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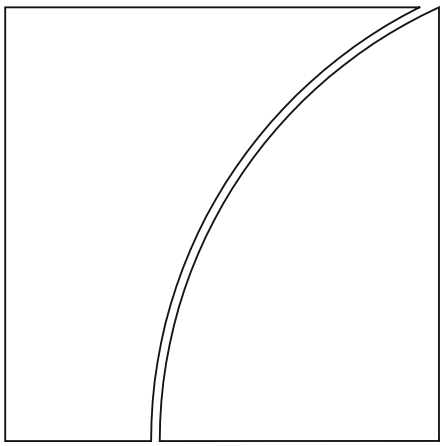

How to manage failures of non-systemic banks? A review of country practices

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Contents

List of abbreviations (authorities and institutions)

BCBS – Basel Committee on Banking Supervision

BoE – Bank of England

BoG – Bank of Greece

BoI – Bank of Italy

BoS – Bank of Slovenia

BSP – Bangko Sentral ng Pilipinas (Philippines)

CBB – Central Bank of Brazil

CBI – Central Bank of Ireland

CDIC – Canada Deposit Insurance Corporation

CNBV – Comisión Nacional Bancaria y de Valores (Mexico)

CSSF – Commission de Surveillance du Secteur Financier (Luxembourg)

ECB – European Central Bank

EU – European Union

FDIC – Federal Deposit Insurance Corporation (United States)

FINMA – Financial Market Supervisory Authority (Switzerland)

IADI – International Association of Deposit Insurers

IMF – International Monetary Fund

IPAB – Instituto para la Protección al Ahorro Bancario (Mexico)

OCC – Office of the Comptroller of the Currency (United States)

OSFI – Office of the Superintendent of Financial Institutions (Canada)

PDIC – Philippine Deposit Insurance Corporation

SRB – Single Resolution Board (EU)

WB – World Bank

How to manage failures of non-systemic banks? A review of country practices[1]

Executive summary

Effective legal frameworks for dealing with failing banks are an essential element of the regulatory landscape.[2] When banks fail or near the point of failure, authorities step in to close them. As regulation and supervision do not and cannot aim to exclude the possibility of bank failures, there need to be effective instruments and efficient procedures for ensuring that banks can be closed in an orderly way, with limited disruptions to the financial system.

Depending on the circumstances, bank failure may be managed through either resolution or liquidation. When deciding how to proceed, authorities assess the likely impact of a bank's closure. If particular functions of the failing bank are considered critical to the stability of the financial system, resolution is likely to be the appropriate course of action to maintain those functions. However, resolution involves the use by authorities of intrusive tools. It is designed for cases where use of such tools is necessary to manage the threats to financial stability where the failure of the bank is likely to be systemic. As a result, an orderly winding-up through liquidation and payment of creditor claims, including pay-out of insured depositors by any deposit protection scheme, is the default process that still applies for the majority of bank failures.

In the aftermath of the Great Financial Crisis (GFC), there is renewed interest in regimes for the orderly management of failing banks. The severe bank stresses and failures that occurred during the GFC have been costly in terms of financial instability, recapitalisation needs and output losses. As a result, one of the main lessons of the GFC is the need to protect public finances when dealing with bank failures. Following the GFC, many jurisdictions have adopted bank resolution regimes, based on the FSB *Key Attributes of Effective Resolution Regimes*. Depending on national frameworks, the application of resolution regimes may be restricted to banks that are systemic in failure.

The social and economic significance of banks' activities mean that even the failure of small, non-systemic banks may entail public interest concerns. Insolvency regimes need to be robust in order to be offer a viable alternative to resolution, while respecting the principle of no bailout agreed internationally. These issues have generated renewed interest in the design of regimes for managing bank failure. But while the international community has developed standards for bank resolution, regimes for dealing with the failure of non-systemic banks have remained in the national domain.

While some countries have developed bank-specific insolvency procedures, in others the insolvency of smaller banks must be managed under the ordinary corporate regime. However, ordinary corporate insolvency regimes are not best suited to the specific characteristics of banking business and particular risks that arise when a bank fails. The unique susceptibility of banks to runs and the role of even non-systemic banks in the functioning of the real economy through activities such as

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[2] In this paper, the term "bank" refers to as a deposit-taking institution. Legal frameworks applicable to other types of financial institution are outside the scope of this study.

deposit-taking and provision of credit and transmission of payments mean that bank failure is significantly more likely to give rise to public policy concerns than ordinary corporate failures. This paper aims to contribute to the discussion about effective insolvency regimes that enable failing smaller and non-systemic banks to be dealt with in a way that reduces the impact of negative externalities and ensures appropriate protections for depositors and other creditors.

Insolvency regimes for banks share many features with ordinary corporate insolvency regimes, but are different in at least four key aspects. In both cases, the purpose of insolvency is to realise debtor assets in order to settle creditors' claims in a specified order of priority. However, bank-specific insolvency regimes typically have particular features that respond to the activities of banks and their role in the financial system and real economy. These bank-specific features relate to the objectives of the insolvency, the grounds for opening the related proceedings, the role of administrative authorities and courts, and the role of creditors.

This paper reviews these special features against bank-specific insolvency regimes in selected jurisdictions. The FSI collected information on a dozen such regimes, and compared them with ordinary insolvency regimes. Although the detailed provisions vary, some general features emerge. In particular, bank-specific insolvency regimes include the objective of deposit protection in addition to, and possibly taking precedence over, the conventional insolvency objective of maximisation of returns to creditors. Bank-specific insolvency regimes generally include a wider range of grounds for opening proceedings – for instance, undercapitalisation, regulatory breaches or forward-looking criteria – in addition to the traditional balance sheet-based definition of insolvency. In terms of the respective roles of administrative authorities and courts, administrative authorities have a leading role in many cases, and retain some involvement even where the proceedings are court-based. Conversely, the role of creditors is reduced in bank-specific, compared with ordinary corporate, insolvency regimes. The paper also reviews the availability of specific instruments or available actions that can apply in the case of bank insolvency, ranging from traditional purchase and assumption transactions to more innovative instruments such as loss-sharing agreements.

The paper assesses these special features against the objective of ensuring effective insolvency options for banks that are not systemically important. Many of the bank-specific features highlighted respond to the special nature of banking. For instance, the involvement of administrative authorities reflects the complexity of banks' business models and the need for specialised expertise, and the potential public interest concerns arising from the economic role of banks. The limited role of creditors and their reduced opportunities to challenged decisions is better aligned with the need for speedy proceedings. Similarly, the broader set of criteria that can trigger the initiation of insolvency proceedings for a bank reflect the fact that a bank may be failing and no longer able to operate before it is technically balance sheet-insolvent. Finally, depositor protection reflects the vulnerability of banks to depositor runs and the need to maintain confidence in the banking sector generally. A wide set of instruments or available actions in insolvency expands the options for closing down a bank that does not meet the conditions for resolution, while still recognising the special functions that banks play in the financial system.

Section 1 – Introduction and definitions

1. **Effective provision for dealing with failed or failing banks is a key building block of a country's legal framework.** Bank supervision and regulation aim to ensure that banks operate soundly and safely. However, they are not intended to prevent failure. If a bank becomes too weak to continue operating, authorities step in to close it, possibly preserving some of its functions. Closure of a bank, however, can have a material impact on its customers, in particular its depositors and borrowers, and on the wider banking and financial sector. The legal arrangements to deal with bank failures are therefore an important element of the framework governing banking.

2. **Legal regimes need to reflect the specific characteristics of bank's activities, compared with other financial firms or non-financial firms.** Banks are considered special in relation to the rest of the financial system, or more broadly to non-financial firms, for a number of reasons.[3] First, the leverage and maturity mismatches on their balance sheet, which are typical features of the banking business, make banks susceptible to runs and loss of public confidence. At the same time, banks provide financial services that are essential to the functioning of the economy, such as deposit-taking, credit extension, the processing of payments and the provision of bank guarantees. Finally, banks are a key element in the transmission channel for monetary policy. Even if credit intermediation can be provided by markets or other types of financial companies, banks retain a crucial role at the centre of market economies.

3. **The many and severe bank failures during the Great Financial Crisis (GFC) have prompted a renewed interest in effective legal frameworks for dealing with failing banks.** During the GFC, an exceptionally high number of banks came under financial stress and authorities intervened in various ways. For instance, in the United States, between 2008 and 2013 almost 500 banks failed, at a cost of approximately USD 73 billion to the Deposit Insurance Fund (DIF). In the euro area, between 2008 and 2014 the gross financial sector assistance by governments amounted to 8% of the area's GDP (ECB (2015)).[4] In response, most advanced economy jurisdictions revised their regimes for dealing with failed or failing banks to better manage systemic implications and retain confidence in the banking sector.[5]

4. **At the international level, the GFC has prompted questions in the official community as to how legal regimes for dealing with bank failures can reduce the impact of negative externalities and systemic implications and limit or avoid the use of public money.** This resulted in, among other things, the adoption by the Financial Stability Board (FSB) of the *Key Attributes of Effective Resolution Regimes* (FSB (2014) as an international standard for resolution regimes aimed at enabling authorities to deal with the failure of systemic banks in a way that preserves their critical functions without reliance on public funds (FSB (2014)).[6] This paper aims to contribute to this debate by focussing on effective insolvency alternatives for smaller and less-systemic banks.

5. **Depending on the systemic importance of a bank's critical functions and the authorities' decision about whether they need to be maintained, the response to a failing or failed bank has been to either resolve it or to liquidate it and wind it up under the applicable insolvency regime.** In the first case, critical functions are preserved, and therefore do not disappear as a result of the intervention by the competent authority. The guiding objective of such resolution is to minimise the impact of a bank's failure on the financial system and the broader economy. In the second, the bank is closed and put into liquidation, and has no critical functions that need to be preserved.[7] Even if operations are maintained in this second case – for example, because parts of the business are sold in the liquidation – the guiding objective of such a sale is to maximise creditor value or minimise costs, in particular to the deposit insurer,

[3] For a more in-depth discussion, see eg Hüpkes (2005).

[4] According to the data published by the IMF, between 2008 and 2012 the fiscal cost of the bank crises in Greece amounted to 27.3% of GDP, in Ireland to 40.7%, in Luxembourg to 7.7%, in Spain to 3.8%, in Germany to 1.8% and in Italy to 0.3% (Leven and Valencia (2012)). In Cyprus, between 2012 and 2013 the fiscal cost amounted to 25% of GDP (IMF (2014)).

[5] For an overview, see eg Schillig (2016) and Moss et al (2017).

[6] The *Key Attributes* have been supplemented by a range of implementation guidance and, in 2015, with a standard covering total loss-absorbing capacity (TLAC), in order to enhance the resolvability of global systemically important banks (FSB (2015)).

[7] Insolvency regimes generally include provision for both restructuring and liquidation of insolvent entities. Restructuring proceedings typically provide a legal, and generally court-supervised, framework for reaching binding accommodation with relevant classes of creditor so as to restore some or all of the business to post-insolvency viability. This paper focuses on insolvency proceedings where the aim is to wind up and liquidate the bank, and does not discuss restructuring proceedings, where the overlap with resolution is significant. Likewise, this paper does not discuss voluntary liquidation.

rather than to preserve the functions per se. Lliquidation may also be used in conjunction with resolution, to wind up a residual entity after a transfer.

6. **The concepts of "resolution" and "insolvency" are not used consistently across jurisdictions.** In some jurisdictions, eg countries in the European Union, "resolution" and "insolvency" are conceptually distinct, and are generally subject to separate legal frameworks.[8] In others, the two concepts are covered by a single bank insolvency framework that provides a selection of tools, the choice of which may be subject to considerations such as the cost to the deposit insurer that various options entail.[9] (See Box 1 for further detail on different approaches and Box 2 for an overview of the EU framework.) The existence of the two concepts also raises the question – as yet, not addressed at international level – as to how they might best be integrated in a coherent legal framework in which their interaction is clear and the circumstances in which resolution or insolvency tools will be used are, as far as possible, transparent and predictable. This paper does not attempt to answer that broader question, but further work on the design of legal frameworks would be beneficial.

Box 1

Insolvency and resolution – history and definitions

The concepts of "resolution" and "insolvency" are not used consistently across jurisdictions, or in the academic literature, and there are no standard definitions that differentiate them clearly. They overlap to the extent that they both entail frameworks and tools for dealing with failing and failed banks.①

Jurisdictions' legal frameworks differ as to whether they distinguish between resolution regimes and insolvency regimes for banks. This difference in approach reflects, among other things, the historical evolution of the relevant frameworks (separate resolution regimes tend to be a more recent development) and the balance between administrative and judicial responsibilities.

US framework

For example, in the United States, banks (ie insured depository institutions) fall under the separate, bank-specific legislative regime provided by the Federal Deposit Insurance Act (FDI Act), which has been in place in broadly similar form since 1950. All failed US insured depository institutions are resolved or liquidated under that regime. The FDI Act provides for several possible courses of action. The Federal Deposit Insurance Corporation (FDIC) can be appointed as the conservator of a failed bank to carry on the business of the institution, pending a sale or other disposition, or as a receiver. The FDI Act confers a range of powers, including powers to transfer assets and liabilities. Consequently, the FDIC may transfer the deposits, together with certain assets, of the failed bank, to an assuming institution in a 'Purchase and Assumption' transaction. It may also organise a bridge bank to continue the operations of the failed bank until it is sold or liquidated. These actions resolve the failed bank by transferring some or all of its activities. Alternatively, in its capacity as a receiver of a failed insured depository institution, the FDIC may also use its broad statutory powers to liquidate the assets of the failed institution and pay out depositors and other creditors.

In contrast to insured depository institutions, US bank holding companies② may file for bankruptcy, or be placed into bankruptcy, under the US Bankruptcy Code. Proceedings under the Bankruptcy Code could result in either a reorganisation or a liquidation of a bank holding company and do not involve the FDIC as conservator or receiver. Additionally, US bank holding companies whose failure and resolution under the Bankruptcy Code is determined to have serious adverse effects on US financial stability may be resolved by the FDIC under the Dodd-Frank Act.

[8] For a recent overview of the European framework, see Moss et al (2017).

[9] For example, both resolution and insolvency are regulated by the US FDI Act. Under this Act, the FDIC can either act as a conservator or charter a bridge bank to operate a failed insured depository institution. These functions can be used to "resolve" a bank failure in a way that preserves some or all of its activities. The FDI Act also provides for the appointment of the FDIC as a receiver to liquidate failed insured depository institutions.

EU framework

The EU framework under the Bank Recovery and Resolution Directive (BRRD)③ explicitly distinguishes between resolution objectives, tools and powers, and "normal" insolvency. Normal insolvency proceedings under the national law of member states are the default option for managing bank failures, and resolution under the BRRD takes place only where the resolution objectives specified in that directive cannot be achieved by putting the bank into insolvency.

Accordingly, a decision is made at the point of failure as to whether the bank will be subject to either the resolution or the applicable national insolvency regime. That decision will affect the range of tools and actions that will be available and, in many cases, the authority or person that conducts the proceedings. If resolution is chosen, insolvency proceedings may still be applied to wind up part of the failed bank, but the administrative resolution tools and powers will be used first to achieve the resolution objectives. On the other hand, if insolvency is chosen, the preservation of critical functions will not be an aim, and resolution tools will not be available (unless similar instruments are provided for in the applicable insolvency regime).

① For example, the IMF and the World Bank used "insolvency proceedings" as an umbrella term for "all types of official action involving the removal of management and/or the imposition of limits on, or suspension of, the rights of shareholders and the assumption of direct control by a banking authority or other officially-appointed person over a bank that has crossed a 'threshold' for the commencement of insolvency proceedings" (IMF and WB (2009)). ② Parent companies which wholly own one or more US insured depository institutions. ③ Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.

7. **Insolvency regimes for non-systemic banks have not been covered extensively by international standard setters.** This is because the international community has priortised the need to address the risks and challenges of the failure of internationally active banks and the proven complexities and uncertainties of cross-border bank failures (eg BCBS (2010)). However, the widely shared determination, following the GFC, to minimise risks to public funds from bank failures also requires efficient insolvency options to deal with banks that are not systemic in failure since in the absence of a framework to facilitate orderly closure and wind-down, there is a residual "bailout" risk and the associated moral hazard.

8. **This paper identifies and discusses key features of bank-specific insolvency regimes, based on a select sample.** The analysis is based on a review by the Financial Stability Institute (FSI) of a sample of a dozen selected jurisdictions with modified or bank-specific insolvency regimes.[10] A principal aim of this review is to better understand the various ways in which these regimes address the special nature of banks and to highlight specific elements that may be effective in dealing with a failed or a failing bank.

9. **The paper is organised in four sections.** Section 2 provides an overview of the bank-specific features of insolvency regimes; Section 3 presents the main findings about the selected jurisdictions, and reviews commonalities and differences; Section 4 discusses the main issues around bank-specific insolvency regimes, from a policy perspective; and Section 5 concludes.

[10] These countries are Brazil, Canada, Greece, Ireland, Italy, Luxembourg, Mexico, the Philippines, Slovenia, Switzerland, the United Kingdom and the United States. Countries were selected on the basis of whether they have some form of modified or bank-specific insolvency regime. The sample aims to capture a range of approaches, but was not designed to be comprehensive.

Box 2

The European framework

Before the GFC, the European framework for bank insolvency was limited to conflict of law provisions that, among other things, required member states to recognise and give effect under their own national law to winding-up measures taken by another member state.① That framework did not provide for any substantive harmonisation of national bank insolvency regimes within the European Union.

In response to the GFC, in 2014 the European Union adopted the Bank Recovery and Resolution Directive (BRRD), establishing an EU-wide resolution framework for bank failures. Resolution is a set of special measures to be used by a designated resolution authority only when the failing bank meets a public interest threshold (financial stability concerns, need to preserve critical functions). Insolvency remains the default, and will be used whenever a bank failure does not meet the public interest threshold. Prior to the adoption of the BRRD, the European Commission② had stressed the need for further harmonisation of bank insolvency regimes with the aim of "resolving and liquidating banks under the same procedural and substantive insolvency rules". However, insolvency remains an exclusively national competence and, accordingly, there are material divergences between the national insolvency regimes that apply to EU banks, depending on where they are established.

This divergence holds true within the Banking Union. This architecture for enhanced cooperation between the 19 countries of the euro area (with an option to join for non-euro area states) consists of a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism for banks based in participating states. Within the Banking Union, the ECB, in its capacity as supervisor, along with national supervisors, is responsible for recovery planning and early intervention measures for significant institutions.③ The Single Resolution Board (SRB), together with national resolution authorities, is responsible for resolution planning and resolution actions for significant banks and other cross-border banks within the Banking Union.

Divergence between national bank insolvency regimes has a number of potential implications for effective management of bank failure within the European Union.④ First, the trigger for resolution (the forward-looking criterion of failing or likely to fail (FOLF)) is not always fully aligned with the grounds for insolvency under national laws, which may be focused more narrowly on balance sheet solvency and the ability to pay debts as they fall due. This risks a situation that a bank determined to be FOLF does not meet the public interest threshold for resolution but cannot be put into insolvency because the grounds for insolvency are not (yet) met. Second, uncertainties may rise in the application of the no-creditor-worse-off (NCWO) principle, which aims at ensuring that creditors in resolution are treated no worse than they would have been under the "counterfactual" of insolvency. In the resolution of a cross-border banking group, the counterfactual valuation of the losses creditors would have suffered in insolvency could be further complicated by differences in applicable insolvency regimes and, in particular, between creditor hierarchies.

① Directive 2001/24/EC on the reorganisation and winding-up of credit institutions. ② European Commission (2010). ③ The criteria for a bank to qualify as significant are set out in the SSMR and in the SSM Framework Regulation. At least one of the following criteria must be met: the total value of assets exceeds EUR 30 billion; the bank is economically important for the member state or the EU economy; the total value of assets exceeds EUR 5 billion and the ratio of its cross-border assets/liabilities in more than one other Banking Union member state to its total assets/liabilities is above 20%; the bank has requested or received funding from the European Stability Mechanism or the European Financial Stability Facility. ④ The potential impact of diverging national insolvency regimes as applicable to banks is also identified by IMF staff in the context of the Financial Sector Assessment Program in the euro area (IMF (2018)).

Section 2 – Overview of bank-specific insolvency regimes

10. **Although bank-specific insolvency regimes have been adopted in many countries, in a good number of others ordinary corporate insolvency regimes remain the only available option for banks.** Based on 2012 findings, about a third of countries worldwide do not have bank-specific provisions

in their insolvency regime[11] (WB (2012)), with the proportion slightly higher for mature economies, including countries such as France, Germany, Japan and Spain.[12] The higher proportion for mature economies possibly reflects the higher number of banking crises in emerging market economies, at least until the GFC, and the fact that in many cases a policy response to such crises included the development of bank-specific insolvency regimes. More recently, recommendations by standard setters for separate legal frameworks for dealing with failing or failed banks - such as the *Key Attributes* in relation to resolution of systemically important institutions or the International Association of Deposit Insurers' Core Principles for Effective Deposit Insurance Systems (IADI (2014))[13] – may have given further impetus to this process.

11. **Generally speaking, insolvency regimes have a number of common principles and procedural features.** The purpose of insolvency is to realise debtor assets in order to pay out creditors. Traditionally, the proceedings involve a court decision that a debtor is insolvent, the opening of a collective procedure, the stay of individual enforcement proceedings against the insolvent debtor, and the appointment of a liquidator who must act in accordance with the applicable creditor hierarchy and principles such as equal treatment of creditors in the same class. However, there are a number of key distinguishing features of bank insolvency regimes that tend to be present to at least some degree.

12. **Key bank-specific features affect most aspects of an insolvency proceeding, including its opening, its objectives, and the roles of authorities and creditors.** The principal bank-specific features can be summarised as follows, although the extent to which they are present in individual regimes varies:

- *Objectives:* the conventional insolvency objective of maximising value for creditors is frequently supplemented by a depositor protection objective, either as an explicit statutory objective for the liquidator, or by virtue of the general mandate of the administrative authority that conducts the procedure under a bank-specific regime. The resolution-specific objective of preserving financial stability, on the other hand, is often absent in insolvency since, where financial stability is a driving concern in the management a bank failure, resolution is the more appropriate approach.
- *Opening of insolvency:* control by administrative authorities over the opening of proceedings, either as an exclusive competence or as a right to petition, contrasts with ordinary corporate regimes where the right to petition conventionally resides with creditors and management. Where the opening of insolvency is entirely under the control of an administrative authority, the possible grounds are generally broader than those for ordinary corporate insolvency.
- *Role of administrative authorities:* even in court-based bank insolvency regimes, administrative authorities generally have some degree of involvement in, or oversight of, the conduct of the liquidation, even if indirectly through appointed representatives. This has no analogy in conventional corporate insolvency regimes (outside other regulated sectors such as utilities).
- *Role of creditors:* the mechanisms for creditor negotiation and control that are a core feature of ordinary corporate insolvency are absent from, or reduced in, bank insolvency regimes.

13. **The bank-specific features respond to the challenges associated with managing bank failure, starting with the objective of the dissolution of the failed entity.** Both bank-specific and ordinary corporate insolvency proceedings aim at winding up the business and settling claims. To that end, in both ordinary corporate and bank-specific proceedings, a liquidator or receiver assumes the control

[11] According to the latest data collected by the World Bank, 67% of countries have some form of bank-specific insolvency regime. The percentage is higher among emerging market economies, around 71% (WB (2012)). For elaborations, see Čihák et al (2012) and Demirgüç-Kunt et al (2014).

[12] Even in countries without a bank-specific insolvency regime or modified corporate insolvency regime, the regime may include some distinct aspecs that apply only in relation to bank insolvency proceedings. One example is the concept of depositor preference (Section 3), which prioritises claims of some or all depositors over those of other unsecured creditors. A second example is a procedural role for the bank supervisor in opening the insolvency.

[13] In particular, IADI Core Principle 14 specifies that an effective regime for dealing with bank failures should facilitate the protection of depositors and contribute to financial stability.

of the entity's estate, collects claims from creditors, realises assets, and distributes proceeds to creditors in accordance with the principle of equal (pari passu) treatment of creditors and with the rules on creditors' hierarchy. A standard statutory objective of the liquidation is to maximise value for creditors, and a liquidator is generally required to exercise those tasks in accordance with that objective.

14. **However, bank insolvency regimes may have additional objectives.** In bank insolvency regimes, the conventional insolvency objective of maximising the value of the failed bank's assets can coexist with other objectives, the most common of which is the protection of depositors. The liquidation of a bank entails more complex issues than the simple distribution of assets among creditors. Even for smaller banks, it gives rise to public interest concerns that do not apply in ordinary corporate insolvency proceedings. In particular, depositors tend to account for a significant percentage of the creditors of a bank, irrespective of a bank's size or complexity. Indeed, the smaller and the less complex the bank, the more likely it is that depositors will constitute the majority of its creditors. Bank deposits also represent a significant proportion of the liquid assets of households and businesses, and the inability of those depositors to access their assets would be rapidly destabilising and damaging to general confidence in the banking sector. Accordingly, for public policy reasons, in order to reduce the economic and societal impacts, deposits may receive special protection in bank insolvency that does not apply to other bank creditors, or to creditors in ordinary corporate insolvencies.[14]

15. **The opening of bank insolvency is also likely to differ from ordinary corporate insolvency proceedings.** In most cases, the process can only be started by, or with the consent of, a public authority, typically the bank supervisor. This generally reflects the need to avoid precipitating a liquidity crisis for the bank should its creditors demand immediate repayment – a heightened concern for banks, given the leverage and the maturity mismatch on their balance sheet. The regulated status of banks is also reflected in the fact that the grounds for opening of insolvency are generally broader in bank-specific regimes than in corporate insolvency. For instance, bank insolvency proceedings can be opened on the basis of breach of bank-specific regulatory thresholds – for example, where regulatory capital falls below minimum capital requirements – even if the bank is not balance sheet-insolvent (ie in accounting terms, assets still exceed liabilities). Similarly, the authority may be able to initiate a bank insolvency even if the bank is technically solvent and still meets the minimum requirements but may not do so in the near future.

16. **Administrative authorities have an enhanced role in bank-specific insolvency regimes.** In ordinary corporate insolvency, the process is fully court-based, while for banks, even when the regime is court-based, an administrative authority generally has some role. This typically reflects two considerations. First, banks are complex entities with a specialised business, so an administrative authority may be better placed to deal with them in insolvency. Second, speed is particularly important in a bank insolvency, as depositors need to access their money, to avoid panic and to continue supporting economic activity. An administrative authority may be able to proceed more quickly, by virtue of the expertise of its staff and, in many cases, limitations on challenges to its actions that could otherwise delay the proceedings.[15]

17. **The role of creditors is generally significantly reduced in bank-specific insolvency regimes, reflecting the broader objectives compared with ordinary corporate insolvency.** Creditors have either no role beyond the filing of claims, or a much reduced role. This is consistent with the fact that the proceedings are not focused exclusively on maximisation of creditor value.

[14] Insured depositors are protected primarily by the deposit insurance system, but in some cases the insolvency regime includes procedural provisions that support the effective operations of deposit insurance.

[15] Creditors can bring a legal challenge against the administrative authority, but remedies are limited to monetary compensation and cannot stay or reverse decisions.

Section 3 – Examples of bank-specific insolvency regimes

18. **This section discusses how the features of insolvency regimes for banks outlined in Section 2 are implemented and combined in the national regimes surveyed.** Following the definition of a few key concepts for the analysis in the rest of the paper, it focuses on the objectives of the insolvency regime and grounds for initiating insolvency proceedings, the type of insolvency proceedings (ie court-based or administrative), the role of judicial and administrative authorities, and the role of creditors. To conclude, the section reviews the types of specific instruments or available actions in bank insolvency.

Classification of insolvency regimes

19. **Bank insolvency regimes can be characterised in accordance with two broad classifications.** The first reflects the extent to which the bank insolvency provisions constitute a free-standing framework separate from the jurisdiction's ordinary corporate insolvency regime. The second is based on whether the proceedings are predominantly administrative or court-based.

20. **Starting with the first classification, based on the type of legal framework, the surveyed regimes fall into two broad categories:**

- *Free-standing bank insolvency regimes:* This refers to regimes in which the provisions governing bank insolvency are contained in a separate statute or legal instrument that is distinct from the general corporate insolvency regime.[16] General insolvency law may apply only in case of gaps and provided it does not conflict with bank-specific provisions.
- *Modified insolvency regimes:* This means that general insolvency law applies to banks, subject to modifications – which may be in a separate statute – that change certain aspects of the general regime in a material way to accommodate bank specificities. General insolvency law therefore applies as a default option.

21. **Concerning the second classification, proceedings are either predominantly administrative or court-based.** Bank-specific insolvency broadly takes one of two possible forms:

- administrative bank insolvency proceedings, in which the insolvency proceeding is managed by an administrative authority involving little or no role for judicial authorities; or
- court-based bank insolvency proceedings, in which the proceeding is driven by a liquidator that is an officer of the court, with a generally limited role for administrative authorities.

22. **Among the surveyed jurisdictions, there is a broad spectrum of approaches to these two types of proceedings.** For instance, even among countries with administrative proceedings (ie Brazil, Greece, Italy, Mexico, the Philippines, Slovenia, Switzerland and the United States; see Table 1), in two cases (Brazil[17] and Slovenia[18]) these can be followed by a court-based winding-up under certain legal conditions and subject to the input of the administrative authority. Similarly, for those that are court-based (Canada, Ireland, Luxembourg and the United Kingdom), the degree of involvement of administrative

[16] A free-standing regime is nevertheless likely to include many of the provisions and principles of the ordinary corporate insolvency regime of the country in question, but its core provisions will be set out in a separate, bank-specific statute or rules.

[17] In Brazil the liquidation proceedings start with the opening of extrajudicial liquidation. A second court-based step (bankruptcy) can follow where, in the course of extrajudicial liquidation, the liquidator provides proof that unsecured creditors would receive less than 50% of their claims. In that event, the CBB may authorise the liquidator to petition for bankruptcy under legal limits. In the last 10 years, 57% of the liquidations ended by conversion into bankruptcy, while 43% ended without the second bankruptcy step, mainly by conversion of extrajudicial liquidation to voluntary liquidation.

[18] The Slovenian winding-up proceedings for banks are compulsory liquidation (administrative) and bankruptcy (court-based). The aim of compulsory liquidation is to close the bank and wind up its operations without unnecessary disruption. Bankruptcy follows compulsory liquidation, and its purpose is to liquidate the bank's remaining assets.

authorities varies. For example, in Luxembourg, the proceedings are entirely judicial, but the court has flexibility to adapt the conduct of the insolvency to the specific case. In the United Kingdom, administrative authorities appoint members of a liquidation committee. In Ireland, the liquidation committee (which is established after a winding-up order has been obtained from the court) is made up of individuals from the administrative authority and an individual as nominated by the minister for finance. In Canada, the Canada Deposit Insurance Corporation (CDIC) is appointed receiver and nominates a liquidator to carry out the liquidation on its behalf, under court supervision.

23. **The sample countries also illustrate how bank insolvency regimes combine the various options under the two classifications in different ways.** While free-standing insolvency regimes are usually administrative (Brazil, Greece, Italy, Mexico, the Philippines and the United States), this is not true of all free-standing bank insolvency regimes (Table 1). For example, the regimes in Canada and Luxembourg are separate from ordinary corporate insolvency but remain court-based. In Canada, the court-based "liquidation"[19] applies to banks and to other financial and non-financial companies that perform utility or utility-like activities, with some bank-specific features. Similarly, bank-specific features can be combined with court-based proceedings. For example, in Ireland and the United Kingdom, the generally applicable insolvency regimes have been modified with specific provisions for certain key aspects of bank insolvency.

Insolvency regimes and proceedings

Type of regime and administrative vs court-based proceedings — Table 1

Jurisdiction	Type of regime	Administrative vs court-based proceedings
Brazil	Free-standing bank insolvency regime	Administrative*
Canada	Free-standing bank insolvency regime**	Court-based
Greece	Free-standing bank insolvency regime	Administrative
Ireland	Modified corporate insolvency law	Court-based
Italy	Free-standing bank insolvency regime	Administrative
Luxembourg	Free-standing bank insolvency regime	Court-based
Mexico	Free-standing bank insolvency regime	Administrative***
Philippines	Free-standing bank insolvency regime	Administrative***
Slovenia	Free-standing bank insolvency regime	Administrative*
Switzerland	Free-standing bank insolvency regime	Administrative
United Kingdom	Modified corporate insolvency law	Court-based
United States	Free-standing bank insolvency regime	Administrative

* The legislation also provides for a second, court-based step.

** The Winding-up and Restructuring Act (WURA) applies to federal banks and to specified corporations that are not subject to general insolvency law (ie the Canadian Bankruptcy and Insolvency Act).

*** The legislation provides for limited court involvement but is principally administrative.

Objectives

24. **The objective of maximising value for creditors, which is standard in corporate insolvency regimes, also applies in bank insolvency.** This objective is clearly specified in all the bank insolvency

[19] In a winding-up, a Canadian superior court must grant a winding-up order, and the liquidator will be court-supervised. In other resolution scenarios, there is no role for the court.

regimes surveyed, irrespective of whether they are a modified version of the ordinary corporate insolvency regime or a free-standing bank-specific regime (Table 2).

Statutory objectives of bank-specific insolvency regimes* Table 2

Jurisdiction	Objective(s)
Brazil	Maximising returns for creditors
Canada	Maximising returns for creditors
Greece	Maximising returns for creditors
Italy	Maximising returns for creditors
Ireland	Protecting insured depositors (Objective 1) Maximising returns for creditors (Objective 2)
Luxembourg	Maximising returns for creditors
Mexico	Maximising returns for creditors Protecting depositors within the least cost option
Philippines	Protecting depositors Protecting the country's banking system
Slovenia	Maximising returns for creditors Ensuring that depositors have access to deposits and clients have access to basic services, and repayment of creditors' claims according their order of priority
Switzerland	Maximising returns for creditors Protecting privileged depositors
United Kingdom	Protecting insured depositors (Objective 1) Maximising returns for creditors (Objective 2)
United States	Maximising returns for creditors Protecting depositors within the least cost option

* This table lists only the explicit statutory objectives under the insolvency regime. Broader financial stability objectives, arising from the general mandate of the responsible authority, are therefore not included.

25. **Depositor protection is a common objective in the bank insolvency regimes among the sampled countries.** All regimes analysed in this study include the objective of depositor protection, although the way in which this objective is framed and its scope – all depositors or insured depositors – vary across the sample. In some jurisdictions, broader financial stability objectives may also be relevant, by virtue of the general statutory mandate of the administrative authority responsible for the insolvency. In those cases, depositor protection is a key element of financial stability.

26. **In some countries, the bank insolvency regime includes an explicit objective of protecting depositors, and where it does, depositor protection takes precedence over the traditional objective of maximising value for creditors.** In the United Kingdom and Ireland for example, one of the principal bank-specific modifications to the general insolvency regime is to supplement the ordinary liquidation objective with a specific depositor-protection objective. Under the UK Bank Insolvency Procedure (BIP), the liquidator has two objectives. Objective 1, which is specific to the BIP and is not an objective of the ordinary corporate insolvency regime, is to "work with the deposit insurer to ensure that, as soon as reasonably practicable, the accounts of protected depositors are transferred to another bank or that the insurer pays out the protected deposits". Objective 2, which is the sole objective of the ordinary corporate insolvency regime, is to wind up the failed bank to achieve the best result for creditors as a whole. Objective 1 takes precedence over Objective 2, although the liquidator should start working on both immediately. The Irish modified bank insolvency regime contains similar provisions.

27. **Other regimes can provide procedural priority for depositor protection through a two-step insolvency proceeding.** For example, in the case of Slovenia, the purpose of the first, administrative, step is to deal with bank-specific objectives, such as depositor protection. This is completed before a collective insolvency proceeding is opened as a second step, aimed at repaying all remaining creditors.

28. **Other regimes embed depositor protection by making the national deposit insurer, with its mandate to protect depositors, responsible for managing the insolvency proceedings of deposit-taking banks.** In Mexico, the Philippines and the United States for example, the deposit insurer is the liquidator (or receiver) for all deposit-taking banks and, in each case, has a general statutory mandate that includes the protection of insured depositors.

29. **Depositor protection is also achieved in most regimes by prioritising depositor claims in the insolvency hierarchy through depositor preference.**[20] For instance, for EU countries, EU regulations require the creditor hierarchy for all insolvency regimes applicable to banks to include priority for depositors over general unsecured creditors.[21] As a general principle, the concept of depositor preference is not limited to bank-specific insolvency regimes, and may also be present where banks are subject to the ordinary corporate insolvency framework.

30. **The scope of depositor preference varies across jurisdictions, including whether it is limited to insured deposits, or whether there is different treatment of domestic and foreign deposits.** Tables 3 and 4 show a spectrum of approaches across the sample countries, from preference for all deposits to no depositor preference.[22] For instance, in EU countries, depositor preference differentiates between insured and other deposits, with "super-priority" for the former. However, the European countries in the sample take different approaches to the treatment of non-insured deposits. Among them, three countries (Greece, Italy and Slovenia) confer special protection on certain categories of bank customers, typically individuals and small and medium-sized enterprises (SMEs) over other depositors (eg large corporates). On the other hand, in two countries in the sample, there is no depositor preference, so that all deposits are treated pari passu with other unsecured senior liabilities (Brazil and Canada).

[20] The IADI Core Principles (2014) define "depositor preference" as: "granting deposit liabilities a higher claim class than other general creditors against the proceeds of liquidation of an insolvent bank's assets. Depositors must be paid in full before remaining creditors can collect on their claims. Depositor preference can take a number of different forms. For example: (i) national (or domestic) depositor preference gives priority to deposit liabilities booked and payable within the domestic jurisdiction and does not extend to deposits in foreign branches abroad; (ii) eligible depositor preference gives preference to all deposits meeting the eligibility requirements for deposit insurance coverage; (iii) insured depositor preference gives preference to insured depositors (and the deposit insurer under subrogation); (iv) a two-tiered depositor preference concept, in which eligible, but uninsured deposits, have a higher ranking than claims of ordinary unsecured, non-preferred creditors, and insured depositors have a higher ranking than eligible depositors; and (v) general depositor preference, in which all deposits have a higher ranking than claims of ordinary unsecured, non-preferred creditors, regardless of their status (insured/uninsured or eligible/not eligible)".

[21] Article 108 BRRD requires EU member states to give deposits of individuals and SMEs a higher ranking than the claims of ordinary unsecured, non-preferred creditors. In this regard, see eg Bank of England (2017). Amendments adopted in late 2017 have further harmonised the creditor hierarchy. By the end of 2018, member states must have adopted supporting legal provision for banks to issue a new class of non-preferred senior debt instruments ranking before other senior liabilities.

[22] In the United States, depositor preference in a bank failure applies to all uninsured deposits in US banks (insured depositors are not treated as claimants of a receivership and are transferred to another insured depository or paid in cash). In contrast, deposits in foreign branches of US banks are not FDIC-insured and are generally classified with other lower-ranked unsecured liabilities of the failed bank unless they are dually payable in the United States, in which case they will be treated as uninsured deposits and will rank above general unsecured creditor claims.

Depositor protection: coverage level and types of depositor preference

Table 3

Depositor preference type	Jurisdiction or group of jurisdictions	Coverage level for insured depositors*	Simplified overview of the ranking of depositors against uninsured liabilities**
General depositor preference	Philippines, United States	PHP 500,000 USD 250,000	Ranking: (i) Insured and all uninsured depositors (ii) Unsecured creditors (other than insured and uninsured depositors)
Tiered depositor preference (Type 1)	Mexico	IU 400,000 (Investment Units)	Ranking: (i) Insured depositors (ii) Uninsured depositors (iii) Unsecured creditors
Tiered depositor preference (Type 2)	Greece Italy Slovenia	EUR 100,000	Ranking: (i) Insured depositors (ii) Uninsured deposits of individuals and SMEs (iii) Other uninsured deposits (large corporations) (iv) Unsecured creditors (other than insured and uninsured depositors)
Tiered depositor preference (Type 3)	Luxembourg Ireland United Kingdom	EUR 100,000	Ranking: (i) Insured depositors (ii) Uninsured deposits of individuals and SMEs (iii) Unsecured creditors (other than insured/uninsured depositors)
Insured depositors preference	Switzerland	CHF 100,000	Ranking:*** (i) Privileged depositors (ii) non privileged depositors and unsecured creditors
No depositor preference (pari passu)	Brazil Canada	BRL 250,000 CAD 100,000	All depositors (insured and uninsured) rank pari passu with other classes of creditors.

* This paper adopts IADI's definitions (IADI (2014)): "deposit insurance" is a "system established to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors". The paper therefore uses the term "insured depositors". However, different terminology is used in some jurisdictions in the sample surveyed: for example, "eligible depositors" protected by a deposit guarantee scheme (eg EU jurisdictions); or "privileged depositors" that enjoy a second layer of protection under an ex post collective scheme (eg Switzerland).

** The column provides a simplified overview of the ranking of depositors against other general unsecured creditors in bank insolvency. It does not cover secured or subordinated creditors. Nor does it cover all classes of unsecured claims that might be preferred over depositors or senior creditors (eg tax or labour claims).

*** Under Swiss law, deposits within the coverage limit (CHF 100,000) have preference over deposits exceeding the threshold and all other unsecured creditors. Switzerland has three levels of depositor protection: (1) preferred deposits up to CHF 100,000 (worldwide) are immediately paid out from the failed bank's available liquid assets, which banks are required by law to hold in the form of domestic receivables or other assets sourced in Switzerland to cover 125% of their preferred deposits; (2) where the available liquid assets do not cover all insured deposits, the depositor protection scheme pays out to cover that shortfall (provided the deposits are in Switzerland); and (3) all deposits up to CHF 100,000 that have not been recovered have a preferred claim in the liquidation. While a large proportion of preferred deposits are also insured, there may be some (eg those outside Switzerland) that would not be covered by level (2), but would have a level (3) preference over other unsecured claims in the insolvency.

Types of depositor preference* Table 4

Creditor hierarchy	General depositor preference	Tiered depositor preference			Insured depositor preference	No depositor preference (pari passu)
		Type 1	Type 2	Type 3		
	Philippines, United States	Mexico	Greece, Italy, Slovenia	Ireland, Luxembourg, United Kingdom	Switzerland	Brazil, Canada
↓	Secured liabilities					
	Insured deposits and uninsured deposits	Insured deposits	Insured deposits	Insured deposits	Insured deposits (privileged)	Insured and uninsured depositors rank pari passu with other unsecured creditors
		Uninsured deposits	Uninsured deposits of individuals and SMEs	Uninsured deposits of individuals and SMEs	Uninsured (non-privileged) depositors and other unsecured creditors	
			Other uninsured deposits (large corporations)	Insured deposits of large corporations and other unsecured creditors		
	Other unsecured creditors	Other unsecured creditors	Other unsecured creditors			
	Subordinated liabilities, equity					

* Situation from 1 January 2019, based on information publicly available at the time of publication of this paper. The table provides a simplified overview of the ranking of depositors in relation to other senior unsecured creditors. It does not cover secured or subordinated creditors (broadly represented in the grey rows), or all classes of unsecured claims that might be preferred over depositors and other senior creditors (eg tax or labour claims).

31. **The design and scope of depositor preference entails trade-offs in allocating assets in the insolvency between different classes of depositors and general creditors, and in the expected recoveries for the deposit insurer.** For instance, under general depositor preference, all depositors rank equally, ahead of other unsecured creditors. This option provides a high level of protection to all depositors since, regardless of their nature, as a class they have a priority claim on the estate over all other unsecured creditors. The deposit insurer will be included in that preferred class through subrogation to the claims of the insured depositors.[23] However, its recoveries may be lower compared with systems of tiered or insured depositor preference, since assets will be shared pari passu between the deposit insurer

[23] For instance, in the United States, the FDIC in its corporate capacity as deposit insurer ranks equal to uninsured depositors and ahead of other unsecured creditors. On the other hand, in EU jurisdictions, Switzerland and Mexico, deposit insurers rank ahead of uninsured depositors and other unsecured creditors.

and all other depositors. If deposits constitute most of the liabilities of the failed bank, this is likely to result in the burden of the failure falling on those that are required to contribute to funding the deposit insurance (usually, the banking industry, on a risk-sensitive basis). On the other hand, when depositor preference is restricted to insured depositors only, the deposit insurer is likely to recover a significantly greater proportion of its costs in covering the insured depositors, since it does not need to share losses with uninsured depositors and other general creditors. However, in that case, uninsured depositors and unsecured creditors are more exposed to the risk that their claims will not be met in full in the liquidation.

32. **In a few of the sampled jurisdictions, financial stability considerations can be taken into account, under specific conditions, in the conduct of the insolvency.** In those cases, the options available in the insolvency proceeding may be expanded. In the United States, during the GFC, authorities addressed financial stability concerns under a "systemic risk exception" to the "least cost" test. While the least cost test[24] requires that the FDIC exercise its functions and powers under the FDI Act in the manner least costly to the deposit insurance fund, the systemic risk exception, as it applied at that time, allowed the FDIC to bypass it if that would avoid or mitigate serious adverse effects on economic conditions or financial stability that would arise if the least cost test were adhered to. Use of the systemic risk exception was subject to strict conditions, and during the GFC it was used only three times (FDIC (2018)). With the passage of the Dodd-Frank Act in 2010, the ability to use the systemic risk exception was further restricted. In the Philippines, deposit insurance funds may only be used to provide financial assistance to an insured bank where the Bangko Sentral ng Pilipinas has determined that its failure and closure would have systemic consequences as a result of the contagion effects of a loss of confidence in the banking or financial system generally. In all other cases, the Philippine Deposit Insurance Corporation (PDIC) must liquidate or resolve the bank, and use of deposit insurance funds is subject to a least cost test.

Grounds for opening insolvency proceedings

33. **In most of the regimes surveyed, the grounds for insolvency are broadly designed to facilitate timely opening of the proceedings.** Involuntary proceedings under ordinary corporate insolvency regimes are normally initiated by petition by one or more creditors or the company's management on the grounds of actual or anticipated insolvency, meaning that the company's liabilities exceed its assets or the company is unable to pay its debts as they become payable. The bank insolvency regimes in most of the surveyed countries allow insolvency to be opened on different, or a broader set of, grounds. These may include pre-insolvency capital-based triggers (for example, where regulatory capital falls below a specified level) or other regulatory triggers such as a determination that the bank is not being operated in a safe and sound manner. Such a broader set of grounds allows for an earlier opening of the insolvency proceedings.

34. **In most of the bank-specific regimes surveyed, the grounds for bank insolvency proceedings go beyond those in ordinary corporate insolvency law and include regulatory triggers.** In Mexico, for example, quantitative capital triggers are specified in the credit institutions law, which contains the bank-specific insolvency framework and the general provisions applicable to banking institutions issued by the Comisión Nacional Bancaria y de Valores (CNBV).[25] In others, the grounds for opening insolvency proceedings include infringements of the requirements for authorisation (Brazil, Greece, Italy, Luxembourg, Slovenia and Switzerland). This would include, in addition to the breach of the

[24] In 1991, the enactment of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) required the FDIC to use the least costly option to the Deposit Insurance Fund (DIF) when resolving failed banks. Consequently, the FDIC performs a least cost analysis to compare the bids of prospective purchasers of a failed bank with the liquidation cost.

[25] In Mexico, liquidation is automatically opened as soon as one of the following three conditions is met and provided that systemic risk exception is not triggered: (i) the bank's capital ratio falls below 4.5% (Common Equity Tier 1); (ii) the bank is in severe non-compliance with its capital restoration plan approved by the CNBV under the Conditional Operation Regime (COR); or (iii) the bank defaults on its payments.

Box 3

Deposit insurance

In a typical bank run, depositors no longer trust the ability of the bank to meet its obligations and demand back their cash on deposit. Deposit insurance systems① are a response to this problem. They cover deposits up to a specified limit, with the aim of reducing depositors' natural incentive to protect their individual interests by withdrawing funds from problem banks. While all the sample jurisdictions have deposit insurance systems in place, this is not universal.

Deposit insurance systems or schemes may be funded ex ante or ex post, but the general approach is that financing should come from the banking sector on a risk-sensitive basis. Irrespective of how they are financed, the common feature of all deposit insurance systems is that they pay out insured depositors in an expedited manner, without the delays of a lengthy insolvency proceeding. Following that payout, the deposit insurer is subrogated to the rights of insured depositors against the failed bank. This automatic subrogation is provided for by the laws of all selected jurisdictions, so that the insurer succeeds to the rights of the insured depositors in relation to their claims.

While payout of insured deposits is always expedited, and not dependent on the liquidation, the time frame varies. Insured depositors should be paid out "as soon as possible" in Brazil, Canada, Mexico, the Philippines and the United States. In practice, the FDIC would make a determination of the insured deposits of the failed bank within 24 hours after its appointment as receiver and would begin payments to insured depositors as soon as possible thereafter, usually on the next business day after bank closing.② In Mexico, the legal framework specifies a longer deadline (90 days), but past experience shows that insured deposits are paid out in a much shorter period. Other countries set precise time limits – for instance, seven business days (EU jurisdictions)③ or 20 business days (Switzerland).

The role of the deposit insurer in bank liquidation varies greatly. In most European jurisdictions, the deposit insurer manages a fund and plays no role in liquidation other than as a creditor by virtue of subrogation. In other jurisdictions, deposit guarantee schemes are required by law to cooperate with liquidators in achieving an explicit insolvency objective of prompt repayment of insured depositors (eg Ireland and the United Kingdom). However, in some jurisdictions (eg the Philippines and the United States), the deposit insurer plays a leading role in bank liquidation in its capacity as receiver. In those cases, the deposit insurer is also responsible for supervising deposit-taking banks.

Approaches also vary as to whether, and to what extent, the deposit insurer can go beyond a pure paybox function and finance other measures or transactions with the objective of protecting deposits. In some countries, deposit guarantee schemes have specific resolution functions (FSB (2012)). In other jurisdictions, deposit insurance funds may be used in an insolvency procedure to enhance the chances of the sale of the failed bank, or part of it, subject, where applicable, to a least cost test.

The EU framework on deposit guarantee schemes (DGS) allows DGS of individual member states to go beyond a pure reimbursement function and finance measures to prevent the failure of a deposit-taking bank, subject to several restrictions, including that the costs of such measures should not exceed the costs of protecting covered deposits. In addition, any measure taken by a nationally established DGS must comply with European state aid rules (Box 4).

① This paper uses IADI's definitions (IADI (2014)): "deposit insurer" refers to the specific legal entity responsible for providing deposit insurance, deposit guarantees or similar deposit protection arrangements. ② FDIC (1998). ③ Currently, the regimes in Ireland, Slovenia and the United Kingdom provide for a longer 20-day time limit, but compliance with EU law requires it to be reduced to seven days by 2023.

minimum capital requirements, other regulatory breaches if sufficiently material. A regulatory determination that a bank is undercapitalised will generally occur before the bank could be determined to be insolvent within the ordinary meaning of that concept. A regulatory determination based on capital impairment may also take due account of the particular fragility of banks as regards liquidity. For banks, the inability to pay debts as they become payable may also be due to a temporary shortage of liquidity, which could arise as a result of extraneous, system-wide causes.

35. **Some countries also include forward-looking grounds that the bank is "likely to fail".** While regulatory factors extend the grounds for insolvency, their capacity to facilitate timely opening of insolvency for troubled banks may be limited by the fact that these triggers tend to be "lagging" indicators

of a bank's condition. In order to allow early action by authorities in cases where failure appears unavoidable, some countries (eg Italy) revised their bank insolvency regimes to include the concept of "likely to fail" as a grounds for insolvency (Table 5). In other countries, the concept of "likely to fail" constitutes grounds for resolution only (Greece and Slovenia). However, a determination that a bank is likely to fail may lead to withdrawal of its licence, which, in turn, constitutes grounds for insolvency (Slovenia). Allowing insolvency proceedings to be opened on such anticipatory grounds may better preserve value and give higher protection to depositors. It also aligns the grounds for insolvency with the conditions for entry into resolution under the national bank resolution regime.

Grounds for bank insolvency* Table 5

Jurisdiction	Balance sheet insolvency	Material regulatory breaches	Specified quantitative capital triggers	Explicit statutory forward-looking criterion
Brazil	✓	✓	×	✓
Canada	✓	✓	×	✓
Greece	✓	✓	×	×**
Ireland	✓	×	×	✓
Italy	✓	✓	×	✓
Luxembourg	✓	✓	×	✓
Mexico	✓	✓	✓	×
Philippines	✓	✓	×	✓
Slovenia	✓	✓	×	✓
Switzerland	✓	✓	×	×
United Kingdom	✓	×	×	✓
United States	✓	✓	✓	✓

* This table is not intended to be comprehensive. It aims to compare at a high level the main grounds for insolvent liquidation of a bank under the sample regimes, and does not cover all the available grounds in some cases. The grounds featured are defined as follows:

– "Balance sheet insolvency" broadly means that liabilities exceed assets and/or the bank is unable to pay debts when they fall due.

– "Material regulatory breaches" refers to breaches that may cause the withdrawal of the banking licence and/or the winding-up of the bank. This will include breaches directly related to financial soundness, such as failure to meet the minimum regulatory capital levels, but may also include conduct-related conditions, such as breach of regulations on money-laundering.

– "Specified quantitative capital triggers" means quantitative thresholds that, if breached, lead to the opening of an insolvency proceeding (eg in Mexico this is the case when CET1 falls below 4.5%).

– "Forward-looking criteria" refers to anticipatory grounds that allow insolvency proceedings to be opened before the bank becomes balance sheet-insolvent or fails to meet regulatory minima. This is a broad category that covers not only the EU concept of "likely to fail", but also other forward-looking assessments (eg expected inability to pay debts as they fall due, expected material regulatory breach).

** In Greece, withdrawal of the banking licence is a formal step prior to the opening of insolvency proceedings. The forward-looking criterion "failing or likely to fail" is only explicitly provided for as a trigger for resolution.

Role of judicial and administrative authorities

36. **The respective roles of administrative and judicial authorities vary substantially across the different types of insolvency proceedings analysed.** In both court-based and administrative bank insolvency proceedings, administrative authorities retain some level of involvement. At a minimum, they have a role in petitioning the court for the opening of the insolvency proceeding, and may have some ongoing involvement in supervising the liquidation. By contrast, in some administrative proceedings, the court has no role other than in the event of a legal challenge or judicial review of the actions of the administrative authority.

Administrative proceedings

37. **In administrative regimes, the supervisor or the deposit insurer may be responsible for conducting bank insolvency proceedings.** In five of the eight administrative regimes analysed, the administrative authority responsible for the insolvency proceeding is the national prudential supervisor (Brazil, Greece, Italy, Slovenia and Switzerland);[26] and in the remaining three jurisdictions, it is the deposit insurer (Mexico, the Philippines and the United States).

38. **The liquidation may be carried out either by a public administrative authority or by a liquidator.** Where the administrative authority does not carry out the liquidation, it may appoint and supervise the external liquidator.

39. **Several of the administrative regimes surveyed combine bank liquidation and resolution functions in the same authority.** In each case, the jurisdiction has a single administrative bank insolvency framework covering resolution and liquidation (Mexico, the Philippines and the United States), and the administrative authority responsible under that regime is also the deposit insurer.[27] Concentration of tasks in a single authority may reflect the benefits of synergies between tasks.[28] In all the other regimes surveyed, the bank resolution authority is not also directly responsible for carrying out the liquidation under the bank insolvency regime, although it may appoint and oversee an external liquidator. However, this may be the result of the historical evolution of the insolvency and resolution regimes, rather than a deliberate policy choice to separate those functions.

[26] For example, in Greece only the central bank can open the insolvency procedure, and it oversees all activities performed by the liquidators. The role of courts is limited to settling disputes between creditors and the special liquidator arising from the distribution plan for the proceeds.

[27] In its corporate capacity, the FDIC serves as deposit insurer for all insured banks and as the federal prudential supervisor for state non-member banks. In the event of a failure of an insured bank, the FDIC would serve in its corporate capacity as deposit insurer and in its receivership capacity as liquidator (receiver) of the bank.

[28] The benefit of concentrating all functions in a single authority, however, has to be balanced against risks that this may give rise to conflicts of interest. For example, although the Canadian regime permits the CDIC to be appointed as liquidator, it has typically not taken up that role because it is also a major creditor in a bank insolvency. Instead, a licensed insolvency trustee is appointed, although the CDIC may enter into agreements with the liquidator and set terms of engagement and reporting.

Role of the authorities in administrative insolvency proceedings Table 6

Jurisdiction	Administrative authority in charge of the insolvency proceedings	Is that authority also the resolution authority?	Is that authority also the deposit insurer?	Who is in charge of liquidating the entity?	Authority appointing liquidator	Authority in charge of supervising liquidator(s)
Brazil	CBB	Yes	No	External liquidator	CBB	CBB
Greece	BoG	Yes**	No	External liquidator	BoG	BoG
Italy	BoI	Yes**	No	External liquidator	BoI	BoI
Mexico	IPAB	Yes	Yes		n/a	n/a***
Philippines	PDIC	Yes	Yes		BSP	n/a****
Slovenia*	BoS	Yes**	Yes	External liquidator	BoS	BoS
Switzerland	FINMA	Yes	No	FINMA or external liquidator	FINMA	FINMA
United States	FDIC	Yes	Yes	FDIC	OCC or state bank chartering authority	n/a

* The table refers to the administrative bank insolvency proceedings (extrajudicial liquidation in Brazil and compulsory liquidation in Slovenia).

** Together with the Single Resolution Board, where the bank is significant or the group is cross-border (Box 2).

*** IPAB, as liquidator, has the power to appoint, by contract, a third party to carry out the process on its behalf. This third party acts under the supervision of a Committee for Bank Liquidation that includes representatives from several departments within IPAB. IPAB remains legally responsible for the process. IPAB or the third party liquidator must report to the court every two months on the conduct of the insolvency proceedings, and the court must share the report with the CNBV, which can make observations. The liquidator has 15 days to respond.

**** The PDIC, as receiver or liquidator, files a petition with the court for assistance in the liquidation of the bank. On granting the petition, the court is constituted as the liquidation court and acquires exclusive jurisdiction over disputed claims involving the assets of the closed bank. The PDIC submits the plan of distribution of the assets of the closed bank to the liquidation court for approval.

Court-based regimes

40. **In court-based regimes, administrative authorities retain some involvement, reflecting the special nature of bank insolvency.** In all court-based insolvency regimes reviewed, an administrative authority has the right to petition to open the proceedings, suggesting that its views and knowledge of the bank's financial condition and prospects of recovery will be highly relevant to a determination of whether the bank should be put into insolvency (Table 7). In some jurisdictions, that is an exclusive right; in others, other parties may also petition, but the administrative authority must be consulted or has to approve. However, after proceedings are opened, administrative authorities generally have little or no role. The liquidator is typically appointed and supervised by the court without the involvement of the administrative authority (although in Ireland the public authority nominates a liquidator for formal appointment by the court).[29] This may be consistent with a broader policy position in favour of judicial

[29] In Ireland and the United Kingdom, public authorities also nominate members of the liquidation committee that oversees the liquidator in respect of the statutory depositor protection objective.

control or oversight of insolvency proceedings that motivates the choice of a court-based bank insolvency regime.

41. **In court-based regimes, courts may have some discretion to adapt the individual proceeding to the specific characteristics of the case.** For example, in the Luxembourg bank insolvency regime, the court has the power to selectively apply and adapt rules of general insolvency law to best deal with the features of the specific case, within the general objective of maximising returns for creditors.[30]

Role of the authorities in the court-based insolvency proceeding — Table 7

Jurisdiction	Administrative authority that petitions for insolvency	Resolution authority	Extent of the ongoing role of the administrative authority in insolvency proceeding	Liquidator	Authority appointing liquidator	Authority in charge of supervising liquidator(s)
Brazil*	CBB (through an external liquidator)	CBB	No role	External liquidator	Court	Court
Canada	OSFI (Attorney General)	CDIC	No role	External liquidator or CDIC	Court	Court and CDIC
Ireland	CBI**	CBI***	– Nominates the liquidator to the court – Appoints two members of the liquidation committee (for purposes of Objective 1)	External liquidator	Court	Court
Luxembourg	CSSF	CSSF***	No role	External liquidator	Court	Court
Slovenia*	BoS	BoS***	No role	External liquidator	BoS	BoS
United Kingdom	BoE	BoE	– May propose liquidator to the Court – Appoints member of liquidation committee (for purposes of Objective 1)	External liquidator	Court	Court

* Refers to the bankruptcy proceeding following the administrative proceeding.

** Other persons can petition for insolvency if the CBI does not object.

*** Together with the Single Resolution Board, where the bank is significant or the group is cross-border (Box 2).

Role of creditors

42. **The role of creditors in bank insolvency regimes is generally significantly reduced in comparison with ordinary corporate insolvency regimes.** In ordinary insolvency regimes, creditors

[30] For example, in the insolvency of the Luxembourg entity of the Bank of Credit and Commerce International (BCCI), the court tailored the procedural rules by: (i) ordering that all claims be converted into US dollars, with the exchange rate as of the date of the opening of the procedure; and (ii) allowing pooling agreements with third-country authorities for the purpose of putting together different bankruptcy estates located in different countries and subject to different statutory regimes. These modifications aimed to address specific challenges arising from the global nature of BCCI.

generally have a right to be heard and their consent may be required in a number of key areas. In particular, creditors' committees commonly provide a mechanism for unsecured creditors to monitor the operations of the liquidator and, in some procedures, constitute a forum for the liquidator to consult the creditors' representatives on specific actions. There is no analogous role for a creditors' committee to represent creditors' interest in most of the bank-specific insolvency regimes surveyed, irrespective of whether those regimes are administrative or court-based. Moreover, creditors (and shareholders) generally do not have the same level of procedural standing in bank insolvency proceedings, and their legal remedies may be modified. This is consistent with the depositor protection objectives of bank insolvency regimes and the fact that, at least for smaller banks, the majority of creditors will be depositors. It also reflects the prioritisation of speed, since procedural requirements such as creditors' meetings may lengthen the proceeding and delay the return of assets to creditors.

Box 4

Limitations to creditors' roles in a FDIC receivership

The US statutory frameworks for bank resolution and corporate bankruptcy (including bank holding companies) are different. Key differences that are relevant to creditors' rights include:

(i) **Claims process** – Under the US Bankruptcy Code, there is a presumption that all claims filed within the deadline are allowed in full, unless explicitly disputed. The same presumption does not apply under the FDI Act. The FDIC as receiver must explicitly allow a creditor's claim filed within the deadline which is proved to its satisfaction.

(ii) **Contract repudiation** – Generally under the US Bankruptcy Code, executory contracts are deemed rejected unless explicitly assumed by the debtor within time frames specified by statute. Under the FDI Act, the FDIC as receiver may adopt or repudiate contracts with a reasonable period after the appointment of the receiver.

(iii) **Litigation stays** – Generally under the US Bankruptcy Code, stays against litigation are automatic unless lifted by a bankruptcy court order. Under the FDI Act, the FDIC as receiver may request a stay of litigation of up to 90 days (or up to 45 days by the FDIC as conservator).

(iv) **Special defences to claims** – Under the US Bankruptcy Code, a trustee may generally only defeat claims with defences that were available to the debtor. Under the FDI Act, additional statutory defences are available to the FDIC as receiver.

(v) **Court action** – Under the US Bankruptcy Code, the debtor and creditors are subject to the jurisdiction of a bankruptcy court and bankruptcy judge. Under the FDI Act, generally no court may take any action to restrain or affect the FDIC's powers as receiver or conservator. However, judicial review is permitted for disallowed administrative claims and certain other claims against the FDIC as receiver or conservator.

43. **Nevertheless, there are some exceptions to this general principle, where creditors retain a role in bank insolvency proceedings.** In Canada and Luxembourg the establishment of a creditors' committee is permitted, though optional. In Switzerland, FINMA may designate a creditors' committee and determine its composition and powers. In Ireland and the United Kingdom, a creditors' committee is not established immediately. Rather, on opening of bank insolvency proceedings, a liquidation committee composed of three individuals is established. Its role is to advise the liquidator on how best to achieve Objective 1 (full payment of depositors eligible for deposit guarantee). Once Objective 1 has been achieved, the liquidation committee can be replaced by a creditors' committee to monitor and advise

liquidators in relation to Objective 2 (maximisation of value and distribution of residual assets to creditors).[31]

Role of creditors' committee — Table 8

Jurisdiction	Type of proceeding	Any role for creditors' committee?
Brazil	Administrative*	No**
Canada	Court-based	Optional
Greece	Administrative	No
Ireland	Court-based	No (Objective 1) – Optional (Objective 2)
Italy	Administrative	No
Luxembourg	Court-based	Optional
Mexico	Administrative***	No
Philippines	Administrative***	No
Slovenia	Administrative	No
Switzerland	Administrative	Yes****
United Kingdom	Court-based	No (Objective 1) – Yes (Objective 2)
United States	Administrative	No

* A subsequent court-based bankruptcy proceeding can take place in accordance with the ordinary insolvency law, in which there is a formal role for a creditors' committee.

** Although creditors have no role in extrajudicial liquidation, the creditors' general assembly must be convened if shareholders submit for creditors' approval a plan to convert the proceedings into voluntary liquidation or to change the bank's corporate objectives to a non-financial activity. After the creditors' general assembly's approval, the CBB can decide the termination of extrajudicial liquidation.

*** The legislation provides for limited court involvement but is principally administrative.

**** Only if approved by FINMA.

Available instruments and actions

44. **The range of instruments available in bank insolvency regimes varies across countries.** As in ordinary insolvency, the authority in charge liquidates assets in order to repay creditors. While piecemeal sale of banks' assets is an option, sale of entire business lines may best preserve value. Liquidators conventionally have broad discretion over how to sell assets in the way that is most likely to maximise creditor value. However, bank insolvency regimes vary in the range of instruments that are available to facilitate sales and the conditions that apply to their use.[32]

45. **At a minimum, any insolvency procedure will involve realisation of assets to repay creditors, and bank insolvency regimes may prioritise repayment of insured depositors.** Rapid payment of insured depositors is generally achieved by payout under the deposit insurance scheme, in which case the deposit insurer is subrogated to the insured claims in the liquidation.

46. **As an alternative to depositor payout, depositors may be protected through a transfer of their accounts to a healthy bank.** This typically involves some form of purchase and assumption transaction by the liquidator, in which a third-party bank purchases assets and assumes liabilities (including

[31] In Ireland, a committee of inspection (that is, a committee of creditors) is optional and may not be set up in every case. Where it is established, the CBI may: (i) attend meetings of the committee of inspection; (ii) receive copies of all documents relating to the business of the committee of inspection; and (iii) make representations to the committee of inspection.

[32] Since some of the selected jurisdictions do not distinguish between resolution and insolvency, the terminology used in Table 8 is, as far as possible, neutral and is not intended to refer to a specific national regime.

deposits). Provided there is market demand for such business acquisitions, they may preferable to liquidation, since payout of deposits is avoided, depositors experience minimal interruption in accessing their accounts, and sales of whole business lines are likely to increase returns for creditors.

47. **In some jurisdictions, the liquidator has additional, innovative instruments that may be used to increase the prospects of a sale by offering various forms of financing support to acquirers.** Table 9 describes some such instruments, which are typically a feature of regimes that combine "resolution" powers and liquidation provisions in a single administrative insolvency regime. For example, in the United States, for a limited period of time the FDIC offered loss-sharing arrangements to purchasers to facilitate the sale of failed bank assets during the GFC. The ability to provide guarantees or enter into profit- and loss-sharing agreements with purchasers that assume deposits (and possibly other liabilities) and acquire assets of the failed banks may increase the options for protecting depositors without resorting to payout of insured claims by the deposit insurer. Such arrangements may facilitate sales (purchase and assumption) in circumstances where buyers might not otherwise exist, and preserve value for creditors compared with liquidation, in which assets may be sold at depressed prices. The use of deposit insurance funds in such instruments is possible even where a least cost test applies.[33]

48. **Sales or asset transfers are frequently available to appointed liquidators in court-based proceedings.** However, administrative authorities may have an advantage to the extent that they can undertake preparatory activities prior to the opening of insolvency: for example, exploring the market to find potential purchasers or preliminary assessments of the failing bank's assets with a view to preparing sale offers and terms. Court-appointed liquidators typically only have access once the bank is put into insolvency. Moreover, a specialised administrative authority may be better placed to act quickly, which may help preserve asset value.

49. **Some insolvency regimes may also provide for the temporary use of a bridge bank.** In jurisdictions that distinguish between resolution and insolvency regimes, bridge banks tend to be available as a resolution tool to preserve critical functions of a failed bank until a purchaser can be found. However, in other jurisdictions, such as the United States, bridge banks have been used under the bank insolvency regime when a purchase and assumption transaction is not a viable option in the market conditions prevailing at the time of the failure, either because fast sales in those conditions would entail significant losses or because of a lack of potential purchasers. In these circumstances, transfer to a bridge bank prevents material interruption of access to deposits, and is also likely to maximise value (and thereby protect the deposit insurer) by preserving the 'going concern' value of the operations. However, to comply with the least cost test requirements, a bridge bank can only be used where the preservation of franchise value would exceed the incremental costs of running the bridge, and the complexity of running a bridge bank mean that it has not been used extensively (FDIC (2018)).

[33] Least cost principles vary between jurisdictions where they exist. In the United States, the test requires that the FDIC evaluate all possible resolution alternatives and compare the cost of the various alternatives on a present value basis to determine the least cost to the deposit insurance fund. These alternatives would include the purchase and assumption of assets and liabilities by prospective third-party purchasers or liquidation of the failing bank. The FDIC then chooses the least costly option from the point of view of the deposit insurance fund. In other jurisdictions, the least cost principle is satisfied provided that the funded measures are less costly for the deposit insurer than a depositor payout combined with liquidation.

Selected insolvency instruments

Table 9

Instrument	Main features
Insured depositor payout and liquidation	The responsible authority or appointed liquidator pays out insured deposits, using deposit insurance funds, and then proceeds with the liquidation of the assets.
Transfers or sales:	The responsible authority or appointed liquidator seeks an acquirer for the bank's assets and liabilities. Insured deposits are thereby transferred to a healthy bank. Deposit insurance funds may be used to provide the acquirer with cash equalling the difference between the assumed deposits and the market value of the transferred assets (subject to any least cost test).
a) of deposits and cash	The acquirer assumes the deposits and receives cash and/or cash equivalent.
b) of the whole or part of the bank	The acquirer assumes liabilities, including the deposits, and receives some or all the assets of the failed bank (ie purchases the assets by taking on liabilities).
c) with loss-sharing	The liquidator agrees to share with the acquirer certain losses (or potentially, profits) arising from assets acquired.
d) with loan pools	Similar loans or assets are grouped to enable potential acquirers to submit separate bids for each pool.
e) combination of a) to d)	
Bridge bank	A temporary bank, generally operated by a public authority, that acquires the assets and assumes the deposits (and potentially other liabilities) of a failing bank for a period until they can be sold to the private sector. The failing bank is closed and wound up.

Sources: FDIC (2018); McGuire (2012).

Box 5

The interplay between instruments available in liquidation and state aid rules in the EU

The BRRD, which became effective in 2015, classifies the use of transfer powers for sale of business, asset separation and bridge transactions as 'resolution'. However, in a number of EU member states, the national bank insolvency regime also contains explicit provision for liquidators to perform transfers to protect insured depositors and to maximise recovery value. In Slovenia, a set of transfer tools mirroring those available in resolution is also available in a liquidation. Similarly, the administrative bank insolvency regimes in Greece and Italy include explicit provision for transfers, such as sale of assets of the insolvent bank to an acquirer. In the United Kingdom, the modified bank insolvency provisions contemplate that liquidators may transfer insured deposits to an acquirer as a means of achieving Objective 1 (protection of insured depositors). Past experience shows that transfer of business is also an available option in judicial liquidation (eg Luxembourg).

The use of such instruments in national insolvency proceedings is not subject to the constraints that apply when substantively similar actions are taken using resolution tools under the BRRD – in particular, the requirement that shareholders and creditors absorb a minimum amout of losses where resolution funds are used to finance the transfer. Such use in insolvency is, however, subject to EU state aid rules, which prohibit member states from taking action that unfairly advantages firms in a manner that affects the proper functioning of the single market. To comply with EU law, asset transfers in insolvency proceedings should not be aimed at rescuing a bank, or part of it, from failure. Nor should they keep the bank open in the pursuance of resolution objectives.

The issue of state aid arises in relation to the funding of transfers, including through the use of deposit insurance funds. Approval of state aid by the European Commission is subject to conditions: it must be needed to remedy a serious disturbance in the economy of a member state; and shareholders and subordinated creditors contribute as much as possible to the cost of the intervention by bearing losses. This imposes a constraint on EU jurisdictions in the use of deposit insurance funds to finance purchase and assumption transactions compared with others where the deposit insurer may enter into arrangements such as loss share agreements with a third party that purchases assets of a failed bank, provided that the least cost test is respected (eg Canada and the United States).

Section 4 – Reflections on features of bank-specific insolvency regimes

50. **Appropriately-designed bank-specific insolvency regimes provide an effective alternative to resolution for banks that do not meet the public interest thresholds or other conditions for use of special resolution tools.** The insolvent winding-up of such a bank may, nevertheless, entail a public policy dimension that ordinary insolvency procedures, with a primary focus on maximising returns to creditors as a whole, are not developed to address.[34] Bank insolvency regimes may be designed in a way that takes better account of the public policy concerns arising from the activities of banks and specific risks that they entail, within a framework where the ultimate aim is the realisation of assets, distribution of the proceeds to creditors and dissolution of the bank as a legal entity.

51. **The design of bank-specific or modified insolvency regimes involves a range of policy choices.**[35] Those choices focus on the objectives of the regime and key features – such as the balance between administrative and judicial control, the nature and role of administrative authorities involved, and the instruments available in the procedure – that best support those objectives. This section discusses various options in the design of bank insolvency regimes and considerations that might inform choices between those options, based on the features of bank insolvency regimes presented in Section 3.

Nature of insolvency proceedings: court-based or administrative

52. **An administrative regime facilitates an expedited insolvency procedure.** Speed may be particularly important in dealing with bank failures and the associated public interest concerns. Since the administrative authority or its appointed liquidator will make most or all of the decisions, this may reduce the time required and, possibly, the costs of the insolvency compared with court-based proceedings. Appropriate expertise for bank insolvency may be concentrated in an administrative authority, which may also support speed and efficiency. An administrative regime may also provide a wider range of options for orderly bank insolvency by conferring on the responsible authority additional instruments beyond conventional liquidation actions, which may increase available options in insolvency.

53. **However, the efficiency of administrative relative to court-based proceedings depends on a number of factors.** The speed with which an individual insolvency is concluded will depend, in particular, on the complexity of the case and the amount of connected litigation, including creditor challenges to the liquidation. Moreover, the possible advantages of administrative proceedings in terms of efficiency may be reduced when there is a wide range of non-depositor creditor claims. Court-based proceedings may be better suited to dealing with a large number of creditor claims of different classes. In complex cases with diverse classes of creditors, there may be a perception that a court-based regime is inherently more impartial with greater procedural protections than administrative proceedings. Furthermore, any advantages in terms of the specialist expertise that might be concentrated in an administrative authority will depend on the size of the authority, the number of bank failures it routinely deals with, and the extent to which it relies on external contractors or practitioners.

54. **The choice between administrative and court-based regimes entails trade-offs between considerations such as speed, efficiency, specialist expertise and safeguards for creditors.** That choice will therefore depend to a large extent on the objectives that are prioritised in the legal framework. If a key objective in bank insolvency is to protect depositors, this may represent an acknowledged policy

[34] There may be an analogous public policy dimension when a failed company is a public utility or infrastructure provider. Many jurisdictions have modified or developed specific insolvency provisions or procedures for such companies.

[35] References in this section to "bank insolvency regimes" include both free-standing, bank-specific regimes and modified regimes (Section 3).

trade-off in favour of an administrative regime that is designed to enable deposits to be dealt with swiftly and efficiently. An administrative authority with appropriate expertise is likely to be better able to direct a complex procedure efficiently and in a way that has due regard to public interest objectives. Although the trade-offs involved in an administrative regime may include reduced procedural rights for non-depositor creditors, creditor protection could take the form of rights to challenge its outcome, but without significantly affecting the speed or effectiveness of the process.[36]

Grounds for opening insolvency proceedings

55. **Provision for timely opening of insolvency proceedings, on a range of grounds, supports public interest objectives.** Where present in insolvency frameworks, such provision reflects a focus on public interest considerations and supervisory concerns about banks, including the difficulties in valuation of banks' assets; the peculiar fragility of banks; and the possible speed of decline. In particular, timely opening of insolvency protects preferred claims of uninsured depositors and the deposit insurance funds by maximising the assets that are available to cover those claims. However, timely opening of proceedings may also protect other creditors insofar as it reduces the chances that asset values will be eroded during unsuccessful or futile recovery efforts by management.

56. **Greater discretion and flexibility in the opening of insolvency proceedings is generally associated with administrative regimes.** This is consistent with control of the procedure by an authority with a statutory mandate focused on public interest objectives. The ability to open proceedings on a broader range of grounds, which might include undercapitalisation, regulatory breaches or forward-looking criteria, supports those objectives. However, timely initiation can be combined with a court-based regime where the court order is based on a supervisory assessment that regulatory grounds are met.

57. **Grounds for insolvency that involve discretion may only operate effectively if coupled with appropriate liability protections for the authority that exercises the discretion.** If the decision to open bank insolvency proceedings is based on a qualitative assessment of broadly framed conditions, there may be a material risk of forbearance on the part of the authority. It is also possible that the insolvency process will be impeded by legal challenges to that decision by shareholders. This risk may be minimised if the legal framework imposes a high legal bar for liability for the authority: for example, administrative law standards such as illegality, gross negligence or misfeasance (as appropriate to the country's broader legal framework).

Role of creditors

58. **Limiting the role of creditors reflects the "public interest" dimension of bank insolvency and may support a more streamlined and faster process.** In particular, it is likely to limit obstructions to the completion of prompt action to protect depositors. However, competing considerations, such as the transparency, predictability and perceived fairness of the process, may also be relevant. Such considerations may be more pertinent if the administrative authority has flexibility to treat creditors of the same rank differently (for example, in order to maximise creditor value as a whole).

[36] There are different views in the literature as to whether court-based or administrative proceedings are preferable for banks (see, eg, IMF and WB (2009)). However, while the design of an effective regime depends on a number of factors, administrative regimes seem better able to support speed and specialisation. In the European Union, this position has been expressed by the European Commission: "The desirability of administrative liquidation proceedings for banks to facilitate a faster and more orderly liquidation than the standard court-based procedure" (European Commission (2010)); and by the recommendation, in the context of the euro area FSAP completed in June 2018, that a flexible administrative liquidation tool be introduced for the Single Resolution Mechanism (IMF (2018)).

Identity of liquidating authority under an administrative regime

59. **In an administrative bank insolvency regime, the tasks of the insolvency may be carried out either by a public administrative authority or by a liquidator that it appoints and supervises.** The choice between these options will be informed by considerations about resources available to the authority and the costs of maintaining sufficient staff with the necessary expertise to deal with bank failures as they arise; the objectives of the insolvency procedure; the level of direct involvement and decision-making by an administrative authority that is considered desirable in the light of those objectives; and the nature and range of instruments chosen to facilitate those objectives.

60. **The choice of the national deposit insurer as liquidating authority may help achieve the depositor protection objectives that are core to its mandate.** That authority controls the process, acting in accordance with its statutory mandate and within any parameters set by the legal framework (the creditor hierarchy, applicable principles relating to equal treatment of creditors, etc). In the regimes surveyed where this is the case, the deposit insurer is responsible for making all the decisions necessary to carry out the insolvency procedure, without any oversight arrangements analogous to the oversight of a liquidator by the court in ordinary corporate insolvency. This policy option is unlikely to be appropriate if the deposit insurer is a private (eg industry-controlled) entity rather than a public authority.

61. **However, this arrangement could result in the person or entity that is responsible for the insolvency being the major, or a significant, creditor in the insolvency.** This is likely to be the case where the deposit insurer is subrogated to claims of insured deposits (which is a standard feature of deposit insurance arrangements). On the one hand, this may support an efficient process by aligning the incentives of the authority responsible for the liquidation with those of the largest class of creditors. On the other, this may give rise to a perceived lack of impartiality, since the liquidating authority has a pecuniary interest in ensuring that the realised assets are sufficient to cover the insured claims to which it has been subrogated, but has no comparable alignment with other creditors. While any conflict of interest can be mitigated by ensuring that, as liquidator, the authority has a legal obligation to maximise value for all creditors, the fact of the alignment with one class of creditors could affect perceptions of fair treatment. The relevance of these considerations may vary depending on the size and funding models of the banks that are subject to the regime (in particular, the likely range of creditors and the proportion of other classes of claims and liabilities relative to insured deposits).

62. **The combination of bank resolution and insolvency functions in the same authority may bring some efficiency gains.** In fact, only three of the jurisdictions surveyed combine bank liquidation and resolution functions and management of the deposit insurance fund in the same administrative authority. In those cases, that authority operates under a single insolvency framework that provides for both resolution and liquidation. On the opening of proceedings under that framework, the authority has the discretion to choose the appropriate instruments, subject to constraints on the use of deposit insurance funds (such as an obligation to take the action that incurs the least cost to those funds). This combination of functions can allow more flexibility to the responsible authority, but its feasibility is linked to the structure of, and interaction and coherence between, the national resolution and insolvency regimes.

Range of instruments available in insolvency

63. **The range of instruments available in an insolvency regime may affect the range of banks for which insolvency is a feasible option.** A regime that confers more options and greater flexibility to undertake a variety of transactions may be better suited to manage the insolvency of larger (but not necessarily systemic) banks than a regime based on a more limited set of liquidation powers. For example, protection of deposits through transfers (purchase and assumption transactions) is likely to be feasible in a wider range of cases if there is also the option for the liquidating authority to offer guarantees or enter

into profit- and loss-sharing arrangements. These options are more compatible with an administrative regime and may be particularly relevant in jurisdictions with separate insolvency and resolution regimes. The failure of a medium-sized bank may not meet that threshold, but the costs of liquidation through the destruction of going-concern value may lead to higher costs to the deposit insurer and greater direct losses to creditors. There may also be indirect impacts on other financial firms as a result of the externalities of a fire sale that fall short of the level of financial stability risk required for the use of resolution powers. A wider range of instruments in insolvency could increase the options for dealing with such cases in a way that best delivers the statutory objectives of the insolvency regime.

64. **However, instruments that go beyond conventional liquidation actions cannot be effective without a source of funding.** Deposit insurance funds may provide a source of such funding, but least cost restrictions on the use of those funds may in practice limit the use of transactions that involve the transfer of uninsured deposits in conjunction with insured deposits.

65. **Clarity over interaction of insolvency instruments and resolution powers is important.** A range of instruments in insolvency that facilitate transactions other than liquidation may complement resolution if they offer greater flexibility for the orderly winding-up of failing banks that do not meet the thresholds for resolution. It may also make insolvency a more feasible option for medium-sized banks for which resolution may not be credible because they lack sufficient loss-absorbing capacity (for example, suffiencient quantities of subordinated debt in their capital structures). While losses need to be allocated in insolvency, and appropriate loss-absorbing capacitycan help ensure orderly liquidation, the amounts required for that purpose will be lower than the amounts needed to maintain critical functions. However, where resolution and insolvency are separate regimes, their different objectives and the circumstances in which they apply should be clear.

Readiness planning

66. **Advance preparation supports the public interest objectives of bank insolvency.** Resolution regimes recognise that effective implementation of resolution requires detailed resolution planning by authorities, with the support of the banks themselves. While the same level of detailed planning may not undertaken for banks that are not systemically important, with critical functions that need to be maintained in resolution, effective delivery of insolvency objectives such as depositor protection is likely to need some form of readiness planning. In particular, rapid transfer or payout of insured deposits (for example, within days of the bank being put into insolvency) may not be feasible unless comprehensive and accurate data on insured deposits are immediately available to the relevant authority or liquidator and the deposit insurer.

67. **Readiness may also depend on an administrative authority and deposit insurer having sufficient advance notice that a bank is failing and that insolvency is likely.** This could require improved procedures for notification from the supervisor, based on effective information-sharing arrangements and protocols.

Cross-border coordination

68. **Cross-border insolvencies entail significant challenges of coordination and cross-border recognition.** These problems are well documented in academic literature and in international policy work, including by the Basel Committee on Banking Supervision (BCBS (2010)). National insolvency regimes are largely territorial in scope (outside of supranational legal frameworks such as the European Union[37]), apply on a legal entity basis, and are largely designed to deal with domestic failures and to minimise the losses

[37] In the European Union, a "universal" approach applies to insolvency proceedings covering EU banks and insurers and any branch located in the European Economic Area.

incurred by domestic stakeholders. Differences in liquidation rules across jurisdictions can affect the returns to depositors and other creditors. Cross-border complexities and uncertainties are a material barrier to efficient insolvency proceedings for banks with international operations. While administrative regimes may facilitate cross-border cooperation between the responsible administrative authorities, these challenges cannot be addressed only through the design of national regimes in the absence of internationally agreed arrangements.[38]

Section 5 – Concluding remarks

69. **Insolvency regimes generally share a number of common objectives and procedural features.** Broadly speaking, a liquidator is charged with realising the assets and settling creditors' claims in accordance with the applicable creditor hierarchy and principles such as equal treatment of creditors of the same class. The liquidator is generally required to carry out that task in a way that maximises value for creditors.

70. **However, ordinary corporate insolvency regimes are not best suited to the specific characteristics of banking business and particular risks that arise when a bank fails.** The unique susceptibility of banks to runs and their importance to the functioning of the financial system and real economy through activities such as deposit-taking, provision of credit and transmission of payments mean that bank failure is significantly more likely to give rise to public policy concerns than ordinary corporate failures. These concerns have motivated the development of resolution regimes for systemically important banks. However, banks that do not meet the thresholds or conditions for the application of resolution regimes are subject to winding-up under the applicable insolvency regime. While some countries have developed bank-specific insolvency procedures, in others a bank insolvency must be managed under the ordinary corporate regime.

71. **Bank-specific regimes typically have a number of common features that reflect the public interest concerns associated with bank failure.** Those features, which include the objectives of the liquidator, an expanded role for administrative authorities and a reduced role for creditors in the proceedings, are aimed in particular at protecting depositors by ensuring as far as possible minimum interruption of access to at least part of their funds and, more generally, at promoting speed and efficiency in the insolvency procedure.

72. **Most bank insolvency regimes have a depositor protection objective, in addition to the conventional insolvency objective of maximising value for creditors.** By contrast, few have explicit financial stability objectives since, where financial stability is a driving concern in the failure of systemically important banks, resolution is generally the more appropriate approach.

73. **Typically, bank insolvency proceedings can be opened on a wider range of grounds than ordinary corporate insolvency.** The ability to open insolvency proceedings on supervisory grounds reflects bank-specific characteristics, such as the difficulty of valuing banks' assets; the peculiar fragility of banks; and the possible speed of decline. Timely opening of insolvency also protects preferred claims of depositors, in particular by maximising the assets that are available to cover those claims.

74. **Bank-specific regimes generally feature an enhanced role for administrative authorities and reduced procedural involvement for creditors compared with ordinary corporate bank insolvency.** This feature tends to be common, to a greater or lesser extent, irrespective of whether the

[38] For example, in the area of resolution the work is ongoing at the international level to facilitate cross-border effectiveness of resolution actions, including through the design of resolution strategies and contractual recognition provisions in debt and financial instruments.

bank insolvency regime is administrative or court-based. It reflects the "public interest" dimension of bank insolvency and may support a more streamlined and faster process.

75. **The paper highlights the trade-offs between considerations such as speed, efficiency, specialist expertise and safeguards for creditors in the design of different bank-specific or modified insolvency regimes.** Generally speaking, timely and fast-moving insolvency proceedings better preserve asset value, thus better protecting preferred claims of depositors, in particular by maximising the assets that are available to cover those claims. Administrative regimes, where the insolvency is conducted or overseen by an administrative authority, may prioritise public interest objectives such as depositor protection. An administrative authority with appropriate expertise may be better able to direct a complex procedure efficiently and in a way that is consistent with its own statutory objectives. An administrative regime may also provide a wider range of options for bank insolvency by conferring on the responsible authority additional instruments beyond conventional liquidation actions, which may increase available options in insolvency. However, depositor protection objectives may also be achieved within a framework of appropriately modified court-based procedures.

76. **Given the large variety of practices in bank insolvency regimes, some guidance on effective features and practices would be beneficial.** Even in the limited sample of 12 jurisdictions covered in this study, country practices differ substantially. This may complicate cross-border insolvencies. Moreover, as this study highlights, there is considerable variation in the range of instruments available in insolvency. Some international discussion about the suitable range of insolvency instruments and institutional and procedural features that are effective in addressing the public interest dimension of bank insolvency could contribute to a broader understanding of efficient procedures.

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