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Insolvency law

Recent developments concerning the global and regional initiatives regarding the insolvency of large and complex financial institutions

Note by the Secretariat

Contents

	<i>Paragraphs</i>	<i>Page</i>
I. Global initiatives: progress in the work of international organizations	4-25	2
A. International Monetary Fund	4-9	2
B. Financial Stability Board	10-22	4
C. Committee on Payment and Settlement Systems, Bank for International Settlements	23-25	7
II. Regional approaches: the European Union	26-28	8
Annex		10



Background

1. At its forty-third session in June 2010, the Commission discussed a proposal to study the feasibility of developing an international instrument regarding the cross-border resolution of large and complex financial institutions (A/CN.9/WG.V/WP.93/Add.5 and A/CN.9/709, para. 5). It was agreed that the Secretariat should prepare a comprehensive report on all or any of a number of issues.¹

2. The Secretariat prepared a note (A/CN.9/WG.V/WP.109) that focused on paragraph (c) of that proposal and outlined the work that had been undertaken by international organizations and regionally in the European Union up to the end of July 2012. To some extent, paragraph (d) of the proposal was addressed in some of the work of international organizations noted in the paper.

3. This note focuses on the work that has been undertaken (and is ongoing) by the organizations covered in the first paper since the date of that paper. Reports referred to are listed in the annex to this note.

I. Global initiatives: progress in the work of international organizations

A. International Monetary Fund

4. In August 2012, the International Monetary Fund (IMF) published a policy paper which reviewed the implementation of the Financial Stability Board's Key Attributes of effective resolution regimes for financial institutions (the Key Attributes).²

5. As a preliminary matter, the IMF's report pointed out that since the Key Attributes were not an international treaty, they did not give rise to binding obligations, but that implementation by all jurisdictions was to be widely encouraged. Moreover, it emphasized that while the Key Attributes represented an important step forward, gaps in the framework remained. One example cited was that the Key Attributes did not articulate principles that would guide burden-sharing

¹ *Official Records of the General Assembly, Sixty-fifth Session, Supplement No. 17 (A/65/17)*, para. 259. These issues included: (a) Identify the issues relevant for and particular to the winding down of large and complex financial institutions; (b) 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; (c) Establish and summarize the work undertaken or being undertaken by other institutions, as well as the contents of any such work in this area; (d) 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; (e) Identify possible alternative approaches for facilitating and ensuring cooperation across borders in the course of a winding down of large and complex financial institutions; (f) 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.

² International Monetary Fund, *The Key Attributes of Effective Resolution Regimes for Financial Institutions — Progress to Date and Next Steps*. The Key Attributes are described in A/CN.9/WG.V/WP.109, paragraphs 14-25.

between national authorities who might have to commit public funds to support the resolution of large cross-border institutions. Furthermore, implementation was uneven and significant political commitment would be required for many countries to amend their legal frameworks to comply with the Key Attributes.³

6. With respect to cross-border cooperation, the IMF identified several problems. Existing legal frameworks in many countries established objectives for national authorities that focused on the promotion of domestic financial stability and did not consider the impact of national resolution actions on financial stability in other jurisdictions. The legal frameworks in some countries failed to make adequate provision for local resolution authorities to support resolution actions taken by their foreign counterparts. In particular, the frameworks failed to provide an effective mechanism under which the authorities with respect to local branches of a foreign institution might give effect to the resolution actions taken by authorities in the home jurisdiction of that institution. The host authority should have resolution powers over local branches of foreign institutions and the capacity to use its powers to either support the home authority in its resolution action or, in exceptional circumstances, to initiate resolution measures either in the absence of home intervention or where the home authority acted in a manner that did not take sufficient account of the need to preserve the host jurisdiction's financial stability. The automatic triggering of a resolution action as a result of the commencement of an intervention action or insolvency proceeding in another jurisdiction was discouraged, except in accordance with the Key Attributes in cases where national action was required to achieve domestic stability in the absence of effective international cooperation and information sharing.

7. A further problem identified was that legal frameworks discriminated against foreign creditors, for example, through rules governing the distribution of proceeds that either explicitly or implicitly gave priority to local depositors and creditors. In addition to those problems, legal frameworks governing information sharing among the relevant home and foreign authorities effectively prevented the sharing of information, either before, or as part of, a resolution action, and greater inter-agency coordination and adequate protection of confidentiality were required.

8. For systemically important financial institutions (in particular, those of global significance or G-SIFIs) the Key Attributes establish a comprehensive procedural framework of resolvability assessments and recovery and resolution planning.⁴ The Financial Stability Board (FSB) had established a timetable for developing recovery and resolution plans (RRP) by the end of 2012. Crisis Management Groups (CMGs) were then to conduct resolvability assessments for all G-SIFIs in the first quarter of 2013 and to develop basic resolution strategies. At the same time, institution-specific cooperation agreements were to be established for all G-SIFIs. Surveys conducted by the FSB indicated that CMGs had been established for nearly all G-SIFIs and recovery plans have been reviewed by national supervisory bodies.⁵ Progress in the completion of resolvability assessments and resolution plans was

³ IMF Progress Report, Executive Summary, p. 3.

⁴ See A/CN.9/WG.V/WP.109, paras. 21 and 23.

⁵ The Report of the Financial Stability Board to G20 Leaders, published in June 2012, indicated that, as of the second quarter of 2012, CMGs had been established for all but four of the 28 FSB designated G-SIFIs. Where a CMG is not yet established or active, substantive action has been planned. See http://www.financialstabilityboard.org/publications/r_120619a.pdf.

less advanced due to the lack of appropriate national resolution frameworks in many jurisdictions.

9. The IMF report notes that key areas identified by the FSB for action included more exhaustive analysis of the potential impediments to the implementation of recovery measures and intensified cross-border cooperation and information sharing.⁶ With respect to the latter, concerns have been expressed by firms subject to the RRP process over inconsistent rules governing the treatment of confidential information across jurisdictions. Moreover, the IMF paper noted that national authorities may prove reluctant to cooperate with their foreign counterparts unless they have a high level of trust in their counterparts' ability to protect confidential information and to implement international resolution.

B. Financial Stability Board

10. In November 2012, the FSB published a guideline concerning recovery and resolution planning, focussing on firm-specific cross-border cooperation agreements (COAGs).⁷ The guideline aimed to establish a general framework for information sharing among the CMGs, and to plan, coordinate and implement resolution strategies between home and host authorities in a timely manner. In general, two approaches for these COAGs were proposed, namely, the single point of entry (SPE) and the multiple point of entry (MPE). The SPE applied the resolution powers at the holding or parent level of the group and usually the resolution authority in the jurisdiction in charge of the global consolidated supervision of the group could initiate the proceeding. Under that approach, the lower level operational subsidiaries were kept as going concerns and the host authorities were able to exercise their powers to support the resolution lead by the home authorities to the extent of their powers vis-à-vis the local subsidiaries. In contrast, the MPE applied the resolution to multiple parts of the group through two or more resolution authorities. The group would be treated in separate parts and coordination should be ensured by the home authority. Accordingly, the powers applied to the separate parts of the group could be different and, in certain circumstance, the application of a combined approach might be appropriate. The guideline outlined in detail how these approaches would be applied in practice and the different steps involved.

11. In April 2013, the Financial Stability Board completed a thematic peer review⁸ focusing on the Key Attributes, the objective of which was to evaluate the existing resolution regimes and any revisions aimed at compliance with the Key Attributes. The review found that while a number of major jurisdictions had undertaken reform of their resolution regimes, implementation of the Key Attributes was still in its infancy and resolution regimes across FSB member jurisdictions exhibited a broad range of practices in terms of scope, mandate and the powers of authorities. Since

⁶ IMF Progress Report 2012, p. 19.

⁷ Recovery and Resolution Planning: Making the Key Attributes Requirements Operational — Consultative Document.

⁸ Thematic review on resolution regimes. The objectives of these reviews are to encourage consistent cross-country and cross-sector implementation; to evaluate (where possible) the extent to which standards and policies have had their intended results; and to identify gaps and weaknesses in reviewed areas and to make recommendations for potential follow-up (including via the development of new standards) by FSB members.

the Key Attributes were silent on the form of the resolution regime or the type of the resolution authority required, jurisdictions had adopted diverse interpretations with respect to what constituted a “resolution regime” and its relationship to ordinary insolvency procedures and to supervisory measures. Such divergence made it difficult to draw definitive conclusions about the alignment of national powers across different sectors with the Key Attributes.

12. According to the main findings of the report, the powers available to resolve financial groups were relatively weak. Most jurisdictions lacked powers to take control of the parent or affiliates of a failed financial institution, particularly if the holding company or the operational affiliates were unregulated. When the powers available with respect to the branches of a foreign financial institution were less comprehensive than those available for domestic institutions, the domestic authorities could only use those powers to support resolution action taken by the home authority rather than by exercising it independently. Further clarification of the resolution powers needed for those entities and for branches of foreign financial institutions was desirable.

13. National legal frameworks for cross-border cooperation were less well-developed than other areas of the Key Attributes. Only a few jurisdictions had legislated to empower and encourage their resolution authorities to cooperate and coordinate wherever possible with foreign resolution authorities and the ability to give effect to foreign resolution actions remained unclear. Very few jurisdictions had provisions for expedited (whether administrative or court-based) procedures for recognition and enforcement of actions taken by foreign authorities.

14. The establishment of information sharing mechanisms among home and host authorities had progressed slowly and very few jurisdictions had clear and dedicated statutory provisions for the sharing of confidential information with foreign resolution authorities. The cross-border exchange of information relied mainly upon existing supervisory channels and unless those resolution authorities charged with planning or carrying out the resolution were included in the arrangements, it would hinder the effectiveness of preparing the resolution strategies and of carrying out resolution. Although the existence of a memorandum of understanding between authorities was not a pre-condition for information sharing, in practice, it was suggested as being highly desirable.

15. With respect to financial contracts, the review found that resolution authorities in most jurisdictions either lacked powers to impose a temporary stay on the exercise of contractual acceleration or early termination rights in financial contracts that arose only because of entry into resolution or in connection with the exercise of resolution powers or, where the power existed, it was not subject to suitable safeguards.

16. While the equal treatment of creditors was also a focus, the review noted that the majority of jurisdictions did not treat creditors according to the location of their claim or the jurisdiction in which the claim was payable. Nevertheless, there was differential treatment of certain types of claims.

17. Based on the findings, certain recommendations were made for implementation by the FSB and its member jurisdictions. First, a continuing full implementation of the Key Attributes was required. For instance, the scope of resolution regimes needed to be extended to include financial holding companies,

non-regulated operational entities and branches of foreign financial firms in order to facilitate the consistent resolution of a group. The mandates and capacity of resolution authorities in cross-border actions needed to be enhanced and domestic legal frameworks for information sharing required review or revision to ensure information exchange channels included all relevant home and host authorities involved in resolution. Additional clarification and guidance on the application of the Key Attributes was also required. For example, guidance on the nature of powers with respect to financial holding companies, non-regulated operational entities and branches of foreign financial firms should be developed; a mechanism to recognize foreign resolution measures, either through administrative, judicial or contractual means, should be established and its effectiveness in the implementation of cross-border resolution strategies evaluated. Finally, on-going implementation monitoring was required for cross-border cooperation and information sharing.

18. On 12 August 2013, the FSB published a number of documents, including a consultative document on information sharing for resolution purposes.⁹ The draft guidance covers two issues, namely, principles on information sharing for resolution purposes and information sharing provisions for cross-border cooperation agreements (COAG). The first section addresses the principles for the design of legal gateways and related confidentiality regimes aimed at supporting information sharing for resolution purposes with foreign and domestic authorities. The second section sets out principles on the provisions relating to information sharing that should be included in COAGs.

19. With respect to information sharing for resolution purposes, the principles require the establishment of clear legal gateways authorizing national authorities, including non-resolution authorities, to disclose information on a timely basis to other domestic and foreign authorities involved in the resolution of the entity to which the information related. The information, being commercially and legal sensitive, is susceptible to disclosure if necessary, however, disclosure is subject to any applicable requirements relating to data protection or banking secrecy and would be conditional on the recipient authority being subject to adequate confidentiality requirements. As to the use of the information, the legal gateways should not prevent or restrict the reasonable and effective use of the information by a recipient authority, however, for re-disclosure, the legal framework should be clear about the conditions under which information received from a foreign authority may be disclosed to another domestic or foreign authority. Where the legal gateways are conditional on reciprocity, they should establish criteria for determining comparability. With respect to authorities and their current and former employees and agents, the principles require a general protection against criminal and civil actions for breach of confidentiality based on the appropriate disclosure of information. Finally, the legal framework should exclude information received from foreign authorities from the application of freedom of information legislation or treat such information as falling within an existing exemption under that legislation.

20. Concerning information sharing in the context of firm-specific cross-border cooperation, the document indicated that the COAGs should specify basic requirements concerning information sharing, including the parties that might need to receive confidential information; the circumstance in which such information

⁹ Information sharing for resolution purposes. The consultation closes on 15 October 2013.

might be shared; the classes of information that might be shared; applicable confidentiality obligations and procedures; information sharing between authorities within the CMG; and the means of communicating information. The parties should also agree on how the information might be used and on issues of disclosure to third parties. These provisions of COAGs on information sharing should be reviewed regularly, in order to ensure the information sharing mechanism is up to date and consistent with resolution plans.

21. In addition to providing detailed guidance on the Key Attributes, the FSB expanded their application to include non-bank financial institutions. Another consultative document published on 12 August 2013¹⁰ concerns the resolution of non-bank financial institutions, which includes financial market infrastructures (FMI) and their systemically important participants, insurers and financial firms that hold client assets. The document notes that while sector-specific resolution regimes should be consistent with the objectives and relevant requirements of the Key Attributes, not all of the powers and features of resolution regimes set out in the Key Attributes are relevant for all sectors. Different types of financial firms — even within a particular sector — have distinctive features that need to be taken into account in the manner in which the Key Attributes are applied. Resolution regimes for FMIs, for example, need to give particular priority to maintaining continuity of the critical functions that such infrastructures perform in financial markets and take account of loss allocation arrangements under the rules of certain kinds of FMIs; resolution regimes for insurers need to protect policyholder interests; and resolution regimes need to interact effectively with client asset protection rules, so that client assets could be rapidly transferred or returned in the resolution of a firm with holdings of client assets.

22. The purpose of the document is to provide guidance to assist jurisdictions and authorities with the implementation of the Key Attributes with respect to resolution regimes for these entities. Once finalized, these guidance notes would be submitted to the FSB for adoption as new annexes to the Key Attributes.

C. Committee on Payment and Settlement Systems, Bank for International Settlements

23. In April 2012, the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements, together with the International Organization of Securities Commissions (IOSCO), published the Principles for financial market infrastructures, which establish new international standards for payment, clearing and settlement systems, ensuring that these infrastructures operate safely and efficiently in normal circumstances and in times of market stress. The Principles require risk controls and contingency plans to be developed in order to safeguard the critical role played by FMIs and to preserve financial stability.

24. In July 2012, the CPSS and IOSCO published a consultative report¹¹ regarding the recovery and resolution of FMIs, which echoed the requirements established in

¹⁰ Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions. The consultation closes on 15 October 2013.

¹¹ Recovery and resolution of financial market infrastructures. The consultation closed on 28 September 2012.

the Key Attributes. As FMIs often operate in multiple jurisdictions, they might be subject to multiple resolution frameworks, established under different laws. The Key Attributes recommended jurisdictions provide transparent and expedited processes to give effect to foreign resolution measures, which could be satisfied either by mutual recognition processes or by taking measures under the domestic resolution regime that supported and were consistent with the resolution measures taken by the foreign resolution authority. Cooperation and coordination among or between those authorities, facilitated by the development of formal cooperation and communication protocols, could ensure fulfilment of their responsibilities during normal times and in times of crisis. Both the Key Attributes and the Principles address the importance of cooperation among domestic and host authorities, at the same time emphasizing the need to respect the responsibilities of each authority, in order to provide a clear regulatory picture for FMIs.

25. In August 2013, CPSS-IOSCO published a report on the recovery of financial market infrastructures.¹² The report provides guidance to financial market infrastructures such as central counterparties on how to develop plans to enable them to recover from threats to their viability and financial strength that might prevent them from continuing to provide critical services to their participants and the markets they serve. It also provides guidance to relevant authorities in carrying out their responsibilities associated with the development and implementation of recovery plans and tools. The report was produced in response to comments received on the July 2012 CPSS-IOSCO report on Recovery and resolution of financial market infrastructures that requested more guidance on what recovery tools would be appropriate for FMIs. The report supplements the CPSS-IOSCO Principles for financial market infrastructures (see above, para. 23), the international standards for financial market infrastructures (FMIs) published in April 2012.

II. Regional approaches: the European Union

26. In October 2012, the European Commission published a consultation document¹³ concerning the possible framework for the recovery and resolution of financial institutions other than banks, expanding the application of the Key Attributes. The document argued that these institutions, like banks, needed to be regulated in view of the public interest at stake, especially when those institutions experienced severe financial or operational difficulties that could lead to their failure. The document noted that the tools currently available to public authorities might not be sufficient to enable an orderly recovery or resolution of these difficulties and public funds might have to be expended to prop up ailing institutions.

27. The document was directed firstly at ascertaining how and when the failure of a financial institution other than a bank could threaten financial stability, the financial institutions covered being FMIs, such as central counterparties (CCPs) and central securities depositories (CSDs), as well as systemic insurance companies. Secondly, the document considered what arrangements might be needed to prevent

¹² Recovery of financial market infrastructures. The consultation closes on 11 October 2013.

¹³ Consultation on a possible recovery and resolution framework for financial institutions other than banks. The consultation closed on 28 December 2012.

the failure of such institutions from compromising financial stability, focussing on extraordinary measure that might be necessary to contain the impact of failure rather than on the regulation necessary to mitigate the risks inherent in their businesses.

28. In late June 2013, the Council of the European Union agreed its position on a draft directive establishing a framework for the recovery and resolution of credit institutions and investment firms and called for the commencement of negotiations with the European Parliament with the aim of adopting a directive at first reading before the end of 2013.¹⁴ The proposed directive¹⁵ is aimed at providing national authorities with common powers and instruments to pre-empt bank crises and to resolve any financial institution in an orderly manner in the event of failure, while preserving essential bank operations and minimizing taxpayers' exposure to losses. The proposed directive is aimed at transposing into European Union law commitments made at the G20 summit in Washington DC in November 2008, when leaders called for a review of resolution regimes and bankruptcy laws "to ensure that they permit an orderly wind-down of large complex cross-border financial institutions."¹⁶

¹⁴ See www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/137627.pdf.

¹⁵ The proposal is discussed in detail in A/CN.9/WG.V/WP.109, paras. 42-58.

¹⁶ See note 13, p. 4.

Annex

List of documents

International Monetary Fund

08/2012 The Key Attributes of Effective Resolution Regimes for Financial Institutions — Progress to Date and Next Steps, prepared by the Legal Department and the Monetary and Capital Markets Department of the IMF available from: <https://www.imf.org/external/np/pp/eng/2012/082712.pdf>

Financial Stability Board

11/2012 Recovery and Resolution Planning: Making the Key Attributes Requirements Operational — Consultative Document. Available from https://www.financialstabilityboard.org/publications/r_121102.pdf

04/2013 Thematic review on resolution regimes (peer review report), available from http://www.financialstabilityboard.org/publications/r_130411a.htm

08/2013 Consultative Document: Information sharing for resolution purposes, available from http://www.financialstabilityboard.org/publications/r_130812b.pdf

08/2013 Consultative document: Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions, available from http://www.financialstabilityboard.org/publications/r_130812a.pdf

Committee on Payment and Settlement Systems, Bank for International Settlements

04/2012 Principles for financial market infrastructures, available from <http://www.bis.org/publ/cpss101.htm>

07/2012 Recovery and resolution of financial market infrastructures, consultative report, available from <http://www.bis.org/publ/cpss103.pdf>

08/2013 Recovery of financial market infrastructures, consultative report, available from <http://www.bis.org/press/p130812.htm>

European Union

10/2012 A possible recovery and resolution framework for financial institutions other than banks, prepared by the Directorate General Internal Markets and Services, available from http://ec.europa.eu/internal_market/consultations/2012/nonbanks/consultation-document_en.pdf