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DRAFT LEGISLATIVE GUIDE ON BANK LIQUIDATION

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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 system
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
MREL	Minimum Requirement for own funds and Eligible Liabilities
NBFI	Non-Bank Financial Institution
NCWO	No Creditor Worse Off
P&A	Purchase and Assumption
SRMR	Single Resolution Mechanisms Regulation (EU)
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 provide 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. Ordinary 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 procedure, 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 interest 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 to manage failures of systemic financial institutions in a way that maintains their critical functions and preserves financial stability while minimising the risk of loss to public funds. 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) as 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 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 institutions 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. This minimum scope of application allows jurisdictions to apply their resolution regime more potentially to all banks, rather than limiting it in advance to a subset identified by systemic significance.[2] Both approaches exist globally.

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". In addition, guidance is lacking on effective liquidation procedures for any residual parts of banks that are to be wound up following

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1 FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (revised 2014).

2 See *FSB Key Attributes Assessment Methodology for the Banking Sector* (2016), Explanatory Note (EN) 1(c). The *FSB Key Attributes* state that, "*[a]ny financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime*" (KA 1.1). 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.

resolution actions, such as the transfer of viable operations to a purchaser, although 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]

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).

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 entity.[4] While the guidance is mostly aimed at facilitating the orderly liquidation of non-systemic banks, certain aspects of the liquidation framework are also relevant to resolution frameworks.[5]

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 possible, 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.[6] 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, 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* intends to revise, replace or override any provisions included in other international standards.

12. The *Guide* is intended to be used as a reference by legislators and policy makers 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 specific rules for the liquidation of non-systemic banks, although it may also be useful for jurisdictions that wish

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[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] See the definition of "bank liquidation proceeding" (*Section C*, *point (g)* of this Chapter). 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.

[5] For instance, the guidance in *Chapter 8. Creditor Hierarchy*, since the order of distribution in liquidation generally governs the allocation of losses in bank resolution proceedings.

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

to reform their existing bank liquidation framework. It is not intended to serve as standard or code used in countries' assessment by international organisations.

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*.

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

(b) "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, saving banks, *Cajas de Ahorro*, *Sparkassen* and others).

(c) "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).

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

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

(f) "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.

(g) "(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.[7]

(h) "Close-out netting provision": a contractual provision on the basis of which, upon the occurrence of an event predefined 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.

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

(j) "Deposit": Any credit balance which derives from normal banking transactions and which a bank must repay at par under the legal and contractual conditions applicable, any debt

[7] See *point (v)* for the definition of "piecemeal liquidation" and *point (z)* for the definition of "sale as a going concern".

evidenced by a certificate issued by a bank, and any other funds or obligations defined or recognised as deposits by the applicable legal framework.

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

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

(m) "Financial contract": a contract that is identified under 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.

(n) "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.

(o) "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).

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

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

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

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

(t) "Liquidator": a natural or legal person authorised by a liquidation authority 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.

(u) "*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.

(v) "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 of the business or parts thereof as a going concern.

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

(x) "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.

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

(z) "Sale as a going concern": the sale or transfer of a business in whole or part, as opposed to the sale of assets of the business piece by piece, to allow its continued operation.

(aa) "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.

(bb) "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).[8] In single-track regimes, 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 ordinary business insolvency law, by the ordinary business insolvency law but with 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.[9] Under that framework, resolution action may be taken only if resolution is "necessary in the public interest",[10] 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.[11] The applicable national insolvency law also applies when a residual entity is wound up following a resolution transfer of the institution's viable activities.

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[12] 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)

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

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

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

11 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.

12 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.

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. 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 in a way that aims to help 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 (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 jurisdictions with 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 for jurisdictions with a dual-track regime.[13] Other aspects of the *Guide* are equally relevant for jurisdictions with 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 included 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). 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.[14]

21. In jurisdictions with a dual-track regime, the provisions governing bank liquidation should ideally be included in a dedicated bank liquidation law but could also be integrated in the banking law or general insolvency law. The enactment of a *lex specialis* contributes to legal certainty and procedural clarity. In jurisdictions with a predominantly court-based regime, it may be sufficient to introduce bank-specific modifications, although some jurisdictions have a *lex specialis* for a court-

[13] 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*.

[14] 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.

based framework. In any case, if the ordinary 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 ordinary 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). 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*).
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 retain such a right, the administrative authority should at least be heard in the proceedings and before any order is granted. 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, and in the case of 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 and 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).[15] It is important that the supervisory framework, in accordance with the *Basel Core Principles*: (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 resolution of a problem bank, including possible closure.[16]

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 through individual bank support (collateralised lines of credit for illiquid but solvent institutions) or as broad-based support.

28. Jurisdictions should have a deposit insurance system (DIS) that is in line with the International Association of Deposit Insurers' *Core Principles for Effective Deposit Insurance Systems* (IADI Core Principles).[17] A DIS helps to protect depositors and contributes to financial stability.

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 appropriate governance arrangements and safeguards to protect the DIF against excessive depletion.[18]

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, ordinary 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 ordinary business

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[15] The *Basel Core Principles* 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.

[16] See *Basel Core Principle* (CP) 11, Essential Criterion (EC) 7; *Basel CP* 1, EC 6; *Basel CP* 3, EC 5.

[17] IADI, *Core Principles for Effective Deposit Insurance Systems* (revised 2014).

[18] 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*.

insolvency law to some extent, those provisions should meet relevant existing international standards. This includes, in particular, the World Bank's *Principles for Effective Insolvency and Creditor/Debtor Regimes* (World Bank Principles)[19] 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).[20] This *Guide* assumes that jurisdictions have implemented these insolvency instruments. It refers to relevant parts of these instruments where 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 quick resolution of disputes. The judiciary should be independent and 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 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.

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 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 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 deposit insurance systems 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, cooperative banks are subject to a separate regulatory and supervisory framework and their deposits are not 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

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

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

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 if the legal framework allows some of the entity's operations to continue during liquidation. 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*, *Aktiengesellshaft*), 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, too, business models 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. Furthermore, the *Guide* covers both single entity banks and banking groups.[21] 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 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 procedures. 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

[21] 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.

in the nature of a guiding design principle while others might be more appropriate as an explicit objective for the liquidator. Finally, subsection 6 provides options on how legal frameworks could guide liquidation authorities and liquidators in balancing the liquidation objectives in case of friction.

1. Value preservation and maximisation

43. Value maximisation is a core objective of business insolvency laws.[22] 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.

44. 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.

45. 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 potentially value-maximising options, such as a sale as a going concern.

2. Depositor protection

46. 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 depositors' access to their deposits is interrupted, this could cause considerable personal hardship for some depositors and undermine general confidence in the banking sector. The objective of protecting depositors aims to reduce such negative impacts for individuals 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 is aimed at maintaining trust in the banking system and avoiding broader negative impacts on the economy.

47. 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.

48. 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 proceedings[23] 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.[24] A depositor protection objective for liquidation may also be derived from

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22 See, e.g., *UNCITRAL Legislative Guide*, Part One, Chapter 1, and the *World Bank Principles*, Principle C1.

23 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.

24 In some jurisdictions, a deposit 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 UK Bank Insolvency Procedure (BIP) the liquidator has two objectives. Objective 1, which

the mandate of the administrative authority in charge of bank liquidation proceedings, either framed explicitly in terms of protecting depositors or as a facet of a broader financial stability objective.[25]

49. 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.[26] 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,[27] DIs protect the insured depositors either by paying out the insured depositors or by funding the transfer of those 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 is discussed further in *Chapter 2. Institutional Arrangements* and *Chapter 7. Funding* of this *Guide*.

50. 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

51. Maintaining financial stability is generally an overarching objective of any framework for prudential regulation and supervision, and for central banks, and it is often an explicit part of the mandate of banking authorities. It is linked to banks' special nature (e.g., susceptibility to runs) and the interplay between banks, the financial 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.[28] 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.

52. Financial stability is a core objective of resolution under the *FSB Key Attributes.* Accordingly, single-track regimes will generally contain a financial stability objective that is derived from the *FSB Key Attributes* and 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

is specific to the BIP and is not an objective of the ordinary 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 ordinary 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.

25 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.

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

27 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 deposits by funding measures (such as transfer transactions) that preserve depositors' access to their funds, see *Chapter 2. Institutional Arrangements* for a discussion of the types of DI mandate.

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

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, either 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 principally 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. Bank-specific liquidation rules can facilitate coordination in those circumstances and thereby contribute to financial stability.

53. 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 taxpayers 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 liquidation authority or in overseeing aspects of the liquidation where financial stability may arise (for example, in the treatment of depositors). As discussed in *Chapter 2. Institutional Arrangements*, administrative authorities with a relevant mandate may be best placed to consider the public interests that may be affected by the failure of a bank. In this context, it is recognised that different stages of the liquidation process can be informed by a different objective. Specifically, financial stability concerns, along with depositor protection, tend to play a more significant role in the first stage of a liquidation proceeding, whereas the objective of value maximisation gains more relevance as the proceeding advances.

4. Avoiding use of public funds and loss to taxpayers

54. 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.[29] 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.[30] 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.[31]

55. 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

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[29] See *FSB Key Attributes,* e.g., Preamble, p. 3. 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*".

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

[31] *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 "no creditor worse off than in liquidation" safeguard) and, if necessary, from the financial system more widely.

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*).

5. Certainty and predictability

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

57. 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 provision 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 procedure and increase legal certainty for stakeholders.

58. 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*).

59. 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.

6. Balancing the objectives of a bank liquidation framework

60. 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.

61. However, there may be situations in which frictions arise. For example, public interest objectives may be in tension with maximising value for creditors. Value maximisation may also require discretion and flexibility, which may reduce the level of certainty and predictability hardwired into the framework.

62. 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.

63. 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 individual 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 interest objectives such as depositor protection or continuity of transferred functions.

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, as well as the 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 losses to taxpayers, and certainty and predictability.

Recommendations

1. The provisions governing bank liquidation proceedings should be clearly set out in the legal framework. This should be done in either a dedicated bank liquidation law or in the banking law or general insolvency law.
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.

CHAPTER 2. INSTITUTIONAL ARRANGEMENTS

A. Introduction

64. 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 parts that consider different aspects of institutional arrangements that are relevant to effective bank liquidation proceedings.

65. *Section B* offers an empirical overview of different institutional models for bank liquidation proceedings. These can be grouped broadly as: (i) administrative, where the proceedings are managed by the relevant banking 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 stages of the process, given the special nature of banks.

66. *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 considerations and features are met under the different institutional models outlined in *Section B*. *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 procedure. In this regard, the analogy of bank resolution is relevant. 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, in any case that role should not impede effective resolution.[32] The *FSB Key Attributes* 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.[33] 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, administrative 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 purchaser.

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

33 *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.*"

B. Institutional models

69. Jurisdictions have different approaches to the nature and extent of relevant banking 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, the same as 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 and 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[34]

71. Under an administrative model, an administrative authority is responsible for managing bank liquidation proceedings. While courts may have a role, for 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).[35]

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 administrative authority.[36] Subsequently, the relevant banking authority may act as liquidator or it may appoint an external liquidator who will act under its oversight.[37]

74. The same administrative authority may be in charge of several stages of the liquidation (e.g., opening the proceedings and overseeing the execution of the liquidation), but it is also possible that different authorities are responsible for managing different stages of the liquidation proceeding.[38]

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

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[34] This section focuses on models in which an administrative authority is responsible for winding up a bank or resolving it without using resolution tools pursuant to the *FSB Key Attributes*.

[35] For instance, in Brazil, Ghana, Greece, and Italy, the central bank is in charge of administrative bank liquidation proceedings, which, in these countries, combines the functions of banking supervisor and resolution authority. In Colombia and Ukraine, bank liquidation competences are shared between the banking supervisor or resolution authority and the DI.

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

[37] 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 of a failed bank or as a receiver. In several other countries with an administrative model (e.g., Brazil, Colombia, Greece, Italy), the administrative authority does not act as liquidator itself but is responsible for appointing a liquidator.

[38] 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.

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 of accountability to ensure that administrative authorities act within their mandates. At the same time, however, the public interest 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 considerations of general public interest, such as depositor protection, on the other. These considerations have led several jurisdictions to, for instance, limit the list of matters that can be reviewed, that are available as interim measures (e.g., no suspension of the authority's decisions pending determination of the review) or that are available as remedies (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 *Parts C* and *D* of this Chapter, a strong role for banking authorities is key in jurisdictions with court-based models.

77. The process starts with a petition to the court to open the liquidation procedure, which is generally made by a banking authority.[39] The ability to file such a petition may be the exclusive competence of a relevant 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 relevant banking authority must generally at least be consulted or must approve the initiation of the bank liquidation proceeding. For guidance on the initiation of bank liquidation proceedings, please see *Chapter 3. Procedural and Operational Aspects*.

78. The opening of bank liquidation proceedings may be subject to additional requirements compared to ordinary business insolvency. In some jurisdictions, court-based bank liquidation proceedings may be opened only following the withdrawal 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 withdrawn simultaneously with, or shortly following, the commencement of liquidation proceedings. For guidance on the interaction between bank liquidation and revocation of the banking licence, please see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*.

79. The degree of involvement of relevant banking authorities in a court-based bank liquidation procedure varies. In addition to their role in the opening of a bank liquidation proceeding, banking authorities are often involved in the appointment of a liquidator.[40] In some jurisdictions, the relevant banking authority may be appointed as liquidator, which significantly increases its role in the liquidation process.[41]

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

[40] In Belgium, for instance, the liquidator is appointed by the court but with 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).

[41] 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 deposit insurer (NDIC) as provisional liquidator, which can subsequently file a petition for winding–up of the bank with the court.

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 proceeding, 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 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*). Liquidation authorities should have experience in balancing diverging interests, both private and public policy interests, which is crucial in bank liquidation proceedings. Administrative authorities are well positioned to pursue public interest objectives such as depositor protection and maintaining financial stability to the extent that they are part of their mandates. Administrative authorities with supervisory knowledge are decisively placed to weigh public and private consideration in decisions related, for example, to 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 general public interest – demand that relevant banking authorities be heavily involved in the proceeding, especially at the initial stages of opening the proceeding and deciding on the liquidation strategy.

2. Preparation

84. 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 (see *Chapter 4. Preparation and Cooperation*). A banking authority has the capabilities needed to prepare for liquidation, to the extent possible due to the circumstances, 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, will be less able to prepare for a bank's liquidation in principle 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 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 of 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 court-based model to prepare for a bank's liquidation might not be fully overcome.

3. Expertise, efficiency and access to information

85. 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[42] 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, as well as the ability to evaluate whether the situation may still be remedied and whether sufficient financing is available.

86. 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 purchasers and the impact of failure management options.

87. The need for expertise, efficiency, and access to information to support timely intervention favour an administrative institutional model. Indeed, the need for timeliness was one of the considerations that motivated the requirement in the *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 a transfer-based strategy and to subsequently smoothly execute (or oversee the execution of) a transfer, building on their knowledge of the specific bank, the banking sector and their existing channels of communication with other banking authorities or DIs.

88. 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, which facilitates preparation and swift decision-making and allows authorities to act promptly throughout the liquidation proceeding.[43]

89. The efficiency of courts and the business insolvency system are another relevant consideration when designing the model. The lack of speed is a significant potential weakness of court-based models. In some jurisdictions, where the judicial system is over-burdened or there is no fast-track procedure to expedite proceedings, court proceedings may be slow and lengthy. Where this is the case, 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 also be lacking. While such a court might well be effective in winding up a residual entity, it 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 a pool of appropriate experts.

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[42] See *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*.

[43] The co-location of supervisory/resolution/central bank/deposit insurance functions, on the one hand, and liquidation functions, on the other, may require internal governance arrangements for decision-making to manage potential conflicts of interest that may arise (see *subsection 5. Independence*).

90. In jurisdictions with court-based models, it is advisable that courts draw on expertise developed in the judiciary in the fields of general business insolvency law and financial matters. In addition, the involvement of relevant banking authorities as appointed liquidators or a special role for banking authorities in the process (e.g., hearing their testimony on relevant matters) are means to further mitigate a lack of specialist judicial expertise. In any case, it is 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.[44]

91. The liquidation authority should have sufficient human resources to fulfil its functions effectively.[45] In court-based proceedings, specific functions are usually assigned to a liquidator. In administrative proceedings, banking authorities should also be able to appoint external liquidators that would carry out their work under the authorities' oversight. Banking authorities that conduct the liquidation itself should also 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

92. 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 to allow these authorities to fulfil their mandates properly, including as part of the broader arrangements to prepare for and manage a bank failure.

93. For example, at the domestic level, the banking supervisor will be involved in the preparatory stage, and coordination between the liquidation authority and the banking supervisor on matters such as the bank's non-viability and the identification of potential buyers 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* 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.

94. 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 full integration of bank liquidation into existing coordination arrangements for crisis preparation and management, such as cooperation agreements or MoUs concluded under bank supervision and resolution frameworks. Building on such existing arrangements for cooperation facilitates preparation, the exchange of information and effective actions during the liquidation proceeding.

95. Under a court-based model, pre-existing cooperation mechanisms are likely to be lacking and effective cooperation and information sharing with several administrative authorities is more difficult. A strong involvement of relevant banking authorities, both prior to the opening of the proceeding

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44 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).

45 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.

and during the liquidation process, could mitigate these drawbacks. For instance, if the court can appoint a banking authority as liquidator, this would allow such authority to build upon and make use of existing cooperation arrangements with other authorities.

96. The need for coordination often extends to relevant banking authorities in other jurisdictions since banks commonly operate internationally and their failure may involve foreign branches and/or subsidiaries. Intensive cooperation and coordination may be needed, in particular, if 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 transfer of assets and liabilities within a liquidation proceeding has a cross-border element. In such cases, 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 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

97. 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, existing international standards require liquidators to be independent (and insolvency laws to specify the consequences of a lack of independence).[46] For administrative authorities, independence requirements also form part of existing international standards,[47] while a liquidator appointed by such an authority would generally be subject to the authority's directions or guidance. Any institutional structure should thus be aligned with existing standards on operational autonomy in order 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 with multiple mandates, such as both supervision and liquidation.[48]

6. Accountability

98. The need for accountability follows from the procedural 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 structures may already provide for internal procedures for reviewing and evaluating actions that the authority takes in carrying out its statutory responsibilities. Periodic publication of reports on its actions and policies may add a layer of public

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

[47] 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.

[48] 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).

scrutiny (see *susbsection 7* below and *Chapter 3. Procedural and Operational Aspects*).[49] Furthermore, non-judicial accountability mechanisms for banking authorities, such as accountability to the executive and parliament, are relevant to the achievement of liquidation objectives assigned to these authorities, presuming such mechanisms are designed in line with good practices and therefore do not interfere with the operational decisions of the authorities.

99. Provision for a form of judicial scrutiny is important to ensure due process and that appropriate legal remedies are available to the bank and to other stakeholders that the domestic legal framework recognises as having a legitimate interest to request such a review. It is also an important mechanism of accountability to ensure that administrative authorities act within their legal powers. The legal framework should guarantee effective judicial protection to those that have a right to legal standing to seek relief against bank liquidation measures. This should encompass processes for legal review, ensuring effective access to a court, and adequate remedies.

100. A liquidation consists of various acts of the relevant 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 execution of a transfer, 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. 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 availability of a stay pending the court's decision or an appeal against it, and (iii) possible effects of successful remedies.

101. 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 only challenged after its implementation.

102. 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 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.[50] 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.

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[49] 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).

[50] For instance, in the 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 case, the court can only rule in favour of the bank (i.e., deny the bankruptcy request) if it determines that the banking supervisor (which is also the resolution authority) could not have reasonably reached the conclusion that the requirements were met.

103. When courts scrutinise acts of liquidation *ex post*, 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 applicable 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 implementation of a transfer of assets and liabilities, should follow the same principles. The statutory provisions could, in particular, require a court to concentrate on matters of law and procedure, unless this is already clarified under the broader administrative law. At the same time, the 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 make clear what the process for legal challenges is for different types of acts during the liquidation proceeding.

104. A second principal distinction relates to acts of the liquidation authority and any appointed liquidator in relation to stakeholder rights. 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 for a challenge in court on their own behalf. Only as far as an act directly determines the outcome of the value available for distribution to stakeholders, a right to legal actions may be useful and, depending on the applicable constitutional framework, also necessary. The legal framework could also consider the fact that the interests of stakeholders in a (bank) liquidation proceeding may be limited to a monetary interest due to the nature of such proceedings, which in turn supports this assessment (and may limit the consequences of a successful challenge).

105. Regarding the availability of a stay pending the court's decision to approve a liquidation act or pending any appeal against such a decision, it is undesirable that the mere individual motion to a court automatically suspends the decision pending the court's judgment when considering the need for legal certainty and to respect the legitimate expectations of stakeholders affected by a liquidation action. 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 court-based proceedings should not suspend the execution of the liquidation proceeding. Subject to their constitutional framework and broader legal system, jurisdictions may deploy different legal mechanisms to ensure that judicial actions do not constrain the implementation of measures taken during liquidation. Some jurisdictions bar any suspension order or any other interim order to that end. In some others, any temporary suspension of liquidation measures with a view to judicial challenges is limited to narrowly defined grounds (e.g., of irreparable harm and *prima facie* illegality) or may consider procedural safeguards (e.g., a presumption that suspension would be against public interest considerations).

106. Regarding possible effects of successful remedies, 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 transfer strategies, 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.[51]

107. 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 may be exposed to the risk of personal liability. At the same time, such personal liability is a means of accountability of the liquidator in many business insolvency frameworks. A balanced approach is needed and discussed in more detail in *Chapter 3. Procedural and Operational Aspects*.

7. Transparency

108. The bank liquidation procedure and the role of 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 stages of preparation, decision-making and implementation.

109. A key issue in bank liquidation proceedings is how to strike a balance between transparency and confidentiality, especially in relation to critical decisions such as those to open a liquidation proceeding or to transfer assets and liabilities of a non-viable bank. Since judicial processes are largely transparent, in 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. The public disclosure of sensitive information should be prevented 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.[52]

110. Administrative authorities will already be subject to confidentiality rules.[53] 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 procedure. 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. 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

111. 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 a purely administrative and a court-based model. The

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[51] 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*).

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

[53] 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.

effectiveness of any institutional model will depend on jurisdiction-specific factors, such as the legal tradition; constitutional protections; the efficiency, capacity and expertise of courts and administrative authorities in a specific jurisdiction; and the structure and development level of the banking system.

112. The factors and considerations in *Section C* 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 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 (parts of) the bank are to be sold as a going concern. In case of a piecemeal liquidation, public policy concerns may be more limited, albeit not entirely ruled out, and an ordinary court process may proceed, subject to monitoring by administrative authorities, which should be able to take appropriate actions if the course of liquidation poses risks to the objectives of the liquidation.

E. The role of deposit insurers

113. In jurisdictions that have a DIS, DIs play an important role in bank liquidation proceedings since they administer the use of (industry-sourced) DIFs. The DIS consists of the DI and its relationships with the financial safety-net participants that support deposit insurance functions and resolution processes. The principal public policy objectives for establishing a DIS are to protect depositors and contribute to financial stability.[54]

114. 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 *Core Principles* classify DI mandates into four categories.[55] 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 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.

115. The role of the DI in a liquidation may be multi-faceted. If it has paid out 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 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 policy makers 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 mandate, that the DI adheres to good governance practices,[56] 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. Of particular relevance in this regard is the institutional nature of the DI. Where the DI is a private entity, assigning

54 See *IADI Core Principles,* CP 1 .

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

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

liquidation functions to such entities poses significant legal and policy challenges that may be insurmountable.

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

117. In any case, irrespective of its mandate and nature, the DI, in its capacity as creditor, should have the right to access information from the liquidator, in line with the *IADI Core Principles* (CP 16, EC 3). Furthermore, to facilitate preparation and cooperation, information sharing arrangements should be in place between the DI and other financial safety-net participants, ensuring the protection of confidential information.[57]

Key Considerations and Recommendations 3 – 17

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;

(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 procedure 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 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 transactions.
- 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) Expertise, efficiency, resources, and access to information: The actors involved in bank liquidation proceedings should have the necessary technical expertise, experience and human and technical resources to carry out their functions

[57] See *IADI Core Principles*, CP 4.

effectively. They should also have access to all relevant information regarding the bank, and other affiliated entities as appropriate, that is relevant to their decision-making. The institutional set-up should enable bank liquidation proceedings to be initiated and continued in a timely and speedy manner.

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

(e) 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.

(f) Accountability: While judicial scrutinity available under the domestic framework remains relevant, such mechanisms should be designed in a way that promotes legal certainty, avoids delays in the proceedings and does not jeopardise the objectives of the liquidation. Non-judicial accountability mechanisms of the banking authorities as provided in their founding legislation and in line with good practices should be relevant for the discharge of duties by banking authorities in relation to their liquidation objectives.

(g) Transparency: The rules and the procedure, 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, limiting the 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 relevant banking authorities 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. Instead of providing for a claim of restitution of assets, rights and liabilities to the liquidated entity, jurisdictions should provide for redress by awarding compensation, if justified.

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

8. The legal framework should meet international standards on operational independence and good governance to provide safeguards against 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 interest objectives are relevant.

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

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

11. 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:

    (a) 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.

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

12. 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.

13. A strong role for the relevant banking authority during the bank liquidation proceeding. To this end, the legal framework could include one or more of the following options:

    (a) Provide for the relevant 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.

    (b) 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.

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

    (d) Assign a monitoring role to the relevant banking authority.[58]

    (e) Give the relevant banking authority legal standing to appeal decisions made by the liquidator.

14. 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.

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

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

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[58] 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*.

Recommendation concerning the role of deposit insurers

17. Where consistent with their mandate, deposit insurers that are performing 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 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 13 (a) to (c)*.

CHAPTER 3. PROCEDURAL AND OPERATIONAL ASPECTS

A. Introduction

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

(a) the notification duty of banks' management in the period approaching liquidation, appropriate legal consequences in case of non-compliance, and coordination among banking authorities (see *Section B*);

(b) the petition for opening a bank liquidation proceeding (see *Section C*);

(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 (see *Section D*);

(d) creditor involvement, considering the special nature of banks and the role of banking authorities (see *Section E*);[59] and

(e) the termination of a bank liquidation proceeding (see *Section F*).

119. While in some jurisdictions a bank-specific liquidation framework is in place, requiring the appointment of 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 business insolvency law may not be suitable for banks. Accordingly, an 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 duty of the bank's management or Board of Directors in the period approaching liquidation

120. Business insolvency law may typically require 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.[60] 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 administrative authority should approve (or not oppose)[61] the initiation of a bank liquidation proceeding or at least be heard before the liquidation process is opened (see *Section C*).

121. Should the obligation to file for insolvency in a timely manner apply to the bank's management, the consequences of non-compliance under the business insolvency framework should apply. This may include compensation for damages (e.g., under business insolvency law, 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 according to the relevant insolvency law provisions.

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59 In general business insolvency proceedings, creditor involvement is generally institutionalised through arrangements such as creditor meetings or a creditors' committee.

60 See *UNCITRAL Legislative Guide*, Part Four, 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.

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

122. Furthermore, pursuant to 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.[62] As indicated in Chapter 1. Introduction, jurisdictions should have a bank prudential and supervisory framework that meets the relevant international financial standards, especially the *Basel Core Principles*. Therefore, the legal framework should include an early notification obligation for the bank. To ensure appropriate coordination among administrative authorities and facilitate preparation, the legal framework should require the banking supervisor to inform the resolution authority and the liquidation authority, where the latter is an administrative authority other than the banking supervisor or resolution authority, of a bank's approaching non-viability.[63] Alternatively, the legal framework could introduce an obligation for the bank to simultaneously notify the relevant banking authorities (banking supervisor, resolution authority, liquidation authority, as appropriate) of its approaching non-viability. This notification obligation would supplement the early notification requirement pursuant to the *Basel Core Principles*.

123. The trigger for such a notification obligation for the bank, and the action(s) required of the authority following such a notification should be specified in the legal framework. Furthermore, depending on possible disclosure requirements under other laws, 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).

124. The legal framework should provide for appropriate legal consequences for a failure to comply with such notification obligation. The type of consequences depend on the jurisdiction's broader legal framework. These may include personal liability of directors for damages and even criminal penalties in cases of bad faith or negligence. Administrative consequences may derive from the applicable banking and may include, e.g., administrative fines or penalties.[64] The specific conditions and possible safe harbours (e.g., for business judgement) could derive solely from the applicable banking regulation and supervision framework.

C. Initiation of bank liquidation proceedings

125. Business insolvency laws generally permit the debtor to petition for the opening of an insolvency proceeding. Furthermore, in most jurisdictions, general business insolvency law grants one or more creditors the right to initiate involuntary insolvency proceedings as one of the options for enforcing their claims. In order to exercise this right, frameworks often require creditors to meet specific formal requirements, such as filing a preliminary proof of claim, or substantive requirements, such as having a legitimate interest in collective proceedings, a minimum claim amount or a minimum headcount or percentage of creditors.

126. 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 sector-specific resolution framework, there may also be a case for the resolution authority to be responsible for initiating liquidation proceedings.[65] In any case, the legal framework should grant a relevant banking authority the right to open bank liquidation proceedings (in jurisdictions with an

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

63 See also Chapter 4. Preparation and Cooperation, Section D.

64 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, *inter alia*, 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. Banks' directors that 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.

65 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 (BRRD and SRMR).

administrative model) or to file a petition to the court for the opening of bank liquidation proceedings (in jurisdictions with a court-based model, or when a court order is needed to open administrative bank liquidation proceedings).[66]

127. 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 the relevant 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;[67] and (b) requiring that the banking authority must approve (or not oppose) the initiation of bank liquidation proceedings or at least be heard before any proceedings are opened.[68] In particular, in a court-based system, a right for the banking authority to be heard before proceedings are opened would function as a minimum safeguard and ensure that the supervisor'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.

128. 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 ability to amplify rumour and misinformation make those risks more acute and arguably impossible to mitigate effectively. Accordingly, the right to petition for the liquidation of banks 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.

129. 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 authority's exercise of discretion in undertaking its functions.

130. Finally, irrespective of whether the framework is administrative or 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 a liquidation procedure. First, the grounds for bank liquidation should include those that are forward-looking (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

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

67 As an alternative to keeping the petition for liquidation confidential, some jurisdictions with a 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*).

68 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.

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 impede cross-border cooperation as well.

131. 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.[69]

D. The bank liquidator

1. Desirable qualities

132. As follows from [*Chapter 2. Institutional Arrangements*](), the liquidator in a bank liquidation proceeding may be an administrative authority or an appointed natural or legal person. In particular, in jurisdictions with 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). Alternatively, the administrative liquidation authority should have the power to appoint a liquidator (e.g., a person from the private sector) that would perform those tasks under the oversight of the administrative authority. In jurisdictions with a 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.

133. Irrespective of who undertakes liquidation functions, the appointed liquidator(s) in a bank liquidation proceeding should possess certain qualities in terms of, *inter alia*, expertise, experience and personal qualities. The minimum qualifications and qualities should be set out in the legal framework or guidance, or should be specified by the relevant administrative authority. In line with existing international guidance on business insolvency laws, such requirements should include integrity, independence, and impartiality.[70] In addition, the liquidator should have appropriate knowledge and technical expertise in, *inter alia*, insolvency cases and the functioning of banks. To enhance efficiency in this respect, and notwithstanding the general rules on the liquidator's selection and appointment, a list of liquidators with the required qualities could be maintained by the liquidation authority. This could facilitate the rapid appointment of a liquidator from a pool of eligible candidates.

2. Selection and appointment procedure

134. 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, operations carried out) in order to ensure

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[69] 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 *vis-à-vis* its depositors and 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.

[70] 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 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](), [subsection 5]().

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.

135. In jurisdictions with a court-based model, the liquidator would be selected, appointed and overseen by the court, possibly acting as an officer of the court. It is recommended that a relevant banking authority be involved in the selection and appointment of the liquidator. This may take place following the opening of the liquidation by the court. In deviation from a possible general rule allowing the court to select and appoint a liquidator as it deems appropriate, the legal framework could either provide that a banking authority should be appointed as liquidator, or the court could be tasked with the appointment of a liquidator on a proposal by the banking authority or based on a list of eligible liquidators established by or in cooperation with the banking authority (see *Chapter 2. Institutional Arrangements*).

3. Remuneration

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

137. Where natural or legal persons from the private sector act as liquidator, 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 range from a fixed remuneration based on the size of the estate, to hourly rates or a combination of both, to a bonus system for quick(er) liquidations of more complex cases.

138. 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). Typically, the remuneration will be based on the amount of liabilities of the bank in liquidation and the proceeds of the liquidation of its assets. Where the liquidator is appointed by the court, the court will generally also determine the remuneration taking into account the size of bank's balance sheet and the nature and expected complexity of the proceedings. In jurisdictions with a court-based model, 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.

139. The method for determining remuneration may be adapted to encourage particular outcomes. 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.[71] 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

[71] For example, in Italy, the central bank 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.

assets will decrease with the passing of time may also act as an incentive for the liquidator not to unjustifiably prolong the process.[72]

4. Oversight, transparency and accountability

140. 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, to an administrative authority overseeing the process, or to a creditor committee (or other body representing creditors in insolvency proceedings).[73]

141. If the liquidation authority has appointed a liquidator, it should submit regular reports to its appointing liquidation authority in line with business insolvency law. Where an administrative liquidation authority itself acts as liquidator, 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).[74]

142. 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.

143. Under an administrative framework for bank liquidation, 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. 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 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 mismanagement, it should be possible to replace the liquidator and commensurately limit the remuneration.

144. For jurisdictions with a court-based model, 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 stages of the liquidation proceeding. Given the need for the relevant banking authority to have a role in stages of bank liquidation proceedings, as discussed in *Chapter 2. Institutional Arrangements*, the legal framework could allow

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[72] 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.

[73] The *UNCITRAL Legislative Guide* 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).

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

such authority to be part of any oversight mechanism; and 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[75]

145. 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).[76] 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 to limit it in a way that prevents a liquidator from being exposed to potentially costly claims for damages for legitimate or justifiable actions or omissions.[77]

146. 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.

147. 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.[78] 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.[79] 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 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

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

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

[77] 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 (p. 184).

[78] 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.

[79] 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.

may be extended to all acts undertaken in accordance with a direction from that authority.[80] 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.

148. Where an administrative authority or any of its officials act 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.[81] 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.

149. 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 interest 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.

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

151. 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 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 creditors' committee).[82] Acts of discretion should be measured by applicable professional standards for liquidators.

152. 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.

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[80] 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.

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

[82] For aspects of the liquidation where public interest 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.

E. Creditor involvement during the liquidation process

1. General aspects

153. 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).

154. 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.

155. The public policy objectives and the role of administrative authorities in bank liquidation proceedings and efficiency considerations justify a different degree of creditor involvement compared to ordinary business insolvency proceedings, combined with appropriate safeguards.[83] 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 impact the efficiency of the bank liquidation process. Importantly, creditors should not be able to interfere with decisions that involve a financial stability concern, more specifically a decision about, and execution of, a liquidation strategy that involves the transfer of (part of) the bank’s assets and liabilities to another entity as a going concern.[84] Creditors should, however, have the right to challenge such decisions *ex post*, although remedies may be limited to financial compensation. In the case of a piecemeal liquidation of a bank or a residual entity following a sale as a going concern, public policy concerns may be more limited, albeit not entirely ruled out, and creditor involvement could be similar as under general business insolvency law provided that the efficiency of the bank liquidation process is ensured. 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*, *subsection 4* above). A main difference compared to general business insolvency proceedings would be the involvement of the DI, which (usually) will have a substantial claim against the liquidation estate.

2. Involvement of the deposit insurer as a creditor

156. Where the DI pays out insured deposits of a bank in liquidation, it is subrogated to the rights of depositors against the failed bank in the liquidation proceeding and, upon subrogation, participates therein as a creditor, being one of the largest – if not *the* largest – creditors in the liquidation.[85] The DI’s special interest and expertise may be reflected in a right to appoint its representative to the

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[83] The extent of creditor involvement greatly varies under existing liquidation frameworks that apply to banks (either sector-specific or modified versions of general business insolvency regimes). In some jurisdictions (e.g., Ghana, India, Nigeria, Paraguay, Ukraine) 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.

[84] 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.

[85] 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).

creditors' committee – where such committee has been established. Where the DI is also the liquidation authority or appointed liquidator, its status as a significant creditor of the bank in liquidation may raise concerns of potential (material) conflicts of interest. At the same time, the risk of (potential) conflicts of interest could be reduced by requirements for the DI to serve the interests of all creditors. 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 governance arrangements to ensure that the DI act 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

157. General business insolvency laws adopt different approaches to the manner in which a liquidation proceeding is to be concluded or terminated.[86] 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 subsequently 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.

158. For the liquidation of banks, in line with general business insolvency law, the 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 omit any confidential information. In jurisdictions with an administrative model, the liquidator should also submit the final accounts and a final report to the administrative liquidation authority (which may be confidential). 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 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 administrative authority involved in the liquidation proceeding. In such a case, the proceeding should be terminated by the court, following the approval of these documents by the court itself and after hearing the administrative authority or receiving its consent (or non-objection).

159. Irrespective of the institutional model, following the termination of a bank liquidation proceeding, the liquidation authority should notify the administrative authority responsible for the registration of business entities in order to remove the former bank from the business register.[87] 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 18 – 37

Purpose of legislative provisions

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[86] See *UNICTRAL Legislative Guide*, Part Two, Section VI (paras. 16-17).

[87] Following the liquidation of limited liability companies, the law generally provides for the disappearance of the legal entity. If creditors have not been paid in full, they will no longer have an outstanding claim against the debtor (see *UNICTRAL Legislative Guide*, Part Two, Section VI (par. 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).

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

(a) The notification duty 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

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

Recommendations

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

18. 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 banking supervisor should, in turn, be required to inform the resolution authority and the liquidation authority, where the latter is an administrative authority other than the banking supervisor or resolution authority, of a bank's approaching non-viability. Alternatively, the legal framework could require the bank to simultaneously notify all the relevant banking authorities of its approaching non-viability.

The legal framework should specify the terms of this notification obligation and the course(s) of action of the administrative authority that has received such a notification. The framework should also provide for appropriate legal consequences of non-compliance by the bank.

Initiation of bank liquidation proceedings

19. 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 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 to open bank liquidation proceedings (directly or by petitioning the court), 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 framework effectively allows a court hearing to 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

20. 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 authority. Such required qualities should include integrity, independence, and impartiality. In addition, the liquidator should have appropriate knowledge and technical expertise on the functioning of banks, as well as expertise in insolvency cases. 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

21. 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.

22. In jurisdictions with a court-based model, in deviation from a possible general rule allowing the court to select and appoint a liquidator as it deems appropriate, it is recommended that a banking authority be involved in the selection and appointment of the liquidator, in line with *Recommendation 13(a)*.

Remuneration

23. The legal framework should establish a mechanism for determining the remuneration of the liquidator in a manner encouraging the timely and efficient conduct of the liquidation, also drawing on models from business insolvency proceedings.

    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 court-based model, the banking authority should be involved in the determination of the liquidator's remuneration.

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

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

Oversight, transparency, and accountability

25. The legal framework should require an appointed liquidator to regularly report on its activities to its appointing liquidation authority. In jurisdictions with a court-based model, the legal framework should require the liquidator to report both to the appointing court and to the 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.

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

27. In jurisdictions with an administrative model, the legal framework should require appointed 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. The liquidator should be accountable to the administrative authority for the performance of its tasks as liquidator.

28. In case of mismanagement, the legal framework should allow replacement of the liquidator and that liquidator's right to be remunerated should be limited commensurately.

Personal liability and legal protection

29. 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 officers extend to their involvement in bank liquidation proceedings in line with international guidance.

30. 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 a liquidation authority. In jurisdictions with an administrative model, it should be assessed whether the legal protection of the administrative authority and its officers extends to persons from the private sector engaged by it, in their capacity as agent of the authority.

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

Creditor involvement during the liquidation process

32. The legal framework should ensure that creditors do not interfere with decisions about, and the execution of, a liquidation strategy that involves the transfer of (part of) the bank's assets and liabilities to another entity as a going concern. In the case of 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.

33. 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 creditors' committee where such committee exists). Where the DI is also the liquidation authority or appointed liquidator, appropriate governance arrangements and transparency and accountability mechanisms should be in place to mitigate the risk of conflicts of interest.

Termination of bank liquidation proceedings

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

    (a) Include a requirement for any appointed liquidator to submit final accounts and a final report to the administrative 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 proceedings are terminated by the administrative authority, after its approval of the documents under (a).

35. In jurisdictions with a 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 administrative authority, and to the creditors (where appropriate, in non-confidential form);

    (b) Specify that the proceedings are terminated by the court, after its approval of the documents under (a) and after hearing the administrative authority or receiving its consent (or non-objection).

36. Following the termination of a bank liquidation proceeding, the liquidation authority should notify the administrative authority responsible for registration of business entities in order to remove the company from the business register.

37. 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

160. A key task for resolution authorities is to draw up *ex ante*, cyclical (e.g. annual) resolution plans, at a minimum for banks that could be systemic in failure.[88] Conversely, cyclical planning for liquidation purposes in normal times might be limited, depending on the legal framework. 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 will have the capabilities to support a transfer. Possible liquidation planning as part of business-as-usual activities is however different from the preparation of an appropriate liquidation strategy and plan in the run-up to a bank's non-viability (so-called "contingency plans" in the twilight zone). 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 helpful to ensure a swift payout of insured depositors if (part of) a bank is liquidated pursuant to a piecemeal liquidation strategy.

161. Against this background, this Chapter provides guidance on how the legal framework can facilitate preparation for bank liquidation proceedings. *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 is key to the success of a liquidation process, and how cooperation between all relevant actors could be enabled by the legal framework, both in jurisdictions with an administrative model and in jurisdictions with a court-based model.

B. Need for preparation

162. Transfer strategies in bank liquidation proceedings ideally need to be completed almost simultaneously with the opening of the proceeding and therefore require a significant amount of preparation. A range of actions might need to be taken *before* the opening of the liquidation proceeding, as illustrated in the next paragraph. This is different from general insolvency law, where little, if any, preparation is envisaged prior to the opening of an insolvency proceeding, unless a "pre-pack" sale of the business is to take place, in which case the parties need to reach an agreement that will take effect once the insolvency proceeding is formally initiated.[89]

163. Transfer strategies in bank liquidation proceedings are 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

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88 *FSB Key Attributes,* KA 11.1.

89 A "pre-pack" sale refers to 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 as soon as the entity enters the insolvency proceeding. Preparatory steps are also common in reorganisation proceedings.

up-to-date information on the state of the bank's affairs and the banking sector, where potential acquirers may be found.

164. 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 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 (a part of) the bank's 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 recognised as a key guiding principle for the development of a contingency plan and the adoption of the relevant preparatory actions in each individual case.

165. *Ex-ante*, regular planning is well established in the context of bank resolution, given that a specific aim of resolution is to ensure the continuity of critical functions of banks that are systemic in failure. This 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 domestically incorporated firms that could be systemically significant or critical if they fail*".[90] 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 draw up such regular plans for liquidation purposes; but where cyclical 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 ensuring a swift payout of insured depositors by the DIS, where such body exists.[91] 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 useful to ensure that the necessary day-to-day operations of the bank (e.g., IT systems) may be continued in liquidation if needed. For instance, it should be ensured that the liquidator maintains access to the infrastructure that is necessary for a payout of insured depositors.

168. Where the liquidation proceeding takes place as part of a resolution process, for the purpose of liquidating residual assets on a piecemeal basis, the resolution planning and advance preparation that took place for the resolution may minimise the need for separate advance 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.[92] Furthermore, where an authority has taken measures *vis-à-vis* the bank with a view to prepare the ground for the possible application of resolution tools, this may also facilitate the preparation of alternative solutions, including piecemeal liquidation.

169. 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

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90 *FSB Key Attributes*, KA 11.1.

91 See *IADI Core Principles,* CP 15, requiring the DIS 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.

92 This consideration applies even if the resolution process did not result in the deployment of a resolution tool.

knowledge of the bank and the broader sector, as well as the ability to 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 actions adopted by the temporary administrator be insufficient to prevent the bank's failure). In 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 the liquidator once the liquidation proceeding is opened.[93]

C. Enabling provisions and Timing

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

171. Irrespective of the institutional model, the legal framework should require the bank to cooperate with the banking authority in the preparatory phase and allow the authority to take appropriate measures if such cooperation does not run smoothly (e.g., appointing a specialised person to cooperate with or replace the management of the bank or to ensure that information is transmitted to the relevant authorities) and to prevent asset stripping. [94]

172. Furthermore, in jurisdictions with court-based models, the legal framework could allow the appointment by the court or by a banking authority of a prospective liquidator.[95] Preparation would be further facilitated if such prospective liquidator were a banking authority (see *Chapter 2. Institutional Arrangements*). 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 framework should allow for cooperation and exchange of information between these persons, subject to adequate 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.

173. In some cases, it may suffice for preparation 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, as this may implicitly include the power to prepare for a liquidation (see *Chapter 6. Liquidation Tools*). In other cases, however, it may be appropriate to explicitly add within the legal framework a general power for the liquidation authority or liquidator to take any other action necessary for the orderly liquidation of the bank, and/or the power to seek the assistance of third parties, including the possibility to hire any specialists, experts or professional advisors.

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93 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.

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

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

174. While the preparatory phase precedes by definition 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 each case. Legal frameworks for bank failure management typically do not define a moment in time to start preparations for liquidation, although administrative authorities in some jurisdictions are required to do so, especially under a Prompt Corrective Action mechanism that provides time-bound interventions, ultimately ending up with liquidation.[96] In court-based models, the legal framework should enable the timely involvement of banking authorities to allow these considerations to be taken into account.

175. A timing issue may arise when the legal framework leaves open the possibility of a gap between the grounds for liquidation being met and the formal opening of a liquidation process. This, for instance, could be the case when a petition for the commencement of a liquidation proceeding needs to be sanctioned by a court. In such case, banking authorities need to take this into account in their planning; the legal framework could provide for expedited procedures and require the court to defer to the petitioning authority's assessment of the facts (see *Chapter 2. Institutional Arrangements*). Another option would be to grant the banking authority 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 (which power may already be part of a jurisdiction's framework). Alternatively, the 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

176. 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 diverse mandates and take decisions and measures under different legal frameworks. Enhanced coordination between these actors (supported by normative consistency across the frameworks) is key to the success of the liquidation process.

177. It is also important to ensure that, if the failing bank is an issuer of securities listed or traded on regulated markets or multilateral trading facilities, cooperation is established with the securities regulator. The securities regulator should be notified in a timely and confidential manner of the bank's situation for its determination on whether or not to suspend the trading of the bank's securities. Coordination between the bank, the banking authority, and the securities regulator is also needed in relation to disclosure requirements under the applicable securities law. The public disclosure of "material adverse developments" or a bank's approaching non-viability (see *Chapter 3. Procedural and Operational Aspects*) 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 specify that coordination needs to take place between the bank, the banking authority, and other relevant authorities to achieve a mutually acceptable solution. Securities laws usually allow, under strict conditions and upon request of the issuer, a delay in the disclosure of relevant information, where the securities regulator is timely informed and has consented to the delay. In this specific context, the consent of the securities regulator should be coordinated with the role of the banking authority. An option could be that (i) the legal framework allows a delay in the disclosure of information that a bank is approaching non-

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

viability for the period strictly necessary to complete the preparation of the liquidation, and (ii) this is done by allowing an issuer to delay public disclosure in these circumstances, provided that the confidentiality of such information can be ensured and the securities regulator is informed in a timely manner and has consented to the delay upon consultation with the banking authority.

178. Cooperation with the bank and between the banking authorities 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 administrative authorities involved vary across jurisdictions. In some jurisdictions, an MoU is in place between the banking supervisor and the liquidation authority. In other 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

179. To the extent that the liquidation process is of administrative character, international good practices on interagency cooperation for bank failure management purposes, as identified in the *Basel Core Principles* and associated guidance, the *FSB Key Attributes,* and the *IADI Core Principles*, remain relevant.[97] These would apply, in particular, to any interagency communications, advance notice, consultations and coordinated actions 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 without delay, thus contributing to an orderly liquidation and, most importantly, for the feasibility of the prompt implementation of a transfer transaction. Bank liquidation frameworks should be aligned with cooperation arrangements under the aforemented standards, and any obstacles to such cooperation should be removed.

180. Apart from legislative provisions, cooperation may also be furthered by concluding MoUs or similar agreements. Such agreements could provide an operational framework within which parties commit to cooperate while exercising their specific competences and powers, and could specify arrangements for data and information sharing, and set out their respective operational duties 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. The formalisation of relations between authorities should not preclude appropriate flexibility during bank failure management. Existing (institution-specific) multilateral coordination mechanisms related to the preparation and management of bank failures could also be a forum to contribute to coordination among relevant authorities.

181. A smooth continuum between supervision and bank failure management is of the essence. Accordingly, the banking supervisor will need to notify the resolution authority and the liquidation authority as early as possible of a bank's approaching non-viability (see *Chapter 3. Procedural and Operational Aspects*, *Recommendation 18*). Conversely, 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.[98]

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

[98] 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.

2. Cooperation between administrative authorities and the court

182. 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.

183. In jurisdictions with a 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, the willingness of courts to validate the preparatory steps, and so on. The judicial actors will not only lack prior knowledge of the situation, court approval may also cause delays. This should be taken into account in the preparatory phase (see also *Chapter 2. Institutional Arrangements*).

184. 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 court-based models, banking authorities have a role in the selection and appointment of liquidators. One option for strengthening preparatory options and cooperation between the court and administrative authorities in such case (e.g., where a banking authority has a role in the appointment of the liquidator) is to involve the prospective liquidator in the preparatory process. Moreover, a banking authority could be appointed as liquidator to help ensure a smooth continuum from pre-liquidation to liquidation and effective cooperation between the court and banking authorities.

185. While cooperation between banking authorities and the court is crucial, the framework should be mindful of constitutional constraints pertaining to the independence of authorities and confidentiality of some information. Nevertheless, high-level principles about the duty to cooperate in good faith could be embedded in the framework and drive the activities of the authorities involved. A precise and well-defined allocation of functions, along with safeguards limiting the scope for judicial review of technical decisions made by administrative authorities, particularly in the pre-liquidation phase, might further such cooperation.

3. Cooperation with the bank

186. Banking authorities may already have access to the data required for the 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.

187. In either case, provisions enabling the flow of information to the authority in charge of the preparation of liquidation should be in place, in line with international good practices. The obligation for the bank to notify the banking supervisor and other relevant authorities of any material adverse development or that it is (likely to be) no longer viable, is also an aspect of cooperation with the bank and may contribute to defusing litigation against the authority about the grounds for liquidation (see *Chapter 3. Procedural and Operational Aspects*, *Recommendation 18*).

188. Furthermore, the legal framework should not constrain the ability of the liquidator to retain the staff of the bank that is deemed necessary for the conduct of the liquidation process (e.g., security personnel, IT staff, loan officers).

Key Considerations and Recommendations 38 – 41

Key Considerations

- Preparation for liquidation in the run-up to a bank's non-viability is useful and should be possible, duly taking into consideration the specificities of the bank and its failure. Preparation is especially relevant for the effective implementation of a transfer strategy.
- In jurisdictions with an administrative model for bank liquidation proceedings, timely access to adequate information and effective preparation and cooperation among administrative authorities are enabled 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 might already provide (some of) the powers recommended in this section.
- In jurisdictions with a court-based model, the legal framework should contain arrangements to ensure that adequate preparation can nevertheless take place (see *Chapter 2. Institutional Arrangements*, *Recommendation 12*).

Recommendations

38. The legal framework should facilitate, in the run-up to a bank's non-viability, the timely and effective preparation for a bank liquidation proceeding and encourage, or at least not impede, the liquidation authority and/or the liquidator and all actors involved in the preparatory phase, including the banking supervisor, resolution authority, and deposit insurer, in cooperating and taking preparatory actions that are proportionate to the nature and size of the bank, and to all other relevant circumstances relating to the failure and its possible impacts.

39. The legal framework should specify that coordination needs to take place between the bank, the banking authorities, and other relevant authorities in order to achieve a solution in relation to applicable disclosure requirements in the period in which the bank is approaching non-viability. If the bank is an issuer of securities listed or traded on regulated markets or multilateral trading facilities, 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.

40. The legal framework should require banks to cooperate with the banking authority prior to bank liquidation proceedings to facilitate preparation. If such cooperation does not run smoothly, 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 for a power to remove non-cooperative management of the bank prior to failure management proceedings.

41. The legal framework should vest the banking authorities – including an administrative liquidation authority, a temporary administrator (or similar) if appointed, and/or an 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, with the banking supervisor, the resolution authority and the deposit insurer, before liquidation actions are undertaken;

    (b) Obtain all the relevant information for the preparation of liquidation from the bank directly or request the banking supervisor to gather the information, 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

189. The specification of the grounds that justify the opening of liquidation proceedings is an essential element of the bank liquidation framework. Nonetheless, in single-track regimes the criteria for the initiation of proceedings are likely to be unitary and already form part of the resolution framework, 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 involves a decision as to whether to put the bank into resolution or initiate a liquidation proceeding. In selecting and giving statutory form to the grounds, attention should be paid not only to the substantive reasons for placing a bank in liquidation, but also to the interaction between the grounds for opening liquidation proceedings and those relating to the revocation of the banking licence, since both procedures concern the bank's exit from the market.

190. Section B of this Chapter offers an overview of the types of substantive grounds that could justify the placement of a bank in liquidation. It explains why such grounds should be broader than traditional insolvency grounds for other businesses, and should ideally contain a forward-looking element to allow 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 seen as a guiding principle for opening bank liquidation proceedings. 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 when opening bank liquidation proceedings. The guidance provided for bank resolution regimes in the *FSB Key Attributes* on the coordination with judicial actions[99] should also apply, *mutatis mutandis*, to bank liquidation proceedings (see Chapter 2. Institutional Arrangements). For court-based liquidation proceedings, in particular, the role of the banking authorities and the court in charge of the liquidation proceeding in ascertaining whether the statutory grounds are met must be clearly specified. Finally, 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

191. The survey undertaken in the preparation of this *Guide* showed that the legal frameworks of jurisdictions around the world contain a variety of grounds for initiating bank liquidation proceedings. These can be classified into two general categories, depending on whether they relate to: (i) the non-viable financial condition of the bank concerned ("financial grounds"); or (ii) other 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 ("non-financial grounds"). 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 a trigger for opening a bank liquidation proceeding (see Section C).

[99] According to the *FSB Key Attributes*, KA 5.4, "*[t]he resolution authority should have the capacity to exercise the resolution powers with the necessary speed and flexibility, 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.*"

192. While the identification of both financial and non-financial grounds at a conceptual level aids the mapping of the possible grounds to be included in the statutory framework, the two categories should not be seen in isolation from each other; an integrated approach is preferable. This is based on the consideration that 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.

193. The general classification of grounds for opening bank liquidation proceedings overlaps with the distinction between grounds specifically linked to the violation of the banking regulatory regime ("regulatory grounds") and other possible grounds. To the extent that the 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. Thus, 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

194. Business insolvency proceedings are generally triggered 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).[100] 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 grounds.

195. In particular, the criterion of illiquidity as conceptualised and applied in the general business insolvency framework may not be appropriate, 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, while, provided that the necessary conditions are met, the central bank may also provide liquidity assistance on a discretionary basis (lending of last resort to solvent banks); in contrast, other companies typically lack 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. It is, instead, necessary to base decisions 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.[101] On the other hand, banks' liquidity problems can escalate at 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).

[100] The *UNCITRAL Legislative Guide*, Part Two, 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."*

[101] 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.

196. 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 of 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.[102]

197. It is, accordingly, 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.[103] The financial grounds for 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,[104] 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 be reasonably expected to return to soundness within a relatively short timeframe.

198. 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*".[105] 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.[106]

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

103 From a procedural perspective, in court-based systems, it is essential that the opening of a liquidation proceeding by the competent court take place immediately upon the submission by the banking authorities 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*, and *Chapter 3. Procedural and Operational Aspects*).

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

105 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."*

106 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, https://www.iadi.org/en/core-principles-and-

199. 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 initiation of bank failure management processes typically requires a holistic assessment of the situation, involving technical evaluations and the exercise of discretion in order to balance competing considerations and optimise expected outcomes. 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 violations 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 of each case.

200. Technical evaluations and/or discretionary judgments may thus play a significant role in: (i) the assessment that a bank is no longer viable, and (ii) the decision on the appropriate responses to a finding of non-viability. As such, should any court involvement be 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 *Chapter 2. Institutional Arrangements*, *Recommendation 5*). In dual-track regimes, the response to a finding of non-viability involves a decision as to whether to put the bank into resolution or initiate a liquidation proceeding.

3. "Negative" condition

201. The *FSB Key Attributes* include a "negative" condition that needs to be fulfilled before a bank may be placed under resolution, i.e., that not only should the bank be *"no longer viable or likely to be no longer viable"*, but that it should also have *"no reasonable prospect of becoming [viable]."*[107] 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 solving the crisis. The liquidation authority (or the resolution authority, if different) 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 interventions, or market-based solutions, and/or supervisory actions to address the problems and restore the bank to viability within a reasonable timeframe.

202. 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. It could then be specified in the legal framework that a negative condition should not include the possibility of interventions involving the use of public funds as an alternative to liquidation. As noted in *Chapter 1. Introduction*, a primary objective of bank failure management frameworks is to reduce loss exposure of the taxpayer by removing the reliance on public funding in managing the failure of financial institutions, including through bail-out to prevent a failure. A properly circumscribed negative condition should thus be confined to the need to balance the authorities' powers of intervention, or be limited to the inability of private sector solutions to rectify the problems of the bank within a reasonable timeframe.

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guidance/glossary/non-viability, 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."*

[107] *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.

203. However, the negative condition may also be considered to be implicitly covered by the overall set of bank failure management arrangements and by 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, the decision on liquidation will likely be made when alternative supervisory actions (whether in the form of normal supervisory actions or of early intervention measures) 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. In this scenario, any remaining alternatives would require either resolution action or the placement of the bank in liquidation. A statutory negative condition may thus be redundant, as the authorities would already need to assess it under the public law.[108]

C. Interaction with licence revocation

204. A jurisdiction's legal framework must not only establish 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 system. Unlike ordinary companies, banks can only operate on the basis of a licence.[109] In every jurisdiction, the serious and/or persistent violation 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 210), 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 serve as triggers for either process.

205. The revocation of the banking licence and the commencement 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 commencing the other. In the latter case, licence revocation can be a trigger for opening bank liquidation proceedings or, conversely, the consequence of such proceedings.

206. 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 initiation of liquidation proceedings. This section does not consider the possible voluntary surrender by a bank of its banking licence, for instance, with a view to change its business activities. Such situation does not strictly speaking relate to liquidation and is not the subject of this *Guide*.

[108] 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 *Chapter 2. Institutional Arrangements*).

[109] 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 withdrawn.

1. Licence revocation as a ground for opening liquidation proceedings

207. In most jurisdictions, the revocation of an entity's banking licence implies that it can no longer fulfil its corporate purpose. This being a compulsory ground for the entity's dissolution, licence revocation can operate as the trigger of liquidation.

208. In several jurisdictions, the two procedures are explicitly linked and sequenced, with the revocation of a bank's licence preceding and leading ineluctably to its liquidation.[110] 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 factual occurrence of the substantive grounds as such, but in the adoption of the supervisory act revoking the licence.

209. There are clear benefits to including licence revocation as one of the grounds for opening bank liquidation proceedings. Importantly, this approach leaves little room for conflicting assessments regarding the occurrence of the relevant facts. 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. Furthermore, the legislation should allow the relevant authorities to permit a bank to continue operations for a short period following a decision to revoke its licence, if necessary to facilitate a transfer to be executed (see paragraph 250).

210. While the approach of initiating liquidation proceedings after the licence has been withdrawn could ensure certainty, a potential disadvantage is that in certain exceptional cases, even though an entity's banking licence has been revoked, its liquidation and dissolution may appear unnecessary and disproportionate. Evidently, this exceptional situation would not apply to entities which are insolvent or illiquid in the narrow sense of general business insolvency law, or those of which 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 their dissolution can be pursued in the public interest.

2. Parallel licence revocation and liquidation proceedings

211. 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 triggered by 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.

212. However, such separation of licence revocation and the opening of liquidation is inadvisable, both on substantive grounds and for reasons of systematic coherence across the two frameworks. 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

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[110] 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.

grounds across the supervisory and liquidation frameworks where these are set out in separate statutes.

213. 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 responsibility for opening a liquidation proceeding is conferred on the liquidation authority (which may be an administrative authority or a court). 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.[111]

214. In court-based (and certain hybrid) models, attention should be paid to the role of the court in assessing a banking authority's petition for opening bank 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.[112] 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 *Chapter 2. Institutional Arrangements*). The legal framework should specify a clear solution in case the court nevertheless departs from the banking authorities' technical assessment in a way to avoid limbo situations.

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

215. 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 since the non-viability of a bank which is already in liquidation is self-evident and the opening of a liquidation proceeding means that the bank cannot continue its business activities. In certain exceptional situations, the maintenance of the licence[113] for a limited period after the opening of the liquidation proceeding may be necessary for the efficient conduct of the liquidation proceeding (see also *Chapter 6. Liquidation Tools*). The banking licence should not remain in force except in so far as necessary for the purposes of the bank failure management process and the effective implementation of liquidation tools. Jurisdictions could establish coordination rules enabling the liquidation authority to cooperate with the banking supervisor on matters relating to the (provisional) retention of the licence.

D. Interaction with triggers for resolution

216. As a general principle, the legal framework should ensure the overall concordance of all failure management decisions. This includes a seamless continuity between the resolution and liquidation regimes.

217. 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

[111] In this context, a limbo situation refers to a scenario in which a bank continues to operate on the financial market despite having been found to be non-viable by a banking authority.

[112] 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.

[113] In such circumstances, the activities that the bank may carry on may nevertheless be limited to those required to support the liquidation or to provide services supporting transferred business for a transitional period. Specifically, a bank would typically not be able to accept new deposits during this period.

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.[114] Accordingly, if a jurisdiction pursues the exit of failed banks from the market either through resolution or by way of liquidation, the legal framework should ensure that one or the other regime must be applied whenever non-viability has been established (or the bank's licence has been revoked). The choice between the two procedures should be left to the resolution authority, which should have sufficient flexibility to decide whether resolution is appropriate and feasible. A liquidation proceeding must necessarily follow swiftly if the 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. Alignment may be pursued through different legal techniques, by referring to the resolution triggers or formulating the grounds for opening bank liquidation proceedings in the same manner as resolution triggers, but with the provision that liquidation is pre-empted by the placement of the entity under resolution or by means of a different formulation that nevertheless captures the resolution conditions. In any event, the decision of the resolution authority that a bank that is considered to be non-viable should not be placed under resolution should be a sufficient ground for opening a bank liquidation proceeding.

218. Attention should also be paid to strategies that envisage the partial transfer of a failed bank's assets and liabilities, followed by the liquidation of the residual entity. In such case, it should be possible to proceed with the liquidation of the residual entity based on the existing non-viability assessment, without need for assessment of any further substantive grounds.[115] 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 42 – 45

Purpose of legislative provisions

The purpose of provisions on grounds for opening bank liquidation proceedings is to enable timely action and facilitate the achievement of 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, preventing depletion and protecting depositors, 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.
- Licence revocation as a ground for opening bank liquidation proceedings has clear benefits; if liquidation proceedings are initiated based on other grounds, licence revocation should generally also be one of the immediate consequences.
- Where license revocation is a ground for opening bank liquidation proceedings, the legislation should enable a discretionary postponement of the effects of the revocation

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

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

decision for a short period, so as to provide the necessary time window for the implementation of transfer strategies following the initiation of such proceedings.

Recommendations

42. 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.

43. 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.

44. 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.

45. In jurisdictions with a dual-track regime, the grounds for opening bank liquidation proceedings should be aligned with the non-viability triggers 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

219. This Chapter provides guidance on the tools and powers that should be included in the legal framework to allow an orderly liquidation of banks which are not placed in resolution, or whose resolution leaves a residual part to be liquidated. *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[116] to a private acquirer, which is referred to as "sale as a going concern" for the purposes of this *Guide*. The Chapter 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.

220. *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* elaborates on the treatment of financial contracts in bank liquidation proceedings.

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

221. Liquidation pursuant to general 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 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.

222. In many cases, the insolvency law also enables the liquidator to sell sets of homogeneous 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 homogeneous assets than the risk of individual assets, thus improving marketability and pricing. Moreover, "functioning" pools, such as branches or business lines, allow immediate use and avoid destruction of value, to the benefit of creditors, while preserving productive capacity and employment, to the benefit of the economy.

223. 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. Similarly, the collective sale of sets of assets must be distinguished 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

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

may accommodate this possibility,[117] although it traditionally tends to treat the insolvent enterprise's asset and the liability sides separately.

224. Accordingly, general insolvency law and practice traditionally entail a separation between the realisation of assets and the discharge of liabilities. Furthermore, it distinguishes 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 legal actions that could cause further destruction of value and lead to an inequitable distribution of the proceeds.

225. 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 arising in bank liquidation relates to the possibility of preserving the banking operation, or parts thereof, where this provides a superior solution in light of the liquidation objectives. Continuity can be achieved through the transfer of part of the bank's assets and liabilities to a third-party acquirer, 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.

226. The impact of a lengthy process of asset realisation in the context of a piecemeal liquidation can be dramatic in the case of banks. Certain shortcomings of piecemeal liquidation become more acute in the banking context. 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, thus risking 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. Thus, the joint disposition of assets and liabilities is crucial in this context. The preservation of the bundle of assets and liabilities constituting the failed bank's business as an operating unit will usually better serve the core objective of value preservation and maximisation (see *Chapter 1. Introduction*, *Section H*) than piecemeal liquidation.

227. 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.

228. These considerations justify the inclusion in the bank liquidation framework of a tool which enables the continuation of a failed bank's business, as a whole or in part, through its swift transfer

[117] 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.

to a private acquirer of proven viability and ability.[118] 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.

229. 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.[119] 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-based solution shields depositors from disruption of access to their deposits, accounts and payment facilities, it can meet the public interest objectives of bank liquidation (see *Chapter 1. Introduction*).

230. 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.[120] 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. The terms used in this *Guide* – including "sale as a going concern" – should be understood only in the specific sense adopted for its purposes. None of the Recommendations should be construed as requiring the abrogation of existing tools and powers in jurisdictions' legal frameworks that are functionally equivalent to those discussed in this Chapter, irrespective of the terminology used in those frameworks.

231. 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. In particular, the statutory framework should ensure that the transfer does not require the consent of third parties.

232. A key consideration with regard to timing is that the DI should reimburse insured deposits promptly, ideally within seven working days.[121] From this viewpoint, a transfer of assets and liabilities should be executed at, or immediately after, the commencement of the liquidation proceeding, and in any event before the lapse of the deadline for the DI's payout of insured depositors. If this is not the case, that payout will eliminate one of the key sources of business interest for third-party acquirers (namely, the existing portfolio of depositor relations), thus undermining the logic of the transaction. The legal framework should also ensure the legal certainty of the outcomes of the transfer, which should not be reversible *ex post* (see *Chapter 2. Institutional Arrangements*).

C. Transfer-based tools: nature and applicability

1. Types of transfer-based tools

233. Bank failure management regimes containing transfer-based solutions differ as to the range

[118] 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.

[119] See *FSB Key Attributes*, KA. 3.2 (vi) and KA 3.3.

[120] E.g., "P&A transaction" in the US; "sale of business tool" in the EU resolution framework.

[121] See *IADI Core Principles*, CP 15.

of the types of transactions that they envisage and the conditions that apply to them.

234. Apart from sale of assets and liabilities as a going concern, frameworks may provide for share deals, i.e., transfers involving the mandatory sale of the failed bank's shares to an acquirer. The essential differences between a sale as a going concern and share deals are 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 not to be available in the context of 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 are likely to impede a carve-out of unattractive parts of the failing bank's business or possible hidden and contingent liabilities, thus depressing prices or increasing the complexity of the transfer transaction. 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. Share deals thus play a marginal role in liquidation, at most.

235. Two other transfer-based tools, namely, the transfer of the bank's business to bridge banks or asset management companies are discussed in *Section E* below.

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

236. In dual-track regimes, the inclusion of transfer-based tools as part of the liquidation framework will ensure that the authorities have the power to transfer (part of) the bank's business also if it is not deemed to be "systemic" at the point of failure and the business has a franchise value although not involving a "critical" function. Introducing transfer-based tools in the liquidation framework would not blur the boundaries between the two processes, which would still differ in terms of the objectives sought, the manner in which the available tools can be used, the applicable safeguards and constraints, or 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, such jurisdictions are invited to assess the extent to which the legislative guidance provided in this *Guide* can be helpful for them to identify the technical details to implement and execute a transfer strategy as part of their 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

237. 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 liquidation authority should be able to select the most appropriate tool depending on the circumstances of each particular case. A liquidation authority or liquidator that is required to prove that, e.g., piecemeal liquidation is unsuitable in a specific case, may prove reluctant to pursue a transfer-based solution. 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*, *subsection 6*).

4. Legal and other prerequisites

238. 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.

239. With regard to the financial considerations, a gap between liabilities and assets and/or valuation uncertainties may make it difficult to successfully implement 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.

240. It is essential that no legal obstacles prevent the transfer of assets and/or liabilities of a failed bank without the consent of third parties, including creditors and shareholders. It is furthermore essential that the legal framework ensure that such transfers are final and irreversible.

241. 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 short stay, 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*).

242. From a procedural viewpoint, it is essential to specify (i) the timing of the decision to apply transfer tools (i.e., whether this 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 consequent allocation of responsibility for that decision and its implementation.

Recommendations 46 – 49

Purpose of legislative provisions

The purpose of provisions enabling the use 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

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

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

48. The express provision of transfer powers should be accompanied by provisions that enable the swift and effective implementation of the transfer. In particular, the legal framework should enable transfer solutions to be implemented at an early point and within a very tight timeframe, to ensure the operational and transactional continuity of the banking business and uninterrupted access to deposits.

49. The legal framework should ensure the legal certainty and irreversibility (finality) of the outcomes of the transfer.

D. Sale as a going concern: process and safeguards

1. General approach and preparatory steps

243. 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.[122]

244. 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 47*), if that power cannot already be deduced from the provisions of general business insolvency law.

245. 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 also be warranted (see also *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.

246. 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 mere practice manuals.

247. 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.

248. 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 definition of the perimeter of the transfer, and the adequacy of the sales process, all of which may benefit from pre-liquidation preparation and contingency planning (see *Chapter 4. Preparation and Cooperation*).

2. Perimeter of the transfer, licensing, and succession

249. The legal framework should grant the liquidation authority or the liquidator discretion and flexibility to define the perimeter of the assets and liabilities to be transferred with a view to maximising the estate's value and serving the other liquidation objectives. The legal framework should not hamper (i) the transfer of the banking operation in its entirety, i.e., 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

[122] For further detail, see 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* (Washington, 2014), or "Crisis and Response, An FDIC History, 2008-2013", Chapter 6. Bank Resolutions and Receiverships.

main business (including by way of securitisation). It should also be possible to transfer particular branches or units.[123]

250. The implementation of a sale as a going concern should not be hindered by other provisions, notably on licensing. Providing some flexibility for the provisional retention of the failed bank's licence during the liquidation process could be beneficial, since it can facilitate a going concern transfer, enable the management of deposits and the continuity of payment services, and provide an additional layer of public control in the form of bank supervision. However, allowing a bank to retain its licence even for a short period of time during its liquidation is an exceptional situation (see *Chapter 5. Grounds for Opening Bank Liquidation Proceedings*). Accordingly, any provisions envisaging this possibility should require the approval of the banking supervisor, clarify the precise objective, and set temporal limits.

251. To facilitate the implementation of transfers that include insured deposits, jurisdictions may envisage the use of DIF resources in support of the relevant transactions, always subject to certain limits and conditions (see *Chapter 7. Funding*). In such case, it is preferable not to prescribe in restrictive terms the form of the contribution (e.g., by confining it to a cash payment) in the legislation, but to use instead generally worded enabling provisions, which leave to the DI the responsibility for designing 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

252. In every sale as a going concern, it will be necessary to identify and select the acquirer. To this end, the relevant authority should be able to use the services of market researchers or other specialist private entities, if necessary, and subject to strict confidentiality requirements. The process may be facilitated through adequate preparation (see *Chapter 4. Preparation and Cooperation*).

253. Jurisdictions must decide whether potential acquirers should be limited to banks (either existing banks or a specially constituted bridge bank (see *Section E*) or could also include other entities, such as non-bank financial institutions (NBFIs) and non-financial corporations. Whenever the envisaged transfer encompasses deposit liabilities, the acquirer should be a licensed bank, able to legally carry on the deposit-taking business from the moment the transfer takes effect. While some jurisdictions entertain the possibility of granting a banking licence to a non-bank acquirer on the basis of special pre-approval procedures and "shelf" charters,[124] such an approach may not be practicable for most jurisdictions.

254. If the transfer is limited to 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 licenced special purpose vehicle as the conduit for managing, servicing, and collecting the assets.

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

[124] FDIC, "Bank Resolutions and Receiverships", p. 198.

4. Disclosure of information to potential acquirers and bidding process

255. To enable a sale as a going concern, the legal framework should allow, or at least not impede, actions by the authorities and/or the liquidator before the initiation of the liquidation proceeding relating to the premarketing of the bank (see *Chapter 4. Preparation and Cooperation*), including the disclosure of a failing bank's proprietary information to potential acquirers. In particular, the legal framework may contemplate an obligation on banks facing an immediate prospect of non-viability to disclose proprietary information to potential acquirers or allow their access to such information, under the direction of the banking authorities, the liquidation authority and/or the liquidator, as the case may be. The relevant provisions should require that the disclosure of confidential information be kept to the necessary minimum and that potential acquirers be strictly bound by confidentiality requirements.

256. Taking time constraints into consideration, potential acquirers should be allowed to conduct due diligence. 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 parameters of the transfer. Preparatory steps taken in cooperation with the failing bank in the run-up to its liquidation can set up the facilities, such as a virtual data room, to give potential acquirers access to detailed information about the bank. In situations where acute time constraints prevent potential acquirers from conducting adequate due diligence, or there are concerns about the availability or quality of data, then it should be possible to offer appropriate assurances to potential acquirers, in case the transferred business turns out to be of 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*).

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

258. The selection of the winning bid must be based on clearly established criteria.[125] 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 even 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

259. 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, conducting a valuation is generally a requirement to inform the initiation of resolution, the choice of resolution tool, decisions about the amount of liabilities to be bailed-in and the application of the "no creditor worse off" (NCWO) safeguard.

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

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

creditors are treated 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*).

261. 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.[126]

262. At the same time, the provisions on valuation should not be overly prescriptive nor hinder swift and effective action, allowing a certain extent 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 due to urgent circumstances. It could allow the valuation to be provisional, to not involve every asset (but to rely instead on sampling), or to be performed by the relevant banking authority, rather than by an external expert. Subject to the criteria for the selection of the participants and the winning bid (see paragraph 258), the price obtained through the bidding process should, in any event, trump the valuation price, unless the marketing and transfer process did not take place under fair and competitive conditions.

6. Safeguards: creditor treatment

263. The availability of a sale as a going concern in liquidation and the discretion of the liquidation authority or the liquidator to choose between such tool and piecemeal liquidation allows for the optimisation of the liquidation strategy but should be accompanied by adequate safeguards. In particular, a transfer-based strategy should only be chosen if it benefits creditors as a whole, or enhances the protection of depositors, while none of the creditors receives less than it would receive if the failed bank had been placed in piecemeal liquidation in its entirety. To ensure compliance with this condition, the net value realised from the sale as a going concern should exceed the estimated net proceeds of the piecemeal liquidation of the whole estate (pursuant to the valuation under *subsection 5* above).

264. A well-functioning transfer process will tend to be value enhancing, leaving the liquidation authority and/or the liquidator in a position to show that the sale as a going concern benefited the failed bank's creditors and that, at any rate, the choice of that tool did not involve any transfer of wealth between classes of creditors.

265. 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 (equally ranking) creditors, including claims arising from the bank's contingent liabilities, may be left behind in the residual entity. If, as a result of such partial transfer, some creditors are better off than they would have been in case of a piecemeal liquidation of the whole estate, while no creditors are worse off, the creditors as a whole should be deemed to benefit from the transaction.[127] Deviations from the *pari passu* treatment of creditors of the same class should be permitted in liquidation only when the transfer is conducive to value maximisation for the benefit of creditors as a whole, or to the achievement of the objective of

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[126] See, e.g., *UNCITRAL Legislative Guide* (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 *UNICTRAL 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).

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

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.

266. 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 recovery for non-deposit unsecured creditors, while facilitating the transfer of the entire deposit base to potential acquirers (see *Chapter 8. Creditor Hierarchy*).

7. Transfers to related parties

267. The treatment of transfers to related parties merits separate attention, since such transfers entail the risk that the persons responsible for the bank's failure may benefit from the failure management process. For this reason, the legal framework may preclude the liabilities owed to related parties from being transferred with the bank's business. Any such restrictions should be aligned with the rules on creditor hierarchy, which may exclude related party deposits from preferential treatment and, in some cases, contemplate the subordination of related party claims (see *Chapter 8. Creditor Hierarchy*). Furthermore, restrictions should apply to the acquisition by a related party of the banking business or, in the event of piecemeal liquidation, of assets of the estate. If the risk of collusion is too high, the transaction should be precluded or subjected to intense scrutiny, including by means of an independent valuation and disclosure of business ties.

8. Execution aspects

268. 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) executing the transfer. This is relevant for the transfer's effectiveness at the domestic level, as well as for its cross-border recognition (see *Chapter 10. Cross-Border Aspects*). In general terms, the transfer may take place by means of an administrative act or a court order, usually accompanied by a transfer contract (such as a P&A contract) between the acquirer and the failed bank (represented by the liquidation authority or the liquidator). The legal framework should be clear about the legal nature of the transfer.

269. Jurisdictions should also consider the practical conditions of the transfer's effectiveness. The latter may depend less on the legislative conferral of explicit powers on the liquidation authority and the liquidator (provided that the general power of transfer is framed in broad enough terms) and more on the prior identification of the legal issues that may arise in the process, and on developing suitable models or templates for the transfer contract or instrument (transfer templates) that deal with them, drawing on experience with M&A transactions where appropriate, so to establish a 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, while indemnities may be used to protect the acquirer from certain liabilities or claims.

270. In this regard, jurisdictions need to consider, in particular, whether their legal system imposes constraints on the transfer of specific assets or rights. Some assets, e.g., real estate assets, securities, or even receivables, and the security interests over them, may be subject to registration, and changes of title may need specific formal acts, which the liquidator should be able to execute swiftly. Some assets may implicate other authorities; e.g., tax assets may need recognition by tax authorities, thus requiring additional coordination. Constraints may affect the transfer of bank records as a result of considerations of privacy (e.g., data concerning former employees) or confidentiality of information (e.g., records relating to non-transferred parts of the business).

271. Specific considerations may arise with regard to the continuation of business activities, the assumption of liabilities, or the novation of contracts. If the continuation of banking operations is a relevant aspect of the transfer, jurisdictions may consider stipulating the acquirer's commitment to carry on the banking business in general, or in specified areas or business lines. 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 specific regulatory obligations committed by the failed bank's employees). These considerations are without prejudice to the bank liquidation rules for the continuity of contracts (see *Section G*).

272. Specific attention should be given to the transfer of deposits and the acquirer's obligations *vis-à-vis* transferred depositors. For example, jurisdictions may consider 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, apart from the notification by the DI, the acquirer is also expected 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 contemplated 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*).

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

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

274. Variants of the transfer strategy would be to transfer assets and liabilities to a bridge bank or an asset management company (AMC). A bridge bank is a licensed bank specially set up by public authorities for the purpose of taking up and continuing, in whole or in part, the business of a failing 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 providing the possibility to continue the bank's business – without interruption of the depositors' access to their deposits – and preserving franchise value until a private acquirer is found. In case of a partial transfer of assets and liabilities, the residual (bad) part of the failed bank (e.g., non-performing assets and other assets of dubious quality and non-transferred liabilities) is left behind to be wound up.

275. An AMC is an entity established for the purpose of taking up 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).

276. Depending on the circumstances, bridge banks and AMCs can improve the outcome of a failure management process.[128] Nonetheless, the considerable complexities and drawbacks relating

[128] 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.

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.[129]

277. Specifically with regard to the bridge bank tool, the immediate and prospective costs of capitalising and running the bridge bank, the funding and organisational resources which must meet the usual prudential standards for banks, can be a major impediment. Accordingly, the availability of the bridge bank tool in the context of bank liquidation is mostly limited to single-track regimes. In practice, the feasibility of the bridge bank tool depends on the availability of external funding, as well as on the ability to keep costs low through proper preparation in normal times.[130] It should be noted, however, that the provision of public support in liquidation proceedings cannot be justified in the absence of financial stability implications of the failure.

278. Special considerations apply to AMCs, which are created to manage the non-performing assets of often multiple institutions on a system-wide basis. These AMCs can present special issues with regard to their constitution, funding, and governance, and their precise configuration must adjust to a jurisdiction's particular circumstances. Since the rationale for these 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 50 – 53

Purpose of legislative provisions

The purpose of provisions on the inclusion and safeguards of the sale as a going concern tool (and other transfer-based tools, if any) in the bank liquidation framework 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 treatment of creditors.

Recommendations

50. 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. Derogations from statutory rules of regulatory, corporate, and insolvency law should be clearly stated and adopted at the statutory level.

51. The legal framework should ensure that the general power to transfer assets and liabilities (see *Recommendation 47*) ensures the swift, effective and final transfer of assets and/or

[129] In the EU's dual-track regime, bridge institutions and AMCs are included in the harmonised resolution toolbox, but less commonly in the Member States' national legislation on bank liquidation. However, in some jurisdictions, it may be possible to use these tools on the basis of the general powers of the liquidator and its responsibility for liquidating the estate in the best possible manner.

[130] 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 utilising 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 utilise staff from failed banks.

liabilities 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 revocation of the failed bank's licence;

(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 actors for purposes such as gauging market interest and conducting due diligence;

(d) Enable the liquidation authority and/or the liquidator to determine the procedure and conditions of sale, with a view to execute the transfer in a transparent but 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 to execute business transfers, subject to the prior approval of the relevant authority;

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

(i) Determine the legal nature of the act(s) of transfer in a sufficiently clear manner, and give due consideration to the legal and practical steps that may be needed to ensure a successful transfer of the different elements of the bank's business, and the legal issues that may arise, and address them in secondary acts, practice manuals, and/or contract templates, with adjustments in the legal framework where needed.

52. The legal framework should ensure that the transfer respect the rules on creditor hierarchy. Transfers that benefit certain creditors should only be acceptable 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.

53. The legal framework should contemplate 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 liquidation authority and/or the liquidator should be empowered to preclude transfers to related parties, or subject them to specific requirements with regard to valuation and the disclosure of business ties.

F. Piecemeal liquidation

279. Piecemeal liquidation will be necessary when a sale as a going concern is not feasible or desirable but also when a transfer 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.

280. 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.

281. Unless it is already contemplated in the general framework for business insolvency law, to ensure the effectiveness of piecemeal liquidation, the legal framework should empower the liquidator to marshal the failed bank's assets, take steps for the protection and preservation of the assets, make arrangements for the lodging of claims by the failed bank's liability holders, 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. The legal framework should further ensure that the net proceeds from the realisation of assets be distributed to the failed bank's liability holders in the order of priority of their claims and *pro rata* (see Chapter 8. Creditor Hierarchy).

282. An important aspect of piecemeal liquidation is the establishment of 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, for their part, should be deemed due and payable.

283. In general business insolvency proceedings, the recognition and enforcement of the differing rights of creditors are hallmarks of an effective system.[131] In bank liquidation, the procedure for determining the validity and priority of claims should be defined in the legal framework, which for this purpose can draw on general business insolvency requirements. However, some adjustments may be warranted. For example, the usual system of individual submission by creditors of their respective claims[132] may be excessively burdensome in light of the strong record-keeping requirements for banks (as well as the recognition of banks' book entries as evidence by national systems of civil procedure) and the special position of certain creditors (depositors). It is thus preferable to allow the liquidator to rely on the bank's records, at least with regard to bank deposits, when determining the creditors' claims, unless there are doubts as to the reliability of said records. In jurisdictions with a DIS, insured depositors should be exempt from the requirement to submit claims in relation to amounts covered by deposit insurance. However, specific rules may be warranted if financial intermediaries hold custodial deposits in their name, but on behalf of investors, and these deposits are subject to deposit insurance and deposit preference. In such cases, the agent or custodian may be required to provide evidence that it holds the deposits as an agent, 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.

284. In the event of piecemeal liquidation, the legal framework should allow advance payments to uninsured depositors by the liquidator or the liquidation authority. This is desirable to minimise disruption for affected depositors, especially in jurisdictions without a DIS.[133] 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

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131 *UNCITRAL Legislative Guide* Key Objective 8, para. 13. Key Objective 8 also includes clear rules on ranking. These are addressed in Chapter 8 Creditor Hierarchy.

132 *UNCITRAL Legislative Guide,* Part Two, Section V, paras. 2 et seq.

133 Also in jurisdictions with a DIS, the legal framework should 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.

available liquidity. Any funding solutions to facilitate an orderly liquidation should ideally also be set out in the legal framework *ex ante*.

Recommendations 54 – 56

54. The legal framework should require the liquidator to establish a balance sheet for the bank, based on the estimated liquidation values of the bank's assets, in order to determine the net financial position of the bank.
55. The legal framework should prescribe the procedure for determining the validity and priority of claims, and the procedures for the liquidation of assets, following general business insolvency rules with appropriate modifications. In particular, when determining the validity of deposit claims, both 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. Furthermore, insured depositors should be exempt from the requirement to submit claims in relation to amounts covered by deposit insurance, although special rules might be warranted for financial intermediaries holding deposits as custodian.
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 swiftly 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

285. The preservation of the insolvency estate is a key objective of an effective and efficient general insolvency framework.[134] This and the need to stabilise business operations and ensure their continuity is even more acute for banks. Thus, the legal framework of bank liquidation should incorporate (either directly or by reference) the norms of general business insolvency law relating to the preservation of the estate and the safeguarding of operational continuity, subject to appropriate adjustments.

286. General business insolvency laws typically seek to prevent a disorderly run for the insolvent estate's assets by provisionally prohibiting the unauthorised disposition of assets and imposing a stay or suspension of enforcement actions by creditors, including a stay on the attachment of assets by secured creditors.[135] These principles should also apply in the context of bank liquidation.

287. For this purpose, the legal framework may rely on the relevant provisions of general insolvency law, including special provisions for a stay as an automatic consequence of the commencement of bank liquidation proceedings or, in administrative liquidation proceedings, it 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

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[134] *UNCITRAL Legislative Guide*, Part One, Key Objective 6, para.10; *World Bank Principles,* C1.

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

stay on contract enforcement in bank liquidation proceedings. This should not affect certain types of financial contracts, where the stay should be subject to specific rules (see Section H).

288. General business insolvency law also includes rules concerning contract termination, which, in the case of contracts where both parties 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.[136] Maintaining certain essential contracts which ensure the operational continuity of key services, systems, and processes, is of special importance in the case of banks. 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 should be considered null and void. Jurisdictions can also adopt a more limited approach by identifying *ex ante* certain types of executory contracts as essential and declaring their continuity, or establishing exceptions to the rule of contract continuity, e.g., in relation to certain financial contracts (see Section H) or special rules for vulnerable counterparties, such as the failed bank's employees. Jurisdictions could also apply the general rules of business insolvency law in cases of piecemeal liquidation, and special rules seeking to ensure that contracts essential for operational continuity not be disrupted when a transfer tool is applied. 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 an executory 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. The legal framework could also provide for a power to modify certain types of executory contracts, subject to adequate safeguards (see Section D, which should apply *mutatis mutandis* to counterparties of the bank). The legal framework should set a deadline for the liquidator to decide on whether to continue, modify, or reject the contracts.

289. The prevention of the dissipation of assets is particularly important for banks. The liquidator's general powers should ensure that it has a sufficient degree of 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, as well as to suspend the payment of capital distributions, or payments to directors, provided that reasonable compensation may be paid to bank directors, senior managers, and staff for services rendered to the bank at the request of the liquidator.

290. 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.[137] 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.*"[138]

291. 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. With regard to the allocation of competences, 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 to this effect.

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136 *UNCITRAL Legislative Guide*, Part One, para. 109; *World Bank Principles*, C10.1-C10.3.

137 *UNCITRAL Legislative Guide*, Part Two, F; *World Bank Principles* C11.

138 *UNCITRAL Legislative Guide*, Part Two, paras. 170-184, Recommendation 87.

292. Jurisdictions can contemplate specific exceptions from the application of the rules of general insolvency law on avoidance, which 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 during the resolution phase should be respected in the liquidation stage. Another exception should apply to certain types of financial contracts (see Section H) 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.[139] 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 Chapter 9. Group Dimension.

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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 modified solely because the bank has been placed in liquidation. Jurisdictions may consider different approaches, including a general rule of contract continuity, or a more limited limited approach by identifying *ex ante* certain types of executory contracts as essential and declaring their continuity, establishing exceptions to the rule of contract continuity, or by applying general rules of business insolvency, with special rules seeking to ensure that contracts essential for operational continuity are not disrupted when a transfer tool is applied. The circumstances in which acceleration or termination may take place should be clear, as well as any exceptions or special rules, as in the case of financial contracts (see Section H);

(b) The liquidator has the power to decide, within a period set forth in the legal framework, whether 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, as well as to suspend the payment of capital distributions, or payments to directors, provided that reasonable compensation may be paid to bank directors, senior managers and staff for services rendered to the bank at the request of the liquidator.

60. The legal framework should establish clear rules, drawing on the principles of 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. Each jurisdiction must decide whether to

[139] 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.

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) Transactions carried out or approved by the relevant banking authority during the period preceding liquidation, including intra-group support agreements;

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

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

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.

Temporary settlement accounts

293. 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.[140]

294. 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. Such accounts may be referred to as "transit accounts", "temporary settlement accounts", "suspense receipt accounts", and so on.

295. There are different ways in which temporary settlement accounts may be protected, and this may depend on their function and the characterisation of the account. Country practices include (i) segregating the funds in transfer and excluding them from the insolvency estate,[141] (ii) qualifying or treating the funds as deposits[142] in jurisdictions with some form of depositor preference, or (iii) allowing the DIS to contribute to transfer-based strategies to protect these accounts.[143]

296. 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

[140] 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 temporally to a transit account, which may be called "separate deposits" or "suspense receipts" until interbank settlement for those funds transfers takes place.

[141] 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*."

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

[143] 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.

participants, the legal framework should not hinder the continued operability of payment and settlement systems and the protection of money in transit.

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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.

H. Limited stay on enforcement of certain financial contracts

297. A legal framework for managing bank failure should include clear, transparent, and consistent procedures for the treatment of financial contracts that incorporate standard-form close-out netting terms. Such contracts include derivatives obligations (swaps, options, and forwards, *inter alia*) based on documentation published by the International Swaps and Derivatives Association (ISDA), which may trigger close-out netting upon the initiation of the bank failure management process.

298. Close-out netting terms in a financial contract (typically, a master agreement) provide for a procedure whereby multiple obligations between the parties are terminated and replaced by a single net payment obligation. Close-out netting terms specify, among other things, events that may trigger the procedure and the method for determining the value of the single net payment obligation. Trigger events in close-out netting provisions typically include the commencement of insolvency, liquidation, or similar proceedings that may stay or otherwise impede contract enforcement.

299. Frequently, when an entity enters an insolvency procedure, a moratorium applies on debt collection which 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, and is part of existing international standards.[144] This "safe harbour" from the normal treatment is based on the premise that a stay on enforcement of certain financial contracts can pose a risk to financial market stability.[145]

300. The *FSB Key Attributes* modify the close-out netting exception for financial institutions in resolution to restrict counterparties' ability to exercise early termination rights under financial contracts when a firm enters resolution. That modification has two elements. First, *FSB Key Attribute* 4.2 provides that statutory or contractual set-off, contractual close-out netting, early termination, acceleration, and similar provisions should not be triggered upon the entry into resolution proceedings and the exercise of resolution powers solely by reason of such proceedings, provided that substantive contractual obligations continue to be performed.

301. Secondly, *FSB Key Attribute 4.3* provides that if the non-failing counterparty retains the right to set off, accelerate or terminate early, the resolution authority should have the power to stay the

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

145 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.*"

counterparty's exercise of such rights for a specified and limited time period (e.g., not exceeding two business days), subject to adequate safeguards.

302. These modifications reflect experience with such contracts in the financial crisis of 2007-2009, 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. 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.

303. Since 2014, 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.

304. 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 insolvency proceeding. Similarly, the ISDA documentation was developed in response to the *FSB Key Attributes* to give effect to resolution stays.[146] The *World Bank Principles*[147] do not restrict the possibility of a limited stay on close-out netting to special resolution proceedings or systemically important firms. Such a stay may be appropriate in bank liquidation proceedings for non-systemic banks in limited circumstances and subject to appropriate safeguards as outlined in paragraph 306 below.

305. Nonetheless, 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 targeted and clearly drawn power to stay close-out netting only where this impedes the implementation of specific failure management tools, in particular the transfer of assets and liabilities to another entity.

306. In line with the *FSB Key Attributes*, the duration of any stay should be strictly limited – e.g., subject to a maximum of 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 liquidation framework, including, in the case of 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. Furthermore, similar safeguards as under the *FSB Key Attributes* should apply. In particular, a "no cherry picking" rule should apply where the stay is used to facilitate the execution of a transfer transaction, so that the liquidation authority and/or the liquidator, as the case may be, is not

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

147 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*".

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

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63. Contractual early termination rights under financial contracts, including close-out netting procedures that operate by reference to the commencement of liquidation proceedings, should remain enforceable in insolvency, operating as an exception to general business insolvency law and practice. The types of financial contracts covered by this exception should be clearly defined in the legal framework.

64. When applying transfer-based tools, to ensure their effective implementation, the liquidation authority should have the power to stay temporarily any rights to exercise early termination rights and 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, which should not exceed, e.g., 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 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 selection for transfer of individual rights and obligations with the same counterparty and subject to the same early termination and close-out netting agreement should not be allowed.

CHAPTER 7. FUNDING

A. Introduction

307. The primary source of funding for bank failure management should be the bank's own available 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 preserve public confidence in the banking system (see *Chapter 1. Introduction*). Such external funding needs 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.

308. 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 potential interaction between funding arrangements and the associated public transparency, on the one hand, and equity and burden-sharing concerns, on the other, is salient in the design of failure management frameworks. These factors are recognised in the international standards applicable to funding for bank failure management: the *IADI Core Principles* (Principle 9) and, where bank failure can be "systemic or critical", the *FSB Key Attributes* (particularly KA 6).[148]

309. Against this background, this Chapter provides guidance on funding in bank liquidation proceedings. *Section B* explains why external funding would likely 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. *Section D* covers the form of DIS financing transaction (e.g., a cash contribution or loss-sharing arrangement). Finally, *Section E* discusses emergency backstop funding for the DIS and the principle that fiscal funding should be avoided.

B. Need for external funding

310. Banks' own loss-absorption capacity has improved with regulatory reforms. Building banks' loss-absorbing capacity 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*.[149]

311. 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,

[148] 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*.

[149] For example, the FSB standard on Total Loss Absorbing Capacity (TLAC) requires G-SIBs to maintain increased levels of loss-absorbing capacity consisting of regulatory capital or other debt instruments that meet specific eligibility criteria 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.

position in the financial system, and the risks associated with its failure; the failure management options available; and the wider circumstances.

312. In bank liquidation proceedings, protecting depositors and maintaining public confidence in the banking system are primary objectives. These can be achieved if insured depositors are promptly reimbursed or deposits are transferred to a healthy bank. The transfer of a non-viable bank's assets and liabilities, including deposits, to another institution may depend on the availability of external funding. Potential buyers often put a premium on the value of a bank's stable client base. Despite such possible premium, there may still be a shortfall between the value of deposits and that of bank assets available for transfer. There may be few or no willing buyers without external funding to fill the gap.

313. External funding may be needed on a contingent basis when the circumstances of a bank failure limit potential buyers' 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 future losses.

C. Use of deposit insurance funds

314. 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 DIF, 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), and the conditions and safeguards specified in the *IADI Core Principles*.

315. Pursuant to *IADI Core Principle 9, Essential Criterion 8*, 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.[150] 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;[151] 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.

316. There are significant advantages to facilitating the use of DIF resources to support the transfer of deposits to an acquirer and thereby ensure continued access to insured deposits. 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.[152] In particular, a failure management regime that includes the option of transferring a non-viable bank's assets and liabilities to a healthy bank may be able to secure a higher "going concern" value for the bank than

[150] *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*.

[151] The extent to which information may be shared depends, among other things, on the nature and governance arrangements of the DI.

[152] 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).

the "gone concern" value that is generally realised in a piecemeal liquidation. A lack of funding arrangements for non-payout measures could limit the failure management options available to authorities, with an associated risk that authorities might resort to public funding on an *ad hoc* basis to protect depositors and manage the impacts of the failure.

Amount of DIS funds that may be contributed

317. To reduce the risk of excessive depletion of DIS resources, 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 be restricted to the costs the DI would otherwise have incurred in a payout of insured depositors net of expected recoveries.[153] 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.

318. In practice, this safeguard 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).[154] Some jurisdictions, by contrast, calculate the 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).[155]

319. 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, for example transfers. Bank failure management 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.

320. 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 determines 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*).

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[153] *IADI Core Principles*, CP 9, EC 8, point (d).

[154] 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 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*). In case a "net" contribution approach is followed, the DI contributes to the transfer while already 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.

[155] Provided that the claims of insured depositors would be 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 piecemeal liquidation process of the residual entity.

D. Design of DIF financing transactions

321. The form of DIF support for transfer transactions in bank liquidation proceedings depends on the DI's mandate, the scope of its authority, and its function 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 the acquisition.[156] More complex forms of support could include providing a guaranteed floor on the value of transferred assets, entering into loss-sharing agreements with purchasers, 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 that facilitates ongoing monitoring of, for example, the ongoing conduct of a loss-sharing agreement. The design of transfer transactions should preserve the ability for the DIS to recover from the estate of the failed bank.

322. 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.

E. Backstops and recovery mechanisms

323. Although most DIFs are pre-funded with industry assessments,[157] 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.[158] Jurisdictions should specify the arrangements for back-up liquidity arrangements for the DI.

324. *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 the situation where there are no *ex-post* industry assessments or taxpayers' money would be used to replenish the DIF. Some DIFs also have authority to borrow in private or public financial markets pending replenishment by the industry.

325. 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.

326. Where a "single-track" regime applies to all banks, including those that are systemic in failure, a framework for the provision of public funding in exceptional cases of systemic impact should be consistent with the *FSB Key Attributes*, which specify conditions that should be in place to limit

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156 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.

157 Pursuant to *IADI Core Principles*, CP 9, EC 1, funding for the DIS should be provided on an *ex-ante* basis.

158 *IADI Core Principles,* CP 9, EC 4. Sources may include a funding agreement with the government, the central bank or market borrowing.

the associated moral hazard and ensure that the costs are internalised by the financial industry. These include the condition that public funds should only be used if necessary for financial stability and private sources of funds have been exhausted or would not achieve the financial stability objectives, and the provision of public funds should be accompanied by a mechanism for recovery from the industry of any losses incurred. That mechanism should be based on explicit provision in the legal framework.

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 for bank liquidation proceedings 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 of the actors involved.

Key Considerations

- The cost of failure should be primarily borne by the bank's shareholders and its other loss absorbing resources. Fiscal resources should not be used to manage the liquidation of a failed bank.
- In jurisdictions that have a DIS, there are significant advantages to granting the DI the option 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 contemplate 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 external source and specifies DI governance, funding sources, instruments, and conditions applicable to the use of DIF funds, depending on the DI's mandate and in line with the *IADI Core Principles*.[159]

[159] 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.

CHAPTER 8. CREDITOR HIERARCHY

A. Introduction

327. 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 strictly followed in the context of piecemeal liquidation. Furthermore, the creditor hierarchy is relevant in case other strategies are applied to deal with the failure of a bank. For banks that are systemic in failure, the *FSB Key Attributes* prescribe that resolution powers should in principle be exercised in a way that respects the hierarchy of claims.[160] The same applies in case of use of transfer powers in bank liquidation proceedings. In addition, the treatment of creditors in a hypothetical piecemeal liquidation scenario is the counterfactual in the context of the NCWO principle in bank resolution proceedings and bank liquidation proceedings under which a sale as a going concern is contemplated or implemented. 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 achievement of objectives in these proceedings.

328. Adequate, transparent rules on creditor ranking are essential to facilitate the smooth implementation of bank failure management strategies, while ensuring the fair treatment of creditors, and 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.

329. While equality among creditors of the same rank is a general principle, absolute equality in loss allocation would be inequitable where there are compelling policy reasons or significant differences in the legal or economic nature of certain claims. Therefore, insolvency laws may contemplate a differentiated treatment for certain claims, including instances of preferential treatment (e.g., secured claims), as well as less beneficial treatment (e.g., subordinated claims).

330. 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).[161] The *pari passu* principle as well as its exceptions are covered in frameworks by the World Bank[162] and UNCITRAL[163] and figure prominently in the *FSB Key Attributes.*[164] 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 framework. *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 a 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, and *Section G* the ranking of post-liquidation financing. Finally, *Section H* provides guidance on the treatment of secured creditors, including covered bondholders and central banks.

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160 See *FSB Key Attributes*, KA 5.1.

161 See *Chapter 1. Introduction*, *Section C*. See also *UNICTRAL Legislative Guide*, Parts One and Two, Glossary.

162 *World Bank Principles*, C12.

163 See, e.g., *UNCITRAL Legislative Guide*, Recommendation 191 and paras. 51-79 on priorities.

164 *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").

B. Establishing rules on creditor ranking

331. Approaches to the establishment of rules on creditor ranking in bank liquidation proceedings vary across jurisdictions. In some jurisdictions, the general 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 present a risk of non-compliance with creditors' safeguards (see *Chapter 6. Liquidation Tools*, *Section D*), reduce predictability, and complicate cross-border cooperation during failure management proceedings.

332. 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 and the DIS or similar funding schemes. Some jurisdictions introduced bank-specific provisions on subordinated or non-preferred claims to facilitate loss absorption and recapitalisation.

333. 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.

334. Options 2 and 3 present good practices. Transparency demands that the hierarchy of claims in bank liquidation be clearly stated in the legal framework.[165] This may take place through a separate regulation of creditor hierarchy in the bank liquidation law, or, if general 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 insolvency law.

335. 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*). 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.[166]

336. The order of loss allocation to creditors in bank resolution *versus* liquidation should not materially differ.[167] Significant divergences between creditor treatment in resolution and liquidation increase the risk of legal challenges and compensation of claims according to the NCWO principle. Any differences should be based on clear reasons of policy as accepted under international standards, e.g., to avoid contagion or seek to maximise value for creditors as a whole,[168] and should in any case be accompanied by appropriate safeguards.

337. 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

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165 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 be provided with discretion to define the relative ranking of claims.

166 See *World Bank Principles*, C12.3; *UNCITRAL Legislative Guide*, Recommendation 187.

167 *The Case for Depositor Preference*, p. 4.

168 See *FSB Key Attributes*, KA 5.1.

creditors and promote predictability.[169] Deviations from the *pari passu* treatment of creditors of the same class 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*).[170] This does not preclude further deviations in the context of resolution justified by other objectives which, in any event, fall outside the scope of this *Legislative Guide*.

Key Consideration and Recommendations 68 –70

Key Consideration

- When designing the creditor hierarchy applicable to bank liquidation proceedings, it should be considered that this ranking can also affect the achievement of effective bank resolution solutions.

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, in case the general 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 *pari passu* unless there are fundamental differences in the legal and economic nature of their relationship with the bank or compelling reasons of policy for distinguishing between them.

70. The legal framework should ensure that pre-insolvency rights and priorities of creditors under commercial or other laws be upheld in bank liquidation proceedings to preserve creditors' legitimate expectations and ensure predictability.

C. Ranking of depositors

338. Depositors tend to make up a significant percentage of the creditors of a bank. 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 aims at reducing such negative impacts (see *Chapter 1. Introduction*). The DIS is key to support depositor protection and avoid contagious bank runs. Depositor preference, i.e., ranking deposit claims ahead of ordinary unsecured claims, may be seen as another means of pursuing the objective of depositor protection.[171]

339. Rules concerning the ranking of deposit claims differ across the world. Depositor preference is present in a majority of jurisdictions that have deposit insurance[172] and in a majority of members

[169] *World Bank Principles*, C12.1.

[170] 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*).

[171] 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 legal and contractual conditions applicable, 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 *Chapter 1. Introduction*, *Section C*).

[172] According to IADI (2023 Annual Survey), 82% of DIS operate under legal frameworks with some form of depositor preference.

of the FSB, although several jurisdictions do not contemplate it.[173] Jurisdictions with deposit preference vary between "general", "insured" and "tiered", as well as insurance coverage levels.

340. "General depositor preference" grants an equal preference to all depositors; "insured depositor preference" grants preference only to insured deposits; and "tiered depositor preference" grants preference to insured deposits over (some) uninsured deposits, and to the latter over ordinary 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[174]

<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="3">All deposits (and DI's claims) rank equally with ordinary unsecured claims</td><td>Insured deposits (those that are eligible and within the deposit insurance limit) and DI's claims enjoy preference</td><td>Insured deposits and DI's claims enjoy preference</td><td>All deposits and DI's claims enjoy preference</td></tr>
<tr><td rowspan="2">Uninsured deposits (and any portion of eligible deposits that exceed the coverage level) rank equally with ordinary unsecured claims</td><td>Uninsured deposits meeting specifically-defined criteria (typically, deposits exceeding DIS coverage) enjoy a more junior preference</td><td rowspan="2">Ordinary unsecured claims</td></tr>
<tr><td>Ordinary unsecured claims and uninsured deposits not meeting the criteria for preference</td></tr>
</table>

341. Based on past experiences, there are compelling reasons supporting a preferential treatment of bank deposits, including their legal characteristics,[175] or policy reasons (reducing runs and contagion, protecting the payment system, reducing DIS costs, aligning the treatment of deposits with the protection granted under resolution),[176] while there may 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).[177]

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[173] E.g., Brazil, Canada, Japan, and South Korea do not have depositor preference at the time of writing of this *Guide*.

[174] 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.

[175] See *The Case for Depositor Preference*, p. 5.

[176] *Ibid* p. 11. See also Kumudini Hajra *et al*, *Depositor Preference and Implications for Deposit Insurance, IADI Briefs* (2020), p. 4.

[177] *Ibid* pp. 11-12; p. 5.

342. It is generally recommended that the legal framework adopt some form of deposit preference.[178] In any event, jurisdictions should make their own choice weighing the potential advantages of depositor preference against the potential disadvantages, including the impact on different unsecured funding sources and their costs, the role of uninsured deposits (i.e., their importance in the payment system as working capital *versus* 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.

343. The ranking of deposit claims shapes how different claims can be treated, and also the DI's costs in liquidation, as it subrogates to the rights of insured deposits.[179] 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.[180] This can also affect the DI's ability to fund non-payout measures, such as transfers. The use of DIF resources for non-payout measures is often limited by rules that take as a reference point the cost of payout as a counterfactual (payout counterfactual) (see *Chapter 7. Funding*). The ranking of deposit claims influences the payout counterfactual when this is calculated "net" of liquidation recoveries, meaning that the DI may be able to contribute less to non-payout measures, e.g., to support a transfer strategy, under certain forms of deposit preference.[181]

344. The different options conceivable for depositor ranking affect the feasibility of the transfer tool, as explained in the next paragraphs. However, in addition to their impact on transfer strategies, legislators should also consider all the policy implications of the various options (see paragraph 341).

345. In the absence of depositor preference, the DI, upon subrogation for insured deposits, has a claim equal to all other ordinary unsecured creditors. This reduces the share of DIS recoveries in a piecemeal liquidation and, correlatively, enhances possibilities for the DI to contribute funding for transfer-based strategies since it increases the DI's net payout counterfactual. However, problems may arise in respecting the *pari passu* principle where insured (and possibly uninsured) deposits are transferred, whereas equally ranking claims of other creditors are left behind in the residual entity.[182] While the application of a transfer tool is generally expected to increase value, this may not be sufficient to ensure that departing from the *pari passu* principle would not result in the creditors left behind in the residual entity being worse off than in a piecemeal liquidation.

346. In case of insured or tiered depositor preference, the DI has, via subrogation, a priority claim to recoveries 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 uninsured deposits are preferred over such claims. Insured or tiered depositor preferences reduce the costs of

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178 *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.

179 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.

180 With a high-priority ranking, the role of the DI would be akin to a liquidity provider given that it would be expected to have high recoveries in liquidation. 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 for Opening Bank Liquidation Proceedings*, a timely initiation of bank failure management proceedings is crucial – and is beneficial for DI recovery rates.

181 The contribution of the DI also depends on the methodology for calculation of the costs the DIS would incur in the payout counterfactual.

182 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.

bank failures to the DIS and reduce the risk of violating the *pari passu* principle in the application of a transfer strategy, as long as the only deposits being transferred are those with a higher ranking than ordinary unsecured creditors. The risk may exist in an insured depositor preference system where uninsured deposits also need to be transferred to another entity, in whole or in part, or the preference is capped at a certain amount, and it is impractical to transfer deposits only in part, while ordinary unsecured creditors with the same ranking are left behind in the residual entity. In any event, insured or tiered depositor preference may make it difficult for the DI to contribute funding in a transfer scenario depending on the relative ranking of deposits compared to other preferred claims, and the concrete content of the limits and safeguards applicable to the DI's contribution.

347. In case of general depositor preference, the DI has, via 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 a payout scenario 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 from the DI to a transfer strategy compared to other forms of depositor preference, while it would not affect in any way the special 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*, the legal framework should not constrain the transfer of insured deposits only, but instead be permissive of transfers involving other deposits if this serves the bank liquidation objectives.

348. Whatever type of depositor ranking is chosen as a result of the overall policy analysis – whereby some form of depositor preference is generally recommended – the legal framework should reflect this clearly and transparently.

349. 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 (see *Chapter 10. Cross-Border Aspects*).[183] 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 of relevant 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.

350. Depositor preference should not in any case be seen as a substitute of deposit insurance. Depositor preference alone does not eliminate the risk of contagion and bank runs.[184] Where there is loss of access to deposits, the DIS is needed to allow a swift reimbursement, up to the applicable coverage level. Jurisdictions increasingly combine deposit insurance and deposit preference.[185] 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

183 See, similarly, *FSB Key Attributes*, KA 7.4; *IADI Core Principles*, CP 8.7 and 14.7. In case of deposits held through branches, the law determining deposit treatment is normally the law of the legal entity in the home jurisdiction, although there may be exceptions. The applicable law to deposits held through a subsidiary is normally that of the subsidiary.

184 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 there will be loss of access to deposits, depositors' fears of a bank failure may not be fully avoided.

185 IADI (2023) *Annual Survey*.

ceiling for deposit insurance,[186] and the DI and insured depositors should be granted the same ranking.[187]

351. 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 deposit preference, the DI's subrogation claims resulting from a deposit payout will enjoy the same priority.[188]

352. 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*). Such withdrawals need to be considered as on-account payments for the purpose of creditors' treatment. This means that the amount of deposits to be paid out should be reduced to take into account the advance payments. In case of a transfer of deposits up to a certain level (e.g., up to the insurance threshold), the amount already provided as an advance payment needs to be deducted.

353. Jurisdictions should also consider the ranking of related party deposits. Such deposits may be excluded or considered ineligible for deposit insurance protection.[189] 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.

354. Finally, jurisdictions should carefully consider the treatment of interbank deposits. Interbank deposits are often excluded from deposit insurance and typically surpass the coverage level offered by deposit insurance.[190] The inclusion of interbank deposits in the scope of depositor preference, on the one hand, appears less justified, because banks, unlike small depositors, are in a 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.[191] In 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

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186 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 applicable ceiling is disproportionately low, and there is no separate preference applicable to the DI, the DI will rank *pari passu* with other senior unsecured creditors for a large portion of its claims when seeking reimbursement. This is problematic as it could possibly 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.

187 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, not granting insured depositors a preferred ranking may lead to litigation and compensation in case a transfer strategy is applied.

188 See *IADI Core Principles*, CP 16, EC 1.

189 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*").

190 *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).

191 See, e.g., IMF Occasional Paper 197, "*Deposit Insurance: Actual and Good Practices*" (2000), p. 4.

difference in the level of sophistication and capabilities of risk management between banks and small depositors.

Key Considerations and Recommendations 71 – 74

Key Considerations

- The choice on 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 eases transfer as compared to tiered depositor preference if a deposit book transfer is considered necessary or desirable as a failure management strategy. As compared to tiered depositor preference, general depositor preference 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 deposit insurance. Deposit insurance is needed to ensure a quick reimbursement of insured deposits or continued access to such deposits where these are transferred 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, 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

355. Debts may be subordinated by contractual agreement (contractual subordination), statutory provision (statutory subordination), or a court order.

1. Contractual subordination

356. Contractually subordinated claims result from an agreement between one or several creditors and the debtor or between creditors, by which some creditors accept that their claims shall be paid only after other creditors' claims have been satisfied.[192] 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.

357. Subordinated debt fulfils important functions for banks, and thus the legal framework should enforce subordination agreements in the context of liquidation, as well as in resolution. It is recommended that the legal framework include an express recognition of contractual subordination

192 *UNCITRAL Legislative Guide,* Part Two, Chapter V, para. 57.

clauses in the context of liquidation if the combined effect of contract law and 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 recognition of the enforceability of subordination clauses in the context of bank liquidation. Such express recognition should encompass both "total" and "partial" subordination clauses.

358. 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.

359. The rules on contractual subordination should be coordinated with the rules on the validity or enforceability of intra-group support arrangements (see below, and also *Chapter 9. Group Dimension*), where these provide for special rules.

2. Statutory subordination

360. In general, ranking and priorities should follow the general rules provided under the law applicable to liquidation proceedings, including on statutory subordination.

361. If the legal framework makes express provision for the subordination of certain types of claims, these provisions shall govern the subordination of those claims, and contractual subordination provisions shall apply in light of the more specific statutory provisions.

362. One specific instance where statutory subordination may be warranted is in cases of related party claims,[193] including intra-group debt (see below *subsection 4*).

3. Equitable subordination

363. 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/authority has the power to change the priority of payment of claims to prevent that creditor from benefitting from such advantage.

364. 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 "equitable subordination" was not contemplated in most jurisdictions, and where they did, it was specifically in the context of subordination of intra-group or related party claims.[194]

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[193] Jurisdictions with a DIS typically consider related party deposits ineligible for insurance, and some jurisdictions have subordinated related-party deposits to avoid moral hazard issues. See *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.

[194] 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.

4. Related party claims

365. In a group context, the advantageous position of a sole shareholder, parent or affiliated company presents 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 define a form of subordination for related party claims, in order to deter wrongdoing, or remedy clear situations of injustice.

366. Business insolvency best practices recommend that claims by related parties be subject to scrutiny, including the possibility of subordination.[195] It is generally recommended that business insolvency laws include mechanisms to identify those types of conduct or situations in which claims will deserve additional attention.[196] Many jurisdictions expressly contemplate the subordination of intra-group or related party claims (directly, or subject to conditions), while in others this possibility may result from the application of other provisions in the legal framework.[197]

367. 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 scrutiny. The legal framework should also facilitate the identification of situations that deserve special attention. If excluded from deposit insurance, related party debt should in any case not benefit from any preference granted to deposits (see *Recommendation 73*). Furthermore, each jurisdiction 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 can follow different approaches. A first, principles-based option, is for the legal framework to vest 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 extend to the possibility to annul the security granted by the debtor to the creditor.

368. A second, "mixed" option is for the legal framework to provide for the subordination of claims by related parties, setting a precise definition of related parties in line with the definition included in the applicable banking law (e.g., directors, shareholders holding more than 10%, etc.), and subject the subordination to certain conditions, such as when the debt financing is granted in a situation where the company receiving the assistance is undercapitalised or in financial difficulties, or masks what would otherwise be an equity contribution, or there is evidence of self-dealing, and/or when doing so results in unfair treatment towards creditors.

369. A third, rules-based option is for the legal framework to automatically subordinate the claims from loans granted by certain related parties, as precisely defined in line with the banking law, possibly leaving the space for creditors to present contrary evidence to demonstrate that the

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195 *UNCITRAL Legislative Guide*, Part Two, Section V.C (para. 48, Recommendation 148).

196 *Ibid. and UNCITRAL Legislative Guide*, Part Three, Section II (para. 85; see also paras. 86-87 for some examples).

197 Some jurisdictions expressly contemplate the possibility of 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 case 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 jurisdictions do not expressly contemplate intra-group subordination. Among these, 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, or application by competent authorities of their powers, which may include drastic remedies such as substantive consolidation.

financing was granted in market-like terms, with a clear business purpose other than causing relative harm to other creditors, and without self-dealing.

370. The analysis of current laws and practices across jurisdictions does not allow the identification of one single best approach. However, it is recommendable 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.

371. Each jurisdiction should choose its approach to subordination of related party claims, although the statutory subordination of related party claims offers various advantages, including facilitating resolution and certain liquidation strategies (e.g., transfers) with lower litigation risk; mitigating moral hazard risks; disincentivising 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.[198] The legal framework governing bank liquidation may reinforce this by expressly contemplating the statutory subordination of intra-group claims that are not concluded at arm's length. Also, when related party transactions are not monitored so regularly, and/or there is special concern about related party abuses, the legal framework may contemplate the automatic subordination of certain related party claims. In general, it may be recommendable to introduce statutory subordination expressly where other forms of subordination (e.g., equitable subordination) set forth under general insolvency law, to the extent applicable to banks, are uncertain or unlikely to apply.

372. 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 its 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 granted inside the group. Where jurisdictions based on policy considerations provide any special rules or exceptions to subordination rules for of intra-group financing granted in the "twilight" pre-liquidation stage, 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 scrutiny. 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, alignment with the arm's length principle in prudential rules, asset stripping risks, and the effectiveness of bank failure management strategies. The introduction of statutory provisions providing for the subordination of related party claims is recommended, especially if the possibility of subordinating such claims under the general insolvency law is uncertain and/or remote.

[198] See *Basel Core Principles*, CP 20.

5. Claims for post-liquidation interest

373. Under business insolvency law, different approaches are taken to the accrual and payment of interest on claims during liquidation proceedings.[199] Once liquidation proceedings are opened, in some jurisdictions, interest ceases to accrue on unsecured debts. In other jurisdictions, interest may accrue but payment is given a low priority (e.g., after the payment of all unsecured creditors).

374. In bank liquidation proceedings, a stay should in principle apply from the moment the proceedings are opened (see *Chapter 6. Liquidation Tools*).[200] 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.

375. This result is undesirable for several reasons: (i) it is contrary to the normal and statutory hierarchy of creditors in which senior, non-preferred creditors trump junior, i.e., subordinated, creditors; (ii) it reduces the effectiveness of the bail-in tool in resolution, because subordinated debt holders can be written down or converted into equity only to the extent that they would have suffered losses in normal liquidation proceedings (NCWO principle); (iii) it increases the risk of claims based on NCWO if bail-in is applied regardless; and (iv) it may have negative consequences for the amount of TLAC/MREL banks must hold, as subordinated debt may thus have a significantly higher threshold for bail-in because of NCWO.

376. To avoid this, unsecured creditors should be allowed to file their interest claims (where appropriate, on a *pro memoria* basis[201]) and, in the creditor hierarchy, subordinated creditors should rank lower than ordinary unsecured creditors, including as regards any claims for interest accrued 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, also to the extent these senior, unsecured creditors' claims include interest claims 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

377. Under business insolvency law, shareholders generally rank behind all other creditors in the distribution of the proceeds from the liquidation estate with respect to 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

[199] See *UNCITRAL Legislative Guide*, Part Two, Section V.A (para. 49).

[200] As explained in *Chapter 6 . Liquidation Tools*, special rules should apply for financial contracts in case of a sale as a going concern.

[201] This would mean that the claim is filed but the value thereof is determined at a later stage.

accrued after the opening of liquidation proceedings).[202] As such, shareholders will rarely receive any distribution from the estate. If there are remaining assets after distribution to creditors, any distribution shareholders receive is normally proportional to the shares they hold in the failed debtor's business.

378. 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 prescribes – in line with the hierarchy of claims in liquidation – that equity should absorb losses first. If a transfer tool is applied, this result may be achieved by leaving the equity interests behind in the residual entity.

379. Shareholders may also have claims *vis-à-vis* the non-viable bank arising from loans provided to the bank. Such debt claims are not always subordinated in business insolvency laws.[203] The ranking of shareholder loans in bank liquidation proceedings is covered in Section D, subsection 4.

Recommendation 79

Ranking of equity holders

79. The legal framework should ensure that holders of equity in the bank rank below ordinary unsecured creditors, with the result that holders of equity are not paid until the bank's creditors have been fully repaid.

Similarly, if a transfer tool is applied, holders of equity should bear losses first. This may be achieved by leaving the equity interests behind in the residual entity.

F. Ranking of resolution financing arrangements

380. 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.[204] The ranking and status of the DIS is discussed above (see paragraphs 343 and 351). Jurisdictions with distinct resolution financing arrangements should clearly specify the ranking of claims of such financing arrangements in liquidation, i.e., *vis-à-vis* the residual entity.[205] Similarly, the legal framework should specify the ranking of government claims, to the extent public funding may be used in bank resolution proceedings on an exceptional basis.

G. Ranking of post-liquidation financing

381. In business insolvency, the continuance 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.[206] These considerations are also relevant for banks, where transfer of the business as a going concern is key

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202 *UNCITRAL Legislative Guide* paras. 94-95.

202 *Ibid* paras. 96-107.

202 *Ibid* paras. 101-102.

203 See *UNICTRAL Legislative Guide,* Part Two, Section V, par. 76.

204 *FSB Key Attributes*, KA 6.3.

205 Different approaches are followed across jurisdictions. In some jurisdictions, resolution financing arrangements enjoy a preferential ranking (e.g., as liquidation expense) while no special treatment is foreseen in other jurisdictions.

206 *UNCITRAL Legislative Guide*, paras. 94-95.

for the preservation of value (see *Chapter 6. Liquidation Tools*) and access to funding is essential to ensure such an orderly exit. In the case of banks, funding will be mostly 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 banks, given that a transfer needs to take place swiftly. 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 such treatment, jurisdictions should follow general principles of business insolvency law.[207]

382. 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.[208] 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").

383. Given the urgency of the situation, it is desirable that the authorisation of post-liquidation financing 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 court-based model, the general business insolvency law may in principle apply[209] but the banking authority should be heard before any authorisation to post-liquidation financing is granted. Each jurisdiction should consider whether there are some instances where, due to the significance of the funding, the effects for other creditors, or other risks, the authorisation of the court is needed.

384. In any event, post-liquidation financing under this section should be exempted from the rules on the avoidance and setting aside of transactions (see *Chapter 6. Liquidation Tools*).

Recommendations 80 – 83

Treatment of post-liquidation financing

80. The legal framework should facilitate the availability 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 ensuring adequate protection for the providers of post-liquidation financing, while ensuring that the interests of the parties whose rights may be affected by the provision of post-liquidation financing, and its treatment, be adequately balanced.

81. The legal framework should establish the ranking accorded to post-liquidation financing. This may consist in its treatment as an administrative expense, ahead of ordinary unsecured creditors, and other statutory priorities, but not ahead of secured creditors with respect to their security interest; or as a special administrative expense, ranking ahead of other administrative expenses.

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207 *Ibid* paras. 96-107.

208 *Ibid* paras. 101-102.

209 *UNCITRAL Legislative Guide*, Part Two, Recommendation 63. In the context of bank liquidation, in the interest of speed, it may be sufficient to make the provision of post-liquidation financing subject to the approval of the appointed liquidator, after hearing the relevant banking authority.

82. The urgency of the situation requires minimising the time for approving post-liquidation financing. 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 court-based model, the power to authorise post-liquidation financing could be granted to the liquidator, after hearing the relevant banking authority.

83. Post-liquidation financing complying with these rules should be exempted from the rules on the avoidance and setting aside of transactions.

H. Secured creditors

385. 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*".[210] Secured creditors' rights are enforceable in business insolvency proceedings, often subject to a temporary stay of enforcement (*see* Chapter 6. Liquidation Tools). The same should apply in bank liquidation proceedings.

386. Security interests are particularly relevant in bank financing. Certain types of financing, such as covered bonds, are dependent on it, and it is also frequent for interbank lenders to hold interests in securities as collateral, something that may also happen for central banks and other lenders of last resort. These and other types of bank financing may not be available if the legal framework does not grant a specific protection in the creditor hierarchy, like most insolvency laws already do. This may be done 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 specialties in the case of central bank financing may be warranted, as discussed below.

387. The priority granted to secured creditors may be an absolute priority, which seems warranted as a general rule, or it may rank after the general costs of the liquidation proceeding[211] and/or some other specific claims (e.g., unpaid wage claims or deposit claims[212]) 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.[213]

388. Beyond the preferential treatment applicable to secured creditors in general, or to secured creditors of bank debtors, the legal framework may contemplate more specific provisions to cover certain types of bank transactions. One example is covered bonds,[214] widely used in some jurisdictions, and enabling 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 of security to ensure

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210 *World Bank Principles*, A2; A3.

211 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. Again 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.

212 E.g., in Colombia and Nigeria.

213 E.g., in Spain, the priority claim is limited to 90% of the reasonable value of the secured asset.

214 Covered bonds are debt obligations issued by banks and secured on the back of a ring-fenced pool of assets, which may be referred to as the "cover pool" or "cover assets". The cover pool comprises high-quality assets, typically mortgage loans and public sector debt.

bondholders' protection.[215] Each jurisdiction should consider whether existing general rules on secured creditors suffice, or an express reference to their preferred treatment could be opportune.

389. Another type of secured creditor that may be of specific relevance for banks are central banks. In some jurisdictions, central banks may provide liquidity through monetary policy operations and/or emergency liquidity funding, which both require collateral. If a jurisdiction grants preferential treatment to secured creditors in insolvency, this may normally suffice to support lender of last resort funding. However, each jurisdiction must examine whether additional provisions are needed to ensure the protection of the central bank as secured creditor.[216]

Recommendations 84 – 85

Treatment of secured creditors

84. The priority of secured creditors of the bank in their collateral should be upheld and, absent the secured creditor's consent, their interest in the collateral should not be subordinated to other priorities granted during the bank liquidation proceeding. Distributions to secured creditors should be made as promptly as possible.[217] Thus, the legal framework should ensure that allowed secured claims shall be paid to the extent of the realisation of the security or by delivering to the secured creditor the security held by the bank for sale or appropriation, if permitted, according to the legal framework.

85. In line with the *FSB Key Attributes*, the legal framework should specify that if a transfer tool is applied, where liabilities are secured by collateral, the liabilities and associated collateral be either 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. For this purpose, examples of adequate protection might include substituting collateral, the provision of a credit support agreement, or financial compensation to counterparties.[218]

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215 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").

216 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.

217 See *World Bank Principles*, C12.2.

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

CHAPTER 9. GROUP DIMENSION

A. Introduction

390. Irrespective of their size, in most jurisdictions banks operate within group structures. 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*).

391. 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 by either a bank or by a non-bank holding company, group structures with an operating bank as the parent company are common.

392. Banking groups' practical relevance and their specific consideration under prudential and bank resolution regimes contrasts with their traditionally limited treatment under insolvency rules.[219] 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.[220] This trend changed recently, however, with some emphasis in international, regional, and national provisions on procedural coordination or consolidation, or group-wide corporate restructuring.[221] Most notably, the *UNCITRAL Model Law on Enterprise Group Insolvency* (MLEGI) now promotes a group-oriented approach, including coordination and cooperation, and "group insolvency solutions" resulting from group-level "planning proceedings",[222] which seek to preserve going concern value at the level of an integrated group to protect and maximise the overall combined value of the assets and operations of the group as a whole and avoid disintegration, to the advantage of all creditors.[223] The *UNCITRAL MLEGI* does not necessarily capture the specificities of banking groups, yet it shows the importance of addressing group implications in reorganisation proceedings, and also, to some extent, in liquidation, 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.

393. 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.[224] 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

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219 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 *UNICTRAL Legislative Guide*, *World Bank Principles*, and IMF papers).

220 E.g., the *UNCITRAL Model Law on Cross-Border Insolvency* (1997), the Winding Up Directive 2001/24/EC and the European Insolvency Regulation No 1346/2000 are entity-centric.

221 The *UNCITRAL Legislative Guide* included, as of 2010, Part Three on the Treatment of Enterprise Groups in Insolvency, and informed national developments. The European Insolvency Regulation Recast of 2015 included provisions on groups, as well as domestic legislation following national reforms in Belgium, Germany, Italy, and Spain.

222 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. The definition of "group insolvency solution" is not limited to the reorganisation type of solutions, which means "*a proposal or set of proposals developed in a planning proceeding for the reorganization, sale or liquidation of some or all of the assets and operations of one or more enterprise group members, with the goal of protecting, preserving, realizing or enhancing the overall combined value of those enterprise group members*".

223 See also *UNCITRAL Legislative Guide*, Part Three.

224 See *FSB Key Attributes*, KA 1.1, and *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN for KA 1.

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*, paragraph 288).[225]

394. 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 of a group (*Section B*). Furthermore, it discusses how cooperation between liquidation authorities and liquidators of different group entities can be encouraged (*Section C*).

B. No group impediments to bank liquidation

395. In the first place, the specificities of the liquidation of a bank when such bank is part of a banking group call for provisions directed at ensuring that the liquidation of such individual bank not be impeded by group relations.

396. 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*, the legal framework should provide the possibility to subordinate related party claims, including intra-group debt, and statutory subordination offers various advantages. However, subordination of intra-group claims may not always be appropriate. Jurisdictions should choose the approach that better aligns with their broader legal framework. As a general principle, support by parents to subsidiaries typically takes the form of equity or subordinated debt, but 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 parent provides liquidity assistance to a liquidity-constrained subsidiary which, however, meets all capital requirements). This can also occur when liquidity assistance is provided by another group entity or by an institutional protection scheme[226] to which the failed bank is affiliated. In such cases, 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 when most needed, which could result in a destruction of value. On the other hand, there is a risk that the parents exploit opportunities to extend the support in the form of debt instead of equity or subordinated capital in which case they would have absorbed losses before unsecured creditors. 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.

397. In principle, 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 entities, it is essential that the treatment of related party claims in liquidation also be consistent with the arrangements in resolution.

398. Furthermore, a bank liquidation in a group context may have implications for possible intra-group financing *post*-liquidation. 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

225 See *FSB Key Attributes Assessment Methodology for the Banking Sector*, EC 3.6.

226 For the purposes of this *Guide*, an institutional protection scheme refers to a contractual or statutory liability arrangement for a group of banks aimed at protecting the member institutions and, in particular, ensuring their liquidity and solvency to avoid failure (sometimes referred to as "institutional stabilisation scheme").

sale of the business or parts of it as a going concern.[227] Best practice in general 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, even when the financing is provided by an insolvent group member, in the form of direct funding, security interests or guarantees.[228]

399. In the banking context, post-liquidation financing by other entities, including 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. In any case, in a court-based model, the general principles of post-commencement financing should be followed[229] with appropriate adjustments for banking groups to ensure that the relevant banking authority be heard before any authorisation to post-commencement financing is granted. In an administrative model , post-liquidation financing should follow a determination by the liquidator, which must also determine that any harm to creditors of that group member will be offset by the benefit to be derived from the financial assistance, and a potential authorisation by the liquidation authority.[230]

400. 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. If the group service provider continues to operate or is transferred, in whole or in part, to a third party, ideally, the liquidator should have the sole discretion to determine whether the relevant service arrangements with the liquidated bank are continued or terminated. To this end, the legal framework could specify that the service provider may be prevented from terminating the service agreement solely on the basis of the commencement of a bank liquidation proceeding or the exercise of liquidation powers, and provided that the bank continues to meet the substantive obligations under the service agreement. The liquidator may need to re-negotiate, where necessary, pre-existing intra-group service agreements or other operational arrangements. On the one hand, there is the risk that if those were not concluded at arm's length, they may result in unfair treatment of the creditors of the liquidated bank. On the other hand, they may be necessary for certain business operations that support the liquidation (e.g., access to IT systems may be necessary for a payout of insured depositors) or to support the successful implementation of a transfer (e.g., ensuring that a group entity continue providing services that support the transferred business for a transitional period until the purchaser puts new arrangements in place). 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 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 also grant the relevant authorities appropriate means to deal with the risk of uncoordinated actions.

Recommendations 86 – 88

No group impediments to bank liquidation: Intra-group transactions and post-liquidation financing

86. 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*). 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.

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227 *UNCITRAL Legislative Guide,* Part Three, para. 56.

228 *UNCITRAL Legislative Guide*, Part Three, Recommendation 211.

229 *UNCITRAL Legislative Guide,* Part Two, Recommendation 63.

230 *UNCITRAL Legislative Guide,* Part Three, Recommendations 212-213.

87. In jurisdictions with a court-based model, the relevant banking authority should be heard before authorising the provision of post-liquidation financing by group entities. In jurisdictions with an administrative model, such post-liquidation financing should be assessed by the liquidator and may require approval by the administrative liquidation authority.

88. When, before entering into liquidation, a bank has received intra-group services from one or more group entities, and those entities continue to operate or are 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 liquidator, to be communicated within a reasonable period of time from the date of entering into liquidation. The counterparty of the bank should not be able to terminate the service agreement solely based on the commencement of the bank liquidation proceeding, provided that the bank continues to meet the substantive obligations under the service agreement.

C. Coordinated actions between administrative authorities and courts

401. Bank liquidation measures – in particular a transfer of a bank's assets and liabilities – need to be prepared when the bank's non-viability is approaching (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 certain group operations for a temporary period during liquidation, including shared services or infrastructures (e.g., IT); and (ii) the preferred liquidation strategy for the bank's subsidiaries, if these are subject to liquidation proceedings as well, to achieve the bank liquidation objectives.

402. 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 may risk frustrating the liquidation authority's efforts in pursuing 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 business insolvency law. It may also arise if group entities are liquidated by different administrative liquidation authorities (e.g., the bank by an administrative liquidation authority for banks specifically, and other group entities by other administrative authorities, e.g., securities regulators).

403. To prevent the risk of uncoordinated actions, the legal framework should ensure that administrative authorities are granted appropriate procedural rights to ensure coordination. In cases where a court is the liquidation authority for at least some entities in the 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 or a reorganisation plan, if this contrasts with and/or threatens the objectives of the bank's liquidation. Furthermore, the insolvency practitioner appointed for the other group entities should be under a general obligation to coordinate with the bank's liquidation authority and any appointed liquidator.

404. 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 coordinated solution is compatible with the authorities' mandate and the objectives of liquidation.

405. The legal framework should provide flexibility to the relevant authorities 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 stage, including by relying on 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.

406. 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.[231] The coordination of the proceedings should, however, fully respect the asset partitioning of each group entity (resulting from its separate legal personality)[232] and should address situations involving conflicts of interest. In the case of multiple proceedings with different liquidators, these should communicate directly and cooperate to the maximum extent possible to achieve an effective solution. Where the structure of the group reflects an integrated group model – which is likely to imply that the group is 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 latter context, it is essential to 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.

Recommendations 89 – 94

Procedural implications of the liquidation of a bank which is part of a group

89. When the liquidated bank is part of a group, the legal framework should ensure that (i) the administrative authorities be granted 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; 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, if this contrasts with and/or threatens the objectives of the bank's liquidation. Furthermore, the insolvency practitioner(s) appointed for any other group entities should be subject to a general obligation to coordinate with the resolution authority, the bank's liquidation authority, and any appointed liquidator.

90. In cases where group entities 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 adopt the necessary actions to ensure coordination, including through the exchange of confidential information.

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231 *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 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. Furthermore, the interest of the creditors of different group entities may give rise to potential conflicts of interest which may be challenging to address.

232 An exception to this rule may materialise in practice when the group entities are bound through cross-guarantees (and the same applies to entities affiliated to the same institutional protection scheme).

91. The legal framework could allow the appointment of the same liquidator(s) if parallel liquidation proceedings are opened for entities of the same banking group, where this is feasible.

92. 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, in case of the appointment of a single liquidator, it should address situations involving conflicts of interest.

93. When multiple parallel proceedings are opened, 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 and to cooperate to the maximum extent possible.

94. 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

407. This Chapter is aimed at assisting legislators in drafting statutory provisions on the cross-border aspects of bank liquidation in a harmonised manner. 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, and thus, cross-border cooperation with other, affected jurisdictions may be needed. Such cooperation may be needed as well when a bank has foreign subsidiaries with an independent licence in the host jurisdiction. Banks' cross-border activities present challenges for the effective administration of liquidation proceedings, which may, in turn, worsen the situation of the bank and increase the likelihood of contagion and spill-over effects. Conversely, smooth cross-border cooperation can minimise those risks and help enhance recovery for deposit holders and other creditors.

408. Results from the survey conducted in preparation of this *Guide* indicate that jurisdictions retain different practices towards cross-border bank liquidation. Different approaches are not *per se* an impediment to cross-border cooperation. However, there can be lack of clarity in the statutory provisions or in the applicability of those provisions to banks, which may result in lack of coordination and/or uncertainties in the adoption and implementation of a liquidation strategy across borders, with the resulting loss of value for creditors and potential prejudice to many stakeholders of the bank.

409. 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. The *FSB Key Attributes* include high-level principles and legal framework conditions for cross-border cooperation. Those principles specify that the statutory mandate of a resolution authority should empower and strongly encourage the authority wherever possible to act to achieve a cooperative solution with foreign resolution authorities. They also include provisions on the legal framework conditions for cross-border cooperation (KA 7), crisis management groups (KA 8), and institution-specific cross-border cooperation agreements (KA 9).[233] The *FSB Principles for Cross-border Effectiveness of Resolution Actions*[234] set out statutory and contractual mechanisms for giving cross-border effect to resolution actions in accordance with the *FSB Key Attributes.*

410. Jurisdictions should align their legal framework for cross-border cooperation with the *FSB Key Attributes and Principles* 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 in a systematic manner. The UNCITRAL framework for recognition is one possible approach to achieve cross-border effectiveness, but it is primarily designed for cross-border insolvency of businesses. Thus, it may offer insufficient detail on matters such as the role of home and host administrative authorities, and their interaction with courts, and it does not consider issues specific to the bank context, such as concerns about financial stability.

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[233] 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)).

[234] FSB, [Principles for Cross-border Effectiveness of Resolution Actions (fsb.org)](). See also *FSB Key Attributes Assessment Methodology for the Banking Sector*.

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.[235]

411. The Chapter refers to such existing standards and guidance where appropriate and concentrates on certain specificities of non-systemic bank liquidation, focusing on the liquidation of single banks with branches, assets, or operations in more than one jurisdiction, and offering specific guidance on cross-border groups when it may be necessary (otherwise, the guidance is equally applicable to non-viable banks forming part of a cross-border group). The Chapter also accounts for the fact 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, or the exercise of discretion not to take domestic action.

412. The Chapter's aim is thus to provide guidance for the design of a legislative framework for cross-border cooperation that takes into account different possible scenarios and legal frameworks, and ensures fairness, as well as participation and control by the jurisdictions involved in the process. 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.

413. The Chapter is organised as follows. *Section B* offers a framework for cooperation and coordination of liquidation authorities in a cross-border context. *Section C* focuses on recognition of foreign proceedings and assistance and relief by host jurisdictions and affected jurisdictions[236] 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. Finally, *Section E* provides guidance on the liquidation of a bank that forms part of a cross-border group, focusing on cooperation and coordination between liquidation authorities across borders. With regard to banking groups, this Chapter should be read with *Chapter 9. Group Dimension*.

B. Cooperation and allocation of competences between home and host authorities

1. Introduction

414. The legal framework should ensure a clear allocation of competences and the smooth cooperation between liquidation authorities and liquidators in different jurisdictions, and with administrative authorities in oversight, preparation, and contingency planning (see *Chapter 4. Preparation and Cooperation*), with due regard to the need for confidentiality. These principles should be compatible with international guidance, importantly, 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

[235] *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) (hereinafter Davis et al).

[236] 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.

authorities from foreign jurisdictions. The Recommendations in this Section aim to assist legislators in developing such provisions.

2. General principle: achieving cooperative solutions

415. 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 (KA 7.1). 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) (KA 7.5). The same should apply, *mutatis mutandis*, in bank liquidation proceedings. Coordination between liquidation authorities, administrative authorities and appointed liquidators across jurisdictions is key to ensuring the smooth liquidation of a failed bank with cross-border activities.

416. The legal framework should empower and encourage the liquidation authority, relevant 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.[237] The legal framework should not unduly restrict the possibility of achieving cooperative solutions by, e.g., preventing recognition in the absence of reciprocity, or by triggering automatic 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

417. In line with the *FSB Key Attributes* (KA 7.3), the legal framework should ensure that 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 a foreign home authority. The legal framework should also vest the authority with powers to take measures on its own initiative, where the home jurisdiction 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, giving notice to and consulting the foreign home authority.[238]

418. Furthermore, in line with KAs 7.6 and 7.7, the legal framework should allow administrative liquidation authorities to exchange information with foreign administrative authorities and liquidators where necessary for the preparation and implementation of a liquidation strategy. Such exchange may include confidential information, provided that the authorities are satisfied that this information will be used for purposes of liquidation and is subject to confidential treatment. Banking authorities may benefit from existing cross-border cooperation mechanisms with their counterparts in other jurisdictions (see subsection 6 below).

419. The legal framework empowering a liquidation authority to appoint a liquidator to act under its direction (see Chapter 2. Institutional Arrangements, 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/or appointed liquidators in foreign jurisdictions.

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[237] *FSB Key Attributes*, KA 7.1; see also *FSB Principles for Cross-border Effectiveness of Resolution Actions,* Principles 1-3.

[238] See also *FSB Key Attributes Assessment Methodology for the Banking Sector*, EN 7 (h), which specifies that this should be understood as the host authority being required to make good faith efforts to communicate with the home authority about the nature of its concerns and the actions it proposes to take, while the host authority's decisions do not require the consent from the home authority.

4. Implications for different institutional models: flexibility to achieve the cross-border effectiveness of liquidation measures

420. The mechanisms for achieving cross-border cooperation may vary depending on the institutional model of the jurisdictions involved (see *Chapter 2. Institutional Arrangements*). Administrative liquidation authorities have the advantage of early cooperation with foreign authorities (see *Chapter 2. Institutional Arrangements*, *Section C*, *subsection 4*), which is key, for example, where DIs must pay out depositors within a short period.[239] In court-based models, courts typically only exercise their powers after a formal application and a judicial determination that a court-appointed liquidator cooperate with foreign liquidation authorities. The legal framework should seek to ensure timely and expeditious cooperation between banking authorities even when court-based jurisdictions are involved. Banking authorities, for their part, are subject to their mandate, which 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 mandate. Instead, the legal framework should anticipate such differences and make adequate provision for them.

421. The *FSB Key Attributes* (KA 5.4) state that resolution authorities should have the capacity to exercise resolution powers with the necessary speed,[240] 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 (KAs 1.13 and 5.4).[241] 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.[242]

422. Consistent with this approach, in jurisdictions with court-based systems, 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 authorities or appointed liquidators in proceedings before local courts. Where a court order is necessary to adopt certain measures, a procedure should be available to obtain it in an expedited manner. Furthermore, in a court-based liquidation where 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.[243] Court review of liquidation measures by administrative authorities need not result in reversal of such measures, and shifts to *ex-post* determination of compensation (see *Chapter 2. Institutional Arrangements*, *Recommendation 6*)[244] should be maintained in cross-border cases.

5. Coordination of proceedings

423. Liquidation authorities in home, host, and affected jurisdictions should retain their own jurisdiction and competences. At the same time, the legal framework should facilitate coordination of the decision-making process 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

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239 According to *IADI Core Principles,* CP 15, EC 1, DIs should be able to reimburse most depositors within seven working days.

240 *FSB Key Attributes*, KA 5.4.

241 *FSB Key Attributes*, KAs 1.13 and 5.4.

242 *FSB Principles for Cross-border Effectiveness of Resolution Actions,* at 5-6.

243 Banking authorities could be granted a special role in the process (e.g., hearing their testimony), see *Chapter 2. Institutional Arrangements*.

244 *FSB Key Attributes*, KA 5.5.

liquidation authority to conduct a decision-making process in coordination 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 administrative authorities and *vice versa*. This coordination includes notice and the rights of interested parties to communicate their views or be heard, to simultaneously bring the parties together to share information and discuss and resolve conflicts, minimising delays.[245] 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.

6. Cooperation mechanisms

424. *Ex-ante* 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 (KAs 8 and 9). Such cooperation arrangements may also be relevant for non-systemic banks, for instance if they are part of a systemically important group. Moreover, administrative liquidation authorities from different jurisdictions may further cross-border cooperation by benefiting from existing MoUs or concluding new MoUs. 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 (CP 5). Specifically, bilateral or multilateral agreements should clarify the responsibilities of DIs in specific cross-border situations (CP 5, EC 2).

425. The legal framework should not impede administrative authorities from benefitting from 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. 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 to access to information by, or cooperation with, foreign courts.

Recommendations 95 – 98

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 Considerations

- The mechanisms or arrangements for achieving cooperative cross-border liquidation should be tailored to the specific institutional (administrative or court-based) model.

Recommendations irrespective of the institutional model

95. 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*

[245] See also *UNCITRAL MLEGI*, Article 12; *UNCITRAL Legislative Guide* Recommendation 245.

Resolution Actions. In particular, in line with KAs 7.1, 7.6 and 7.7, the legal framework should:

(a) Empower and strongly encourage the liquidation authority and any appointed liquidator(s) wherever possible to act to achieve a cooperative solution with foreign authorities and liquidator(s);

(b) Authorise and encourage communication, subject to confidentiality provisions, and coordination between liquidation authorities, any appointed liquidators, and banking authorities in different jurisdictions at an early stage, including in respect of decision-making processes, determining any rights, cooperating to develop possible paths for orderly liquidation, formal recognition of proceedings in other jurisdictions or adoption of support measures, agreement on contingency plans or solutions and coordination of proceedings;

(c) Ensure that authorities in host jurisdictions be duly informed of the liquidation proceeding in the home jurisdiction and actions taken, receive notices, and be given the opportunity to be represented in the decision-making process; and

(d) Authorise liquidation and banking authorities and liquidators to exchange information with foreign liquidation and banking authorities and liquidators, subject to the preservation of the confidentiality of information.

96. In line with the *IADI Core Principles*, deposit insurers should enter into information sharing and coordination arrangements with other deposit insurers in relevant jurisdictions.

Recommendation for jurisdictions that provide for court involvement

97. The legal framework should:

(a) Facilitate the participation of foreign administrative liquidation authorities or the liquidator appointed by them before local courts, and the participation of competent authorities supervising branches or subsidiaries, where appropriate;

(b) Contemplate expedited procedures for obtaining court orders where such orders are legally 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

98. The legal framework should not impede administrative liquidation authorities from benefitting from 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 with other liquidation or banking authorities, subject to the protection of the confidentiality of the information shared.

C. Recognition of foreign proceedings and support measures[246]

426. Recognition and support measures should be swift and should enable actions of a liquidator or provisional liquidator to have effect in a host jurisdiction. The *FSB Key Attributes* (KA 7.5) specify

[246] 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

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 "support" measures under the domestic regime. Such recognition or support 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.[247] Recognition or support of foreign measures should be subject to the equitable treatment of creditors in the foreign proceeding.[248]

427. 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 support 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 by both the home jurisdiction's authority and representative, taking into account the need for timely action. Recognition and support 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*.

428. Where the host or an 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. In particular, under both administrative and court-based models, the legal framework should allow for local recognition of proceedings administered by a foreign administrative authority. The legal framework of the home jurisdiction should 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.

429. 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.[249] Recognition is subject to adequate safeguards being met (*Section D* below).

430. The legal framework should also have the necessary flexibility to provide support measures for foreign liquidation measures in case recognition proceedings are not feasible or desirable.[250] In particular, the legal framework should grant discretion to administrative liquidation authorities to use

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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)).

[247] *FSB Principles for Cross-border Effectiveness of Resolution Actions,* at 12.

[248] *FSB Key Attributes*, KA 7.5.

[249] *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).

[250] 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.

their powers to support foreign measures, if necessary, by opening a liquidation proceeding in the host jurisdiction. Liquidation authorities and liquidators in the home jurisdiction, for their part, 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. For example, the legal framework may facilitate the appointment of the same liquidator as in the home jurisdiction, but also to appoint a liquidator who coordinates with that liquidator in the home jurisdiction. 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.

431. Recognition and support may also take the form of deference to the home forum process and law, in line with KA 7.5, which provides that recognition and support "*would enable a foreign home resolution authority to gain rapid control over the firm (branch or shares in a subsidiary) or its assets that are located in the host jurisdiction, as appropriate, in cases where the firm is being resolved under the law of the foreign home jurisdiction*." Support may alternatively be granted by means of applying domestic (host forum) equivalent measures which are consistent with the home country actions.

Recommendations 99 – 102

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

99. Subject to the safeguards indicated in *Section D* below, the legal framework should empower administrative and judicial liquidation authorities to promptly recognise the opening of liquidation proceedings and liquidation measures taken in another jurisdiction, 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. Recognition and support measures for cross-border liquidation should also be available to support cross-border resolution action.

100. The legal framework should grant discretion to administrative authorities to use their powers to support foreign liquidation proceedings. Such powers may be conferred on liquidation authorities, where liquidation measures are required, or banking supervisors, where supervisory measures are needed, provided that the prudential conditions for the use of such powers are met. Both liquidation authorities and banking supervisors should also enjoy discretion to abstain from adopting liquidation or supervisory measures where such abstention may 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.

101. 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. This recognition may happen by means of recognising foreign proceedings, and adopting any measure the home authority is authorised to take during

the liquidation proceeding, or by adopting measures under local liquidation or supervisory law. The measures should include the following non-exhaustive list:

(a) Entrusting the administration or realisation of assets located in the host's own jurisdiction to the foreign home liquidation authorities;

(b) The appointment of the same liquidator as in the foreign jurisdiction, or of a local administrator or liquidator, in coordination with the home authority and liquidator;

(c) 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;

(d) Ordering the transfer of assets and/or liabilities of the failed bank as a going concern, or the segregation of assets to satisfy depositors;

(e) 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;[251] and

(f) 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 97 (b).*

Accommodating parallel proceedings

102. 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.

D. Safeguards (grounds to refuse recognition, support, or cooperation)

432. While liquidation authorities must be granted ample powers to deal with cross-border bank liquidation through effective cooperation, authorities in host jurisdictions and affected jurisdictions must retain the needed degree of control over the acts affecting assets, creditors, debtors, branches and/or subsidiaries in their own 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.[252] 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*.

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[251] 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.

[252] 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*.

433. 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 undermine the effectiveness of cross-border cooperation. Each jurisdiction should construe the public policy safeguard with clear, transparent, and narrowly defined contours to guide the application of the safeguard in a specific case. Refusal to recognise or support a foreign liquidation measure based on the public policy exception may be justified, for instance, where the foreign liquidation or resolution proceeding fails to provide for equitable treatment of creditors;[253] discriminates against creditors on the basis of their nationality, location of their claim or jurisdiction where it is payable, including where liquidation measures manifestly discriminate against the rights of local creditors by giving differentiated treatment for home and foreign creditors; or where basic standards of fairness are manifestly breached. Recognition, support, or cooperation may also be refused on the basis of a material adverse effect on the financial stability of the local markets or would have material fiscal implications.

434. Where discrimination is limited to a certain ancillary decision, refusing 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 manifest discrimination.

435. The Recommendations below seek to advance the principles of cross-border cooperation, coordination, and recognition of home jurisdiction strategies adopted, by ensuring that home and host jurisdictions duly consider the impact of actions on other jurisdictions involved or impacted. The Recommendations also have the objective of allowing authorities in host jurisdictions and affected jurisdictions to retain the needed degree of control, even where coordinated or centralised proceedings take place in a home jurisdiction, regarding acts affecting assets, creditors, debtors, branches, and/or subsidiaries in their own jurisdiction, on the basis of certain fundamental safeguards.

Recommendations 103 – 105

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

103. In line with FSB standards and implementation guidance,[254] the process for giving effect to foreign measures should be guided by the principle of equitable treatment of creditors and should not have adverse fiscal and financial stability implications in the host jurisdiction or be contrary to the public interest.

Ensuring that the process is fair and efficient

104. 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

253 *FSB Key Attributes,* KA 7.5.

254 *FSB Key Attributes*, KA 7.5 and *FSB Principles for Cross-Border Effectiveness of Resolution Actions,* Principle 3.

(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

105. The legal framework should allow authorities in host countries to refuse to recognise, support, or cooperate with the home jurisdiction or with other host jurisdictions and to take appropriate local actions (e.g., commencing liquidation proceedings by host authorities if the home authority does not take appropriate actions), where such recognition, support or cooperation would be contrary to the public policy of the State. Recognition, support, or cooperation may also be refused on the grounds that it would have a material adverse effect on the financial stability of the local markets or material fiscal implications.

E. Liquidation of cross-border groups

436. The liquidation of banks that form part of a group and operate across borders can benefit from the Recommendations included in the previous Parts, while presenting certain unique challenges (see *Chapter 9. Group Dimension*). Bank subsidiaries (i.e., that have separate legal personality) may form part of an integrated and centrally controlled group, which is often the case in smaller and medium-sized banks that centralise financial and control processes to control costs. Thus, to achieve the aims of orderly, efficient liquidation, it may be important to coordinate the liquidation proceedings of such banks within groups. In other cases where banks within a group may operate more independently, coordination may still desirable to achieve optimal liquidation solutions. At the same time, the challenges of achieving such coordination in practice must be acknowledged.

437. The administrative authorities that are responsible for the supervision and liquidation of entities belonging to a single group in different jurisdictions should be allowed and strongly encouraged to cooperate in advance to prepare for the liquidation (see *Chapter 4. Preparation and Cooperation*, *Recommendation 41*, which should also apply in a cross-border context).

438. The Recommendations on recognition of and support to foreign liquidation measures should apply in the case of cross-border groups with proper adjustments. The legal framework should empower the liquidation authority or the appointed liquidator to approve the implementation of cross-border agreements for the coordination of proceedings relating to the same banking group, in order to recognise the importance of timely action to preserve value. It should allow the authorities to make and implement such agreements before the lapse of the applicable deadline for DIs in the home and relevant host jurisdictions to pay out insured deposits.

439. The fact that communication and cooperation are taking place between liquidation authorities across borders should not change the responsibilities and powers of those authorities.[255] Each liquidation authority should be entitled at all times to exercise its independent jurisdiction, power, and judgment with respect to matters presented to it and the conduct of the parties involved in the process.[256]

440. In the rare case where assets or liabilities are highly integrated, or in case 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 from obtaining more than

255 See also Article 11, *UNCITRAL MLEGI*; *UNCITRAL Legislative Guide,* Recommendation 244.

256 *FSB Key Attributes*, KA 7.2.

the creditor would otherwise obtain in one liquidation proceeding, by claiming in more than one liquidation proceeding.

Recommendations 106 – 108

Powers of liquidation authorities/liquidators in case of liquidation of a cross-border group

106. The legal framework should entitle the liquidation authority or the appointed liquidator to approve the implementation of cross-border agreements concerning 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.

107. Cooperation and coordination should not:

(a) Change the responsibilities and powers of those authorities, and the liquidation authority should be entitled at all times to exercise its independent jurisdiction, power, and judgment;

(b) Imply a waiver or compromise by the liquidation authority of any powers entrusted to, or responsibilities allocated to such authority.

108. The legal framework should:

(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 different proceedings in different jurisdictions for the liquidation of individual entities of the same group;

(b) Facilitate procedural cooperation 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.