Resolution of Cross-Border Banks: A Proposed Framework for Enhanced Coordination

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INTRODUCTION

The recent financial crisis has given renewed urgency to the need for resolution systems for financial institutions that both safeguard financial stability and limit moral hazard. However, experience demonstrates that these systems will not be effective unless progress is also made in developing a framework that applies on a cross-border basis. Since many systemically important financial groups operate globally, an uncoordinated application of resolution systems by national authorities will make it much more difficult to both secure the continuity of essential functions (thereby limiting contagion) and ensure that shareholders and creditors bear the financial burden of the resolution process.

This chapter responds to calls from the G-20 leaders who, at their London Summit in April 2009, agreed “to support continued efforts by the IMF, FSB, World Bank, and BCBS to develop an international framework for cross-border bank resolution arrangements.” At their summit in Pittsburgh in October 2009, the G-20 leaders called for the development of “resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in future” (G-20, 2009a, 2009b). The chapter builds on the work of the Basel Committee’s Cross-Border Bank Resolution Group (BCBS, 2010f).

The call for work on this issue arises from two related considerations. First, the establishment of an effective framework for the resolution of financial institutions is essential to any strategy that seeks to both secure financial stability and limit moral hazard. The recent crisis demonstrates the extent to which the existing system may force national authorities to choose between two equally unattractive options: (i) a bailout that does not fully allocate losses to shareholders and creditors; or (ii) reliance on an insolvency regime that is ill-equipped to restructure...
financial institutions in a manner that both preserves value and safeguards financial stability. Accordingly, a key objective is to establish a resolution mechanism that will facilitate rapid and preemptive action by the authorities to preserve business continuity while restructuring an institution in a manner that allocates all losses to shareholders and creditors as promptly as possible, consistent with financial stability objectives.

Second, a resolution framework will be ineffective unless it is accompanied by a robust cross-border coordination mechanism. Although large, complex financial institutions operate globally, their resolution is subject to national legal frameworks. There are two possibilities in this context:

- **A far-reaching solution** to this problem would be the establishment of an international treaty that would obligate countries to defer to the resolution decisions of the jurisdiction where the financial institution or group has its main activities. There are examples in other areas of international relations where treaty frameworks of this kind have been put in place (e.g., regulation of shipping accidents) but the adoption of such an approach in the area of financial regulation would necessitate a considerable sacrifice of national sovereignty and does not appear to be feasible in the foreseeable future. Given their concerns over financial stability and the potential fiscal costs of bank failure, the authorities of many countries have been unwilling to surrender control over these issues.

- In these circumstances, the most realistic approach, at least in the medium term, is one that focuses on enhancing coordination among national authorities, something that has generally been lacking. Indeed, unless such coordination is achieved, it may be argued that financial stability concerns may require a “de-globalization” of financial institutions so that they fit within the existing local resolution frameworks. But such de-globalization would result in significant efficiency losses and could undermine emerging market access to capital markets and the expansion of international trade more generally (these issues are discussed in more detail in Chapter 11).

Recognizing the benefits of globalized financial institutions and the difficulty of establishing an international treaty that would be signed by a broad range of countries, this chapter discusses key elements of a pragmatic framework for enhanced coordination. Although the implementation of such an approach is likely to require modifications to the domestic laws of some countries to give their national authorities the mandate to coordinate their resolution actions with other jurisdictions, national authorities would only be required to do so to the extent that, in their judgment, coordination is consistent with the interests of creditors and financial stability.

This chapter uses the term “resolution” broadly and generically to refer to the full range of recovery and resolution activities that involve public intervention (whether privately or publicly funded), including, for example, mergers and acquisitions, equity recapitalization, debt-for-equity conversions, transfers of assets and liabilities, temporary administration, reorganization, and liquidation.

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2The only exception may be on a regional basis among closely integrated groups of countries.
The issues addressed in this chapter apply to the resolution of international financial groups. For some international financial groups, a banking business will be their main activity. However, many cross-border banks exist within financial groups whose activities extend far beyond simple deposit-taking and lending to cover a full range of nonbank financial activities. Moreover, some of the most systemically risky international financial groups are, at their core, investment banks and broker-dealers that conduct little or no deposit-taking activity. Although the substantive elements of resolution regimes for banks and nonbank financial institutions of course differ, in a number of respects the mechanisms for coordinating resolution actions are similar for banks and nonbanks. Although not all of the entities within a group will be regulated, it is assumed that many of them will be, given their systemic importance.

Effective supervision—whether nationally or in a cross-border context—is an essential component of any effective crisis prevention framework; however, it is not the focus of this chapter (this issue is discussed in detail in Chapter 5). No matter how effective supervision is, failures of financial institutions will continue to occur and, for this reason, supervision is not a substitute for credible resolution mechanisms. Nonetheless, it would be appropriate for a country to require that the existence of a robust supervision framework in other countries be a precondition for establishing cross-border resolution-coordination frameworks with them. Effective supervisory coordination is, therefore, a key element of the enhanced resolution coordination framework that is discussed here. In this context, the existence of an effective resolution framework will likely enhance supervision and reduce the risk of “regulatory forbearance” by giving national authorities credible resolution options.

The rest of the chapter is organized as follows. The next section examines the growth of cross-border financial services and the challenges involved in effectively supervising and resolving international financial groups. The third section identifies a possible way forward, setting out the essential features of an international framework for cross-border resolution.

THE STATUS QUO—AND ITS COSTS

The Globalization of Financial Institutions

Financial globalization has led to the emergence of a large number of international financial groups. Cross-border banking has expanded rapidly over the last decade. Many large banks now rely on a global network of branches and subsidiaries, with centralized funding that is distributed within the financial group under a global strategic plan. The activities of these groups have expanded beyond traditional deposit-taking and lending to include a range of nonbank financial activities, such as securities and insurance brokerage and fund and asset management. In addition to these universal banks,4 the international space is now dominated by several large financial institutions that operate across borders, in

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3 Some financial groups are also headed by large, internationally active insurance companies.
4 “Universal bank” in this sense refers to the wide range of financial sector activities, irrespective of the international reach of the group.
multiple currencies and time zones, and that act as systemically important nodes within a globalized market for capital. Several factors drive the globalization of financial services:

- **Financial liberalization.** In recent years, many countries have eliminated barriers to the entry of foreign financial institutions.
- **Risk diversification.** The opportunity for financial institutions to expand abroad allows them to diversify their risk, reduce reliance on their home markets, and seek new business opportunities in overseas markets.
- **Servicing of key corporate clients.** As corporations have expanded abroad, large banks have followed them to support and profit from their expansion plans.
- **Brand value in emerging markets.** An internationally recognized brand with a local presence in foreign markets can rapidly gain market share abroad.

The legal form of a complex financial group may not always reflect the economic substance or operational functions of that group (see also Chapter 11, which discusses in more detail the factors affecting the choice, and relative merits, of different organizational structures for efficiency and stability). Several different factors may influence its structure and organization in ways that go beyond legal considerations.

- **Commercial factors/operational efficiency.** Groups may choose to organize their operations according to business lines, using matrix management structures that do not reflect the relationships between legal entities. Often a large group will organize itself with centralized functions for the entire group, such as capital and liquidity management, risk management, and IT, so that its subsidiaries, while legally separate, may have no *de facto* independence.
- **Separability/location of assets.** Activities carried out in a host jurisdiction may reflect decisions taken in a remote home state rather than locally. For the group, this may be an efficient allocation of resources. For example, domestic Swedish deposits supported the expansion of Swedish banks in the Baltic region, and similarly, much of Dexia’s lending to French regional governments was funded using Belgian deposits.
- **Regulatory factors.** Formal requirements may be imposed by home or host national authorities for the establishment and development of cross-border financial activities.
- **Tax treatment.** The structure and organization of the group may be influenced by tax considerations.

In some circumstances, a financial group may effectively function as a single entity—in particular where a guarantee has been issued by the parent for the components of the group. As a result of the interconnectedness of the financial group’s legal entities, weaknesses in one entity can adversely affect the entire group. In group structures where liquidity is centralized, any sudden and material downgrading of the central entity’s credit ratings or the opening of insolvency proceedings against it would lead to the immediate illiquidity of the other entities.
in the group. The triggering of cross-default or cross-guarantee arrangements for funding purposes, whether resulting from rating downgrades or otherwise, may also lead to financial distress in other parts of the group.

Moreover, the scale of activity or the size of an international financial group may create systemic risks for either the home or the host jurisdiction when such a group enters into financial distress. Certain branches or subsidiaries may, in economic terms, be comparatively insignificant to a group, yet be of critical importance to its host country’s financial system. In the case of a subsidiary in this position, its legal separateness may as a legal matter permit the parent bank to simply “walk away” should the subsidiary encounter difficulties, irrespective of the impact on the host country economy. However, “abandoning” a subsidiary in such a manner would involve reputational risk and could be counterproductive for the stability of a financial group.

**Localized Resolution Frameworks**

Although international financial groups operate globally, the frameworks for addressing their distress and failure are local and apply to distinct parts of the group rather than to the group as a whole. By allowing financial institutions under their supervision to establish a presence in a range of jurisdictions, home authorities expose themselves to the reality that the legal frameworks for facilitating cross-border finance in stable periods are typically more effective than the cross-border resolution arrangements that are available in times of distress.

Although the existing fragmented approach is due to a number of factors, a fundamental one is the fact that resolution frameworks are established by national laws and, absent the cooperation of the national authorities of other jurisdictions, are only enforceable vis-à-vis those institutions—or branches of institutions—operating in their territory. In the absence of an international legal framework that empowers a supranational entity to resolve global institutions, the resolution of such institutions is subject to different national frameworks and, accordingly, national authorities must proactively coordinate their actions to avoid the significant costs of an uncoordinated approach.

Moreover, the legal frameworks of many jurisdictions do not sufficiently facilitate coordination. National frameworks in some jurisdictions do not sufficiently empower their supervisors or the relevant resolution authorities to share information with their counterparts in other jurisdictions. In the context of an ailing bank, the ring-fencing of assets by host jurisdictions may undermine an effective resolution. Home-country official administrators may face difficulties in having certain recovery operations, such as “purchase and assumption” transactions, implemented in the host jurisdictions of bank branches.

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5The knock-on effects on subsidiaries of Lehman Brothers are perhaps the clearest illustration of this problem in the context of nonbank financial institutions.
6Of course, the weaknesses of many countries’ bank insolvency frameworks go beyond questions of cross-border cooperation and include other areas, including the powers of the supervisors to take prompt and effective action to restructure a failing bank.
Effective coordination is also hampered by the absence of a minimum level of harmonization. National legal and regulatory frameworks often differ in key areas. In the context of bank insolvency, there is no universally agreed approach to such questions as what triggers should be used to commence insolvency proceedings or what powers are available to the supervisors to deal with an insolvent bank.

Even where there is a minimum degree of harmonization, the multiplicity of regulatory actors may impede coordination. A financial group, whose activities might cover a range of separately regulated banking and nonbanking activities, would potentially be subject to oversight from a number of different competent authorities, even at a purely domestic level. Not surprisingly, in the context of an international financial group, overlapping competencies and difficulties in discerning the scope of various national supervisors’ responsibilities are amplified.

Finally, and perhaps most importantly, when the regulatory authorities are faced with the distress or failure of a financial institution within their territory, they tend to give primary consideration to the potential impact on their own stakeholders, namely, creditors to branches or subsidiaries located within their jurisdiction, depositors, and, in the final analysis, local taxpayers. In these circumstances, national priorities translate into a “territorial” approach that effectively precludes coordination, where in the event of the failure of a domestic branch of a foreign bank, local assets are “ring-fenced” for the benefit of creditors to the branch. The practice of ring-fencing is geared toward favoring the interests of depositors and creditors to a bank’s local presence to the detriment of stakeholders in other jurisdictions (see Box 6.1). In contrast, universality implies no ring-fencing and instead would place all similarly ranked international creditors on an equal footing.

Although the national focus of resolution frameworks appears at odds with internationally coordinated supervisory frameworks, a closer examination reveals that even these supervisory frameworks are shaped by national concerns (see Box 6.2). Moreover, the implementation of such frameworks by some countries anticipates the ring-fencing approach they rely on during the resolution phase. For example, although licensed branches of foreign banks in the United States (and in some other jurisdictions) do not, as legal extensions of a foreign entity, have separate capital of their own, they are nevertheless required to deposit cash or eligible securities at approved depository banks to satisfy a “capital equivalency requirement” established by applicable law.

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7To the extent that an objection to ring-fencing is based on the unsettling of third-party expectations, this concern is sharper where the practice of ring-fencing is ad hoc (e.g., where it is in response to a particular crisis situation rather than part of a preestablished legal and supervisory framework).

8In the United States, for federally licensed branches of foreign banks, such requirements are set forth in section 3102(j) of the International Banking Act of 1978 (12 U.S.C.), which also requires any receiver of a federally licensed branch to take possession of all the property and assets of the foreign bank located in the United States and to prioritize payment of claims arising out of any transactions with a U.S. branch or agency of a foreign bank over the distribution of assets to the foreign bank directly or to any foreign liquidator or receiver of the foreign bank.
Territoriality and Universality

The approaches developed by countries for dealing with cross-border insolvencies (including of banks) fall by and large in one of the following two categories.

Universality—Under a “universal” approach, the insolvency proceedings initiated against the debtor in its home country will purport to have “universal reach.” This implies that the home-country trustee will seek to gain control over all of the debtor’s assets and liabilities—including those located in other countries—to realize all assets and pay out the resulting proceeds to both domestic and foreign creditors according to their ranking. To be effective, universality of the home country depends on different host countries recognizing this extraterritorial effect of the home-country proceedings. Such recognition is, however, far from evident for the reasons set out below.

Territoriality—Many countries follow some form of “territorial” approach, under which a host country will initiate separate insolvency proceedings against a foreign debtor, instead of participating in, or deferring to, the insolvency proceedings opened by the home country. Typically, territorial jurisdictions will ring-fence the assets and liabilities of foreign entities that are located in their territory in order to satisfy the claims of local creditors. To be effective, a territorial approach requires a sufficient amount of assets (and liabilities) to be located within the country. In the case of the local branch of a foreign bank, the effectiveness of ring-fencing is buttressed by supervisory rules requiring the branch to maintain sufficient local assets relative to their local liabilities.

These categories are not absolute, and several countries have insolvency regimes with mixed features. For instance, as regards cross-border banks, the United States is universal for locally domiciled banks but territorial with respect to branches of foreign banks. In a similar vein, the EU’s so-called “Winding Up Directive” follows an EU-wide universal approach for EU banks, but member states are free to maintain a territorial approach to branches of extra-EU banks.*

*The “Winding Up Directive” (Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganization and Winding up of Credit Institutions) provides a harmonized legal framework for the reorganization and winding up of EU banks under which the home-state authorities are exclusively responsible for the opening of insolvency procedures against the head office and all EU branches of an EU bank. Specifically, home-state authorities will steer, and home-state law will govern (with some exceptions), the insolvency procedures for all EU-wide assets and liabilities of the EU bank. The Directive does not, however, establish a common framework for the insolvency treatment of EU branches of extra-EU banks. While thus keeping national rules largely intact, the directive merely requires the various host state authorities of branches located in EU member states to “endeavor to coordinate their actions.”

This focus on national interest is also reflected in the mandates of many financial supervisors. With important exceptions (such as in the EU framework), these mandates typically emphasize the need to protect financial stability at the national—and not the international—level. Hence, when a group becomes distressed, the national supervisory authorities are likely to focus on domestic interests.
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The costs of the existing approach may be distilled as follows.

First, the absence of an effective cross-border resolution framework undermines financial stability in a number of different respects. Uncoordinated actions by national authorities may hasten the failure of a financial institution in a manner that destroys value. This could occur, for example, if during a period of stress the host jurisdiction required a transfer of assets to cover the liabilities of the branch and destabilized the bank in the home jurisdiction.9

BOX 6.2

**International Coordination in Banking Supervision**

Effective supervision at the international level has been promoted through the development of international standards and best practices that national authorities voluntarily implement through the enactment of legislation or the conclusion of memoranda of understanding with supervisors in other jurisdictions. The goal of these initiatives is consolidated supervision that aims at empowering bank supervisors with the tools necessary to understand, monitor, and, when appropriate, minimize the risks associated with an organization’s consolidated or group-wide activities.

Internationally agreed principles on the supervision of cross-border banking groups have been in place for several decades. The BCBS issued its first statement of principles or “Concordat” regarding the supervision of banks’ foreign establishments in 1975. These basic principles have been underpinned by further statements from the BCBS addressing cross-border supervision and home-host supervisory relationships. Since then, it has consistently called for international cooperation to ensure that no foreign bank operation evades proper supervision—including through the issuance of principles on cross-border supervision and home-host supervisory relationships.

These efforts have facilitated cooperation but have not been entirely successful in facilitating effective supervision at the international level. Despite progress made worldwide in the adoption of international standards on capital, risk management, accounting rules, and other prudential matters, national authorities are not yet able to construct a complete map of the key risks affecting financial firms on a consolidated basis. Problems include:

- **Legal constraints and regulatory perimeter.** In some cases, supervisors lack the legal authority to share information with foreign counterparts.
- **Divergences between supervisory approaches.** Although there may be agreement on the regulatory standards to be applied, they may be applied differently by different national supervisors.
- **Diverse reporting systems.** Different supervisory models lead to different reporting systems that hinder timely data compilation.

**The Costs of the Existing Approach**

The costs of the application of local resolution frameworks to global institutions may be distilled as follows.

First, the absence of an effective cross-border resolution framework undermines financial stability in a number of different respects. Uncoordinated actions by national authorities may hasten the failure of a financial institution in a manner that destroys value. This could occur, for example, if during a period of stress the host jurisdiction required a transfer of assets to cover the liabilities of the branch and destabilized the bank in the home jurisdiction.9

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9Similar problems may occur in the case of subsidiaries if supervisors have imposed restrictions on intragroup transfers (BCBS, 2010f).
Moreover, recourse to uncoordinated local liquidation proceedings may prevent a recovery effort that seeks to preserve the continuity of critical functions, thereby giving rise to contagion. For example, the efforts of the national authorities to preserve continuity through a purchase and assumption transaction may be stymied if the national authority that has jurisdiction over the branch is unwilling to allow for the necessary transfer of assets and liabilities and focuses exclusively on a liquidation designed to satisfy stakeholders.

Finally, in circumstances where a financial institution or group operates in numerous jurisdictions, the uncertainty as to how the various national authorities will coordinate their actions makes it very difficult for effective action to be taken quickly. Yet quick action is essential to any strategy that seeks to both preserve value and limit contagion.

Second, the existing framework exacerbates moral hazard. Given the financial stability problems that arise from uncoordinated national approaches, as described above, it is not surprising that a more tempting approach is to provide public bailouts without any effort to ensure that action is taken to ensure that shareholders and unsecured creditors assume the necessary losses before public funds are committed. Moreover, even if national resolution frameworks are relied on, an uncoordinated approach might not maximize the value of the institution or the group and therefore might increase the amount of financing that will have to be provided by a state. For example, a financial group operating in numerous jurisdictions may lose a significant portion of its franchise value—and therefore its attractiveness to potential private investors—if it is broken up along national rather than business lines. This is also true where the liquidation of a cross-border institution is implemented in a purely piecemeal manner.

Indeed, recent experience demonstrates that the more interconnected and integrated international financial institutions and groups become, the more disruptive and value-destroying uncoordinated local resolution actions are likely to be. The cases of Fortis and Lehman (Box 6.3) demonstrate how the existing approach may fail to realize coordination benefits in either a restructuring or a liquidation of an integrated cross-border institution.

POSSIBLE ELEMENTS OF ENHANCED COORDINATION FRAMEWORK

While the inadequacies of the existing framework are manifest, several options for improving the framework for cross-border resolution are available, each with its own advantages and disadvantages. Moreover, regardless of which steps are taken in relation to resolution, measures that address prevention and preparedness, including simplifying financial group structures where necessary to facilitate resolution, will also be of critical importance in the future (see Box 6.4).
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The Cross-Border Bank Resolution Group

Of the several international initiatives on cross-border resolution, the most important contribution to date has been that of the Cross-Border Bank Resolution Group (CBRG) of the Basel Committee on Banking Supervision (BCBS, 2010f). The group published its final Report and Recommendations on Cross-Border Bank

10For a more complete summary of the CBRG recommendations, see Appendix 6.1.
Initiatives Directed Toward Crisis Prevention

Since the start of the financial crisis, policymakers have developed several proposals to strengthen cross-border supervision and to reduce the likelihood of a large cross-border financial group falling into difficulty. Some of these proposals have already been implemented whereas others are under discussion.

Colleges of banking supervisors have been expanded now to almost 40 financial groups. Although colleges are not a new initiative, it is intended that home and host supervisors will have enhanced, direct, and frequent liaison with one another and with the banks on key issues such as risk management, capital, and liquidity, which in turn will enhance mutual trust among national authorities. To make these colleges more effective, however, amendments to national legal frameworks will in some cases be necessary—in particular to authorize the sharing of critical information between supervisors when the financial conditions of banks are deteriorating.

The Financial Stability Board (FSB) will identify jurisdictions that fail to implement internationally agreed standards concerning international cooperation and information exchange. The FSB will engage with such jurisdictions in order to bring them toward full compliance and, in some cases, may impose countermeasures.

Proposals are under consideration to: (i) discourage banks from engaging in activities that give rise to systemic risk through a systemic risk charge on “systemically important” institutions; (ii) make large complex financial institutions more resilient to shocks by increasing capital levels and buffers; and (iii) reduce the complexity of large financial groups (i.e., by “de-risking” cross-border firms and by “subsidiarization”).

Crisis management groups have been established under the auspices of the Cross-Border Crisis Management Working Group of the FSB for the major international financial firms. Formed of supervisors, central banks, and resolution authorities from the key home and host jurisdictions of the major international firms, they are tasked with developing recovery and resolution plans (RRPs) for these firms. RRPs can be useful tools for ensuring the preparedness of firms and authorities if they are used to identify measures that a firm and/or authority can undertake prior to a shock to facilitate more effective and coordinated recovery or resolution. This might include measures the firm should undertake to strengthen its capital position or liquidity buffer or to improve its ability to provide the detailed information needed quickly in a resolution. RRPs may also help identify measures the authorities should undertake to strengthen their resolution powers or incentivize structural changes in the firm.

Resolution in March 2010. Other important regional initiatives are also underway on cross-border resolution, including the European Commission’s consultations directed toward improving the EU framework for cross-border bank crisis management.

In its report, the CBRG observed that a number of alternative approaches to cross-border resolution are available:

- Full “universality” via a binding legal instrument, such as an international treaty. To be fully effective, the CBRG recognized that such a treaty would
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need to include substantive obligations related to key issues such as selection of lead authority and burden sharing.

• De-globalization of financial institutions. At the other extreme from a pure universal solution would be a uniformly territorial approach in which institutions would be separately structured for capital, liquidity, assets, and operations within each jurisdiction. By promoting the separate functionality of financial organizations through stand-alone subsidiaries, such an approach could contribute to the resilience of host country operations (see Chapter 11).

• A “middle ground” approach. The CBRG recognized that enhanced coordination among resolution authorities might provide a solution that steers a path between territoriality and universality. The CBRG recommended that national authorities develop procedures to facilitate the mutual recognition of crisis management and resolution proceedings and/or measures.

When evaluating the various alternatives identified by the CBRG, it is important to bear in mind a number of considerations.

First, the ongoing debate on the merits of universality versus territoriality is somewhat theoretical and, as recognized by the CBRG, is not entirely relevant to the existing problem. It is theoretical because, at least in the short term, it is very unlikely that all key jurisdictions will agree to sacrifice the degree of national sovereignty necessary to implement full universality. It is not entirely relevant because the debate applies exclusively to single entities (e.g., a parent bank and its branches) and is not applicable to the resolution of interconnected but separate legal entities within a group.

Second, the de-globalization of financial groups and institutions is problematic on a number of different levels. It would both reduce efficiencies and could undermine access to credit to emerging market economies. Although some reduction in the scope of the international activities of large international banks may contribute to financial stability, the presence of large international banks in emerging markets has, in some cases, strengthened the resilience of these markets. As has been demonstrated recently in Central and Eastern Europe, the financial support provided by parent banks to subsidiaries operating in member countries experiencing a financial crisis plays an important role in crisis resolution.11

In light of the above, this chapter proposes possible elements of a framework that would underpin the “middle ground” approach, one that would facilitate coordination across borders without requiring a surrender of national sovereignty. This framework draws on many of the achievements of the United Nations Commission on International Trade Law (UNCITRAL) in the field of cross-border corporate insolvency (see Box 6.5).12 While recognizing that the specific features

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11This financial support has been buttressed by the European Bank Coordination Initiative (“Vienna Initiative”) which was launched in January 2009 and served as a public-private sector collective action platform for dealing with home and host country issues relevant for large cross-border banking groups active in merging Europe.

12A more complete description of UNCITRAL’s initiatives in the area of cross-border corporate insolvency is set out in Appendix 6.2.
UNCITRAL and Cross-Border Corporate Insolvency

The United Nations Commission on International Trade Law (UNCITRAL) has been a driving force for progress in the development of an international framework for the coordination of cross-border corporate insolvency proceedings. An important achievement of UNCITRAL in this area is its Model Law on Cross-Border Insolvency (the “Model Law”), adopted in 1997. The Model Law is not a treaty but, as its name suggests, a model that countries may voluntarily incorporate into their domestic legal frameworks.

The Model Law applies to the insolvency of a single firm with a presence in foreign jurisdictions. It does not apply to types of entities for which special insolvency regimes may exist in national law—in particular, banks and insurance companies. Moreover, it does not apply to corporate groups comprised of legally distinct subsidiaries or affiliates. The insolvency of corporate groups is currently the subject of a separate UNCITRAL project—the preparation of a legislative guide on the treatment of enterprise groups in insolvency.

The Model Law sets out a framework for managing the insolvency of a cross-border financial firm in a fair and orderly manner. A central feature of the Model Law is the principle under which the courts of one jurisdiction will “recognize” proceedings in another jurisdiction. Importantly—and of particular relevance to the issues discussed in this chapter—recognition generally permits, but does not require, the court to grant relief to a foreign insolvency representative if it determines that the interests of the debtor and creditors would be protected. While some aspects of the framework contemplated in the Model Law may not be entirely appropriate for the insolvency of a cross-border financial group, other features are of great relevance, including the following.

- **Center of Main Interest.** The Model Law distinguishes between the “main” and “non-main” insolvency proceedings respecting an enterprise. In identifying the main proceeding, the Model Law looks to the jurisdiction in which the debtor has its “center of main interests.”
- **Cooperation.** The Model Law provides legal authority for insolvency representatives in different jurisdictions to collaborate with each other (via direct communication and information sharing) and to coordinate concurrent insolvency proceedings.
- **Discretionary Relief.** With one exception (i.e., an automatic stay on execution in connection with a foreign “main” proceeding), the granting of relief to a foreign representative is at the discretion of the court. Moreover, it is subject to conditions. In particular, the court must ensure that the debtor and its creditors are adequately protected. The Model Law forbids discrimination against foreign creditors.
- **Protocols.** The framework for cooperation set out in the Model Law has been very effectively supplemented through the negotiation of protocols on cooperation between insolvency officials in individual cases. Protocols are formal agreements typically negotiated through professionals representing major interests involved in insolvency. They are normally approved by relevant courts. Since the adoption of the Model Law in 1997, a huge body of protocols has been negotiated.
of corporate insolvency are not applicable to the financial services industry (in particular, a financial institution’s resolution will generally be led by specific resolution authorities rather than courts), IMF staff is of the view that two elements of the approach developed by UNCITRAL are of potential relevance. First, while a court is required under the UNCITRAL framework to “recognize” the existence of insolvency proceedings in other jurisdictions, it retains broad discretion as to the degree to which it will actually defer to the decisions and requests made by the courts and insolvency officials in such jurisdictions. Second, UNCITRAL addresses a number of the specific procedural issues that can hamper coordination as a matter of practice.

It is recognized that, in the context of financial institutions, the host authorities will only feel that they can cooperate with the home authorities if they have confidence that the home authorities are willing and able to take effective action. Indeed, the “universalist” framework that exists in the European Union is a product of a very high level of integration among the countries of the EU (see Box 6.1). Although it is recognized that this level of integration would be difficult to replicate outside the EU, the proposed approach recognizes the need to have some minimum commonality of resolution and supervision systems in order for cross-border cooperation to be effective. Accordingly, and as a supplement to the two elements derived from the UNCITRAL framework described above, the approach proposed here would identify certain “core coordination standards” that countries would need to have in place in order to be eligible to participate in the enhanced coordination framework.

Taking into account the above analysis, the proposed approach envisages the establishment of an enhanced coordination framework. The framework would be put in place through a nonbinding multilateral understanding reached among those countries that are in a position to adhere to its various elements.13 These elements would include the following:

• *Facilitating coordination.* The modification of domestic laws that would require national authorities to coordinate with foreign jurisdictions—but only to the extent that, in the judgment of the national authority in question, such coordination would be consistent with the interests of creditors and domestic financial stability.14

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13 This approach does not preclude countries from establishing deeper coordination mechanisms in the context of single financial markets or monetary unions. Some monetary unions (e.g., in central Africa and the Eastern Caribbean) already have single bank supervisory and resolution authorities, with a common bank resolution framework. The EU similarly has a common legal framework for bank resolution, but lacks a single resolution authority (see Box 6.1).

14 As of the date of this writing, one version of legislation pending in the United States would require the Federal Deposit Insurance Corporation (FDIC) to cooperate with foreign competent authorities to the maximum extent possible on the liquidation of systemically important financial companies that have assets or operations in any country other than the United States (see *Restoring American Financial Stability Act of 2010*, §210(a)(1)(N), as passed by the Senate, May 20, 2010). Another version could potentially require the FDIC to coordinate with foreign competent authorities on the dissolution of foreign subsidiaries of systemically important financial companies (see *Wall Street Reform and Consumer Protection Act of 2010*, §1609(a)(1)(L), as passed by the House of Representatives, December 11, 2009).
• Identification of “core coordination standards” that would be used to identify those countries with which a more coordinated cross-border resolution would be expected to take place.15

• Funding the resolution process. Recognizing that public funding in the resolution process may, on occasion, be needed, if only on a temporary basis, the establishment of principles that would set forth the criteria and parameters to guide the burden sharing process among the members of the enhanced coordination framework.

• Specification of coordination procedures to be relied on by those countries that adhere to the enhanced coordination framework. Each of these four elements is discussed in greater detail below.

Facilitating Coordination

The authorities of a country would be required to coordinate with resolution authorities in other jurisdictions, but only to the extent that the authorities determine that such coordination is consistent with their own national interests. More specifically, members would ensure that their domestic legislation required national authorities to coordinate their resolution efforts with their counterparts in other jurisdictions to the maximum extent consistent with the interests of creditors and domestic financial stability. In determining whether a coordinated approach is consistent with the interests of creditors, the national authorities of a host jurisdiction would assess whether, under a coordinated approach, creditors to branches or subsidiaries located in their territory are likely to receive at least what they would receive had the branch or entity been liquidated on a territorial basis by the host jurisdiction. Of course, a coordinated approach that is consistent with the interests of creditors may still involve the imposition of losses upon creditors. National authorities would continue to retain the discretion to act independently if, in their judgment, such action were more consistent with the interests of creditors and financial stability.16

At present, there are cases where a country’s framework does not sufficiently facilitate coordination.17 For example, in some jurisdictions, existing laws may effectively prevent competent authorities from sharing information with foreign competent authorities.18 Moreover, local law may encourage the ring-fencing of assets of the branch of a foreign bank for the benefit of the creditors of the branch. In addition, attempts by the national authorities of the home jurisdiction

15Although it would be possible to require such coordination through a binding international treaty, such an approach is not proposed in this chapter.
16A country’s legal framework could also permit its authorities to coordinate with jurisdictions that do not meet the elements described in this chapter.
17Even where the law, by its terms, may not preclude cooperation, there may be practical obstacles to effective coordination.
18In some countries, a bank supervisor will only be permitted to share information with foreign bank supervisors but not with supervisors of other aspects of a foreign country’s financial system or with separate resolution authorities.
to continue critical operations of a bank through a purchase and assumption transaction may be frustrated by the regulatory actions of the host authorities with respect to branches falling under their control.

**Coordination Standards**

Even if domestic legal frameworks are modified to establish a coordination mandate, subject to the interests of creditors and financial stability, experience demonstrates that the national authorities will only be willing to coordinate their activities if they have adequate confidence in their counterparts. To that end, the objective would be to identify certain standards that countries would be expected to adhere to as a condition for cooperation. As a matter of practice, it would be presumed that all countries that meet these standards would be expected to coordinate their activities with each other in the context of a resolution, it being recognized that this presumption could always be rebutted by a national authority that had reached the judgment in a particular case that independent action was necessary to protect financial stability or the interests of creditors. 19 Three standards would appear to be the most relevant: minimum harmonization, robust supervision, and institutional capacity. Each is discussed in turn.

**Minimum Level of Harmonization of National Resolution Rules**

Host-country authorities will only be willing to cooperate with home-country authorities if their national frameworks have a reasonable level of high quality convergence. In particular, the legal framework of the authorities involved in group-wide resolution will need to share certain key features:

- **Nondiscrimination against foreign creditors.** With respect to jurisdictions where branches of foreign banks are located, the authorities of the host countries will need to be satisfied that other countries’ resolution procedures will not discriminate against the creditors of the local branch, including depositors and, by extension, deposit guarantee schemes, and governments. Domestic depositor preference in the home country, based on the nationality or location of the depositor, would be inconsistent with this principle.

- **Effective intervention tools.** Many countries are recognizing the need for special bank resolution regimes and official administration procedures that allow competent authorities to intervene rapidly and in a manner that both preserves the critical functions of the institution and avoids contagion. Strengthening countries’ domestic legal frameworks for resolution would, in itself, represent an important step forward, and work on developing best practices in this critical area is being pursued in a number of different

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19 An analogous approach is taken in Article 21.2 of the UNCITRAL Model Law, which provides that upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor’s assets located in this State to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in this State are adequately protected.
forums, including in the FSB. Among those intervention powers that are currently considered to be the most critical are the following:

- Early intervention authority, that is, the existence of common triggers that allow the authorities to take action well before balance sheet insolvency.
- Powers that would enable the authorities to unilaterally restructure the various claims of an institution; for example, debt-for-equity conversions or the reduction of the value of unsecured creditors.
- The authority to conclude mergers and acquisitions without shareholder consent.
- The unilateral power to transfer assets and liabilities to other institutions, including a bridge bank that would be established for this purpose, without the need to obtain the consent of third parties.
- The authority to provide bridge financing to facilitate the transactions described above.
- The ability to assume public ownership of an institution on a temporary basis, once its shareholders and unsecured creditors have absorbed the necessary losses.
- As a means of both limiting contagion and preserving critical operations, the temporary suspension of termination provisions contained in some financial contracts.

**Appropriate creditor safeguards.** The intervention powers described above may be exercised in pursuance of a public interest in financial stability. However, these powers potentially interfere with private contractual and property rights. Accordingly, rules on creditor safeguards and the judicial review of supervisory and recovery and resolution actions to ensure the equitable treatment of creditors are essential features of resolution regimes (see Box 6.6). Where a bank is resolved under a special resolution framework, compensation ought to be available to creditors to ensure that they are left no worse off in the resolution than if the firm had been allowed to fail and lapse into liquidation. Similarly, where resolution powers permit transfers of property, resolution regimes need to provide sufficient safeguards to stakeholders by protecting customer property rights, security interests, and financial collateral arrangements in financial contracts (including netting rights).

**Sufficiently robust and harmonized rules on priority.** At least for banks, it is necessary to have sufficiently robust and harmonized rules on priority that

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20Recently, the need for early intervention tools has been recognized in a number of international forums. See, for instance, the communication of the European Commission on “An EU Framework for Cross-Border Crisis Management in the Banking Sector” (EC, 2009). Attention is also being devoted to the possibility of requiring firms to issue contingent convertible securities that would recapitalize a bank in financial distress by converting to common stock upon the occurrence of certain triggers.
recognize the interests of host-country insured depositors and deposit guarantee scheme. If these rules in the home country do not ensure equal priority for the host country insured depositors and deposit guarantee scheme, the latter’s resolution authorities will have a strong incentive to choose a domestic solution. Arguably, this may require a broader harmonization of deposit guarantee scheme features, including the categories of insured depositors and the amounts of the protection.

**Robust Supervision**

For any host-country authority to accept the leadership of home-country authorities and to collaborate with other host authorities, the former will also...
need to be satisfied that the level of prudential supervision in the latter is of sufficient quality and that the relevant supervisors engage in consolidated supervision (e.g., including insurance firms and securities firms). It is true that for some types of financial institutions there already exists a set of broadly accepted international standards (e.g., the Basel Core Principles on Effective Bank Supervision). 21 Similarly, at least for banks, the Basel Concordat already includes the principle that host countries should not grant market access to foreign banks if the latter are not well supervised in their home jurisdictions (and vice versa).

Nevertheless, in light of the crisis, it is felt by many supervisory authorities that these standards have not brought about a sufficient increase in the quality of prudential supervision and the willingness of supervisors to intervene in all relevant countries. To coordinate with foreign resolution authorities, home resolution authority might thus require higher quality supervision and greater convergence on these points. The establishment of colleges of banking supervisors and the steps being taken by the FSB to promote global adherence to international cooperation and information sharing standards are measures in the right direction.

Institutional Capacity to Implement an International Solution

For host-country authorities to accept the leadership of home-country authorities and to collaborate with other host authorities, the former must feel comfortable that the latter can effectively implement an international solution. This will require an organizational structure and staff that is capable of acting swiftly across borders. Given that several of the largest financial groups are active in more than 30 countries, this might constitute an enormous challenge to overcome in and by itself. Obviously, supervisory colleges are a tool to build up such capacity, as well as the necessary contacts with host authorities so as to facilitate cross-border interinstitutional cooperation. 22 The coordination criteria described above could take the form of a set of international standards to which countries could choose to adhere. Adherence would indicate to other countries a capability to implement an international resolution.

21The establishment of colleges of banking supervisors and steps being taken by the FSB to promote global compliance with international cooperation and information sharing standards are measures in the right direction. These aim at ensuring that key core principles for effective supervision (covering licensing criteria, methods of ongoing supervision, and consolidated supervision) concerning cross-border banks and insurance and securities firms are fully complied with.

22At the same time, however, there is a risk that a supervisory college may engender "group think" among relevant supervisors and blur the delineation of responsibilities as to who should take action when an institution’s condition begins to deteriorate. These risks may be mitigated through the establishment of effective governance arrangements that, to strengthen public confidence in supervisory processes, should be made public.

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The Funding of Cross-Border Resolution

Although one of the key objectives of any resolution is to minimize the need for public funding, such funding may occasionally be needed, if only on a temporary basis. The question then arises as to whether and how agreements on financial burden sharing among national authorities should be an element of any cross-border coordination framework.

As noted above, one of the key objectives of the proposed framework is that the final cost of the resolution be borne by private stakeholders. Box 6.7 gives a
brief overview of how the final costs are typically allocated in both the liquidation and recovery of banks, and illustrates that it is more straightforward to impose losses through liquidation than through recovery action. In recovery, the equity position of pre-insolvency shareholders may be significantly diluted or completely wiped out, but imposing losses on existing creditors may be more difficult. As discussed earlier, a key objective is to design recovery tools that also allow for the imposition of haircuts (including through the establishment of the necessary legal basis for such an approach).

However, even if losses are imposed on creditors at the time of recovery, temporary public funding may still be necessary for a number of reasons. First, most legal frameworks do not have the necessary underpinnings for private sector “debtor-in-possession” type financing of bank resolution processes.23 Second, even if such underpinnings were available, private providers of funds would often have difficulty in organizing the funding and structuring the process within the urgent context that is typical to failures of large, systemic banks. This is particularly the case in the context of systemic turmoil when other financial institutions face generalized funding pressures. Faced with such market failure, up-front public funding provided by the ministry of finance or the central bank, as appropriate (with protection against future losses by the MOF), may be the only option. A partially prefunded “orderly resolution fund” or a deposit insurance fund may contribute to such funding.24 To the extent that there is a risk that, at the end of the process, the recovery will fail and the national authorities will face a loss, this can be addressed through the establishment of a fund that would receive ex ante (or ex post) contributions from the private sector.

In light of the potential for temporary financing needs, the question arises as to how such needs should be coordinated in the context of the resolution of an international financial group. Home countries are likely to be unwilling to or incapable of delivering all the public funding necessary to stabilize a large international financial group. By consequence, host countries may need to contribute financing if they want to keep the international financial group intact. Moreover, a host country’s decision whether or not to financially contribute to a group-wide solution ought to be informed by the fact that funding from the host country is likely to be required even if a strictly national solution is pursued.

Some form of financial burden sharing might thus be necessary. There will be cases where reaching an agreement between national authorities after a crisis

23Under debtor-in-possession frameworks, the providers of post-insolvency liquidity acquire a priority over pre-insolvency creditors.

24Several countries have established such funds, which are funded by contributions from the financial sector and managed by the government with the aim of financing orderly resolution processes when and if needed. However, such funds need not necessarily be established. See “Draft Final Report for the Group of Twenty Ministers on a Fair and Substantial Contribution by the Financial Sector” (IMF, 2010c).
has occurred will facilitate the recovery of a troubled financial institution. Ideally, agreement on burden sharing should be reached by the authorities of the principal jurisdictions on an institution-specific basis before a crisis occurs, especially if such agreements are supported by institution-specific recovery and resolutions plans (RRPs) or “living wills” (see Chapter 9 for more details on RRP). However, regardless whether it is before or after the crisis has occurred, reaching agreement on these questions will never be an easy task. For this reason, it would be desirable for the enhanced coordination framework to set out the range of criteria and parameters that would guide the burden-sharing process; for example: (i) the relative systemic importance of the group across jurisdictions, (ii) the relative contribution from DGS and any other resolution funds (if available) from different countries, and (iii) the relative distribution of losses across jurisdictions.

Establishment of Coordination Procedures

Even if there is a group of countries that have satisfied the above coordination standards, their ability to actually coordinate rapidly and effectively will be enhanced if there is an established set of procedures that will serve as a road map in the context of a crisis.

Drawing on the corporate insolvency experience and, more specifically, the coordination framework established by UNCITRAL, a framework for the resolution of international financial groups could be designed in a manner that ensures that there is an understanding of (i) who will take leadership in the initiation and conduct of resolution proceedings and how such leadership will be exercised, and (ii) what the modalities of communication and consultation are that will take place during the process. The framework could apply between jurisdictions that adhere to the elements identified above. Moreover, it would need to be designed in such a manner that it could provide guidance with respect to the resolution of both a parent bank with foreign branches and an international financial group involving bank and/or nonbank subsidiaries. Although a number of issues would need to be resolved, the following general points may be made.

Leadership

Where a financial institution with branches in foreign jurisdictions falls into financial difficulty, it is important to have clear understandings as to who will play the lead role in the initiation and conduct of the resolution proceedings. It would appear appropriate for the lead role to be played by the home country authorities. This approach would be consistent with the Concordat, and would reflect the reality that the parent jurisdiction is likely to be the principal source of public funds necessary to finance a restructuring. As noted earlier, the procedural framework would need to specifically acknowledge that, although it would be presumed that a host country would accept the leadership of the home jurisdiction that adheres to the coordination framework, the host jurisdiction would reserve the right to act independently if it formed the judgment that independent
action was more consistent with domestic financial stability and the interests of creditors.25

The modalities of leadership would depend on the circumstances. In the case of court-based proceedings, the home authorities could be given standing to launch proceedings in the host jurisdiction’s courts directly or through the host authorities acting on the basis of the guidance of the home authorities.26 In the case of administrative proceedings, the host jurisdiction’s legal framework could either permit the host authorities to conduct such proceedings on the basis of guidance provided by the home authorities, or permit the home authorities to do so directly.27 It would be expected that the home authority would design the overall resolution strategy, decide on the type of proceeding (e.g., restructuring vs. liquidation) to be launched in the home and host jurisdictions, and play the lead role in the conduct of resolution proceedings. This would be a substantial departure from current practice.

Although the above procedures are most directly applicable to a financial institution and its branches, the framework could also identify the modalities of leadership and coordination that would be applicable to the resolution of financial groups. The framework would clarify who is responsible for the resolution of each entity within the financial group. Following the approach taken at the national level in some jurisdictions (e.g., Italy), each country could designate a lead authority to initiate and conduct all resolution proceedings with respect to all bank and nonbank subsidiaries (both regulated and unregulated) and branches located within its territory and to serve as a point of contact with lead authorities in other jurisdictions. Moreover, the framework would require these authorities to coordinate their actions to the maximum extent possible. Although separate insolvency proceedings would be conducted with respect to each legal entity within the group, a host lead authority would be required to consult with the home lead authority before initiating resolution proceedings against a local subsidiary. It is also possible that the framework could require authorities to coordinate their actions on a range of issues—for example, by consolidating court proceedings involving separate entities that form part of a financial group (i.e., where the proceedings would remain separate but would be adjudicated by a single court at the same time) wherever possible, by coordinating actions taken to protect assets, by cooperating on the resolution of intragroup claims, and with creditors.

25Of course, there may well be cases where host jurisdictions reject the leadership of the home supervisor—for example, where the banking sector of the home jurisdiction collapses as a result of a sovereign debt crisis that severely undermines the ability of the home authorities to finance a restructuring.

26Such proceedings could involve the recognition of certain decisions taken in the context of insolvency proceedings in other jurisdictions.

27In a restructuring, decisions on the transfer of assets and liabilities would be taken by the home authorities and, if necessary, implemented in the jurisdictions in which the assets and liabilities to be transferred are based. In the context of liquidation, the assets of the bank would be collected and realized on a global basis and in a collective fashion, with the proceeds distributed to all creditors on the basis of the priorities set out in the legislation of the home jurisdiction.
**Communication**

The implementation of such a system would require a very high level of communication and sharing of information among the supervisors and the resolution authorities. In taking key decisions on the resolution, the home authorities would be required to consult with the host authorities and to consider the impact of the decision on host jurisdictions. The relevant authorities and, in some cases, the relevant courts would need to have in place arrangements for communication and consultation and would need to have the statutory authority necessary to share highly sensitive information.

The framework should also require the sharing of information at an early stage of a financial institution’s difficulties. Such a requirement is particularly important to address the information asymmetries that exist between home and host authorities. Home authorities invariably have more information on an institution than do their counterparts in host jurisdictions. Unless host authorities have a high level of trust in the home supervisor and are confident that they will be fully informed of developments in the institution’s financial position and of the possibility of action by the home authorities, they will have every incentive not to cooperate but, instead, to ring-fence assets.

As a means of facilitating communication and consultation, consideration could be given to the establishment of institution-specific agreements. In the context of cross-border insolvency, the cooperation framework established under the UNCITRAL Model Law has been supplemented by cooperation agreements that are reached in the context of specific cases. These agreements, referred to as “protocols,” are approved by the courts and address specific modalities for communication and consultation that are relevant to the case at hand. Although such protocols would be useful in the context of the resolution of financial institutions, they would need to be reached in advance of a crisis, given the need for rapid action. Such standing protocols could form part of the recovery and resolution plans that large financial groups will be required to establish.28

**CONCLUSIONS**

Although one can debate the precise contours of the solution to the problems described in this chapter, it is clear that there is a need for urgent action. Countries need to strengthen their resolution frameworks at the national level to ensure that ailing financial institutions and groups can be dealt with promptly and in a manner that protects the stability of the financial system. But effective action at the national level is not enough. Given the global nature of the financial services industry and its dominant institutions, national resolution frameworks will only be effective if they facilitate effective cooperation between authorities at the international level.

The approach outlined in this chapter seeks to facilitate such coordination in a manner that is achievable in the near future. It is recognized that a number of

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28For guidance on the manner in which such protocols have been developed in the context of cross-border corporate insolvency, see UNCITRAL (2009b).
issues would need to be resolved before this approach is implemented—in particular, what mechanism would be used to determine whether a country met the “core coordination standards” or how to monitor their compliance with these standards over time. However, the approach described above would form the basis for incremental progress being made as more and more countries voluntarily adhere to the framework over time. The “carrot” that would encourage countries to do so would be the possibility of a more effective and value-preserving international resolution.

In the near term, a limited group of countries that already meet the standards described above could begin to cooperate among themselves. To the extent that these countries include the world’s principal financial centers, such cooperation would represent a major step forward. As other countries (e.g., developing countries and emerging markets) adhere to the standards over time, the circle of cooperation would expand. It would therefore represent a pragmatic and achievable mechanism for the strengthening of international cooperation worldwide.

**APPENDIX 6.1. RECOMMENDATIONS OF THE CROSS-BORDER BANK RESOLUTION GROUP**

The Cross-Border Bank Resolution Group (CBRG) of the Basel Committee on Banking Supervision developed the following recommendations as a product of its stocktaking of legal and policy frameworks for cross-border crises.

**Recommendation 1: Effective National Resolution Powers**

National authorities should have appropriate tools to deal with all types of financial institutions in difficulties so that an orderly resolution can be achieved that helps maintain financial stability, minimizes systemic risk, protects consumers, limits moral hazard, and promotes market efficiency. Such frameworks should minimize the impact of a crisis or resolution on the financial system and promote the continuity of systemically important functions. Examples of tools that will improve national resolution frameworks are powers, applied where appropriate, to create bridge financial institutions; transfer assets, liabilities, and business operations to other institutions; and resolve claims.

**Recommendation 2: Frameworks for a Coordinated Resolution of Financial Groups**

Each jurisdiction should establish a national framework to coordinate the resolution of the legal entities of financial groups and financial conglomerates within its jurisdiction.

**Recommendation 3: Convergence of National Resolution Measures**

National authorities should seek convergence of national resolution tools and measures toward those identified in Recommendations 1 and 2 in order to facilitate the coordinated resolution of financial institutions active in multiple jurisdictions.
Recommendation 4: Cross-Border Effects of National Resolution Measures

To promote better coordination among national authorities in cross-border resolutions, national authorities should consider the development of procedures to facilitate the mutual recognition of crisis management and resolution proceedings and/or measures.

Recommendation 5: Reduction of Complexity and Interconnectedness of Group Structures and Operations

Supervisors should work closely with relevant home and host resolution authorities in order to understand how group structures and their individual components would be resolved in a crisis. If national authorities believe that financial institutions’ group structures are too complex to permit orderly and cost-effective resolution, they should consider imposing regulatory incentives on those institutions, through capital or other prudential requirements, designed to encourage simplification of the structures in a manner that facilitates effective resolution.

Recommendation 6: Planning in Advance for Orderly Resolution

The contingency plans of all systemically important cross-border financial institutions and groups should address as a contingency a period of severe financial distress or financial instability and provide a plan, proportionate to the size and complexity of the institution’s and/or group’s structure and business, to preserve the firm as a going concern, promote the resiliency of key functions, and facilitate the rapid resolution or wind-down should that prove necessary. Such resiliency and wind-down contingency planning should be a regular component of supervisory oversight and take into account cross-border dependencies, implications of legal separateness of entities for resolution, and the possible exercise of intervention and resolution powers.

Recommendation 7: Cross-Border Cooperation and Information Sharing

Effective crisis management and resolution of cross-border financial institutions require a clear understanding by different national authorities of their respective responsibilities for regulation, supervision, liquidity provision, crisis management, and resolution. Key home and host authorities should agree, consistent with national law and policy, on arrangements that ensure the timely production and sharing of the needed information, both for purposes of contingency planning during normal times and for crisis management and resolution during times of stress.

Recommendation 8: Strengthening Risk Mitigation Mechanisms

Jurisdictions should promote the use of risk mitigation techniques that reduce systemic risk and enhance the resiliency of critical financial or market functions
during a crisis or resolution of financial institutions. These risk mitigation techniques include enforceable netting agreements, collateralization, and segregation of client positions. Additional risk reduction benefits can be achieved by encouraging greater standardization of derivatives contracts, migration of standardized contracts onto regulated exchanges and the clearing and settlement of such contracts through regulated central counterparties, and greater transparency in reporting for OTC contracts through trade repositories. Such risk mitigation techniques should not hamper the effective implementation of resolution measures (cf. Recommendation 9).

**Recommendation 9: Transfer of Contractual Relationships**

National resolution authorities should have the legal authority to temporarily delay immediate operation of contractual early termination clauses in order to complete a transfer of certain financial market contracts to another sound financial institution, a bridge financial institution or other public entity. Where a transfer is not available, authorities should ensure that contractual rights to terminate, net, and apply pledged collateral are preserved. Relevant laws should be amended, where necessary, to allow a short delay in the operation of such termination clauses in order to promote the continuity of market functions. Such legal authority should be implemented so as to avoid compromising the safe and orderly operations of regulated exchanges, central counterparties, and central market infrastructures. Authorities should also encourage industry groups, such as the International Swaps and Derivatives Association (ISDA), to explore development of standardized contract provisions that support such transfers as a way to reduce the risk of contagion in a crisis.

**Recommendation 10: Exit Strategies and Market Discipline**

In order to restore market discipline and promote the efficient operation of financial markets, the national authorities should consider, and incorporate into their planning, clear options or principles for the exit from public intervention.

**APPENDIX 6.2. THE UNCITRAL FRAMEWORK FOR CROSS-BORDER CORPORATE INSOLVENCY**

**The Model Law**

The Model Law on Cross-Border Insolvency (the “Model Law”) was adopted in 1997. It sets out a framework for managing the insolvency of a cross-border firm in a fair and orderly manner. It contemplates the insolvency of single entities with establishments, assets, or creditors in more than one jurisdiction. It does not apply to groups comprised of legally distinct subsidiaries or affiliates and it is not intended to apply to types of entities for which dedicated insolvency regimes may exist in national law (such as banks and insurance companies).

Above all, the Model Law provides means by which foreign insolvency representatives (liquidators, administrators, etc.) may gain access to courts in another
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jurisdiction where, for example, important assets or creditors of the insolvent entity may be located. Thus, an insolvency representative from Country A that is winding up or administering an entity in Country A may apply to have its proceeding recognized in Country B. Typically, unless the application is contested on public policy grounds (the Model Law includes a public policy exemption), obtaining recognition in Country B ought to be a mere formality. Neither reciprocity nor the quality of the insolvency law in Country A would be relevant to the decision of the court in Country B whether or not to recognize the applicant’s proceeding. While the application is pending, the court in Country B may (but is not required to) grant various forms of relief to the foreign insolvency representative (such as a stay on execution against the insolvent entity’s assets in Country B or entrusting the administration or realization of those assets to the applicant).

If a foreign proceeding has been recognized as a “main” proceeding, the Model Law imposes an automatic stay on execution, freezing the assets of the insolvent entity. Under the Model Law, “main” (as opposed to “nonmain”) proceedings are deemed to be located in the jurisdiction where the insolvent entity has its center of main interests (COMI).

When any proceeding is recognized (whether or not a main proceeding) the Model Law affords the recognizing court broad discretion in granting relief to the foreign representative. Most importantly, the court may entrust the realization and distribution of assets located in its jurisdiction to the foreign representative, provided that the court is satisfied that the interests of creditors located in the court’s jurisdiction are adequately protected. The equality of creditors in all jurisdictions is a basic principle underpinning the Model Law.

As well as establishing terms for recognition and relief including (potentially) the turnover of assets to a foreign insolvency representative, the Model Law also provides legal authority for insolvency representatives in different jurisdictions to collaborate with each other (via direct communication and information sharing) and to coordinate concurrent insolvency proceedings.

UNCITRAL Progress on Enterprise Groups (Domestic and International)

Although the Model Law addresses only single entities with a cross-border presence, the treatment of financial groups in insolvency has been the subject of discussion in the context of UNCITRAL’s Legislative Guide on Insolvency Law (the “Guide”). Since publication of the Guide in 2004, UNICTRAL’s Working Group V (Insolvency) has continued to develop draft recommendations relating to the insolvency of “enterprise groups” (i.e., two or more enterprises that are connected by control or significant ownership).29

29The Working Group’s latest draft commentary and recommendations in this area are discussed in document A/CN.9/WG.V/WP90 (“Treatment of Enterprise Groups in Insolvency”) from the Working Group’s 37th session, November 2009 (see: www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html).
The focus of Working Group V has been on domestic groups, recognizing that there are two basic approaches to their insolvency treatment. The first and internationally most prevalent approach assesses solvency on a per-entity basis, recognizing the legal separateness of the different companies that comprise a group. The second approach considers economic reality above legal form, creating the potential for a more coordinated and consolidated approach to group insolvency.

**Domestic Groups**

The Guide envisages streamlining the process for commencement of proceedings by allowing all group companies that would meet the relevant insolvency threshold to make a single, joint application to commence insolvency proceedings. The main purpose of such joint application would be to reduce the costs and coordinate the timing of commencement.

Following the commencement of multiple insolvency proceedings for different group companies, the Guide contemplates the possibility of their coordination, potentially under the auspices of a single insolvency representative. Procedural coordination might involve information sharing between competent authorities, combined hearings and other methods of streamlining, and expediting multiple proceedings. Importantly, though, under any mechanism for procedural coordination the assets and liabilities of the separate insolvent entities would remain distinct, with the substantive rights of claimants unaffected. The greatest scope for procedural coordination exists domestically, where all group companies are located in a single country.

The Guide contemplates the possibility of extending stays of execution to solvent group companies in certain limited situations (e.g., to protect an intragroup guarantee that relies on the assets of the solvent group company providing the guarantee). However, the Guide notes that in some jurisdictions extending stays to solvent group members would not be possible under property or constitutional law.

The Guide also considers post-insolvency group financing, which would be of particular importance in any reorganization proceeding intended to return a group (or parts of it) to viability. The Guide considers that both solvent and insolvent group companies (and nongroup entities) should be able to contribute to postcommencement financing but that appropriate protection should also be established for the providers of financing as well as parties whose rights may be affected by the provision of financing. The Guide acknowledges that the provision of financing by a solvent member might not be possible under the laws of some jurisdictions.

Regarding laws to avoid or set aside antecedent transactions with insolvent companies, the Guide notes that special considerations might apply to transactions between group members, observing that some transactions that might appear to be preferential or undervalued as between their immediate parties might be viewed differently in the broader, group context, where both the benefit and the detriment of transactions may be spread more widely. Also, the Guide notes that
laws governing the subordination of related party claims may mean that in a group context, the rights of group members under intragroup claims could be subordinated to those of external creditors.

The Guide recognizes that the single-entity approach to the insolvency of enterprise groups limits a party’s recovery to the assets of the specific entity of which it is a creditor. Conversely, extensions of liability, contribution orders, or substantive consolidation measures might, in certain circumstances, permit a court (in insolvency proceedings involving two or more group companies) to disregard their separate identity and to treat their assets and liabilities as one. At present, few jurisdictions permit substantive consolidation, and those that do employ it sparingly and in carefully prescribed circumstances. Such consolidation constitutes a legally radical remedy and is at odds with the basic principle of the separate legal identity of the limited liability company. However, in certain situations, such as a Ponzi fraud in which assets may have been isolated from claims in separate entities, a rationale for substantive consolidation might exist.

### International Groups

Promoting coordination and cooperation in a cross-border group insolvency is inherently more difficult than in a domestic group insolvency. However, in some instances the best outcome for each of the different members of a cross-border enterprise group might be achieved through a more broadly based global solution rather than by treating each individual member in isolation. Thus, the Guide suggests that national laws ought to authorize cooperation between courts and the insolvency representatives overseeing the insolvency of different members of an enterprise group in different jurisdictions.

The Guide also advocates frameworks to promote the coordination of different proceedings, including, for example, joint hearings (subject to conditions and safeguards to protect the substantive and procedural rights of interested parties in each jurisdiction) and, potentially, to permit the appointment of a single insolvency representative to be responsible for multiple insolvencies. However, the Guide acknowledges that in certain circumstances, conflicts of interest may require that separate insolvency representatives should be appointed for each entity. Some of the problems and difficulties that arise in a cross-border group insolvency (and which may be susceptible to solution using cooperation and coordination as suggested by the Guide) include, piecemeal liquidations of separate group components, ring-fencing of assets, shifting of assets between jurisdictions, and jurisdiction “shopping” to identify more favorable jurisdictions for recovery.

UNCITRAL’s Practice Guide on cross-border insolvency explains the utility of cross-border insolvency agreements to facilitate coordination of cross-border insolvency. Such agreements are increasingly common, and the Legislative Guide recommends that national insolvency laws permit the use of such agreements in respect of enterprise group members, allowing insolvency representatives to enter agreements for coordination with their counterparts in other jurisdictions and empowering courts to approve and implement such agreements.
The Guide’s recommendations in the context of cross-border group insolvency are less ambitious than those for domestic groups. This is recognition that cross-border cases are inherently more complicated than domestic ones. Additionally, the Guide only considers ordinary corporate groups. The Working Group has not examined how the Guide’s recommendations might be developed in the context of a cross-border financial group, whose members might be subject to the oversight of various supervisors, central banks, and deposit guarantee schemes in diverse jurisdictions.