRAL Legislative Guide*, Part Three.

243 See *FSB Key Attributes*, KA 1.1, and *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN for KA 1.

244 See *FSB Key Attributes Assessment Methodology for the Banking Sector*, EC 3.6. For a discussion of this in the context of bank liquidation, see *Chapter 6. Liquidation Tools, Section G*.

group (*Section B*).

- How cooperation between liquidation authorities and liquidators of different group entities can be encouraged (*Section C*).

B. No group impediments to bank liquidation

404. When a non-viable bank is part of a banking group, its liquidation calls for provisions directed at ensuring that the process is not impeded by group relations.

405. This has implications, first, for the treatment in liquidation of the financing received by the non-viable bank from the parent company or other group entities before liquidation. As indicated in *Chapter 8. Creditor Hierarchy, Section D.4*, the legal framework should enable the subordination of related party claims, and this would include intra-group debt. However, subordination of intra-group claims may not always be appropriate. There may be circumstances where there are valid reasons for intra-group financial support to be provided through instruments or arrangements that are not subordinated (e.g., where the group member that receives the support is liquidity stressed but meets all capital requirements).[245] If a jurisdiction's legal framework subjects all forms of intra-group financing to automatic subordination, or makes subordination a probable consequence without distinction, this could deter the liquidity provider from making such financing available in those circumstances, which could result in a destruction of value.

406. On the other hand, where a parent company provides assistance in the form of debt instead of equity or subordinated capital, there is a risk that this choice of instrument is intended to avoid absorbing losses before unsecured creditors. Accordingly, jurisdictions that consider introducing special rules on the treatment in liquidation of intra-group financing provided prior to liquidation pursuant to specific intra-group support arrangements, should not introduce a blanket exemption from subordination. Instead, any exceptions to subordination rules should be subject to strict safeguards and conditions that ensure that they work for the benefit of the entity ultimately subject to liquidation.

407. In principle, as discussed in *Chapter 8. Creditor Hierarchy,* the treatment of intra-group financing in liquidation should be consistent with the arrangements that support going concern operations. If bank resolution rules apply to some of the group

[245] A valid reason for financial support may exist when liquidity assistance is provided by an IPS to which the failing bank is affiliated, in support of the IPS' core function of preventing the failure of a member bank. An explicit exclusion from subordination of such support in the legal framework could be considered, subject to appropriate safeguards.

entities, it is essential that the treatment of related party claims in liquidation also be consistent with the rules applicable in resolution.

408. Furthermore, a bank liquidation in a group context may also have implications for possible *post*-liquidation intra-group financing. In business insolvency, post-commencement finance may be necessary in the group context, since absent such financing it may be extremely difficult to effect a sale of the business or parts of it as a going concern.[246] Best practice in general business insolvency law recommends the facilitation of post-commencement finance for the continued operation or survival of the business or the preservation or enhancement of the value of the assets (*Chapter 8. Creditor Hierarchy, Section G*). This can be the case even when the financing is provided by an insolvent group member, in the form of direct funding, security interests or guarantees.[247]

409. In the banking context, post-liquidation financing by other group entities may be less relevant given that a transfer of assets and liabilities needs to take place swiftly and considering that DIF resources are an important potential source of external funding to meet a shortfall between the value of assets and liabilities to be transferred. *Chapter 8. Creditor Hierarchy* explains how general principles of post-commencement finance should be followed,[248] with appropriate adjustments for banks.[249] For failing banks that are part of a group, if provision of post-liquidation financing is envisaged by other group entities that are also in liquidation, it should be ensured that the relevant banking authority be heard in all proceedings before any authorisation of post-liquidation financing is granted. In an administrative model, provision of such post-liquidation financing should follow a determination by the relevant liquidators, based on an entity-specific assessment, that any potential harm to creditors of that group member will be offset by the benefit to the creditors of that group member to be derived from the financial assistance. The funding arrangement may also need to be authorised by the liquidation authority.[250]

410. A further aspect of intra-group relations and dependencies that can be relevant in the liquidation of an individual member of a banking group relates to services that the non-viable bank received from the parent bank or other group entities before entering into liquidation. If the group service provider continues to operate or its operations are transferred, in whole or in part, to a third party, as part of the exercise of transfer powers (*Chapter 6. Liquidation Tools*), the liquidator of

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246 *UNCITRAL Legislative Guide,* Part Three, para. 56.

247 *UNCITRAL Legislative Guide*, Part Three, Recommendation 211.

248 *UNCITRAL Legislative Guide,* Part Two, Recommendation 63.

249 See *Chapter 8. Creditor Hierarchy, Section G* and *Recommendation 82*.

250 *UNCITRAL Legislative Guide,* Part Three, Recommendations 212-213.

the non-viable bank should have the sole discretion to determine whether the relevant service arrangements with that bank are continued or terminated. The legal framework could specify that the service provider is prevented from terminating the service agreement solely on the basis of the commencement of a bank liquidation proceeding or the exercise of liquidation powers, provided that the bank continues to meet the substantive obligations under the service agreement (see *Chapter 6. Liquidation Tools, Section G*). In some cases, the terms of pre-existing arrangements may be inadequate or unavailable, e.g., if the terms were not at arm's length or reflected economies of scale depending on the group structure and operations that will change after liquidation. Thus, the liquidator should have the power to re-negotiate and modify on commercial terms existing intra-group service agreements or other operational arrangements or enter into new service agreements to take those factors into account. If the service provider of the group is also in liquidation and needs to cease the operation of such services, the liquidator of the bank should be allowed to enter into new service agreements and take all necessary actions to maintain access to infrastructures that are necessary for the effective liquidation of the bank. In this context, considering that group service providers may not be licensed as banks, the legal framework should grant the relevant authorities appropriate means of dealing with the risk of uncoordinated actions.

Recommendations 84 – 86

No group impediments to bank liquidation: Intra-group transactions and post-liquidation financing

84. Transactions between members of a banking group should, as a general rule, be subject to the general provisions on the treatment of related party claims (see *Chapter 8. Creditor Hierarchy, Section D.4*). Any exceptions or special rules concerning the treatment in liquidation of liquidity support provided by group entities prior to the liquidation proceeding should be subject to strict safeguards and conditions.

85. In jurisdictions with a predominantly court-based model, before the provision of post-liquidation financing by group entities is authorised, the relevant banking authority should be heard in both any liquidation proceedings of group entities providing financing and in the liquidation proceeding of the group entity receiving such post-liquidation financing. In jurisdictions with an administrative model, the provision of post-liquidation financing should be assessed by the liquidator of both the group entity providing it and the group entity receiving it, and may require approval by the administrative liquidation authority.

86. When a bank has received intra-group services from one or more group entities before entering into liquidation, and those entities continue to operate or their operations have been transferred, in whole or in part, to a third party, the continuation or termination of the existing service arrangements should be at the discretion of the bank's liquidator. The liquidator should also have the power to re-negotiate and modify pre-existing intra-group service agreements or enter into new service agreements on commercial terms.

C. Coordinated actions between administrative authorities and courts

411. Bank liquidation measures – in particular a transfer of a bank's assets and liabilities – need to be prepared when the bank is approaching non-viability (see *Chapter 4. Preparation and Cooperation*). If preparatory actions include the drawing up of a contingency plan, the relevant banking authorities could usefully identify (i) the intra-group arrangements that may be important for ensuring operational continuity of specific group operations for a temporary period during liquidation, including shared services or infrastructure (e.g., IT); and (ii) the preferred liquidation strategy for the bank's subsidiaries, if these are also subject to liquidation proceedings.

412. In any case, cooperation among all relevant authorities for different group entities, including courts (where appropriate), needs to be smooth and effective. Uncoordinated and untimely actions risk frustrating an orderly liquidation of the bank. Such risk may arise if a bank is subject to liquidation under the oversight of an administrative liquidation authority, while its parent or other (non-bank) group entities are subject to liquidation or reorganisation by a court, typically under general business insolvency law. It may also arise if group entities are liquidated by different administrative liquidation authorities with responsibilities for different sectors (e.g., banks, securities and investment firms, etc.). For integrated and centrally controlled groups, coordination could result in centralisation of proceedings for the whole group, or parts of the group, or in group-wide solutions where this better serves liquidation objectives. In cases where a bank is in liquidation, it is important to consider whether proceedings for other group entities may be imminent and coordinate accordingly.

413. To mitigate the risk of uncoordinated actions, the legal framework should ensure that administrative authorities are granted appropriate procedural rights to pursue coordination. In cases where a court is the liquidation authority for at least some entities in a group, or the court's approval or intervention is otherwise necessary for such liquidation, administrative authorities' procedural rights should include (i) the right to be heard before the court appoints an insolvency practitioner

for the reorganisation or liquidation of a group entity; (ii) legal standing – also for any appointed bank liquidator – to challenge an action of the insolvency practitioner for that group entity, or a reorganisation plan, if this threatens or is inconsistent with the objectives of the bank's liquidation. Furthermore, the insolvency practitioners appointed for the other group entities should be under a general obligation to coordinate with the bank's liquidation authority and any appointed liquidator. If the group is cross-border, coordination should also take place among the administrative liquidation authorities and any appointed liquidators in different jurisdictions (see *Chapter 10. Cross-Border Aspects*).

414. In cases where the banking group includes regulated entities that are subject to supervision and, potentially, liquidation by administrative authorities other than the administrative authority responsible for bank liquidation, the legal framework should ensure that the relevant administrative authorities are allowed, and strongly encouraged, to cooperate in reaching a coordinated solution, and that such a coordinated solution is consistent with the authorities' mandate and the objectives of liquidation.

415. The legal framework should give the relevant authorities the flexibility to adopt the necessary actions as part of their cooperation, including by allowing the exchange of confidential information. The guidance in *Chapter 4. Preparation and Cooperation* on cooperation between administrative authorities in the preparatory phase, including use of existing cooperation arrangements pursuant to international guidance, should also apply in the group context. In addition, for banking groups with cross-border operations, the Recommendations in *Chapter 10. Cross-Border Aspects* apply.

416. The need for effective cooperation may also have additional procedural implications. When several entities of the same banking group are to be liquidated and this results in multiple liquidation proceedings, the legal framework should support strong coordination between these liquidation proceedings. Where this is possible, the legal framework could allow the same liquidator(s) to be appointed for all proceedings.[251] The coordination of the proceedings should, however, fully

[251] *World Bank Principles*, C16.5. The appointment of the same liquidator for different group entities may only be possible in specific scenarios, e.g., when the group entities are subject to predominantly court-based liquidation proceedings and the court is in charge of appointing a private liquidator for these proceedings, or, *vice versa*, when the entities are subject to administrative liquidation proceedings and the administrative liquidation authority is in charge of appointing a liquidator. On the other hand, appointing the same liquidator for different group entities is difficult to conceive under an administrative model whereby the administrative liquidation authority acts itself as liquidator (especially for cross-border groups). Furthermore, the interests of the creditors of different group entities may give rise to potential conflicts of interest which may be challenging to address.

respect the asset partitioning of each group entity (resulting from its separate legal personality)[252] and should address situations involving conflicts of interest. In the case of multiple proceedings with different liquidators, those liquidators should communicate directly and cooperate to the maximum extent possible to achieve an effective solution. Where the group is integrated – and therefore likely to be subject to resolution for its systemic relevance – there may be a combination between liquidation and resolution if the group resolution plan envisages liquidation for one or more subsidiary bank(s). In this event, the legal framework should ensure that the measures taken during the liquidation proceedings of such bank(s) and of any other group entity are coordinated with resolution actions in order not to impede the resolution objectives for other group entities.

417. Finally, the legal framework should grant liquidators appointed in bank liquidation proceedings the right to obtain information and collaboration from any viable group entities with a view to facilitating the bank's orderly liquidation.

Recommendations 87 – 92

Procedural implications of the liquidation of a bank which is part of a group

87. When the liquidated bank is part of a group, the legal framework should ensure that:

(i) the administrative authorities have the right to be heard before the court appoints a liquidator for reorganisation or liquidation of any other group entity that is material for the bank's liquidation or resolution; and

(ii) the bank's liquidator and the relevant administrative authorities have legal standing to challenge an action of the insolvency practitioner or reorganisation plan of a group entity, if this threatens or is inconsistent with the objectives of the bank's resolution or liquidation.

Furthermore, the insolvency practitioner(s) appointed for any other group entities should be subject to a general obligation to coordinate with the

252 An exception to this rule may arise in practice when the group entities are bound through cross-guarantees (and the same applies to entities affiliated to the same IPS). In exceptional cases, following the example of the *UNCITRAL Legislative Guide*, Part Three, Recommendations 219-230 and *World Bank Principle* C16.3, substantive consolidation of the estates of the group entities could apply when, due to the commingling of assets and business functions in violation of law, it is impossible to identify separate estates.

resolution authority, the bank's liquidation authority, and any appointed liquidator.

88. In cases where group entities are subject to separate liquidation proceedings or they fall under the competence of different administrative liquidation authorities, the legal framework should allow and strongly encourage those administrative authorities and any appointed liquidators to cooperate. The legal framework should allow the relevant administrative authorities to take the actions necessary to coordinate, including through the exchange of confidential information.

89. The legal framework could allow the appointment of the same liquidator(s) if parallel liquidation proceedings are opened for entities of a banking group, where this is feasible, including in a cross-border context.

90. Procedural cooperation should respect the separate legal entity principle, and its implications for asset partitioning. It should avoid discrimination, prevent harm to stakeholders, and minimise adverse effects on them and, where a single liquidator is appointed, it should address conflicts of interest.

91. When parallel proceedings are opened in respect of entities of a banking group, liquidation authorities and any appointed liquidators should cooperate to the maximum extent possible to achieve an effective solution. Liquidators should be encouraged to communicate directly.

92. The legal framework should grant liquidators appointed in bank liquidation proceedings the right to obtain information and collaboration from any viable group entities.

CHAPTER 10. CROSS-BORDER ASPECTS

A. Introduction

418. This Chapter is aimed at assisting legislators in drafting statutory provisions on the cross-border aspects of bank liquidation in a harmonised manner.[253] Banks of all sizes may have branches licensed by either the home jurisdiction or both the home and host jurisdictions, or foreign assets that need to be liquidated. Accordingly, cross-border cooperation with other, affected jurisdictions may be needed. Such cooperation may also be needed when a bank has foreign subsidiaries that are licensed and supervised in the host jurisdiction. Such cross-border dimensions present challenges for the conduct of liquidation proceedings which, if not effectively dealt with, may affect recoveries for depositors and other creditors and increase the likelihood of contagion and spill-over effects. Conversely, smooth cross-border cooperation can minimise those risks.

419. Results from the survey undertaken in preparation of this *Guide* indicate a range of different approaches among jurisdictions to cross-border bank liquidation. This is not *per se* an impediment to cross-border cooperation. However, a lack of clarity in the statutory provisions or in the applicability of those provisions to banks may impede or prevent coordination or result in uncertainties in the cross-border implementation of a liquidation strategy, with a resulting loss of value for creditors and potential prejudice to stakeholders of the bank.

420. Several international standards have addressed cross-border insolvency, including the 1997 *UNCITRAL Model Law on Cross-border Insolvency* (MLCBI) and the *UNCITRAL MLEGI*. However, neither addresses the specificities of banks (for example, they have not considered the role of banking authorities, which play a prominent role in bank liquidation proceedings). Both *UNCITRAL Model Laws* offer States the option of excluding banks from their scope, recognising that banks may be subject to a special insolvency regime. The *FSB Key Attributes* include high-level principles and provisions on the legal framework conditions for cross-border cooperation (KA 7). Those principles specify that the statutory mandate of a resolution authority should empower and strongly encourage it wherever possible to act to achieve a cooperative solution with foreign resolution authorities. They also

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253 Several commentators and academics have noted that a gap exists in this area, since there is no international model law tailored to the circumstances of banks in cross-border liquidation proceedings. This issue is addressed in detail in Ronald Davis, Stephan Madaus, Monica Marcucci, Irit Mevorach, Riz Mokal, Barbara Romaine, Janis Sarra and Ignacio Tirado, *Financial Institutions in Distress: Recovery, Resolution, Recognition* (Oxford University Press, 2023).

include provisions on arrangements to support cross-border coordination in the form of crisis management groups (KA 8) and institution-specific cross-border cooperation agreements (KA 9).[254] The *FSB Principles for Cross-border Effectiveness of Resolution Actions*[255] set out statutory and contractual mechanisms for giving cross-border effect to resolution actions in accordance with the *FSB Key Attributes.*

421. Jurisdictions should align their legal framework for cross-border cooperation with KA 7 and the *FSB Principles for Cross-border Effectiveness of Resolution Actions* and apply such framework to both systemic and non-systemic banks, to achieve effective cross-border solutions. However, they may encounter difficulties in codifying high-level principles into detailed legal provisions. The UNCITRAL framework for recognition is one possible approach. However, as noted above, it is primarily designed for cross-border insolvency of ordinary businesses and may offer insufficient detail on matters such as the role of home and host administrative authorities and their interaction with courts. Furthermore, it does not consider issues specific to the bank context, such as concerns about financial stability.

422. This Chapter offers guidance in line with the FSB framework and also builds on other international standards, principles and models, including of UNCITRAL and the World Bank.[256] It refers to such standards and guidance where appropriate and concentrates on certain specificities of cross-border liquidation of non-systemic banks. The Chapter also acknowledges that there are different forms of cooperation, including the recognition of foreign proceedings, the use of liquidation powers under domestic law to support foreign proceedings, the use of supervisory powers to support foreign liquidation proceedings, and the exercise of discretion not to take domestic action.

423. The Chapter's aim is to provide guidance on the design of a legislative framework for cross-border cooperation that takes into account different possible

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254 KA 7 applies to cooperative arrangements for all financial institutions that could be systemic in failure. KAs 8 and 9 apply specifically to G-SIBs and other designated global systemically important financial institutions, although the *FSB Key Attributes Assessment Methodology for the Banking Sector* specifies that there should also be arrangements for cross-border cooperation and information sharing in place between home and host authorities of any bank with material cross-border operations that is subject to resolution planning in its home jurisdiction to support that process (see EC 11.9 and EN 11 (c)).

255 FSB, *Principles for Cross-border Effectiveness of Resolution Actions (fsb.org)*. See also *FSB Key Attributes Assessment Methodology for the Banking Sector*.

256 *World Bank Principles*. It also draws on the model proposed by Ronald Davis, Stephan Madaus, Monica Marcucci, Irit Mevorach, Riz Mokal, Barbara Romaine, Janis Sarra and Ignacio Tirado, *Financial Institutions in Distress: Recovery, Resolution, Recognition* (Oxford University Press, 2023).

scenarios and legal frameworks, and ensures fairness for creditors and participation and control by the jurisdictions involved in the process. Such a legislative framework would be subject to any treaty or other form of agreement to which the jurisdiction is party. The Recommendations in this Chapter reflect the norm of "modified universalism", which envisages a global, centralised approach to cross-border bank liquidation, but recognises that in certain circumstances parallel proceedings (in home and host jurisdictions) or the application of local measures may be more efficient and that safeguards are necessary to ensure that public policy concerns of host or affected jurisdictions are not overlooked. Modified universalism is a norm inspired by the theoretical model of pure universalism. Like universalism, it seeks to achieve maximum cooperation and optimal solutions taking a global approach. It does so by adjusting the pure universalist model (of one-forum-one-law in all circumstances) to real-world circumstances and to different bank structures. It contrasts with "territorialism", which envisages a country-by-country liquidation in all circumstances.

424. The Chapter is organised as follows:

- *Section B* offers a framework for cross-border cooperation and communication between liquidation authorities and liquidators.
- *Section C* focuses on recognition of foreign proceedings and assistance and relief by host jurisdictions and affected jurisdictions[257] to give effect to specific measures.
- *Section D* discusses safeguards that are critically important to creating a fair and effective cross-border regime, safeguarding local interests. It suggests grounds for a host or affected jurisdiction to refuse recognition, cooperation, assistance or support to a home jurisdiction. The guidance provided in Sections B to D covers the liquidation of a single bank with subsidiaries, branches or assets abroad.
- *Section E* provides additional guidance for cross-border cooperation and coordination in liquidation proceedings relating to two or more banks within a cross-border group. With regard to banking groups, this Chapter should be read together with *Chapter 9. Group Dimension*.

[257] For the purposes of this *Guide*, the term "affected jurisdiction" means a jurisdiction that is not a host jurisdiction of a bank and to which the bank has connection owing to the location, or governing law of, any of its assets, rights, liabilities or creditors so that, in the event of the liquidation of the bank, action by the authorities in that jurisdiction may be required in order to recognise or give effect to foreign liquidation measures.

B. Cooperation and allocation of competences between home and host authorities

1. Introduction

425. The legal framework should provide for a clear allocation of competences and facilitate the smooth cooperation between liquidation authorities and liquidators in different jurisdictions, and with banking authorities in preparation and contingency planning for and execution of a liquidation proceeding (see *Chapter 4. Preparation and Cooperation*), with due regard to the need for confidentiality. The provisions in the legal framework should be compatible with international standards and relevant guidance, including the *FSB Key Attributes* and the *FSB Principles for Cross-border Effectiveness of Resolution Actions,* and the UNCITRAL framework (and corresponding *World Bank Principles* C15 and C17). Ultimately, an effective legal framework for cross-border bank liquidation requires tailored provisions on cooperation and communication with authorities from foreign jurisdictions. The Recommendations in this section aim to assist legislators in developing such provisions.

2. General principle: achieving cooperative solutions

426. The *FSB Key Attributes* require that resolution authorities be empowered and strongly encouraged, wherever possible, to act to achieve a cooperative solution with foreign resolution authorities.[258] Also, jurisdictions should provide for transparent and expedited processes to enable resolution measures taken by a foreign resolution authority to have cross-border effect (with appropriate safeguards).[259] The same should apply, *mutatis mutandis*, in bank liquidation proceedings. Coordination between liquidation authorities, banking authorities and other administrative authorities, and appointed liquidators across jurisdictions is key to ensuring the smooth liquidation of a failed bank with cross-border activities.

427. The legal framework should empower and strongly encourage the liquidation authority, banking authorities and other administrative authorities, and any appointed liquidator(s) to communicate and to cooperate on a timely basis with foreign counterparts in order to achieve a cooperative solution.[260] The legal framework should not unduly restrict the ability to achieve cooperative solutions by, e.g., preventing recognition in the absence of reciprocity, or by triggering automatic

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258 *FSB Key Attributes*, KA 7.1.

259 *FSB Key Attributes*, KA 7.5.

260 *FSB Key Attributes*, KA 7.1; see also *FSB Principles for Cross-border Effectiveness of Resolution Actions,* Principles 1-3.

action as a result of official intervention or liquidation in a foreign jurisdiction (see *Section C* below).

3. Powers of administrative liquidation authorities and liquidators

428. In line with the *FSB Key Attributes* (KA 7.3), the legal framework should ensure that relevant liquidation authorities are able to take appropriate actions in a host capacity. To this end, the framework should grant them powers over local branches of foreign banks and the capacity to use such powers to support a liquidation carried out by an authority in the home jurisdiction (see *Section C* below). The legal framework should also vest the domestic authority with powers to take measures on its own initiative, where the home authority is not taking action or acts in a manner that does not take sufficient account of the need to preserve the host jurisdiction's financial stability. Before taking such measures in relation to the local branch of a foreign bank, host authorities should notify and consult the home authority.[261]

429. Furthermore, in line with KAs 7.6 and 7.7, the legal framework should allow administrative liquidation and relevant authorities to exchange information with foreign administrative authorities and liquidators where necessary for the preparation and implementation of a liquidation strategy (including to facilitate due diligence by potential acquirers). Such exchange may include confidential information, provided that the authorities are satisfied that this information will be treated as confidential and used exclusively for the purposes for which it was provided. Banking authorities may benefit from existing cooperative arrangements with their counterparts in other jurisdictions (see *subsection 6* below).

430. The legal framework empowering a liquidation authority to appoint a liquidator to act under its direction (see *Chapter 2. Institutional Arrangements, Section C.3* and *Recommendation 10*), should authorise that liquidator to undertake cross-border communication and cooperation where relevant, including the permission to communicate directly with, and/or to request information or assistance directly from, liquidation authorities and appointed liquidators in foreign jurisdictions.

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261 See also *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN 7 (h), which specifies that this should be understood as requiring the host authority to make good faith efforts to communicate with the home authority about the nature of its concerns and the actions it proposes to take. The consent of the home authority is not required.

4. Implications for different institutional models: flexibility to achieve the cross-border effectiveness of liquidation measures

431. The mechanisms for achieving cross-border cooperation may vary depending on the institutional model for bank liquidation proceedings (see *Chapter 2. Institutional Arrangements*). Administrative liquidation authorities have the advantage of early cooperation with foreign authorities (see *Chapter 2. Institutional Arrangements, Section C.4*), which is key, for example, where DIs must pay out depositors within a short period.[262] In jurisdictions that have a court-based model with administrative involvement, courts typically only exercise their powers after a formal application and a judicial determination that a court-appointed liquidator cooperate with foreign liquidation authorities. In such jurisdictions, the legal framework should still enable timely and expeditious cooperation between banking authorities and their foreign counterparts to facilitate the bank liquidation process. The mandates of banking authorities may include the protection of depositors or financial stability, and the framework on cross-border cooperation should not impose any duties or objectives inconsistent with such mandates. Instead, the legal framework should make adequate provision for dealing with any such inconsistencies.

432. The *FSB Key Attributes* state that resolution authorities should have the capacity to exercise resolution powers with the necessary speed,[263] but they also indicate that, where court orders are required to apply resolution measures, the time required for court proceedings should not compromise effective implementation of resolution actions.[264] The *FSB Principles for Cross-border Effectiveness of Resolution Actions* specify that processes for giving effect to foreign resolution actions should be expedited, including where judicial authorities are involved.[265]

433. Consistent with this approach, in jurisdictions with a predominantly court-based model, the legal framework should empower and encourage banking authorities to cooperate in advance with foreign banking authorities, to prepare and facilitate the subsequent implementation of cooperative liquidation strategies. The legal framework should also facilitate the participation of foreign administrative liquidation authorities or appointed liquidators in proceedings before local courts, and the participation of authorities supervising branches or subsidiaries, where appropriate. Where a court order is necessary to adopt certain measures, an expedited procedure should be available. Furthermore, in a predominantly court-based

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262 According to *IADI Core Principles,* CP 15, EC 1, DIs should be able to reimburse most depositors within seven working days.

263 *FSB Key Attributes*, KA 5.4.

264 *FSB Key Attributes*, KAs 1.13 and 5.4.

265 *FSB Principles for Cross-border Effectiveness of Resolution Actions,* at 5-6.

liquidation proceeding where, in determining a cross-border matter, the court is required to consider liquidation objectives and/or considerations that are difficult for a court to assess, e.g., financial stability, the legal framework should facilitate coordination between the court and banking authorities in order to make such assessments.[266] The principle that court review of liquidation measures by liquidation authorities and liquidators should not result in reversal of such measures (see *Recommendation 6*)[267] should also apply in cross-border cases (e.g., in case of local measures taken by a host authority).

5. Procedural coordination of bank liquidation proceedings

434. Liquidation authorities in home, host and affected jurisdictions should retain their own jurisdiction and competences. At the same time, the legal framework should facilitate coordinated decision-making by liquidation authorities. It may be more challenging to coordinate effectively between administrative liquidation authorities and courts, given the differences in their mandates, decision-making processes, procedural rules and limitations that apply to their functions. However, irrespective of the applicable institutional model, the legal framework should allow the liquidation authority to coordinate its decision-making with liquidation authorities in other jurisdictions, or at least not impede it from doing so. In particular, the legal framework should not prevent courts from coordinating with foreign administrative liquidation authorities and *vice versa*. This coordination includes notice and the rights of interested parties to communicate their views or be heard, and the ability to bring the parties together to share information, discuss and resolve conflicts, minimising delays.[268] Coordination agreements between liquidation authorities, or between liquidators (and approved by liquidation authorities), can safeguard the substantive and procedural rights of the parties and the jurisdiction of the relevant authorities. The liquidation authority should nonetheless remain responsible for reaching its own decision on the matters before it. Furthermore, the legal framework may facilitate the appointment of the same liquidator as in the home jurisdiction, but also the appointment of a different liquidator who coordinates with the liquidator in the home jurisdiction.

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266 Any financial stability issue should primarily be assessed and decided by the relevant banking authority, see *Chapter 2. Institutional Arrangements, Section C.1* and *Recommendation 12*). Banking authorities could also be granted a special role in the process (e.g., allowing the court to seek their specialist advice (*Recommendation 11(c)*).

267 *FSB Key Attributes*, KA 5.5.

268 See also *UNCITRAL MLEGI*, Article 12; *UNCITRAL Legislative Guide,* Part Three, Recommendation 245.

6. Cooperation arrangements

435. Early cooperation between liquidation authorities can assist in the preparation and management of multiple proceedings in different jurisdictions and facilitate the coordination of cross-border bank liquidation by agreeing on a liquidation strategy. Standing cooperation arrangements between authorities or liquidators are a well-established feature of internationally accepted frameworks. The *FSB Key Attributes* require crisis management groups and institution-specific cooperation agreements to be maintained for globally systemically important financial institutions at a minimum.[269] Non-systemic banks may be covered by such arrangements if they are part of a systemically important group. In addition, in line with the *IADI Core Principles*, formal information sharing and coordination arrangements should be in place among DIs in relevant jurisdictions, subject to confidentiality provisions. [270] Specifically, bilateral or multilateral agreements should clarify the responsibilities of DIs in specific cross-border situations. The use of cross-border agreements for procedural coordination (cross-border protocols) is also a well-established method in the context of general business insolvency proceedings.[271] It may be used in the context of liquidation of cross-border banks and banking groups to facilitate joint decision-making processes, ensure consistent communication strategies, and address potential conflicts between home and host jurisdictions.

436. Against this background, the legal framework should not impede administrative liquidation authorities from taking advantage of or building on existing cross-border cooperation arrangements with foreign authorities (e.g., extending resolution cooperation agreements or MoUs to liquidation), and could allow liquidation authorities to conclude new agreements for mutual assistance and information sharing with other liquidation or banking authorities, subject to appropriate confidentiality assurances and recognising the need for proportionality with regard to the development of such agreements for banks that are not systemically important. Where the conclusion of such agreements is contemplated as part of the legal framework for regulation and supervision of financial institutions, it should be sufficiently broad to include agreements with foreign liquidation authorities and/or concerning matters of bank liquidation. The legal framework for such agreements should not result in undue restrictions on access to information by, or cooperation with, foreign courts.

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269 *FSB Key Attributes*, KAs 8 and 9.

270 *IADI Core Principles*, CP 5.

271 See *UNCITRAL MLCBI*, Article 27(d) and *UNCITRAL MLEGI*, Article 10(f), and the additional forms of cooperation noted in these instruments.

Recommendations 93 – 95

Cooperation and communication with authorities in other jurisdictions

Purpose of legislative provisions

The purpose of provisions on cooperation and communication with foreign authorities in the context of bank liquidation proceedings is to allow cooperative solutions to be achieved and to facilitate the efficiency and effectiveness of liquidation proceedings with cross-border elements.

Key Consideration

➢ The mechanisms or arrangements for achieving cooperative cross-border liquidation should be tailored to the specific institutional model (administrative or court-based with administrative involvement).

Recommendations irrespective of the institutional model

93. The legal framework should be aligned with the provisions on cross-border cooperation in the *FSB Key Attributes* (KA 7) and the *FSB Principles for Cross-border Effectiveness of Resolution Actions.* In particular, in line with KAs 7.1, 7.3, 7.6 and 7.7, the legal framework should:

(a) Empower and strongly encourage the liquidation authority, any appointed liquidators and banking authorities, wherever possible, to act to achieve a cooperative solution with foreign authorities and liquidators;

(b) Vest the liquidation authority with powers to take measures on its own initiative, where the home authority is not taking action or acts in a manner that does not take sufficient account of the need to preserve the host jurisdiction's financial stability (e.g., commencing local liquidation proceedings). Before doing so, the host authority should, where possible, notify and consult the home authority;

(c) Authorise and encourage communication and exchange of information, subject to confidentiality provisions, and coordination between liquidation authorities, any appointed liquidators and banking authorities in different jurisdictions at an early stage;

(d) Authorise the liquidation authority to coordinate decision-making with foreign liquidation authorities;

(e) Allow cooperation to develop possible paths for orderly liquidation, formal recognition of proceedings in other jurisdictions or adoption of supportive measures, agreement on contingency plans or solutions and coordination of proceedings;

(f) Ensure that authorities in host jurisdictions are duly informed of the liquidation proceeding and actions taken in the home jurisdiction and that the home liquidation authority consults, and considers the views of, relevant host authorities; and

(g) Authorise liquidation authorities, any appointed liquidators and banking authorities to exchange information with foreign liquidation and banking authorities and liquidators throughout the proceeding, subject to the preservation of the confidentiality of information.

The legal framework could allow the appointment of the same liquidator as in the foreign jurisdiction, or of a local liquidator, who would conduct the liquidation in coordination with the home authority and liquidator.

Recommendation for jurisdictions that provide for a court-based model with administrative involvement

94. The legal framework should:

(a) Facilitate the participation of foreign administrative liquidation authorities or the liquidators appointed by them before local courts, and the participation of authorities supervising branches or subsidiaries, where appropriate;

(b) Provide for expedited procedures for obtaining court orders where such orders are required for the adoption of specific measures; and

(c) Ensure the alignment of courts' consideration of cross-border matters with broader liquidation objectives and facilitate coordination between courts and banking authorities to ensure that courts can properly assess such considerations.

Recommendations for jurisdictions with an administrative model

95. The legal framework should not impede administrative liquidation authorities from taking advantage of or building on existing cross-border cooperation arrangements with foreign authorities, such as resolution

cooperation agreements. Where relevant, the legal framework could allow liquidation authorities to conclude (additional) mutual assistance and information sharing agreements, or agreements concerning the coordination of proceedings, with other liquidation or banking authorities, subject to the protection of the confidentiality of the information shared.

C. Recognition of foreign measures and supportive measures[272]

437. Recognition and supportive measures should be swift and should enable actions of a liquidator or provisional liquidator to have effect in a host jurisdiction. Such swift recognition procedures should cover the range of possible liquidation measures, including a stay on early termination and/or netting rights, and a transfer of assets. The *FSB Key Attributes* specify that jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of a "recognition" process (e.g., judicial recognition) or by "supportive" measures under the domestic regime.[273] Such recognition or supportive measures would enable a home resolution authority to gain rapid control over the bank branch or shares or assets that are located in another jurisdiction in cases where the firm is being resolved under the law of the home jurisdiction. Principle 3 of the *FSB Principles for Cross-border Effectiveness of Resolution Actions* specifies that the legal framework for giving effect to foreign resolution measures or adopting measures to support foreign resolution actions should clearly establish the conditions for recognition, enforcement, or support actions; the grounds for refusal of such actions, which should be limited; and the process for taking such actions.[274]

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272 For the purposes of this *Guide*, "recognition of foreign measures" means a process or framework for giving effect to foreign liquidation measures whereby, at the request of a foreign authority or liquidator, a jurisdiction accepts the commencement of a foreign liquidation proceeding domestically and empowers the relevant domestic authority (either a court or an administrative authority) to enforce the foreign measure or grant other forms of domestic relief, for example, a stay on domestic creditor proceedings (see *FSB Key Attributes Assessment Methodology*, EC 7.4 and EN 7(e); and *UNCITRAL MLCBI*, Articles 15-21). "Support of foreign measures" means a process or framework for giving effect to foreign liquidation measures whereby a jurisdiction, by means of its liquidation authority or banking supervisor, adopts liquidation measures or supervisory measures under relevant domestic law, or exercises its discretion not to act, to produce the effect of, or otherwise support, the measures taken by the foreign authority (see *FSB Key Attributes Assessment Methodology*, EC 7.4 and EN 7(e)).

273 *FSB Key Attributes*, KA 7.5.

274 *FSB Principles for Cross-border Effectiveness of Resolution Actions,* at 12.

Recognition or support of foreign measures should be subject to the equitable treatment of creditors in the foreign proceeding.[275]

438. Recognition of, and support for, foreign proceedings should also be enabled in bank liquidation proceedings. The legal framework should provide relevant authorities with the power to grant such recognition or provide support. A liquidation authority or appointed liquidator should have access to foreign liquidation authorities to seek recognition and supportive measures. Authorities should seek to give information and give effect to the measures requested by means of a recognition process or by applying domestic measures that support and are consistent with the actions adopted under the home jurisdiction's framework, taking into account the need for timely action. Recognition and supportive measures for cross-border liquidation should also be available to support cross-border resolution. Recognition and support should, in any event, be subject to the safeguards discussed in *Section D*.

439. Where the host or affected jurisdiction has a system of cross-border recognition, e.g., based on the *UNCITRAL MLCBI*, the legal framework may apply it with appropriate adjustments for bank liquidation. Such adjustments should be clear in the legal framework. In particular, under both administrative and predominantly court-based models, the legal framework should allow for local recognition of proceedings administered by a foreign administrative authority. It should furthermore contemplate expedited proceedings for obtaining a court order where it is necessary to ensure the cross-border effectiveness of liquidation actions or expedite the adoption of the necessary measures.

440. Recognition should follow a request by the liquidator or liquidation authority, including adequate notice of the opening of (foreign) bank liquidation proceedings. The legal framework should provide for the prompt recognition of foreign bank liquidation proceedings. Recognition should, in principle, not be made contingent on reciprocity.[276] Recognition is subject to adequate safeguards being met (*Section D* below).

441. The legal framework should also have the necessary flexibility to provide for supportive measures for foreign liquidation measures in cases where recognition

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275 *FSB Key Attributes*, KA 7.5.

276 *FSB Principles for Cross-border Effectiveness of Resolution Actions,* at 12, indicate that, even if there is a requirement of reciprocity, it should not be absolute, and should not prevent recognition without reciprocity where such recognition is in the interests of the jurisdiction, for example, by contributing to financial stability. See also *FSB Key Attributes Assessment Methodology*, EN 7 (b).

proceedings are not feasible or desirable.[277] In particular, the legal framework should grant discretion to administrative liquidation authorities to support foreign measures, if necessary, by using their powers to open a liquidation proceeding in the host jurisdiction, or by refraining from taking action to initiate liquidation. Liquidation authorities and liquidators from the home jurisdiction should be allowed to request the adoption of such measures. The legal framework should also grant discretion to banking supervisors in the host jurisdiction to adopt supervisory measures that give effect to the measures adopted in foreign liquidation proceedings or to abstain from adopting such measures where it serves the interest of the proceedings. It should make it possible to order a stay of enforcement proceedings, including of the exercise of early termination rights. It may allow a transfer of assets and liabilities ordered by the home authorities to occur by way of recognition proceedings or allow the local authority to order such transfer under domestic law. In any event, the legal framework should not contain provisions that trigger automatic action as a result of official intervention or the initiation of liquidation or comparable proceedings in another jurisdiction.[278]

Recommendations 96 – 98

Recognition of foreign proceedings and actions and support measures

Purpose of legislative provisions

The purpose of provisions on recognition and support is to enable prompt effect to be given to foreign liquidation actions.

Recommendations

96. Subject to the safeguards indicated in Section D below, the legal framework should empower administrative and judicial liquidation

[277] See *FSB Cross-Border Recognition of Resolution Action, Consultative Document*, 29 September 2014, which exemplifies different scenarios where recognition, or support, measures, may be granted.

[278] This reference to "automatic action" means, *inter alia*, that the legal framework should not provide for the automatic commencement of a bank liquidation proceeding or the automatic revocation of a bank's licence due to the initiation of a bank failure management proceeding in another jurisdiction. The reference to automatic action does not cover any automatic effects of recognition that are intended to facilitate giving effect to foreign actions. See *FSB Key Attributes*, KA 7.2; see also *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN 7(c), which contains explanations with regard to the concept of "automatic action".

authorities to promptly recognise the opening of liquidation proceedings and liquidation measures taken in another jurisdiction, including to support cross-border resolution action, without requiring further certifications or authorisations, and/or support those proceedings or measures. Recognition should, in principle, not be contingent on reciprocity, but may be conditional on adequate safeguards being met.

97. The legal framework should enable administrative authorities to use their powers to support foreign liquidation proceedings. This should allow liquidation authorities to exercise powers where liquidation measures are required, and banking supervisors to exercise powers where supervisory measures are needed, provided that the grounds or prudential conditions for the use of such powers are met. Both liquidation authorities and banking supervisors should be able to abstain from adopting liquidation or supervisory measures where that would support the foreign proceedings or measures. The legal framework should not contain provisions that trigger automatic action as a result of official intervention or the initiation of liquidation or comparable proceedings in another jurisdiction.

98. The legal framework should empower liquidation authorities to swiftly grant recognition and support to foreign liquidation measures where foreign liquidation proceedings have been opened in respect of a bank with assets, creditors, or branches in the jurisdiction where assistance is sought. Recognition and support may be provided by recognising and giving effect to the measures adopted by the home authority during the liquidation proceeding, or by adopting measures under the local liquidation or supervisory framework. Support may be in the form of the following non-exhaustive list:

(a) Entrusting the administration or realisation of assets located in the host jurisdiction to the home liquidation authorities;

(b) Ordering a stay of proceedings, and enjoining creditors and other parties from enforcement and other actions that may undermine liquidation measures under foreign law, including early termination rights or collateral enforcement;

(c) Ordering the transfer of assets and/or liabilities of the failed bank, or the segregation of assets to satisfy depositors;

(d) Ordering the liquidation of some or all of the assets, and allowing and/or assisting in the transfer of ownership, including

registration of assets or interests located and/or registered in their own jurisdiction;[279] and

(e) Adopting measures of procedural assistance, including the examination of local witnesses and taking of evidence and information.

Liquidation authorities should have the power to order the above measures, or, in the case of administrative authorities, the ability to request court assistance for the ordering of such measures, as contemplated in *Recommendation 94(b)*.

D. Safeguards: grounds to refuse recognition, support or cooperation

442. While liquidation authorities should have wide powers to cooperate on a cross-border basis for the purposes of bank liquidation, authorities in host jurisdictions and affected jurisdictions must retain sufficient control over measures affecting assets, creditors, debtors, branches and/or subsidiaries in their jurisdiction, as they are unlikely to cooperate in the absence of minimum safeguards. Although their formulation may differ across standards and their implementation by jurisdictions, existing safeguards tend to refer to principles of public policy.[280] Important principles that can inform the design of safeguards specific to cross-border bank liquidation are procedural fairness, protection of depositors, the fair and non-discriminatory treatment of creditors, financial stability and fiscal implications. Such considerations are present in the frameworks of the FSB, World Bank and UNCITRAL. The following Recommendations are aligned with these criteria, particularly those in the *FSB Key Attributes* and the *FSB Principles for Cross-border Effectiveness of Resolution Actions*.

443. The public policy safeguard is broadly recognised and relatively common. However, the survey undertaken in preparation of this *Guide* revealed that the meaning of "public policy" may differ according to the domestic law. These differences can impede cross-border cooperation. Each jurisdiction should apply the public policy safeguard in accordance with clear, transparent and narrowly defined parameters. Refusal to recognise or support a foreign liquidation measure based on the public policy exception may be justified, for instance, where the foreign

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279 Of note is that this assistance can be given by way of supervisory approvals for change in control under many domestic banking laws, without specific need for empowerment to support foreign proceedings.

280 See, for example, *FSB Principles for Cross-Border Effectiveness of Resolution Actions,* Principle 3; Article 6 *UNCITRAL MLCBI* and similar provisions in the *UNCITRAL Model Law on Recognition and Enforcement of Judgments*, and the *UNCITRAL MLEGI*.

proceeding fails to provide for equitable treatment of creditors;[281] discriminates against creditors on the basis of their nationality, location of their claim or jurisdiction where it is payable, such as where liquidation measures treat home and foreign creditors differently to the detriment of local creditors; or where basic standards of fairness are breached.

444. Where discrimination is limited to a specific ancillary decision, refusing to give effect to all measures or the whole strategy would not be justified. Only measures that have an impact on the local creditors' rights in general and to a material extent would be expected to meet the threshold of discrimination for the purposes of the public policy safeguard.

445. Recognition, support or cooperation may also be refused on the basis of an adverse effect on domestic financial stability or material fiscal implications (for example, if the measures would expose local public authorities or taxpayers to loss).

446. The Recommendations below seek to advance the principles of cross-border cooperation and coordination, and the recognition of home jurisdiction liquidation measures, by ensuring that relevant authorities duly consider the impact of the measures in other jurisdictions. The Recommendations also have the objective of ensuring that authorities in host jurisdictions and affected jurisdictions have sufficient control, based on certain fundamental safeguards, regarding acts affecting assets, creditors, debtors, branches and subsidiaries in their own jurisdiction, including where liquidation proceedings are coordinated or centralised in a home jurisdiction.

Recommendations 99 – 101

Purpose of legislative provisions

The purpose of provisions on safeguards is to promote fairness and clearly define the limited grounds for refusing recognition, enforcement or support actions.

Ensuring local interests are safeguarded

99. In line with FSB standards and implementation guidance,[282] the process for giving effect to foreign liquidation measures should be guided

281 *FSB Key Attributes,* KA 7.5.

282 *FSB Key Attributes*, KA 7.5 and *FSB Principles for Cross-Border Effectiveness of Resolution Actions,* Principle 3.

by the principle of equitable treatment of creditors. In addition, the process should have due regard to domestic public policy, financial stability implications and fiscal impacts in the jurisdiction in which recognition of or support for the measures is sought. Recognition or support may be refused on the grounds that foreign liquidation measures would have an adverse effect on domestic financial stability or material fiscal implications.

Ensuring that the process is fair and efficient

100. The legal framework should require liquidation authorities in the home jurisdiction, when taking actions or measures in cross-border liquidation proceedings in respect of branches or subsidiaries, to swiftly cooperate and communicate with host jurisdictions and to ensure that:

(a) Their actions are guided by the principle of equitable treatment of creditors, and depositors and other creditors are not discriminated against based on their nationality, residence or the location of their claims; and

(b) In choosing how to address the bank liquidation proceeding, proper consideration is given to the impact on host countries' financial stability.

Public policy safeguard

101. The legal framework should allow authorities in host countries to refuse to take action to recognise or support foreign liquidation measures, or otherwise cooperate in foreign liquidation proceedings, where such recognition, support or cooperation would be contrary to the public policy of the State.

E. Additional considerations concerning the liquidation of cross-border groups

447. The liquidation of banks that form part of a group and operate across borders can benefit from the Recommendations included in the previous sections of this Chapter, but also present particular challenges (see *Chapter 9. Group Dimension*). This section seeks to expand on considerations that are specific to cross-border banking groups. Bank subsidiaries may be part of an integrated and centrally controlled group. This may be the case, for example, with smaller and medium-sized banks that centralise financial and control processes to control costs. To achieve an orderly, efficient liquidation, it may be important to coordinate liquidation proceedings of such banks within groups. Centralisation of proceedings in the home

jurisdiction of the parent company or parent financial institution may be the most efficient approach. Even where banks within a group operate more independently, procedural coordination may still be desirable to achieve optimal liquidation solutions.[283] Furthermore, in circumstances where some group entities are not yet in liquidation, cooperation among relevant authorities for entities whose liquidation may be imminent may be important to consider whether procedural coordination or centralisation of proceedings would then be preferable. However, the challenges of achieving such coordination in practice must be acknowledged. The number of proceedings could be minimised, in appropriate circumstances, by facilitating deference by the host jurisdiction to home jurisdiction proceedings, through allowing claims based on the host jurisdiction laws to be treated in the home jurisdiction in accordance with the treatment that would be accorded in proceedings under the host jurisdiction laws.[284]

448. In cases where some entities of a cross-border group are subject to resolution and some to liquidation, liquidation measures need to be coordinated with resolution actions in order not to impede the resolution objectives for other group entities (see *Chapter 9. Group Dimension, Section C*).

449. The relevant banking authorities and other administrative authorities should be allowed and strongly encouraged to cooperate in advance to prepare for the liquidation of group entities in different jurisdictions (see *Chapter 4. Preparation and Cooperation*, *Recommendation 40*, which should also apply in a cross-border context).

450. The Recommendations on recognition of and support for foreign liquidation measures should apply to cross-border groups with appropriate adjustments. The legal framework should empower the liquidation authority or the appointed liquidator to engage in cross-border agreements for procedural coordination of proceedings relating to the same banking group. It should allow the authorities to make and execute such agreements before the lapse of the applicable deadline for DIs in the home and relevant host jurisdictions to pay out insured deposits.

451. The fact that cross-border communication and cooperation are taking place between liquidation authorities should not change the responsibilities and powers of

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283 For the meaning of the term "procedural coordination" in line with the *UNCITRAL Legislative Guide*, Part Three, see *Chapter 9. Group Dimension*, footnote 240.

284 This approach may be subject to conditions, including that (a) an undertaking by the home authority to accord such treatment is given; (b) the undertaking meets the formal requirements of the host jurisdiction; (c) the competent authority in the host jurisdiction approves the treatment to be accorded in the home proceeding; and (d) the undertaking is enforceable and binding on the estate of the bank (see for additional guidance, *UNCITRAL MLEGI,* Articles 28-32).

those authorities.[285] Each liquidation authority should be able (and required) at all times to exercise its independent jurisdiction, powers and judgment with respect to matters presented to it and the conduct of the parties involved in the process.[286]

452. In the rare case where assets or liabilities are highly integrated or where there is a high level of managerial integration across related banking entities, a group liquidation process may be most effective if led by the liquidation authority of the jurisdiction of the parent bank, or if a single liquidator is appointed. Enhanced procedural cooperation in liquidating the banking group or some entities within the group should also seek to deter ring-fencing strategies, and prevent any creditor who is claiming in more than one liquidation proceeding from obtaining more than the creditor would have obtained in a single liquidation proceeding.[287]

Recommendations 102 – 105

Powers of liquidation authorities/liquidators in case of liquidation of a cross-border group

102. The legal framework should enable the liquidation authority or the appointed liquidator to engage in cross-border agreements for the coordination of proceedings relating to the same banking group. It should allow the authorities to make and implement such agreements before the lapse of the applicable deadline for deposit insurers in the home and relevant host jurisdictions to pay out insured deposits.

103. Cooperation and coordination should not:

(a) Change the responsibilities and powers of those authorities, and the liquidation authority should be able at all times to exercise its independent jurisdiction, powers and judgment;

(b) Imply a waiver or abnegation by the liquidation authority of any powers entrusted to, or responsibilities allocated to, such authority.

104. The legal framework should:

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285 See also *UNCITRAL MLEGI,* Article 11; *UNCITRAL Legislative Guide,* Part Three, Recommendation 244.

286 *FSB Key Attributes*, KA 7.2.

287 This is in line with Article 31 of the *UNCITRAL MLCBI* on the "hotch-potch rule".

(a) Specify that the liquidation authorities and liquidators should cooperate to the maximum extent possible to achieve an effective solution, including in cases where there are separate proceedings (including imminent proceedings) in different jurisdictions for the liquidation of individual entities of the same group;

(b) Permit procedural coordination and the centralisation of the liquidation proceeding in a group home jurisdiction or allow the appointment of the same liquidator(s) when this approach better serves the objectives of the liquidation framework and the mandate of the liquidation authority;

(c) Facilitate the cooperation and participation of host and affected authorities in the group home proceedings in case of centralisation.

Centralisation and accommodation of parallel proceedings

105. The legal framework should enable, where determined appropriate by home and host liquidation authorities, centralisation and the avoidance of multiple processes where centralised proceedings better serve the objectives of bank liquidation. The legal framework should allow host authorities to retain authority to institute a liquidation proceeding where they determine that such proceeding better protects bank liquidation objectives, or where it is considered more efficient in the circumstances, in coordination with the home authorities.

Centralisation and minimisation of multiple proceedings may be assisted by treating claims under host jurisdiction laws in a centralised liquidation proceeding in accordance with the treatment they would be accorded in the host jurisdiction.

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	Dora Sofía MORALES SOTO – Advisor, Group of resolution mechanisms and plans
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2024-2028

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