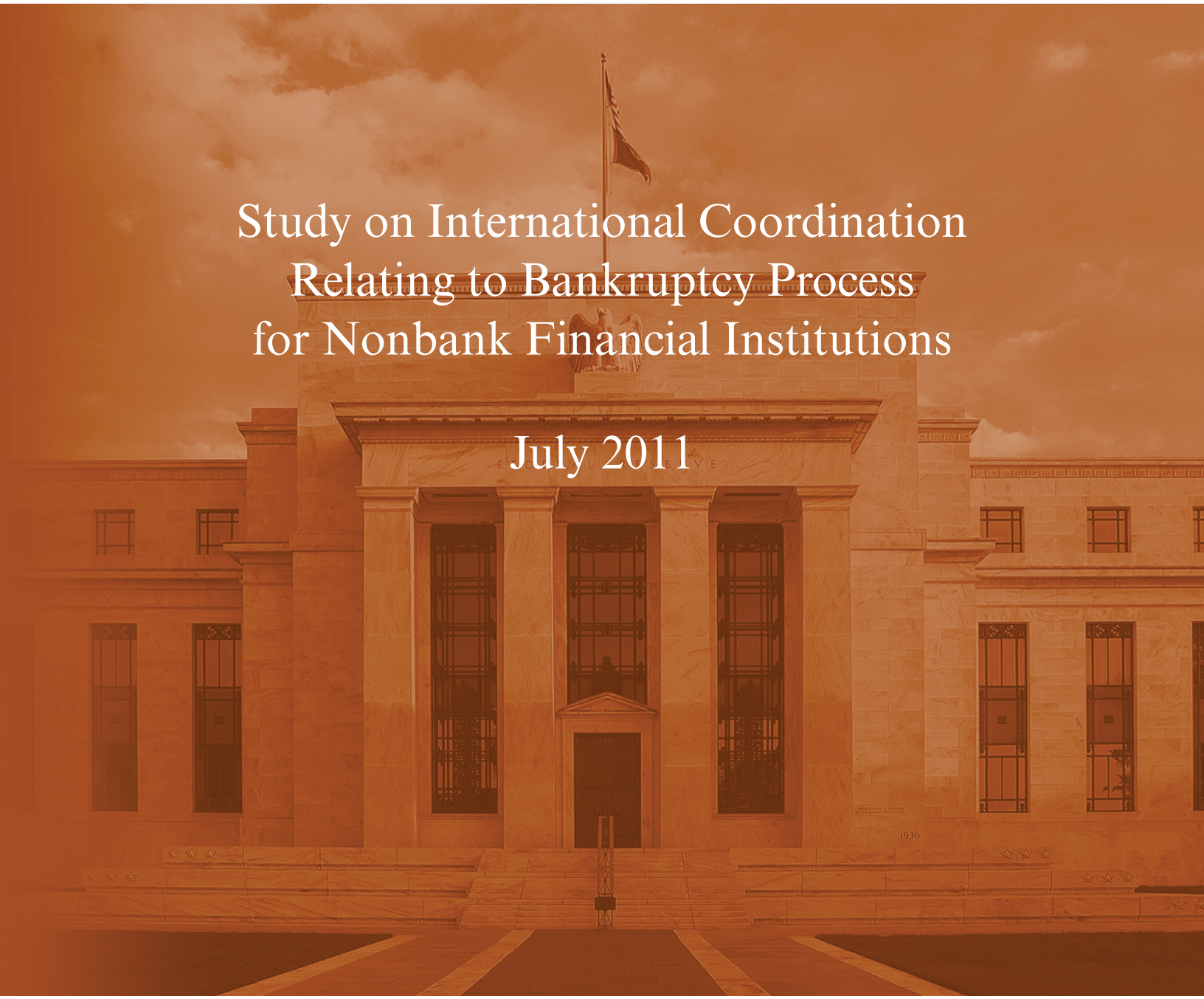

Study on International Coordination Relating to Bankruptcy Process for Nonbank Financial Institutions

July 2011

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Preface: Implementing the Dodd-Frank Act

The Board of Governors of the Federal Reserve System (the Board) is responsible for implementing numerous provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act requires, among other things, that the Board produce reports to the Congress on a number of potential reform topics.

See the Board's website for an overview of the Dodd-Frank Act regulatory reform effort (www.federalreserve.gov/newsevents/reform_about.htm) and a list of the implementation initiatives recently completed by the Board as well as several of the most significant initiatives that the Board expects to address in the future (www.federalreserve.gov/newsevents/reform_milestones.htm).

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Study on International Coordination Relating to Bankruptcy Process for Nonbank Financial Institutions

Table of Defined Terms

Basel Committee on Banking Supervision	Basel Committee
Basel Committee's CBRG – *Report and Recommendations of the Cross-border Bank Resolution Group*	CBRG Report
Board of Governors of the Federal Reserve System	Board or Federal Reserve Board
Chapter 15 of the U.S. Bankruptcy Code	Chapter 15
Cross-border Bank Resolution Group	CBRG
Dodd-Frank Wall Street Reform and Consumer Protection Act	Dodd-Frank Act
European Commission	Commission
European Union	EU
Federal Deposit Insurance Corporation	FDIC
Federal Reserve Board and the Federal Reserve Banks, collectively	Federal Reserve
Financial Stability Board	FSB
FSB – *Reducing the Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Time Lines*	FSB Moral Hazard Report
FSB – *Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability: Report of the Financial Stability Board to G20 Finance Ministers and Central Bank Governors*	FSB Progress Report
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UN Commission on International Trade Law	UNCITRAL
UNCITRAL Model Law on Cross-Border Insolvency	Model Law
UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation	UNCITRAL Practice Guide
United States Bankruptcy Code	Bankruptcy Code

Executive Summary

Section 217 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directs the Board of Governors of the Federal Reserve System (the Board), in consultation with the Administrative Office of the United States Courts, to conduct a study regarding international coordination relating to the resolution of systemic financial companies under the United States Bankruptcy Code (Bankruptcy Code) and applicable foreign law.[1] The act requires the following issues to be studied:

1. The extent to which international coordination currently exists
2. Current mechanisms and structures for facilitating international cooperation
3. Barriers to effective international coordination
4. Ways to increase and make more effective international coordination of the resolution of financial companies, so as to minimize the impact on the financial system without creating moral hazard

The financial services sector in the United States has grown more global in recent decades. Currently, U.S.-based bank holding companies with $50 billion or more in consolidated assets own, in aggregate, over 6,000 foreign entities.[2] These U.S.-operated foreign entities include over 550 foreign branches and engage in a variety of activities including investment advice and investment banking and securities dealing (over 200 entities), commercial banking (over 100 entities), insurance (over 120 entities), trust, fiduciary, and custody activities (over 190 entities), and acting as financial vehicles (over 1000 entities).[3] These foreign entities are a part of the larger international financial services system involving a host of regulatory, supervisory, and legal regimes, which were tested during the recent international financial crisis.

The recent financial crisis prompted a variety of national and international efforts to explore, analyze, and address the weaknesses exposed by the crisis. The failures of, and government interventions in, several large global financial institutions brought into focus issues related to the coordination of the resolutions of cross-border financial firms.

The mechanisms to resolve distressed financial firms are generally local in nature, while firms' enterprise-wide operations may be global in nature. The development of a framework for the resolution of cross-border financial institutions is a component of initiatives to address the growing number of financial firms that operate on an international or global basis. International consensus favors a framework for international coordination to address the resolutions of cross-border financial institutions. The underlying premise of the international consensus is that proper coordination among national and international authorities will mitigate the extent to which a disorderly collapse of a cross-border financial firm could cause systemic damage and expose taxpayers to losses.

This study will describe the initiatives undertaken by the following official and private sector groups[4]:

1. Financial Stability Board (FSB)
2. Basel Committee on Banking Supervision (Basel Committee) and the Cross-border Bank Resolution Group (CBRG)
3. European Commission
4. United Nations (UN) Commission on International Trade Law (UNCITRAL)
5. International Monetary Fund (IMF)
6. Institute of International Finance

While this study will provide overviews of the efforts by the parties listed above, the initiatives undertaken by the FSB and the Basel Committee will be described in detail because of their specific focus on the cross-border resolution of systemically important financial institutions (SIFIs)[5] and the active involvement of the Federal Reserve Board and the Federal Reserve Banks (collectively, Federal Reserve) in these multilateral initiatives. This study will also provide an overview of U.S.-specific efforts, including the Dodd-

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) section 217. The Board is also required by section 216 of the act to conduct a study, in consultation with the Administrative Office of the United States Courts, regarding the resolution of financial companies under Chapter 7 and Chapter 11 of the Bankruptcy Code. *Id.* at section 216.

[2] This number excludes those U.S. bank holding companies with foreign parents.

[3] National Information Center Structure, Bank Holding Company Surveillance Financial Table 1Q2011.

[4] This study also provides an overview of the efforts in the United Kingdom (UK) and Switzerland as examples of country-specific initiatives. The discussion is provided in Appendix A.

[5] SIFI is a commonly used term, but is not used in all of the papers. This study will only use "SIFI" in situations where the papers use the term.

Frank Act, Chapter 15 of the Bankruptcy Code, and the initiatives of U.S. financial regulatory agencies.

The papers described in this study express a preference for private and/or prophylactic measures to avoid or minimize the impact of a cross-border financial institution's insolvency on the larger financial system. There is no expectation that all future insolvencies of multinational SIFIs can be avoided. The ultimate shared goal is, therefore, an effective cross-border resolution mechanism that minimizes the impact of such a failure on the public purse and the financial system as a whole. As such, some of the suggested frameworks have as their basis the stipulation that resolution measures do not depend on public funds.

Current coordination of insolvencies is ongoing on regional levels, such as the European Union. Broader initiatives to analyze and provide recommendations regarding coordination specific to systemic financial companies are also underway. The scope of these initiatives and the level of participation by various countries and international organizations provide insight into the extent to which international coordination currently exists. The groups that will be discussed in this study, such as the FSB and the Basel Committee, provide forums and collect data from member countries and organizations that provide details into individual country efforts and approaches. Numerous countries participate in the international efforts as both home and host country authorities, contributing their viewpoints and providing insight into their approaches to resolution.

Currently, the mechanisms and structures to facilitate international cooperation are largely at the national levels. For example, Chapter 15 of the Bankruptcy Code, which is modeled after a United Nations model law, provides a mechanism for the resolution of certain international insolvencies within U.S. courts. While certain regional arrangements exist and international efforts are underway to address cross-border insolvency cooperation, there is no definitive framework for the coordinated resolution of cross-border financial groups or financial conglomerates, specifically of those that are considered SIFIs. This study describes the mechanisms that are currently in place, and provides overviews on the suggestions to further facilitate cooperation.

The barriers to effective international coordination are numerous, and will be described further in this study. In general, the barriers to the coordination of cross-border insolvencies include disparities in, and conflicts between, national laws, including priority of creditor claims, and the difficulties in applying a stay or suspension of actions against the debtor or its assets across borders. The coordination for a SIFI resolution is further complicated by the larger number of legal entities involved, the numerous regulatory regimes that are implicated, and the possible use of public funds to avoid a disorderly collapse.

The recommendations to improve international coordination include the development of resolution plans or frameworks, the development of cooperation and coordination agreements regarding resolution plans among the relevant authorities, and increased access to and sharing of information by regulatory authorities in times of stress. The suggestions of each of the parties are summarized in this study.

This study's conclusion will summarize the proposals and how they address each of the issues listed in the Dodd-Frank Act.

Official Sector Parties—Background

Financial Stability Board

The FSB was established in April 2009 as the successor to the Financial Stability Forum (FSF), which was founded in 1999 by the Group of Seven Finance Ministers and central bank governors. The mandate of the FSB, broadly speaking, is to promote global financial stability. The FSB includes international standard-setting bodies and a range of national authorities responsible for financial stability, and operates by consensus. Membership in the FSB was expanded in 2009 to include emerging market countries from the Group of Twenty (G-20).[6] The United States actively participates in the FSB.

Basel Committee on Banking Supervision

The Basel Committee[7] was established by the central bank governors of the Group of Ten countries at the

[6] Current FSB member jurisdictions are Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Mexico, The Netherlands, Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, the United Kingdom, and the United States.

[7] Basel Committee members are Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Luxembourg, Mexico, the Netherlands, Republic of Korea, Russia, Saudi Arabia, Singapore,

end of 1974 to fill supervisory gaps exposed by problems in a number of internationally active banks. The Basel Committee formulates supervisory standards and recommendations of best practices that are intended to guide individual national authorities in the implementation of regimes best suited to each national system. The Basel Committee's conclusions and recommendations do not have legal force. The Basel Committee created the Cross-border Bank Resolution Group (CBRG) at the end of 2007 to review and analyze existing resolution policies and legal frameworks and to develop a better understanding of the possible barriers to cooperation. The CBRG's initiatives are discussed further in this study. The U.S. banking agencies are active participants in the ongoing efforts of the Basel Committee and the CBRG.

European Commission

The European Commission (Commission) is the European Union's (EU) executive body and is responsible for proposing legislation. The Commission has outlined an EU framework for crisis management in the financial sector with a goal of a legislative proposal for a harmonized EU regime for crisis prevention and bank recovery and resolution. The coordination of such initiatives within the EU is based, in part, on a harmonized legal and regulatory framework applicable to EU member countries.

UN Commission on International Trade Law

The UN established UNCITRAL in 1966 to develop a framework to further the harmonization of international trade law. The United States is a member of UNCITRAL. UNCITRAL's Working Group V (Insolvency) is engaged in ongoing efforts in the development of an international framework for coordination of cross-border corporate insolvency proceedings.

International Monetary Fund

The IMF is an intergovernmental organization comprised of 187 countries, including the United States. The IMF released a proposed framework in 2010 for the coordination of cross-border bank resolutions, which will be further discussed in the "International Monetary Fund" section on page 9.

South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

Financial Stability Board Initiatives

The FSB has undertaken a number of initiatives in response to the financial crisis. It has published a list of principles for cooperation in crisis management, and has provided recommendations regarding the supervision of SIFIs. As part of its overall work on SIFIs and to address institutions that are considered "too big to fail," the FSB is studying the issues posed by cross-border resolutions of SIFIs and has set forth a mid-2011 to end of 2012 timeline for completion of the various actions related to cross-border resolutions.[8]

Principles for Cross-Border Cooperation

In April 2009, the FSF (predecessor of the FSB) released the *Principles for Cross-Border Cooperation on Crisis Management* (FSF Principles).[9] The high-level principles were developed and endorsed by members of the FSF and committed the relevant authorities to cooperate in making advanced preparations for dealing with and managing financial crises. The principles call for an awareness of the impact that interventions may have on the public purse, and acknowledge that international cooperation is necessary to resolve cross-border financial crises.

The principles are divided between preparation for and management of financial crises. In preparing for financial crises, the principles call on the authorities to

1. develop common support tools for managing a cross-border financial crisis;
2. meet at least annually to consider the specific issues and barriers to coordinated action that may arise in handling severe stress at specific firms;
3. ensure that all countries in which the firm has systemic importance are kept informed of the arrangements for crisis management developed by the primary authorities;
4. share, at minimum, information including the firm's group structure, inter-linkages between the

[8] The complete timeline is set forth in the Annex to the FSB's paper *Reducing the Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Time Lines* (Basel: FSB, October 20, 2010), www.financialstabilityboard.org/publications/r_101111a.pdf.

[9] Financial Stability Forum, *Principles for Cross-Border Cooperation on Crisis Management* (Basel: FSF, April 2, 2009), www.financialstabilityboard.org/publications/r_0904c.pdf.

firm and the financial system, the firm's contingency funding plans, and potential impediments to a coordinated solution;

5. ensure that firms are capable of supplying information that may be required by authorities to manage a financial crisis;
6. encourage firms to maintain contingency plans and procedures for use in a wind-down situation;
7. ensure that firms maintain robust, updated funding plans that may be used in stressed market scenarios; and
8. seek to remove any practical barriers to efficient, internationally coordinated resolutions.[10]

In managing a financial crisis, the principles urge authorities to

1. strive to find internationally coordinated solutions that take account of the impact of the crisis on the financial systems and economies of other countries;
2. share national assessments of systemic implications;
3. share information as freely as practicable with relevant authorities from an early stage;
4. if a fully coordinated solution is not possible, discuss as promptly as possible national measures with other relevant authorities; and
5. share plans for public communication with the appropriate authorities.[11]

Reducing Moral Hazard Posed by SIFIs

In its October 2010 report, *Reducing the Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Time Lines* (FSB Moral Hazard Report), the FSB focused on the systemic and moral hazard risks associated with SIFIs whose failures would cause significant disruption to the global financial system.[12] The FSB Moral Hazard Report recommends that all FSB jurisdictions have in place a policy framework to "reduce the risks and externalities associated with" the domestic and global SIFIs in their jurisdictions.[13]

The FSB Moral Hazard Report recommends that a policy framework combine

1. a resolution framework and other measures so that all financial institutions can be safely and quickly resolved;
2. a requirement that SIFIs have higher loss absorbency capacity to reflect the greater risks that they pose to the global financial system;
3. more intensive supervisory oversight for financial institutions that may pose systemic risk;
4. robust core financial market infrastructures to reduce the contagion risk from the failure of individual institutions; and
5. other requirements as determined by national authorities.[14]

As a baseline, the FSB Moral Hazard Report stipulates that any effective approach to address "too big to fail" institutions must have an effective resolution framework, and that a SIFI resolution must be a viable option.[15] In short, a SIFI must be allowed to fail. A national regime must provide national authorities with tools to intervene in a failing institution to continue performance of the firm's essential functions, such as maintaining access to depositor funds, and to transfer and sell viable portions of the firm and apportion losses in a fair and predictable manner.[16] The report concludes that, currently, the "complexity and integrated nature of group structures and operations, with multiple legal entities spanning national borders and business lines, make rapid and orderly resolutions under current regimes virtually impossible." [17]

The G-20 leaders at the FSB's Seoul Summit in November 2010 endorsed the FSB's policy framework outlined in the FSB Moral Hazard Report, including the work processes and timelines set out in it. With respect to the efforts related to SIFI resolutions, the FSB is expected to provide, in mid-2011, criteria for assessing the resolvability of globally active SIFIs. The FSB also is expected to set forth the key attributes of effective resolution regimes, includ-

[10] *Id.* at 2–3.
[11] *Id.* at 3–4.
[12] Financial Stability Board, *Reducing the Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Time Lines* (Basel: FSB, October 20, 2010), www.financialstabilityboard.org/publications/r_101111a.pdf.
[13] *Id.* at 2.
[14] *Id.*
[15] *Id.* at 3.
[16] *Id.*
[17] *Id.* at 4.

ing the minimum level of legal harmonization and legal preconditions needed to make cross-border resolutions effective. The FSB, in consultation with the CBRG, expects to conduct thematic peer reviews on key attributes of resolution regimes by the end of 2012.

The FSB provides periodic reports to the G-20 regarding progress in the implementation of its recommendations. In its April 2011 report, the FSB notes that work toward the implementation of recommendations in the FSB Moral Hazard Report is progressing.[18] Specifically, the FSB has established a steering group to oversee the work-stream on resolutions and to develop the key attributes of effective resolution regimes. The FSB's Cross-Border Crisis Management Group is monitoring the development of global SIFI recovery and resolution plans, and is developing elements for effective recovery plans along with a framework to assess the resolvability of individual SIFIs.[19]

In addition, various work-streams are underway to analyze issues such as obstacles to, and essential elements of, cross-border cooperation agreements. U.S. banking agencies are actively participating in the FSB's Cross-Border Crisis Management Group.

Other FSB Initiatives

FSB member countries have responded to a survey conducted by the FSB, which details each country's policy developments and implementations that have taken place since 2008.[20] The responses were as of September 2010. Each country detailed its progress in addressing various FSB recommendations, including addressing cross-border resolutions of SIFIs. The FSB will conduct an additional survey of national implementation progress and will publish the results around November 2011.

[18] Financial Stability Board, *Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability: Report of the Financial Stability Board to G20 Finance Ministers and Central Bank Governors* (Basel: FSB, April 10, 2011) (FSB Progress Report).www.financialstabilityboard.org/publications/r_110415a.pdf.

[19] *Id.* at 3.

[20] Each country's response is separately linked at www.financialstabilityboard.org/publications/r_101111b.htm. The United States, for example, reported that the institution-specific crisis management groups for major U.S. banking organizations continue to meet on a multi- and bilateral basis to address outstanding recovery and resolution issues. U.S. firms have submitted recovery plans to applicable U.S. regulators, and such information will help inform the regulators in developing and maintaining firm-specific resolution plans.

Basel Committee on Banking Supervision Initiatives

The Basel Committee approved the CBRG's mandate in December 2007 to analyze relevant countries' resolution policies for a better understanding of potential barriers and possible improvements to cooperation in the resolution of cross-border banks. During the first half of 2008, the CBRG collected descriptions from countries represented on the CBRG[21] on issues such as national laws and policies on the resolution of cross-border banks. The CBRG used the responses to identify significant impediments to effective cross-border resolutions of banks. In December 2008, it published an interim report summarizing the existing resolution approaches and identifying differences that may lead to conflicts in cross-border resolutions.

In December 2008, the Basel Committee asked the CBRG to expand its scope to analyze the "developments and processes of crisis management and resolutions during the financial crisis with specific reference to case studies of significant actions by relevant authorities."[22] The CBRG conducted case studies of four financial institutions whose experiences during the financial crisis illustrated the problems associated with cross-border crisis management frameworks.[23] The CBRG sought to identify concrete and practical steps to facilitate cross-border crisis management and resolutions. Its recommendations are intended to "strengthen national resolution powers and their cross-border implementation"[24] and are also intended to complement the FSB's *Principles for Cross-Border Cooperation on Crisis Management* by providing practicable approaches to implement the principles.

The result of these efforts was the CBRG's *Report and Recommendations of the Cross-border Bank Resolution Group* (CBRG Report).[25] In the CBRG Report, the CBRG proposed the following 10 recommendations:

[21] U.S. members of the CBRG include the Board, the Federal Reserve Bank of New York, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

[22] Basel Committee on Banking Supervision, *Report and Recommendations of the Cross-Border Bank Resolution Group* (Basel: CBRG, March 2010) at 8, www.bis.org/publ/bcbs169.htm.

[23] A summary of the case studies is provided in Appendix B.

[24] *See* www.bis.org/publ/bcbs169.htm.

[25] *See supra* footnote 22.

1. National authorities should have appropriate tools to address all types of financial institutions in difficulty so that an orderly resolution can be achieved.

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

3. National authorities should seek the convergence of national resolution tools.

4. National authorities should consider the development of procedures to facilitate the mutual recognition of crisis management and resolution proceedings.

5. Supervisors should work closely with relevant home resolution authorities to understand how group structures and their individual components will be resolved in a crisis.

6. The contingency plans of all systemically important cross-border financial institutions and groups should address a period of severe financial distress, and provide a plan to preserve the firm as a going concern, and facilitate the rapid wind-down of the firm, if necessary.

7. Different national authorities should have a clear understanding of their respective responsibilities for regulation, supervision, liquidity provision, crisis management, and resolution.

8. Jurisdictions should promote the use of risk mitigation techniques that reduce systemic risk and enhance the resiliency of critical financial or market functions during a crisis.

9. National resolution authorities should have the legal authority to temporarily delay immediate operation of contractual early termination provisions in order to complete a transfer of financial market contracts.

10. National authorities should consider clear options or principles for exit from public intervention.[26]

[26] CBRG Report at 1–3 (summary of recommendations).

CBRG Report—Issues Raised

The CBRG Report recommendations listed above are discussed in detail in the report, and are intended to address the issues that were identified in the financial crisis. The CBRG Report notes the actions taken during the financial crisis were *ad hoc*, limited by time constraints, and involved a significant amount of public support.[27] The CBRG Report drew from case studies of the following cross-border financial crises that illustrated the shortcomings of current frameworks: (1) Fortis Group (Belgium, the Netherlands); (2) Dexia (Belgium); (3) Kaupthing (Iceland); and (4) Lehman Brothers (the United States). These case studies presented certain common issues related to the insolvencies of cross-border financial firms, but also raised issues unique to each institution and relevant jurisdictions. An overview of each case study is provided in Appendix B.

Currently, there is no international insolvency framework for financial firms. The current territorial[28] approach to the resolution of cross-border financial firms is due to the absence of a viable international framework, and the reality that legal systems and fiscal responsibilities are national in nature.[29] National interests are "most likely to drive decisions particularly where there is an absence of pre-existing standards for sharing the losses from a cross-border insolvency."[30]

The CBRG Report explores various options for reform derived from its recommendations. One option is the implementation of a broad and enforceable agreement on the sharing of financial burdens by stakeholders in different jurisdictions, but it acknowledges that such an agreement on the mechanisms for sharing financial burdens appears

[27] CBRG Report at 3.

[28] The concept of the "territorial" approach, and its counterpart, the "universal" approach, are discussed throughout the literature on international resolutions. Broadly speaking, the "territorial" approach, at its purest, would rely on territorial notions of sovereignty such that parties would have full jurisdiction over all assets within its jurisdiction, but cannot act outside of its jurisdiction. The "universal" approach, at its purest, would require that states agree in advance to one jurisdiction handling the main insolvency proceeding and all other jurisdictions would merely aid the main jurisdiction. Each concept has been modified throughout various proposals. *See, e.g.,* Thomas C. Baxter, Joyce M. Hansen, and Joseph H. Summer, "Two Cheers for Territoriality: An Essay on International Bank Insolvency Law," *American Bankruptcy Law Journal*, vol. 78 (Winter 2004), pp. 57–91; IMF Paper at 10.

[29] CBRG Report at 4.

[30] *Id.* at 16.

unlikely in the short term.[31] The alternative and opposite option is a ring-fencing[32] approach of supervision and a territorial approach to resolution,[33] but the CBRG Report notes that this could be counterproductive since ring-fencing in one jurisdiction may lead to stresses on the financial group's legal entities in other jurisdictions. A "middle ground" approach would acknowledge the likelihood of ring-fencing by national authorities in a crisis but implement reforms to promote national resiliency during crisis management and resolution.[34] The reforms would include "enhancing the effectiveness of existing risk mitigation processes, including netting, collateral arrangements, and segregation."[35]

The June 2010 Toronto Summit of the G-20 leaders endorsed the recommendations made in the CBRG Report and the G-20 leaders expressed their commitment to implementing its recommendations. A number of jurisdictions have adopted legislation or are considering legislation to enhance their resolution regimes based on the CBRG's recommendations.[36] The CBRG continues to study the issues in conjunction with the initiatives currently underway at the FSB. In July 2011, the Basel Committee released a report summarizing its progress on the development of national resolution policies and frameworks since the CBRG Report was issued.[37]

European Commission

In an October 2010 communication, the Commission outlined a framework for crisis management in the financial sector based on seven objectives.[38] In January 2011, the Commission published a consultation paper outlining the technical details of a possible EU framework for bank recovery and resolution that gives effect to the seven objectives outlined in the October 2010 communication.[39] The Commission indicated that it would adopt a legislative proposal to harmonize the EU regime for crisis prevention and bank recovery in 2011. The Commission stated that it will then examine the need for further harmonization of bank insolvency regimes within the European communities, with an aim toward publishing a report with further legislative proposals by the end of 2012.

In general, the framework outlined by the Commission is intended to apply to all credit institutions and certain investment firms, and envisions granting authorities certain emergency powers for early intervention and to restructure or resolve financial institutions. Accordingly, each EU member state will be required to identify a resolution authority to exercise resolution powers. The framework requires recovery plans from credit institutions that preclude access to public financial support. In addition, the parent financial holding companies will be required to draft a group recovery plan for the consolidated organization. The framework also contemplates providing supervisors powers of early intervention that include requiring the institution to take steps to raise funds, restricting or limiting the business and operations, and requiring the use of net profits to strengthen the capital base. The framework proposes giving resolution authorities resolution tools including authority regarding the sale of business, bridge banks, asset separation, and debt-write down or conversion.

In addition, the EU has in place Directive 2001/24/EC of the European Parliament and of the Council of the EU[40] that provides for the winding up of credit institutions with branches in other EU member states, and specifies that the winding-up will be subject to a single bankruptcy proceeding in the credit institution's home state. In 2007, the

[31] *Id.* at 4–5. The CBRG Report notes that the challenges to developing mechanisms for sharing financial burdens of future resolutions would make any short term agreement unlikely.

[32] To "ring-fence" is often understood as to separate certain assets or liabilities of a company within a given jurisdiction for the benefit of local creditors.

[33] CBRG Report at 5.

[34] *Id.*

[35] *Id.* at 6.

[36] Two such jurisdictions, the UK and Switzerland, are discussed further in Appendix A. Other jurisdictions include Canada, France, Germany, Japan, Luxembourg, and the Netherlands.

[37] Basel Committee on Banking Supervision, *Resolution Policies and Frameworks—Progress So Far* (Basel: CBRG, July 2011), www.bis.org/publ/bcbs200.pdf.

[38] European Commission communication, *An EU Framework for Crisis Management in the Financial Sector* (October 20, 2010), http://ec.europa.eu/internal_market/bank/docs/crisis-management/framework/com2010_579_en.pdf. The seven objectives are (1) put prevention and preparation first; (2) provide credible resolution tools; (3) enable fast and decisive action; (4) reduce moral hazard; (5) contribute to a smooth resolution of cross-border groups; (6) ensure legal certainty; and (7) limit distortions of competition.

[39] European Commission (DG Internal Market and Services) working document, *Technical Details of a Possible EU Framework for Bank Recovery and Resolution* (January 6, 2011), http://ec.europa.eu/internal_market/consultations/docs/2011/crisis_management/consultation_paper_en.pdf.

[40] Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2001:125:0015:0023:EN:PDF.

Commission launched a public consultation on the directive to determine whether it could be extended to cross-border banking groups.[41] The results of the consultation will be included in the Commission's report on the implementation of the directive due at the end of 2011.

UN Commission on International Trade Law

In 1997, UNCITRAL adopted the Model Law on Cross-Border Insolvency (Model Law) that applies to the insolvency of a single firm with a presence in foreign jurisdictions.[42] The Model Law focuses on the legislative framework needed to facilitate cooperation and coordination on cross-border insolvency cases, but it does not apply to groups with legally distinct subsidiaries or affiliates. It is also not intended to apply to entities that are subject to special insolvency regimes, such as banks or insurance companies.[43] In 2005, the Bankruptcy Code was amended to include Chapter 15, which incorporated the Model Law, with certain modifications.[44] Further discussion of Chapter 15 is provided in the "Chapter 15 of the U.S. Bankruptcy Code" section on page 14.

The UNCITRAL *Practice Guide on Cross-Border Insolvency Cooperation* (UNCITRAL Practice Guide) is the result of further work undertaken on coordination and cooperation in cross-border insolvency cases.[45] Adopted by UNCITRAL on July 1, 2009, the UNCITRAL Practice Guide provides "information for practitioners and judges on practical aspects of cooperation and communication in cross-border insolvency cases, specifically in cases involving insolvency proceedings in multiple States."[46] It outlines various international initiatives and possible forms of cooperation that may be used when creating a framework to address cross-border insolvencies.

Drawing on case studies and practical experience, the UNCITRAL Practice Guide discusses in detail the use of cross-border insolvency agreements, or similar arrangements, to facilitate the cooperation and coordination of multiple insolvency proceedings in different states. It also provides, at length, suggested language and approaches to drafting such agreements. According to the UNCITRAL Practice Guide, cross-border insolvency agreements have reduced the cost of litigation as parties are able to focus on the conduct of the proceedings, and not disputes such as conflicts of law.[47]

The UNCITRAL Practice Guide notes that such agreements have been successfully used in insolvency proceedings, including those that involve multiple plenary proceedings.[48] For example, in the insolvency proceedings for Lehman Brothers Holdings Inc., which involved more than 75 insolvency proceedings and 16 jurisdictions worldwide, the parties agreed to a statement of intentions and guidelines[49] that covered communication among insolvency representatives and among courts and creditor committees, comity, notice, asset preservation, claims, reorganization plans, amendment, execution and application.[50]

International Monetary Fund

The IMF released *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination*[51] (IMF Paper) in response to calls from G-20 leaders to develop an international framework for cross-border bank resolution. The IMF Paper addresses issues related to the resolution of international financial groups, noting that many cross-border banks exist within financial groups whose activities extend beyond deposit-taking and lending,

[41] An overview of the consultation is provided at http://ec.europa.eu/internal_market/bank/windingup/index_en.htm.

[42] UN Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment* (New York: UN), www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf.

[43] *Id.* at Chapter 1, Article 1(2).

[44] UN Commission on International Trade Law, *Developments in Insolvency Law: Adoption of the UNCITRAL Model Law on Cross-Border Insolvency*, 38th session (Vienna: UNCITRAL, July 4–15, 2005), http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V05/856/74/PDF/V0585674.pdf?OpenElement.

[45] UN Commission on International Trade Law, *Practice Guide on Cross-Border Insolvency Cooperation* (New York: UN, 2010), www.uncitral.org/pdf/english/texts/insolven/Practice_Guide_Ebook_eng.pdf.

[46] *Id.* at 1.

[47] *Id.* at 28.

[48] *Id.*

[49] The case study notes that the parties were unable to reach a formal signed insolvency agreement because not all would be able or willing to sign an agreement. However, they were permitted to adhere to the terms of the agreement without formal signatures. As such, the agreement became a statement of intentions and guidelines rather than a legally enforceable agreement.

[50] UNCITRAL Practice Guide at 123–4.

[51] International Monetary Fund, *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination* (Washington, D.C.: IMF, June 11, 2010), www.imf.org/external/np/pp/eng/2010/061110.pdf.

and that some of the most systemically risky groups are investment banks and broker-dealers. The IMF Paper observed that while international financial groups operate globally, the mechanisms for addressing their failures are local, and do not apply at an enterprise-wide level. The IMF Paper describes the various barriers to coordination, including the lack of authority for supervisors to share information, the absence of a minimum level of legal and regulatory harmonization, the multiplicity of regulatory actors, and the territorial approaches taken by national authorities to prioritize their own stakeholders.[52]

The IMF Paper sets forth the following four elements[53] for a framework for enhanced coordination:

1. Amendment of national laws so as to require national authorities to coordinate their resolution efforts with their counterparts in other jurisdictions
2. Core-coordination standards[54]
3. A specification of the principles that would guide the burden sharing process
4. Coordination procedures designed to enable resolution actions in the context of a crisis to be taken as quickly as possible and to have cross-border effect

The IMF Paper argues for "the establishment of a pragmatic framework for enhanced coordination, which would be subscribed to by countries that are in a position to satisfy the elements" listed above.[55] The approach would establish such a framework through a nonbinding multilateral understanding.

With the framework in hand, the IMF Paper notes that the ability of subscribing countries to coordinate rapidly and effectively will be "enhanced if there is an established set of procedures that will serve as a road map" during a crisis.[56] The IMF Paper suggests that the home country authorities should design the overall resolution strategy, including the type of proceeding, to be initiated in the home and host jurisdictions, and should play the lead role in the conduct of the proceedings.[57] The procedural road map would have to acknowledge, however, that while the home country accepts a leadership role, the host jurisdiction may need to act independently if doing so is consistent with domestic financial stability and the interests of creditors.[58]

The IMF Paper notes that in the near term, "a limited group of countries that already meet the standards" could "begin to cooperate amongst themselves."[59] If these countries represent the world's main financial centers, then this coordination may propel other countries to adhere to these standards over time.

In May 2011, the IMF released a staff discussion note, *The Too-Important-to-Fail Conundrum: Impossible to Ignore and Difficult to Resolve* (IMF Discussion Note),[60] that discussed orderly resolutions of SIFIs as part of a larger framework on how to address risks posed by SIFIs' complexity and interconnectedness, and moral hazard issues associated with SIFIs viewed as "too important to fail." The discussion on resolution reiterated points made in the IMF Paper, and noted that additional work is needed to "produce methodologies and criteria to assess institutions' resolvability and the consistent implement of [recovery and resolution plans] across different jurisdictions."[61]

Private-Sector Initiatives

Institute of International Finance

The IIF is a global association of financial institutions.[62] Its membership includes commercial and investment banks, insurance companies, and investment management firms. The IIF's activities in cross-border resolutions are led by its Cross-Border Resolution Working Group. In May 2010, the IIF submitted to the FSB its report, *A Global Approach to Resolving Failing Financial Firms: An Industry*

[52] *Id.* at 9.

[53] *Id.* at 3–4.

[54] The "core-coordination standards" include a harmonization of national resolution rules, robust supervision (including through consolidated supervision), and institutional capacity to implement an international solution. *Id.* at 4.

[55] *Id.* at 3.

[56] *Id.* at 25.

[57] *Id.* at 26.

[58] *Id.* at 25.

[59] *Id.* at 27. The IMF Paper does not specify which countries currently meet the standards.

[60] Ýnci Ötker-Robe, et al., *The Too-Important-to-Fail Conundrum: Impossible to Ignore and Difficult to Resolve*, IMF Staff Discussion Note (Washington, D.C.: IMF, May 27, 2011), www.imf.org/external/pubs/ft/sdn/2011/sdn1112.pdf.

[61] *Id.* at 20.

[62] *See* www.iif.com/.

Perspective (IIF Global Approach Report).[63] The IIF Global Approach Report followed up in May 2011 with its submission to the FSB, *Addressing Priority Issues in Cross-Border Resolution* (IIF Addressing Priority Issues Submission),[64] which built upon the IIF's prior works.

IIF Global Approach Report

The IIF Global Approach Report notes the need to create an international framework on cross-border resolution, and proposes the establishment of "a high-level international task force acting under a G-20 mandate" to develop the framework.[65] While acknowledging that it "will never be possible to have complete confidence" that failures of major firms would not have systemic consequences, or that government intervention would not be needed, the IIF Global Approach Report asserts that a "great deal" can be done to minimize such failures and the need for government interventions, and that in doing so, market discipline will be strengthened and moral hazard reduced.[66]

The IIF Global Approach Report is comprised of the following discussions: (1) recovery and resolution planning; (2) special resolution regimes; (3) national self-sufficiency approaches to regulation and supervision; (4) resolution of cross-border financial firms; and (5) funding resolutions.

The industry, and the IIF, view recovery and resolution planning "very positively," and believe that if "done well, recovery and resolution planning can play a very positive role in ensuring that financial firms are able to exit the market without causing systemic disturbance."[67] The IIF Global Approach Report does not support the notion of "living wills" whereby firms draft instructions for their own insolvency and liquidation, stating that living wills presume a "static state of the world that can be relied on for planning purposes."[68] The IIF Global Approach Report instead considers an approach in which firms make available information regarding their businesses to the authorities such that the authorities have a complete understanding of the firms.[69] The IIF Global Approach Report makes additional proposals regarding resolution planning, including permitting firms to structure their organizational and legal structures to reflect business models; using identified improvements as the basis for a dialogue with appropriate supervisors, without introducing national ring-fencing around group entities; and ensuring the confidentiality of the plans.[70]

With respect to the creation of special resolution regimes, the IIF Global Approach Report notes that the following principles governing the design of such regimes should be followed:

1. No financial firm should be considered too big to fail.
2. A more resilient system and a change in creditor behavior and counterparty risk management based on the assumption that all firms can fail and that creditors will not be protected from loss are required.
3. Recourse to a special resolution regime should be infrequent.
4. If it is determined that allowing a firm to fail using normal insolvency procedures would lead to systemic consequences, then powers should be available to take steps to maintain systemic stability.
5. Such powers should be tailored to prevailing circumstances.
6. There must be no expectation that shareholders and unsecured, insured creditors will be protected from loss.
7. Private sector solutions should be pursued whenever possible.

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[63] Institute of International Finance, *A Global Approach to Resolving Failing Financial Firms: An Industry Perspective* (Washington, D.C.: IIF, May 2010), www.iif.com/press/press+148.php. The IIF Report notes that it and the proposals within this report should not be considered a final report, but that the proposals provide a roadmap for progress.

[64] Institute of International Finance, *Addressing Priority Issues in Cross-Border Resolution*, (Washington, D.C.: IIF, May 2011), www.iif.com/regulatory/.

[65] IIF Global Approach Report at 9.

[66] *Id.* at 9 and 13.

[67] IIF Global Approach Report at 15, 19.

[68] *Id.* at 20.

[69] *Id.*

[70] *Id.* at 21–22.

8. Resolution regimes should operate effectively to manage the exit of cross-border financial entities.[71]

The IIF Global Approach Report discusses in detail the scope of such a regime,[72] when such a regime should be used,[73] and the key features of such a regime.[74]

The IIF member firms expressed concerns regarding approaches to regulation or supervision that "seek to achieve enhanced national resilience by reinforcing national boundaries."[75] The IIF Global Approach Report states that "[r]egulatory or supervisory requirements to adopt particular structures to support ring-fencing jurisdictions should be avoided."[76] In the industry's view, the development of resolution regimes capable of ensuring that firms, including internationally active firms, are able to exit the market in an orderly manner would "obviate the need for ring-fencing and other approaches that risk increasing fragmentation of the global financial system."[77]

The development of mechanisms for the resolution of cross-border financial firms, which the IIF views as desirable, requires what the IIF Global Approach Report describes as "significant marshalling of political will."[78] To reach political agreement on a framework for the resolution of such firms, IIF believes that a high-level international task force composed of finance ministries, justice ministries, central banks, and regulators at senior levels is required. The IIF Global Approach Report advocates a "multifaceted approach" involving a "convergence of national regimes, coordination of resolution proceedings [and] further consideration of the achievement of equitable cross-border outcomes."[79]

The discussion in the IIF Global Approach Report on the resolution funding regime presupposes a reformed financial system that is more resilient to systemic risk, and the introduction of a framework for resolution that facilitates the orderly exit of all financial firms.[80] The key principles underpinning the resolution funding approach are

1. avoiding failures in the first place should be the main priority;
2. rigor in imposing loss on equity and nonequity capital providers and on uninsured, unsecured creditors;
3. seeking private sector solutions wherever possible; and
4. to the extent that costs arise after losses have been absorbed and after appropriate steps have been taken to maximize the firm's assets, no expectation that these costs be borne by taxpayers.[81]

The IIF Global Approach Report stresses that shareholders and providers of capital must bear the majority of losses associated with failure.[82] Any additional costs that arise as necessary to preserve financial stability should not include payments to protect such stakeholders against losses. These additional costs should be incurred only to effect the orderly exit and wind-down of the firm.

According to the IIF Global Approach Report, a majority of the industry considers *ex post* solutions desirable since they avoid the moral hazard that may arise from a standing "bail-out" fund. An *ex post* approach would place the responsibility for meeting the cost of avoiding systemic events with the sections of the industry responsible for creating the problem and/or those likely to benefit from the solution.[83]

IIF Addressing Priority Issues Submission

The IIF efforts are ongoing as it continues to develop a more complete industry perspective and proposals. Its Cross-Border Resolution Working

[71] *Id.* at 24.

[72] The IIF Global Approach Report recommends that special resolution regimes be available to all firms that have the potential to be systemically important. *Id.* at 24–25.

[73] The IIF Global Approach Report urges that a regime be utilized only when the failure of a firm would cause major dislocations to the financial system if the firm's resolution were governed by existing insolvency laws, with a criteria governing the "triggering" of intervention by the authorities. *Id.* at 25–27.

[74] The IIF Global Approach Report describes key features of such a regime as including (1) protected transactions and contracts; (2) transfer of assets, liabilities, and contracts; (3) delay of termination clauses; and (4) the powers to preserve value. *Id.* at 27–31.

[75] *Id.* at 33.

[76] *Id.* at 16.

[77] *Id.* at 35.

[78] *Id.* at 37.

[79] *Id.* at 16.

[80] *Id.* at 43.

[81] *Id.* at 44.

[82] *Id.* at 44–45.

[83] *Id.* at 12.

Group has submitted additional papers to the FSB building on previous submissions, including the May 2011 submission, IIF Addressing Priority Issues Submission. The IIF Addressing Priority Issues Submission identifies three priority areas for further investigation: (1) resolution planning for the maintenance of critical functions; (2) "bail-in" mechanisms; and (3) key cross-border issues.[84]

"Critical functions" are determined by their systemic relevance. The IIF would apply the following criteria to define a "critical function":

1. The function is a critical part of the financial system infrastructure.
2. Users of the service could not reasonably be expected to have put alternative, fall-back options in place *ex ante*.
3. The service cannot be substituted in a timely manner.
4. The service is essential to the financial system and the economy and its failure would cause severe trauma.[85]

While it may be important that firms be able to extract their critical functions in the event of failure, the IIF Addressing Priority Issues Submission reiterated the industry's view that a firm's organizational and legal structures should reflect its business model.[86] To that end, the IIF Addressing Priority Issues Submission states that firms are responsible for providing clear explanations to authorities on how their critical functions may be isolated and transferred in the event of a failure.[87]

A "bail-in" would allow a firm to be recapitalized by, for example, converting a certain proportion of its debt into equity. In general, the industry's view is that existing debt should not be retrospectively subject to bail-ins, and that bail-in techniques should be prospective.[88] The submission sets forth draft principles that may support the development of a bail-in regime in various jurisdictions. The submission argues that bail-in measures should be deployed only where it is determined that there is a significant risk of loss of value such as was seen in the failure of Lehman Brothers.[89] Designated authorities would be able to exercise "bail-in powers"—power to dilute shareholders or write-off shares of the firm, and power to alter the terms and conditions of subordinated debt of the firm, including the conversion of such debt into equity—at a time that is as close to possible as when the firm would otherwise become insolvent or go into bankruptcy.[90]

Finally, the IIF Addressing Priority Issues Submission discusses key aspects in resolving cross-border firms, with an underlying premise that groups should have the ability to run their business to optimize the "group interest" and that "material disbenefits" would follow from attempts to require firms to adopt particular structures or organizational approaches.[91] The IIF Addressing Priority Issues Submission argues that while a "group interest" perspective may be useful in running a business across numerous legal entities, during times of crisis, tensions between the group interests and legal-entity interests will arise.[92] The IIF Addressing Priority Issues Submission argues that, while the work currently being undertaken by the FSB on firm-specific crisis management agreements may help alleviate the tensions, such agreements must be legally effective so that they are reliable and enforceable during times of crisis.[93] The IIF Addressing Priority Issues Submission further suggests features that should be incorporated into firm-specific agreements, such as a recognition that the home resolution regime will be applied, appropriate depositor protection, requirement for close cooperation among resolution authorities, and an absence of obstacles to the transfer of assets and collateral between jurisdictions.[94]

U.S.-Specific Initiatives

In addition to its participation in the international initiatives discussed above, various branches of the U.S. government have taken steps to address issues

[84] IIF Addressing Priority Issues Submission at 14.

[85] *Id.* at 16.

[86] *Id.* at 17.

[87] *Id.* at 18. For example, financial firms should be able to clearly describe the function in question, identify how the function is provided by the firm, and identify how the functions may be separated and transferred from the firm.

[88] *Id.* at 20.

[89] *Id.* at 22.

[90] *Id.* at 22. The IIF Addressing Priority Issues Submission states that the primary scope of the bail-in powers would be limited to subordinated debt, and only as a last resort, subject to clear criteria, will it be necessary to bail-in unsecured senior debt.

[91] *Id.* at 12.

[92] *Id.* at 28.

[93] *Id.* at 29 and 31.

[94] *Id.* at 30.

raised by the potential failure of multi-national SIFIs.

Dodd-Frank Act

The United States responded to the financial crisis with the Dodd-Frank Act, which was passed in 2010. Its provisions are responsive to and consistent with the international coordination initiatives. For example, Title II of the Dodd-Frank Act establishes an orderly liquidation authority, which provides for the resolution of financial institutions if their failures are deemed to have broad systemic consequences for the United States.[95] Title II permits the FDIC to be appointed as receiver for a nonbank financial firm, the failure of which may cause systemic risk to the U.S. economy. The FDIC may also transfer the firm's assets, liabilities, and operations to a bridge financial institution established by the FDIC.[96] The Dodd-Frank Act also requires nonbank financial companies supervised by the Board and bank holding companies to make periodic reports regarding such company's plan for its rapid and orderly resolution under the Bankruptcy Code in the event of a financial distress or failure.[97]

Chapter 15 of the U.S. Bankruptcy Code

Chapter 15 of the Bankruptcy Code[98] (Chapter15) is based on the UNCITRAL Model Law.[99] Adopted in 2005, Chapter 15 applies to cases filed on or after October 17, 2005. Chapter 15 applies where

1. a foreign court or foreign representative seeks assistance in the United States in connection with a foreign bankruptcy proceeding;
2. a U.S. or foreign representative on behalf of a U.S. bankruptcy case seeks assistance from a foreign country in connection with a U.S. bankruptcy case;
3. a foreign proceeding and a U.S. bankruptcy case with respect to the same debtor are pending concurrently; or
4. foreign creditors or other interested foreign parties desire to commence a U.S. bankruptcy case or participate in a pending U.S. case or proceeding.[100]

Like the Model Law, Chapter 15 does not apply to entities subject to special resolution regimes such as banks and insurance companies.[101] Likewise, Chapter 15 does not apply to a foreign bank that operates a branch or agency in the United States.

Chapter 15 provides a comprehensive structure for the U.S. recognition, cooperation, and grant of deference to foreign insolvency proceedings. With Chapter 15, the United States has adopted a "modified universalist" approach to international bankruptcy law.[102] This approach takes the view that "there should be a single main case for an international business in its home country," but permits a "non-home country court to open secondary insolvency cases to supplement the home country dominant case for a debtor."[103] Under Chapter 15, a "foreign representative"[104] may seek recognition in U.S. courts of a "foreign proceeding." A "foreign proceeding" is the insolvency proceeding in a foreign country.[105] If a U.S. court recognizes that a foreign proceeding is a "foreign main proceeding,"[106] certain provisions of the Bankruptcy Code, such as the automatic stay imposed by section 362, automatically apply to the debtor and its U.S. assets.[107] In addition, the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent per-

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95 Dodd-Frank Act, Title II.

96 *Id.* at section 210(a)(1)(D).

97 Dodd-Frank Act section 165(d). For additional discussion on resolution plans in the context of the Dodd-Frank Act, *see, e.g.,* The Pew Charitable Trusts, *Standards for Rapid Resolution Plans* (May 2011), http://pewfr.articulatedman.com/admin/document/files/Standards-for-Rapid-Resolution-Plans.pdf.

98 11 U.S.C. sections 1501–32.

99 Samuel L. Bufford, *United States International Insolvency Law 2008–2009* (New York: Oxford University Press, 2009), p. 2. For additional discussions on cross-border insolvencies involving United States enterprises, The American Law Institute has developed proposed principles and procedures for managing the default of a company with its assets, creditors, and operations in one or more NAFTA countries. The American Law Institute, *Transnational Insolvency: Cooperation Among the NAFTA Countries—Principles of Cooperation Among the NAFTA Countries* (New York: Juris Publishing, Inc., 2003).

100 11 U.S.C. section 1501(b); *see also* Bufford, *United States International Insolvency Law*, p. 75.

101 11 U.S.C. section 1501(c).

102 Bufford, *United States International Insolvency Law*, p. 24.

103 *Id.* at 22–23.

104 11 U.S.C. section 1515. A "foreign representative" is any person or body authorized in the foreign proceeding to administer the reorganization or liquidation of the debtor's assets or act as representative of such foreign proceeding. 11 U.S.C. section 101(24).

105 11 U.S.C. section 101(23).

106 A "foreign main proceeding" is a foreign proceeding pending in the country where the foreign debtor has its "center of main interest." 11 U.S.C. section 1502(4). The "center of main interest" is where the debtor's registered office is located. 11 U.S.C. section 1516.

107 11 U.S.C. section 1520(a).

mitted under the Bankruptcy Code.[108] Further, the court and the parties would look to the foreign main proceeding for guidance in determining the proper course of conduct for the Chapter 15 case.

U.S. Banking Regulators

As noted in this study, all three U.S. banking regulators and supervisors—the Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency—are active participants in the international efforts underway, including in the FSB and the Basel Committee. The FDIC, the receiver for failed U.S. banks, has entered into Memoranda of Understanding with international counterparts, such as the Bank of England, to promote greater coordination in the resolution of cross-border firms.[109] The FDIC is also collaborating with the Basel Committee, the IMF, the European Forum of Deposit Insurers, the World Bank, and the Commission to develop and finalize the Methodology for Compliance Assessment of the *Core Principles for Effective Deposit Insurance Systems*.[110]

Further, the FDIC and the Board published proposed rules regarding resolution plans under section 165(d) of the Dodd-Frank Act, which requires nonbank financial companies supervised by the Board and bank holding companies with assets of $50 billion or more to report the resolution plan, also called a "living will," of such a company for its rapid and orderly resolution under the Bankruptcy Code in the event of material financial distress or failure.[111] The proposed rule notes that such resolution plans will help regulators to better understand a firm's business and how that entity may be resolved, and will also enhance the regulators' understanding of foreign operations in an effort to develop a comprehensive and coordinated resolution strategy for a cross-border firm.[112]

Conclusion

The overarching theme of the papers presented in this study is the need for an international cooperative resolution framework that can safely and quickly resolve a globally active SIFI (or cross-border financial institution) in a way that mitigates major disruptions to the financial system and without taxpayer support. The four issues raised in section 217 of the Dodd-Frank Act are implicitly and explicitly discussed in the papers surveyed.

Current International Coordination

Coordination of the resolution of cross-border financial institutions can be seen at certain regional levels, such as in the European Union. Efforts at international coordination in bankruptcy proceedings have also occurred between parties through private agreements and protocols, and between countries through adopting the Model Law or similar provisions. Since the recent financial crisis, international public sector groups such as the FSB and the Basel Committee have been working on numerous initiatives to address financial stability and, as outlined in this study, the international coordination of cross-border insolvencies is one such initiative. Such efforts are ongoing and dynamic, with additional information and materials expected in the coming months.[113]

Current Mechanisms and Structures for Facilitating International Cooperation

Existing international groups, including standard-setting bodies like the Basel Committee, international financial institutions such as the IMF, and coordinating bodies like the FSB, have added cross-border resolution to their agendas and are actively working to develop better mechanisms to facilitate international cooperation. The ongoing efforts have generated proposals that include input from various parties and countries. The United States banking agencies are active participants in these efforts.

Current mechanisms and structures to facilitate international cooperation in cross-border bankruptcies are largely at the national level. Notably, some countries have adopted the Model Law, which provides a mechanism for the resolution of certain international insolvencies under local law (as is the case with Chapter 15). However, the Model Law's application is limited by the number of jurisdictions that have adopted it, the exemption of certain types of institutions, and each jurisdiction's interpretation

[108] *Id.* at section 1520(a)(3).

[109] Federal Deposit Insurance Corporation, *FDIC and Bank of England Announce Enhanced Cooperation in Resolving Troubled Cross-Border Financial Institutions*, press release, January 22, 2010, www.fdic.gov/news/news/press/2010/pr10013.html.

[110] *See* FSB U.S. Report on Monitoring Progress at 17, www.financialstabilityboard.org/publications/r_110401x.pdf.

[111] 76 *Fed. Reg.* 22,648 (April 22, 2011).

[112] *Id.* at 22,649.

[113] *See, e.g.,* FSB Progress Report (outlining upcoming FSB reports and recommendations).

of the Model Law. Protocols and cross-border agreements between parties also have been used as mechanisms to facilitate international cooperation in insolvency proceedings. However, such an agreement can be limited in both its scope and its effectiveness if certain parties in an insolvency proceeding does not participate in the agreement.

Barriers to Effective International Coordination

The barriers to effective international coordination are varied and numerous. As the CBRG Report notes, current legal and regulatory arrangements are not designed to address the insolvency of financial groups operating in multiple, separate legal entities.[114] Insolvency proceedings of cross-border firms involve multiple legal entities, courts, and regulatory actors with different policies and objectives. As was pointed out by several papers, national insolvency regimes may greatly differ in their approaches and policy goals and often are designed to deal with domestic failures and to protect domestic stakeholders.[115] Legal and regulatory regimes differ across borders giving rise to conflicts of law such that there is no universally agreed approach to certain insolvency issue.[116] National interests may often trump other considerations. As pointed out by certain papers, the possible use of public funds would add another layer of complexity.[117]

Ways to Increase and Make More Effective International Coordination without Creating Moral Hazard

The papers discuss various recommendations to improve international coordination. As pointed out by some of the papers, SIFIs viewed to be "too big to fail" create moral hazard risks.[118] As such, virtually all of the proposals advocate the development of resolution plans for the resolution of such groups so that they may be allowed to fail in an orderly manner.[119] Some papers presented in this study express a preference for private rather than public measures to reduce moral hazard and to avoid or minimize the impact of a cross-border financial institution's insolvency on the larger financial system.[120] To further improve coordination, parties such as the FSB and the Basel Committee also advocate the adoption by national authorities of a common set of resolution tools, enhanced recovery and resolution planning for individual institutions, and increased access to and sharing of information between relevant authorities.[121] The goal of such measures is to simplify proceedings and provide for quicker and less costly cross-border resolutions with greater cooperation between groups.

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[114] CBRG Report at 4, 15. *See also* FSB Moral Hazard Report at 3–4; IIF Addressing Priority Issues Submission at 27; IMF Paper at 7–8.

[115] CBRG Report at 4; IIF Global Approach Report at 33–34, 37; IMF Paper at 5, 8–9.

[116] IMF Paper at 9; UNCITRAL Practice Guide at 9–10.

[117] *See, e.g.,* IMF Paper at 12; IIF Global Approach Report at 43–44.

[118] *See generally* FSB Moral Hazard Report; IIF Global Approach Report; IMF Discussion Note.

[119] *See generally* CBRG Report; FSB Moral Hazard Report; IIF Global Approach Report; IIF Addressing Priority Issues Submission; IMF Paper.

[120] *See, e.g.,* IIF Global Approach Report at 43–47; IMF Paper at 23.

[121] FSF Principles at 3, CBRG Report at 34–35.

Appendix A—Country-Specific Initiatives Overview

In response to the recent financial crisis, individual countries have undertaken various initiatives, specifically the passage of legislation, to address weaknesses exposed in the crisis. These initiatives acknowledged that the regulatory and legal regimes in place did not adequately account for the complexity of many failing institutions. This appendix reviews the initiatives undertaken by the United Kingdom and Switzerland as examples of ongoing efforts.

UK Independent Commission on Banking

The UK Independent Commission on Banking (UK Banking Commission) was established in 2010 to "consider structural and related non-structural reforms to the UK banking sector."[122] In April 2011, the UK Banking Commission released its *Interim Report Consultation on Reform Options* (UK Report) setting forth its views on possible reforms and seeking responses to those views, but excluding any final conclusions on any of the matters presented.

The UK Report presents the UK perspective of the recent financial crisis. It observes that UK bank leverage increased significantly, making UK banks more vulnerable to losses.[123] Further, when the losses were incurred, banks' liability structures "proved to be poor at absorbing them."[124] The UK was severely affected by the crisis, with a rise in unemployment, a sharp deterioration of public finances, and state intervention in and ownership of the Royal Bank of Scotland and Lloyds Banking Group.[125] The UK is currently creating a number of new bodies to enhance the supervision of financial service entities and strengthen the stability of the financial system, and the regulatory framework is expected to be in place by the end of 2012.[126]

The UK Report presents options for reform to reduce the probability and impact of bank failures "by increasing the loss-absorbing capacity of banks and by structural reform to create some degree of separation between retail banking and wholesale and investment banking."[127] The UK Banking Commission advocates an approach that includes a combination of internal ring-fencing within universal banks[128] to isolate retail banking, and higher capital requirements together with measures to "make bank debt effectively loss-absorbing."[129] The UK Report anticipates that the ring-fencing approach may simplify and reduce the costs of a failing universal bank, allow the UK system to better absorb shocks, and curtail perceived government guarantees.[130] The UK Report explores various types of loss-absorbing capacities including common equity, increasing the effective loss-absorbency of bank debt ("bail-in"), contingent capital, and depositor preference that subordinates the claims of other senior unsecured creditors to those of depositors.[131]

The UK Report is focused on solutions for the UK financial system, but it incorporates the initiatives of other international parties such as the Basel Commission and the FSB. It is not the final view of the UK Banking Commission, but it solicits views, evidence, and analysis of its proposals. The UK Banking Commission is expected to publish its final report in September 2011.

Switzerland

The Swiss Federal Council, which is the seven-member executive council that comprises the Swiss government, established a Commission of Experts (Swiss Commission) on November 4, 2009, to review the economic risks posed by large companies and make recommendations regarding the "too big to fail" issue. On September 30, 2010, the Swiss Commission released the *Final Report of the Commission of Experts for limiting the economic risks posed by large companies* (Swiss Report).[132]

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[122] UK Independent Commission on Banking, *Interim Report Consultation on Reform Options* (London: UK Independent Commission on Banking, April 2011), at 11, http://s3-eu-west-1.amazonaws.com/htcdn/Interim-Report-110411.pdf.

[123] *Id.* at 20.

[124] *Id.* at 21.

[125] *Id.* The UK government acquired ownership stakes in the Royal Bank of Scotland and Lloyds Banking Group in October 2008, resulting in an 80 percent and 40 percent state ownership of each, respectively.

[126] *Id.* at 58.

[127] *Id.* at 63.

[128] The UK Report notes that the activities of "universal banks" can generally be divided into retail and wholesale/investment banking, and the ring-fencing approach would be with respect to the retail banking activities. *Id.* at 77. *Cf. supra* at footnote 32.

[129] UK Report at 63–64.

[130] *Id.* at 77.

[131] *Id.* at 67–75.

[132] Switzerland Commission of Experts, *Final Report of the Commission of Experts for Limiting the Economic Risks Posed by*

In addressing the "too big to fail" issue, the Swiss Report notes that a central notion in the discussion is that of "systemic importance." It identifies the following conditions for a company to be considered "systemically important":

1. The company performs services that are essential for the economy and are indispensable.
2. Other market participants cannot replace the company's systemically important services within a time frame that is acceptable for the economy as a whole.[133]

Given the importance of companies that are considered "too big to fail" to an economy, such companies benefit from implicit state guarantees that may create harmful incentives. The Swiss Report identifies four core measures to remove such incentives and distortions of competition, and to avoid government rescues of such companies. The measures, which are discussed in detail in the Swiss Report, are

1. Capital—the capital measure includes a minimum requirement to maintain normal business activities, a buffer that allows banks to absorb losses, and progressive components that ensure that systemically important banks have higher levels of solvency;
2. Liquidity—the liquidity measure requires banks to have sufficient liquidity to cover its outflows for one month under a stress scenario created by the regulatory authorities;
3. Risk diversification—the risk diversification measure defines the maximum risk that an institution may incur with single counterparties, with an objective to reduce the degree of interconnectedness within the banking sector; and
4. Organization—the organization measures are designed to ensure the continuation of systemically important functions in the event of insolvency.[134]

With respect to capital, the Swiss Report's commentary on the draft Swiss Banking Act notes that the use of convertible capital, in which debt can be converted into equity ("bail-in"), may be useful in a crisis situation.[135] By converting debt into capital, the "costs that would otherwise have to be borne by third parties, including the government, are transferred to outside creditors."[136] The new provisions should create a legal framework to facilitate the recognition of foreign bankruptcy orders by simplifying the process for recognizing such orders and other insolvency measures ordered by foreign authorities in Switzerland.[137] The Swiss Report also notes that Switzerland is working with countries to coordinate insolvency measures.[138]

Large Companies (September 30, 2010), www.sif.admin.ch/dokumentation/00514/00519/00592/index.html?lang=en.

[133] *Id.* at 12.

[134] *Id.* at 21–43.

[135] *Id.* at 86.

[136] *Id.* A recent Swiss legislative amendment provides for the authority to impose a debt-to-equity conversion in the context of formal reorganization proceedings.

[137] *Id.* at 44.

[138] *Id.*

Appendix B—Case Studies

The CBRG Report presents case studies of the following cross-border financial crises that illustrated the shortcomings of current frameworks: (1) Fortis Group; (2) Dexia; (3) Kaupthing; and (4) Lehman Brothers. These case studies presented certain common issues related to the insolvencies of cross-border financial firms, but also raised issues unique to each institution and jurisdiction. An overview of each case study is provided in this appendix. The overview summarizes only the materials provided in the CBRG Report.

Fortis Group

Fortis Group[139] (Fortis) was a Belgian/Dutch financial conglomerate with subsidiaries in Belgium, the Netherlands, and Luxembourg. The consolidating and coordinating supervisor was in Belgium, and Fortis was considered systemically important in each of the three countries in which it had subsidiaries.

Fortis' financial difficulties are traced to its 2007 acquisition of ABN AMRO. Due to the financial crisis in 2008, Fortis was unable to strengthen its financial position to finance or integrate the acquisition. In June 2008, doubts increased in the market as to whether Fortis could realize its acquisition plans, and Fortis' market share price began to deteriorate, thereby causing a loss of liquidity.

In September 2008, Fortis clients began to withdraw deposits and Fortis lost access to the overnight interbank market. Fortis turned to the National Bank of Belgium's Marginal Lending Facility of the Eurosystem. Public intervention followed and the Dutch and Belgian governments purchased or increased their holdings of shares of Fortis entities. BNP Paribas also took a majority stake in certain Fortis entities. The sales were transacted and finalized under Belgian law.

The Fortis case involved interventions along national lines, without the use of statutory resolution mechanisms. The Fortis case demonstrated that, in a situation where a firm needed to be quickly stabilized while maintaining the current business as a going concern, formal supervisory crisis management tools may be limited. Disclosure that such tools have been used may undermine market confidence or trigger termination events in contracts. Dutch and Belgian authorities also assessed Fortis' situation differently, which led to differences in the sense of urgency.

Dexia

Dexia[140] is the result of a merger between a Belgian and a French bank, and had a significant presence in Luxembourg. Dexia faced financing difficulties in 2008. In September 2008, Dexia's board of directors authorized the increase of the bank's capital by EUR 6.4 billion, portions of which were provided by Belgian and French public and private sector investors and Luxembourg. In October, Belgium, France, and Luxembourg agreed to facilitate Dexia's access to financing, and additional Belgian and French public guarantees were announced the following month.

The Dexia case did not involve the use of statutory resolution mechanisms. Authorities in each of Belgium, France, and Luxembourg agreed to share the burden to ensure that Dexia had continued financing, and to provide time for the sale of certain operations and the retrenching of others. The CBRG Report concludes that tensions caused by the centralization of liquidity management within a cross-border group can be overcome by adequate cooperation between the relevant central banks, and that home and host authorities' clearly stated support to the cross-border group can overcome timing issues related to the resolution process.

Kaupthing

Kaupthing,[141] an Icelandic bank, had active branches and subsidiaries in 13 jurisdictions: Austria, Belgium, Denmark, Dubai, Finland, Germany, the Isle of Man, Luxembourg, Norway, Qatar, Sweden, Switzerland, and the UK. In 2007, approximately 70 percent of Kaupthing's operating profits originated outside of Iceland.

In 2008, Icelandic banks faced mounting problems, causing the Iceland government to take control of the banks or put them into receivership. Iceland's central bank lent Kaupthing EUR 500 million, but despite government assurances that Kaupthing would not require the same measures as other Icelandic banks, Kaupthing depositors in the UK with-

[139] *See* CBRG Report at 10–11 for the entire Fortis case study.

[140] *See* CBRG Report at 11–12 for the entire Dexia case study.

[141] *See* CBRG Report at 12–14 for the entire Kaupthing case study.

drew their funds en masse. Kaupthing's UK supervisor, the Financial Services Authority, determined that Kaupthing no longer met the conditions for operating as a credit institution, and therefore should be closed to new business. The UK government also transferred the remaining Kaupthing deposits in the UK to a different bank, and the UK government became Kaupthing's creditor. Despite these developments, Kaupthing continued to provide assurances to its European supervisors that it had enough liquidity to continue to pursue its daily business.

On October 9, 2008, the Icelandic Financial Supervisory Authority took control of Kaupthing. This act triggered a series of reactions from Kaupthing's various European supervisors, including a prohibition from receiving payments not intended for the payment of debts in Germany, the appointment of administrators and commissioners in Luxembourg and Switzerland, respectively, the financing by Finnish banks of a EUR 100 million payback to depositors in Finland, a loan from the Swedish central bank, and a freezing of Kaupthing's assets in the UK.

Ultimately, Kaupthing's growth had exceeded its home jurisdiction's ability to provide effective consolidated supervision or financial support. The case study demonstrates that the limitations of national resources and supervisory capacity affect the ability to respond to a crisis involving institutions that become too large for its home country supervisor. Cross-border expansions may create risks of unmanaged growth without effective supervision by home authorities.

Lehman Brothers

The Lehman Brothers group[142] included 2,985 entities operating in approximately 50 countries. Its overseas entities were subject to host country regulation and in the United States its ultimate holding company was subject to supervision by the Securities and Exchange Commission under the Consolidated Supervised Entities program.

[142] *See* CBRG Report at 14–15 for the entire Lehman Brothers case study.

Lehman Brothers faced a liquidity issue that led to varying results based on whether certain subsidiaries could obtain a source of liquidity. The Federal Reserve Bank of New York agreed to provide liquidity to the U.S. broker-dealer to facilitate an orderly wind-down that ultimately resulted in the purchase of certain assets and the assumption of certain liabilities by Barclays Capital. Lehman Brothers' London investment firm, however, relied on the holding company for liquidity, which became unavailable once the holding company filed for bankruptcy. The overall outcome is that the various Lehman Brothers entities that were not acquired, including the holding company and the London investment firm, are being wound down by insolvency officials in numerous jurisdictions.

Based on the Lehman Brothers case study, the CBRG Report identified the following factors relevant to effective crisis resolution:

1. In a situation where an acquirer for the entire firm can be identified, counterparties and other parties providing short-term funding will expect some guarantees so that they will continue to do business with the firm in the interim.
2. Government resources may be required to provide liquidity.
3. A prepared resolution plan may be useful to the authorities.
4. Monitoring by regulators and the interactions of insolvency regimes are important.
5. Regulators need to understand and monitor group structures and interdependencies.
6. In the event of a cross-border failure, the insolvency regimes applicable to the major entities will likely be separate proceedings with different policies, priorities, and objectives.
7. These differences make coordination and cooperation among insolvency officials a challenge. Insolvency officials need access to information and records that are part of an insolvency proceeding in another jurisdiction.

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