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Insolvency Law: possible future work

Further proposal by the delegation of Switzerland for preparation by the UNCITRAL Secretariat of a study on the feasibility and possible scope of an instrument regarding the cross-border resolution of large and complex financial institutions

1. The financial crisis, in particular the insolvency of Lehman Brothers on 15 September 2008, has made it painfully clear that certain financial institutions are “too big” or “too interconnected to fail”. They cannot be wound down in an orderly fashion without exposing the financial system to unacceptably high risks. This state of play implies a great deal of moral hazard and imposes potentially huge costs on taxpayers. Establishing a legal framework which permits an orderly winding down of a large and complex financial institution without putting the stability of the financial system at large at risk therefore is a priority for Switzerland.
2. In the case of large and complex financial institutions (“LCFI”) with major cross-border activities, an orderly resolution cannot be achieved without coordination among relevant jurisdictions. In the absence of a coordinated approach, reorganization and/or liquidation measures will be of limited effect, resulting almost inevitably in a disorderly dismantling of the institution or the group. Coordination across borders, therefore, is a necessary, albeit not sufficient, condition for an orderly winding down of large and complex financial institutions with major cross-border activities.
3. The most efficient way to achieve coordination would be by concluding a multilateral international instrument on the recognition and enforcement of insolvency orders. This approach, which would require agreement on who has jurisdiction to resolve a LCFI, seems overly ambitious to achieve for the foreseeable future for a number of reasons, including the important public policy objectives at stake in such an instance and probably the need for an ex ante agreement on burden



sharing. It is therefore necessary to explore other options to improve coordination, including coordination (i) through parallel proceedings in home and host states; (ii) by means of cross-border insolvency agreements, or (iii) by way of conflict-of-laws mechanisms.

4. The need for improved cross-border coordination of resolution proceedings has been acknowledged by leading international organizations and specialized bodies. In particular, Recommendation 4 of the Cross-border Bank Resolution Group (CBRG), a subcommittee of the Basel Committee on Bank Supervision, advocates that “further work toward more effective recognition of foreign crisis management and resolution proceedings should be undertaken at the bilateral, regional or international level”.¹ The CBRG specifically refers to the work undertaken by UNCITRAL regarding the treatment of domestic enterprise groups, suggesting that the relevant concepts developed in the Legislative Guide may provide guidance in view of the establishment of such a framework.

5. At the 38th session of Working Group V (Insolvency Law) (“Working Group”) the Swiss delegation submitted a proposal for a study on the feasibility of an international instrument regarding the cross-border resolution of large and complex financial institutions for consideration by the Working Group (A/CN.9/WG.V/WP.93/Add.5). During that session, some delegations, as well as certain observers, expressed reservations, arguing that matters relating to the insolvency of financial institutions did not fall into the core competencies of the Working Group and that similar work was being done by other bodies. Switzerland respectfully submits that (i) UNCITRAL is better suited than any other international organization to tackle this kind of issue and that (ii) no similar work has been or is currently being undertaken on the technical level envisaged by the Swiss proposal.

6. While it is correct that the insolvency of banks and other financial institutions has been excluded so far from the scope of insolvency-related work undertaken by UNCITRAL,² Switzerland maintains that UNCITRAL is better suited than any other organization to undertake the proposed study. First, a resolution is primarily a highly technical process requiring special skills and knowledge, whether or not the firm is a financial institution. Second, many tools used in national resolution regimes can also be found in corporate bankruptcy, like e.g., the transfer of assets to a new corporation or the conversion of debt into equity. Switzerland therefore is convinced that UNCITRAL is better suited than any other organization to undertake the proposed study. Also, no other international organization or body is currently undertaking work similar to the study proposed by Switzerland. While the issue is being discussed in many forums, none of these has actually tackled the task of exploring practical alternatives and avenues.

7. As exposed, we do not share the concern that the Working Group might not be the appropriate forum or might be unable to address the issues proposed. Nevertheless, we respect the views expressed within the Working Group that it may not be advisable to deal with these issues in the plenum and in the perspective of establishing normative provisions. At the same time, we acknowledge that

¹ See Report and recommendations of the Cross-border Bank Resolution Group — final paper (March 2010), <http://www.bis.org/publ/bcb169.htm> (accessed May 18, 2010).

² See Legislative Guide on Insolvency Law, p. 40 (2005); UNCITRAL Model Law on Cross-Border Insolvency, Art. 1(2) (1997).

considerable support was expressed by different delegations of the Working Group in respect of the possibility to assign the Secretariat with the task of a comprehensive report encompassing the issues raised by the Swiss proposal. Such a report could tackle any or all of the following issues:

- Identify the issues relevant for and particular to the winding down of large and complex financial institutions;
- Establish a comparative study of selected legal orders in respect of mechanisms to ensure cooperation across borders in the course of a winding down of large and complex financial institutions;
- Establish and summarize the work undertaken or being undertaken by other institutions, as well as the contents of any such work in this area;
- Identify areas and legal issues where the principles established in the 2004 UNCITRAL Legislative Guide on Insolvency Law and the 1997 UNCITRAL Model Law on Cross-Border Insolvency could or should be applied directly or by analogy;
- Identify possible alternative approaches for facilitating and ensuring cooperation across borders in the course of a winding down of large and complex financial institutions;
- Issue recommendations in respect of possible future work by UNCITRAL or other bodies as well as national legislators or regulating authorities in the fields identified.

8. The Swiss delegation was deeply impressed by the quality and efficiency the Secretariat showed when establishing the 2009 UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation. A document of comparable quality in the field of insolvency of financial institutions would be invaluable to legislators, regulators and practitioners.

9. Consequently, the Swiss delegation hereby submits a modified proposal that takes into account the valuable suggestions expressed by different delegations and the Secretariat itself. This new Swiss proposal suggests that the UNCITRAL Commission give a mandate to the Secretariat to establish a report on the feasibility and possible scope of an instrument regarding the cross-border resolution of large and complex financial institutions that would deal with the issues raised in the previous paragraph. Such a mandate would not interfere with any of the proposals submitted by other delegations for work to be carried out within the Working Group V in the course of its regular meetings. We further suggest that discretion be given to the Working Group, acting in cooperation with the Secretariat, to determine the content of such a report as well as the timelines and working methods used in its making. The report would ultimately be agreed upon by the Working Group and be submitted for approval to the UNCITRAL Commission.