

MYKOLAS ROMERIS UNIVERSITY
UNIVERSITY OF BASEL

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**BANK RESOLUTION REGIME.
BALANCING PRIVATE AND PUBLIC INTERESTS.
A COMPARATIVE ANALYSIS**

Doctoral Dissertation
Social Sciences, Law (01 S)

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LIST OF ABBREVIATIONS

Art. – article;

Aut.note. – comment by the author;

Bail-in – restructuring mechanisms to recapitalise a bank in resolution or effectively capitalise a bridge bank under the specified conditions, through write-down, conversion or exchange of debt instruments and other senior or subordinated unsecured liabilities of the bank in resolution into, or for, equity or other instruments in that bank, the parent company of that bank or newly formed bridge bank, in accordance with the legal framework and market capacity of a certain jurisdiction;

Bail-out – any transfer of funds from public sources to a failing or likely to fail bank or a commitment by a public authority to provide funds with a view to sustaining a failed bank that results in benefit to the shareholders or uninsured creditors of that bank, or the assumption of risks by the public authority that would otherwise be borne by the bank and its shareholders, where the value of the funds transferred is not regained from the bank;

Basel III – new international financial regulatory standards on bank capital adequacy ratios and liquidity agreed by the members of the Basel Committee on Banking Supervision. The third regulatory package of financial regulations was reviewed in the light of the financial crisis. The package strengthens bank capital requirements on bank liquidity and bank leverage requirements;

BCBS – Basel Committee on Banking Supervision;

BIS – Bank for International Settlements;

BRRD – Bank Recovery and Resolution Directive;

Chap./Sec. – chapter/section;

CoE – Council of the Europe;

DGS – Depositors Guarantee Scheme;

DIA – Deposit Insurance Agency;

Dodd-Frank – Dodd-Frank Wall Street Reform and Consumer Protection Act;

EBA – European Banking Authority, an independent EU Authority which seeks to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objectives are to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector;

ECB – European Central Bank;

EC – European Commission;

ECHR – the European Convention for the Protection of Human Rights and Fundamental Freedoms of 4 November 1950. The members of the Convention are the members of the EU;

ECoHR – the European Court of Human Rights

e. g. – for example;

EU – European Union, international organisation established on 7 February 1992 under the Maastricht Treaty;

CJEU – The Court of Justice of the European Union;

EP – the European Parliament;

FDIA – *US Federal Deposit Insurance Act*;

FSB – The Financial Stability Board;

FINMA – The Swiss Financial Market Supervisory and Bank Resolution Authority

FDIC – The Federal Deposit Insurance Corporation, competent Authority in the US that carries out prudential regulation, insuring deposits and performing bank resolution functions. Preserves and promotes public confidence in the US financial system by insuring deposits in banks, by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect of bank failure on the economy and the financial system.

IMF – The International Monetary Fund;

IFS – International Financial Standards;

US – Unites States of America;

UK – United Kingdom;

LR – Republic of Lithuania;

No. – number;

SIFI – systemically important financial institutions;

TFEU – Treaty on the Functioning of the European Union – official title of the Treaty establishing the European Community, renamed from 1 December 2009 after entry into force of the Treaty of Lisbon.

SRM – Single Resolution Mechanism;

V. – versus;

UNCITRAL – United Nations Commission on International Trade Law;

WB – World Bank;

* Other abbreviations used in the thesis are presented in the text below.

LIST OF KEY TERMS

Bank – any credit institution that takes deposits or repayable funds from the public and is defined as a bank by relevant national legislation.

Bank liquidation – *ultima ratio* model of distressed bank resolution, when bank activity is terminated, a liquidator is appointed, who must sell the bank's assets and distribute the funds to creditors and ultimately exclude the insolvent entity from civil circulation. At the same time, for the purposes of the dissertation, bank liquidation is conceived as the last stage of bank resolution, when the bank resolution tools have already been applied (e.g., when the bank is split into 'good' and 'bad' bank by the decision of the relevant resolution authorities), and only then the 'bad' bank assets are liquidated due to insolvency.

Bank insolvency – for the purposes of the study, bank insolvency is considered as a financial condition of the bank at which several different solutions can be taken. In general terms, for the purposes of the dissertation, bank insolvency is understood as either a situation when a bank that is *de facto* insolvent can be restructured and under certain circumstances the procedure can be initiated to restore the solvency of the entire bank or any part of it, by maintaining and developing its activities, while the remaining part of the bank is liquidated.

Bank resolution – one of the bank insolvency procedures, administrative procedure and legal tools dedicated for bank restructuring or managing dissolution of failing banks while preserving insured deposits and other services essential for maintaining financial stability. Bank resolution also means any action taken by a relevant public authority in respect of a bank that meets the resolution threshold, including the exercise of resolution powers or seeking resolution targets specified in the national law and taking into account the specific features of the bank. At the same time, it is the last step of actions taken by supervisory authorities, often initiated as soon as possible and justified after applying early intervention tools, when private sector solutions or regulatory actions taken within a reasonable period of time and according to the existing circumstances are not sufficient to protect the bank from bankruptcy and it is determined that general insolvency laws and procedures might pose a threat to the public interest.

Bank resolution regime – the elements of legal framework and the policies governing the application of resolution powers by national authorities. It is based on the "Key Attributes of Effective Resolution Regime for Financial Institutions", adopted by the Financial Stability Board and other relevant international organisations, agreed at international level.

Non-performing loan – includes loans where payment of interest or principal payment are past due and the obligor is in default with regard to the borrower, or when there are good reasons to believe that the payment will not be repaid in full.

Banking Union – a system governed by the legislative package for the banking sector crisis management. Integrated financial system in the EU seeking to ensure financial stability and reduce the cost of bank insolvency. This system consists of a common super-

visory mechanism and a new, integrated deposit guarantee schemes and resolution system of credit institutions, a comprehensive and detailed rulebook on distressed banks conduct.

Financial contracts – any securities contracts, commodities contracts, forward contracts, repurchase agreements, option contracts, swap agreements and any similar agreement that, in every case, is explicitly identified under the legal framework of a particular jurisdiction as subject to special treatment with regard to resolution and insolvency (in relation to early termination rights or in order to preserve the effect of netting agreements) and distinct from non-financial contracts.

Depositor – a natural or legal person holding deposit in a bank or its branch.

Official intervention – any actions, including formal corrective action, taken by supervisory or resolution authorities in response to weaknesses of a financial bank prior to resolution. Normally taken in the form of financial assistance, including in conjunction with nationalisation of financial institutions, when the bank is no longer able to operate independently.

Ordinary bankruptcy – collective bankruptcy proceedings aimed at selling all or any part of the debtor's assets. This procedure generally involves the designation of a liquidator or receivership, usually initiated against credit institutions according to national law only on the basis of certain procedures, or according to the law applicable to all natural and legal persons in general.

Bail-in – legal bank resolution tool for exercising write-down and conversion powers of a resolution authority in relation to liabilities of a bank under resolution in accordance with national law.

Competent resolution authority – an authority, acting independently or together with other competitive authorities, that manages the conduct of resolution procedures applied to banks established and operating under its jurisdiction (including the resolution planning functions).

Bridge bank – an entity authorised or licensed following the applicable requirements under national law, established on a temporary basis in order to take over and maintain the specific assets, liabilities and operations of a failed bank, and viewed as one of the resolution tools for the purposes of this dissertation.

Insolvency – a particular financial condition experienced by the debtor, which can be temporary or permanent in nature. Insolvency is not only legal but also an economic category.

Equity instruments – shares, other instruments granting equity or property, tools that can be converted into shares or other equity instruments or granting the right of purchase, and measures as a combination of shares or other equity instruments.

Resolution threshold – conventional evaluation of bank resolution conditions by the public authorities, when a bank matches the conditions under which resolution procedures or execution of resolution powers may be initiated according to the statutory powers conferred on the competent authorities.

Resolution powers – powers available to public authorities under the legal framework and resolution regime for the purposes of resolution.

Resolution actions – a decision to commence bank resolution procedure or apply bank resolution tool or implementation of one or several resolution powers.

Supervisory authority – an authority responsible for bank licensing, compliance with license requirements and prudential regulation. The supervisory authority shall take appropriate legal measures to protect the interests of bank depositors, determine bank insolvency, take corrective action to maintain discipline in the market, adopt decisions on bank resolution and/or bank liquidation procedures.

Systemic risk – risk of disruption of the financial system, which could have serious negative consequences for the financial system and the real economy.

Systemically important financial institution – a financial institution or a group thereof, when due to its size, complexity and systemic interconnectedness, it may, in the opinion of the relevant authority, cause significant disruption to the domestic or broader financial system and economic activity, if it were to fail in a disorderly manner.

Systemically important or critical functions – bank activity or operations is systemically significant or critical, if its interruption, suspension or discontinuation could lead to a disruption of services vital for the functioning of the financial system or real economy.

Financial leverage – the ratio of credit institution's own funding and of bank assets, off-balance sheet liabilities and contingent liabilities incurred to fulfill an obligation, to provide collateral, including obligations for received funding, commitments, derivatives or repurchase agreements, but excluding obligations, the execution of which can be guaranteed only by liquidating the credit institution.

International financial standards – legal recommendations based on 'soft law'. Regulatory guidelines developed by international organisations for model regulation of bank insolvency procedures.

Asset separation tool – bank resolution tool, necessary for the resolution authority to transfer bank assets, rights or obligations to the asset management company or a third party in accordance with the law.

Managing body – means body or bodies of a bank, appointed in accordance with national law, and empowered to set the bank's strategy, objectives and overall direction, and which oversee and monitor decision-making of the management; they include persons who effectively direct the business of the bank.

Sale of business – bank resolution tool for effecting a transfer by a resolution authority of shares or other equity instruments issued by an institution under resolution, or assets, rights or liabilities, of an institution under resolution, to a purchaser that is not a bridge institution.

*Other remarks on the terms used in the dissertation are contained in sections 1.1., 1.6.1., 1.6.2., 2.1. and 5.1.

PREFACE

Issues and interest of the research. Despite their significant dynamics in the field of financial services, banks are the most widespread financial institutions all over the world, they undertake essential, crucial functions and play a significant role in sovereign economies¹. Consequently, the banking crisis is ever more associated with rather sensitive and provocative social, political, budgetary and legislative events². Efficient, reliable and predictable regulation of banking activities at national and international level helps to maintain critical banking functions and solvency. Efficient and practical legal regulation of banking activities primarily relates to quantitative risk management activities of a bank and numerous limitation criteria of prudential regulation. However, the recent banking crisis highlighted the equally important role of qualitative risk criteria of banking practice and their impact assessment important, especially bank insolvency crisis management rules, legal measures and bank insolvency procedures.

The doctrine highlights that bank insolvency is an unavoidable phenomenon in a free market economy³. In spite of that, the legal rules and tools that assist, indeed facilitate, in coping with these dilemmas arising from insolvent banks have been explored for many years⁴. This fact is *inter alia* confirmed by statistics⁵. The initial bank bankruptcy proceed-

1 See more Chapter 1 Sec. 2

2 Hoelscher D.S. Bank restructuring and resolution. Palgrave Macmillan, New York, 2006. P. 3.

3 Despite regulatory controls, banks can also fail, just like other corporations. The goal of banking supervision is not fully prevent bank insolvencies. It is not possible and would be run counter the essence of free market economy. Moreover, this is impractical, since it would excessively limit bank's business activities. Thus, this could result in the destruction of overall economy. In order to protect the financial stability of the banking system as a whole, supervisory authorities must be able to timely close and liquidate banks whenever a bank no longer meets its extensive licensing requirements and appears in a position where even the most reliable bank is no longer able to recover its financial situation. Hüpkes E. *Insolvency-why a special regime for banks? Current developments in monetary and financial law*. Vol. 3, IMF, Washington DC, 2003. Preface. BCBS. Core Principles for Effective Banking Supervision. Basel, 2012 [interactive]. [accessed on 2014-03-25]. <<http://www.bis.org/publ/bcbs230.pdf>>.

4 Particularly, around 2000, international financial regulatory authorities began boosting bank insolvency law issues and concerns regarding lack of regulation. However, international authorities failed to solve relevant and important problems (banking group problems, systemic risks, etc.) prior to the beginning of recent last banking crisis. Financial Stability Forum. Guidance for Developing Effective Deposit Insurance Systems. September 2001 [interactive]. [accessed on 29-12-2014]. <http://www.financialstabilityboard.org/2001/09/r_0109b/>. BCBS. Supervisory Guidance on Dealing with Weak Banks: Report of the Task Force on Dealing with Weak Banks, March 2002 [interactive network]. [accessed on 29-12-2014]. <<http://www.bis.org/publ/bcbs88.pdf>>.

5 Between 2008 and 2014, around 508 cases of bank insolvency proceedings were initiated in the US. FDIC. *Failed Bank List* [interactive]. [accessed on 2014-12-29]. <<https://www.fdic.gov/bank/individual/failed/banklist.html>>. Between 2009 and 2014, bank insolvency proceedings were initiated against around 186 banks in Switzerland. FINMA. Enforcement, Insolvency, Insolvencies [interactive]. [accessed on 2014-12-29]. <<http://www.finma.ch/e/sanktionen/insolvenz1/insolvenzen/Pages/insolvenzen.aspx>>. In the EU, in 2007-2009 more than 500 banks faced insolvency. The largest bank insolvency cases were observed in Ireland, Greece, France, Belgium, Holland, Italy, Spain, Germany, UK. Claessens S., Kose A.M., Laeven L., Valencia F. Financial Crises: Causes, Consequences, and Policy Responses. IMF- Business & Economics, 2014. P. 412. Valiante D. Framing Banking Union in the Euro

ings emerged in the Middle Ages⁶. Since that time, accurate administration of these bank insolvency procedures was a relevant yet problematic matter. Accordingly, cases of bank insolvency have caused many obstacles and adverse outcomes, not solely with regard to individuals, lenders, shareholders, but also for the public and the society as a whole.

Bank insolvency law and procedure, including their complexity, is commonly known as a “Gordian knot” in the legal doctrine⁷. In theory, from the very inception of modern financial markets⁸, insolvency procedures of financial institutions and correlated legal relations have served as a point of reference for economists, bankers, lawyers and legal researchers⁹. In practice, until the *recent banking crisis*¹⁰, the substance and procedure of bank insolvency laws largely diverged, and a systematic approach was missing. Typically, in order to address the sensitive bank insolvency issues general corporate insolvency law – *lex generalis*¹¹ – was applied without taking into account and observing the unique char-

Area. Some empirical evidence. CEPS Working Document. No. 389, 2014. P. 9. It must be noted that, starting from the independence period up to nowadays, 15 banks became insolvent in Lithuania. Recently, the bank ‘Snoras’ was declared insolvent, and afterwards the liquidation procedures were initiated and early intervention tools were applied. This case had considerable repercussions in the Lithuanian society. The bank ‘Ūkio Bankas’ was also declared insolvent, and its banking license was revoked. Given that the transferring of bank’s assets, rights, transactions and liabilities to another bank would allow maintaining depositor confidence in the banking system and banking sector stability and secure the public interest, as compared to liquidation (bankruptcy), the bank was placed under resolution. The Lithuania Ministry of Economy. Bankruptcy Management Department. Insolvent banks [interactive] [accessed on 2014-12-10] <<http://www.bankrotodep.lt/Bankrotas.php?Tipas=3>>. 2011-12-12 Vilnius Regional Court judgment in civil case *Lietuvos bankas v. Bank Snoras*, AB No. B2-7791-611/2011 and judgment of the Central Bank of the Republic of Lithuania of 18 February 2013, No. 03-31.

6 See more Chapter 1 Sec. 4 Subsec. 1.

7 Bank insolvency procedures are characterised by their complexity and are governed by the insolvency law and company law, financial law and private law, administrative and banking law.

8 The starting point of modern financial markets is in the 20th century when advanced technologies stimulated the evolution of the banking industry. It must also be noted that the financial markets are associated with asset markets, while property markets refer to the concepts of assets and liabilities. Classic trading in assets originated by banks also flourished in the 1980s and 1990s. However, in the 21st century the definition was transformed into the idea of financial markets. This approach was based on the classic fact that these days the financial markets principally deal with the issues of obligations (debt) rather than the value of actual properties. The difference is quite significant as most investments, physical commodities or services are purchased on a long-term basis, which accordingly affects the value of the assets in short term. Chorafas N.D. *Basel III, the Devil and Global Banking*. Palgrave Macmillan Studies in Banking And Financial Institutions. Great Britain, 2012. P. 25. Wright S., Smithers A., Warburton P. *Practical History of Financial Markets*. UK. Edinburgh Business School, 2011. P. 76.

9 Robert C. Clark. *The Soundness of Financial Intermediaries*. Yale Law Journal. Vol. 86. No. 1, 1999. Swiret P.P. *Bank Insolvency Law Now That it Matters Again*. Duke Law Journal. Vol. 42, No. 3, 1992.

10 See more Chapter 1 Sec. 1.

11 WB. Public statistical data of 2007 m. regarding the banking regulations and supervision in 143 jurisdictions worldwide [interactive]. [accessed on 2014-10-15] <<http://www.worldbank.org/financialdevelopment>>. Angkinand A. Wihllborg C. *Bank Insolvency Procedures as a foundation of Market Discipline*. LEFIC Working Paper, 2005-2008. P. 4. Cihak M., Demirguc-Kunt A., Maria Soledad Martinez P., Mohseni-Cheraghloou A. *Bank regulation and supervision around the world: a crisis update*. Policy Research working paper. No. WPS 6286. Washington, DC, WB, 2012. Specific regulations for bank insolvency procedures are a distinguishing feature of the US system. Legally, FDIC cannot apply direct liquidation and general insolvency rules, but started acting as a receivership. From 1898, bank insol-

acteristics, functions and purpose of the banks.¹² In addition, most legislation imposed minimum regulation with regard to legal principles of bank resolution, and was therefore unpredictable, incomplete, lacking legal certainty, with no alternative solutions available¹³. Normally, former regulations were restricted to the application of governmental stabilisation measures, while alternative solutions describing how to manage cases of bank insolvency were neither established nor developed. As time went by, deregulation and the lack of balance of rights and obligations of diverse groups of stakeholders operating in bank insolvency procedures, namely the state, public institutions, bank administrators, creditors, shareholders became more obvious. Due to the lack of proper legal safeguards, including the former inadequate legal framework, uncertainty and the risk of litigation increased. Accordingly, from the inception of the financial crisis, up to the present day, academics, regulators, policy-makers, and related international organisations have undertaken effort to examine possibilities for more effective sound legal measures that could assist in addressing insolvent bank issues without resulting in the chaos of the financial sector and by avoiding other severe consequences. At that point, a reasonable question arises as to *the types of bank insolvency regulation procedures that have been modified since the recent global banking (financial) crisis, with its peak period in 2008-2009*¹⁴?

From a practical point of view, a question arose as to whether *lex generalis* was adequate to resolve the problems of an insolvent bank effectively¹⁵. Legal mechanisms for re-

veny cases were separated and no longer heard by ordinary corporate bankruptcy courts. Starting from 1933, bank insolvency procedures were governed by the US FDICA by means of special rules. *Lex specialis* for bank insolvency procedures was repeatedly revised in 2010. Hynes M. R., Walt D. S. *Why Banks are Not Allowed in Bankruptcy*. Virginia Law and Economics Research Paper No. 2010-03, 2009. P. 14. In 2004 Switzerland implemented special legal rules on bank insolvency to a limited extent. The main legal acts governing bank insolvency law were revised in 2011 and 2012, including rules governing bank resolution. Other regulations governing bank insolvency procedures were also modified, for this reason consistent legislation was created only at the end of 2012. Since the recent banking crisis, some of the EU Member States have undertaken individual efforts to reform their bank insolvency laws (Germany, UK, Netherlands, Spain, Belgium). However, in substance, legal acts on bank insolvency procedures were harmonised only with the entry into force of the Banking Union acts. FSB. Thematic review on resolution regimes. Peer review Report. 2013.

12 See more Sec. 1 sub-sec. 3.

13 Several practical examples could illustrate this statement. In 2008, the UK had to react promptly and adapt changes in the banking laws, by creating special bank insolvency procedures empowering public authorities to nationalize the failing Northern Rock bank. Belgium, Luxemburg and the Netherlands were bound to apply bail-out to Fortis Bank, as it was found that in the case of liquidation, uncontrolled procedures could severely damage the real economy. Firstly attempts were made to sell the bank, but the shareholders of the bank did not agree for the sale. The Brussels Court of Appeal suspended the transaction until the time when the consent of the shareholders was obtained. Marinč M., Rant V. *A cross-country analysis of bank bankruptcy regimes*. Journal of Financial Stability, No. 13, 2014. P. 134. Koch B.E. *Challenges at the Bank for International Settlements*. Berlin-Springer, 2007. P. 36.

14 See more Chapter 1 sec. 5.

15 The conclusion reached in the doctrine is based on the fact that during liquidation the value of the bank's assets is severely damaged, in addition, it reduces the possibilities for bank creditors to restructure and rescue the bank, increases the risk of financial contagion in the financial markets and threatens the real economy. Such negative consequences double in particular where a large and complex bank is failing or likely to fail. IMF European Department. *The Need for Special Resolution Regimes for Financial Institutions – The Case of the European Union*. Prepared by Cihak M. and Nier E, 2009. Abstract.

structuring banks were limited, while ordinary bankruptcy procedure was hardly suitable for banks¹⁶. In parallel, it was generally recognised that ordinary bankruptcy is not suitable for banks. An issue arose: how a country should respond to the symptoms revealed by one or several banks, showing serious financial and (or) operational difficulties, distress, or that a bank is failing or likely to fail, or is insolvent? What are the legal and administrative measures that the state must have in place and what are the steps to be taken to deal with bank insolvency problems effectively? These issues became fundamental in the context of the reforms of bank insolvency law.

According to WB data, in 2008, which was the peak period of the global banking (financial) crisis, only 18% of all states in the world had *lex specialis*, although abstract and often ineffective legal procedures regulating bank insolvency¹⁷. Naturally, a conceptual question arises as to what has changed and are we witnessing the development of a new bank insolvency paradigm?¹⁸.

Before the recent banking crisis, bank insolvency regulation in most countries lacked legal certainty, and the effect of this was that bank insolvency rules and procedures were created, administered and conducted on an *ad hoc* basis, by a spontaneous process of banking crisis management. While the states often employed public finances and bail-out for solving and addressing bank insolvency problems and saving banks, bank liquidation procedure was applied as an alternative¹⁹. At the same time, banks were prevented from initiating bankruptcy proceedings, even if they could avoid the adverse consequences for the real economy. This resulted in spill-over effects and different risks, such as moral haz-

- 16 Swiss Financial Market Supervisory Authority. Resolution of Global Systemically Important Banks. FINMA position paper, 2013 [interactive]. [accessed on 2014-12-09] <<http://www.finma.ch/e/finma/publikationen/Documents/pos-sanierung-abwicklung-20130807-e.pdf>>. P. 4. IMF. *Supra* note 15. P. 6.
- 17 Čihák M., Demirgüç-Kunt A., M.S.M. Peria, A. Mohseni-Cheraghloou. Bank Regulation and Supervision around the World. A Crisis Update. Policy Research Working Paper No. 6286, 2012 [interactive]. [accessed on 2014-12-01]. <<https://openknowledge.worldbank.org/bitstream/handle/10986/12159/wps6286.pdf?sequence=1>>. Marinč M., Rant V. A cross-country analysis of bank bankruptcy regimes. *Journal of Financial Stability*. Vol. 13, 2014. P. 134-150.
- 18 In his book, Thomas Kuhn described a *paradigm* as admitted scientific knowledge, which serves the particular scientific community in promoting and solving practical and theoretical problems with the help of methodological approach during particular time. With time, the concept of paradigm was replaced by research performance theory. An essential element of paradigm's performance is its solid core, which is typical, consisting of observations, principles and assumptions. After significant changes in the bank insolvency legal system and legislation at both national and international level, we can talk about a paradigm's transformation in the financial system. In addition, problems related to bank insolvency procedures and their solving methods were changed, science admitted the predominance of bank insolvency deregulation, and the paradigm of bank insolvency law was changed. See Kuhn. T.S. *The Structure of Scientific Revolutions*. Prada, Vilnius, 2003 [1962]. Chorafas N.D. *Supra* note 8. Introduction (ix). See more Chapter 1 Sec. 8.
- 19 Although normally public support maintained the bank as a going concern for some time and the bank continued its operation, a bail-out distorted shareholder, creditor and management initiatives and incentives to restructure the bank. Acknowledging that taxpayers 'stand' for all the other stakeholders created an unfair competitive advantage over the other banks, competitors and even increased the competitive advantage of the countries whose authorities were more prone to save public money. Hüpkens E. *Allocating costs of failure resolution. Shaping incentives and reducing moral hazard*. (in) Lastra R.M. *Cross-border bank insolvency*. New York, Oxford university press, 2011. P. 105.

ard, systemic risk, distortions of competition, protection of the depositor's rights, threat for financial stability, etc. In addition, nearly every official bank restructuring decision was taken, or at least confirmed, with the approval of the political leadership. The competent authorities and the governments could choose one of the two equally undesirable options: either to initiate expensive public rescue of the failing banks by using public finances (bail-out), or to apply ordinary bankruptcy procedures as an alternative even to systemically important banks with the ensuing negative impact on the financial system as a whole and the economy in general.

G20 authorised an action plan in November 2008, and suggested that the legislators, regulators and other competent authorities “review the legal regulation of bank restructuring and bankruptcy laws, according to a new experience and [...] ensure that the states would assist for the orderly winding up of banks²⁰”. It was concluded that it was vital to establish and develop effective legal instruments that could accurately liquidate insolvent banks in an ordinary way while maintaining the systemically important banking functions. A well-defined approach, namely *the bank resolution regime* was supported²¹. The *central purpose* of the bank resolution system was to provide the “third insolvency alternative and a new direction” between uncontrolled or inadequately managed bank liquidation procedure (bankruptcy), which usually operates together with reducing the impact of bank assets and other bank insolvency jeopardies, covered when the bank's shareholders and the majority of creditors are rescued by using public finances. Bank liquidation proceedings generally have an adverse effect. They swiftly interrupt and disturb the bank's conduct and business operations and further destroy the value of the property²². During the transitional period and in the final outcome, the continuity of critical banking functions and business continuity presumption is not met. Therefore, the first priority was to resolve the bank as a going concern, by applying resolution tools and avoiding any significant adverse

20 Declaration at the Summit on Financial Markets and the World Economy of 15 November 2008. Washington DC [interactive]. [accessed on 2014 -12-05] <<http://www.un.org/ga/president/63/commission/declarationG20.pdf>>.

21 October 2011, on the international level the Financial Stability Board has developed and introduced, and the G20 determined a new bank resolution regime, including the related characteristics. The most significant international rules and guidelines described the degree of regulation of bank insolvency procedures by means of “The Key Attributes of Effective Resolution Régime for Financial Institutions”. The document presented the legal basis for the implementation of a particular legal regime of bank resolution. Another official international organisation, the Basel Committee on Banking Supervision, likewise adopted recommendations regarding insolvent bank resolution and/or liquidation, and the creation of a new legal regime for bank resolution. Essentially, this was the first time in world history when essential and general bank resolution legal systems and regulatory backgrounds and legal criteria have sustained efforts to identify and unify bank insolvency procedures at the global level, based on “soft law” measures. The obligation set for the G20 countries to implement the legal regime of resolution in their jurisdictions was established. See more Chapter 1 sec. 10. With regard to the assimilation of the definitions see more Chapter 2 sec. 2.

22 EC. Commission Staff Working Document. Impact Assesment. Accompanying the document. Proposal for a directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010. Brussels, SWD, No.166 final, 2012. P. 17.

effect on the financial system²³. At the international level, jurisdictions were required to undertake a broad range of legislative measures, in particular, to restructure banks while extending banking business activities, meanwhile non-viable or systemically insignificant parts of the banking business were subject to regular liquidation procedures.

Bank resolution procedures are an extremely complicated economic, social and legal phenomena, featuring complexity and interaction of substantial and procedural legal norms. Among other items, bank resolution regime needs to be designed not only to protect shareholders and creditors, but simultaneously to achieve the other objectives set by public authorities and vital for the efficient functioning of the economy as a whole²⁴. When formulating the source of legal regulation of social bank resolution regime and the related legal rules in the form of community conventions, *at least five principal issues to be dealt with and related to the balancing of private and public interests in bank resolution regime* are addressed in the dissertation.

First of all, only after making the adjustments at the international level, the issue arose with regard to the extent of the loss resulting from a bank's insolvency and those responsible for the loss. An equally important question then arises: is it possible to rely on public interest, placing it above private interests? If so, what is the legal basis and the legal principles to be followed.

Secondly, the existing regulation governing bank resolution was reviewed or modern regulation was created in the relevant jurisdictions. The new era of bank resolution regime is indissociable from the broad powers exclusively delegated to competent authorities (e.g. the right to convert bank debt instruments into capital by financing bank recapitalisation, official intervention in the bank, etc.). Simultaneously, as demonstrated in practice, applying resolution tools can create similar obstacles, where the impact on the ownership rights

23 Bank liquidation procedures are costly, complex and lengthy. Costs of bank bankruptcy can be very significant. Moreover, additional risks may arise, such as loss of confidence in the entire financial system. *Direct costs* include the costs incurred by bank liquidators or administrators or public institutions, such as courts, the Ministry of Finance. *Indirect costs* include the costs related to the reduction of bank assets and loss of income. In addition, a bank's operation may also be negatively affected by the lack of liquidity, operational or funding problems, lack of investment. Loans can become "non-performing", commitments unfulfilled, and the bank's customers may face difficulties in finding alternative funding sources in short term, and therefore the existing obligations would be challenged with the necessity to be restructured or refinanced in short term. Costs may be incurred by the creditors, including depositors, not only due to their assets becoming illiquid, but also due to their obligation to take part in administrative proceedings, litigation and undertake efforts by proving the validity of their financial claims and size. Costs may be interrelated. Administrative problems and delays inevitably increase the cost of illiquidity and credit quality decline. These facts are confirmed by various empirical studies. Scmieder C., Scmieder P. *Impact of Legislation on Credit Risk – Comparative Evidence from the United States, the United Kingdom, and Germany*. IMF Working Paper WP/11/15, 2011 [interactive]. [accessed on 2014-12-15] <<https://www.imf.org/external/pubs/ft/wp/2011/wp1155.pdf>>. Hardy C.D. *Bank Resolution Costs, Depositor Preference, and Asset Encumbrance. Bankruptcy Costs*. IMF Working Paper. WP/13/172, 2013 [interactive]. [accessed on 2014-12-15] <<http://www.imf.org/external/pubs/ft/wp/2013/wp13172.pdf>>. P. 4-7.

24 The powers granted to public authorities may inevitably affect the rights of shareholders and creditors in the bank resolution procedures, potentially reduce the economic value of their ownership rights and interests. Among other things, the legal regime of bank resolution should have been designed not only to protect shareholders and creditors, but also to attain other objectives pursued by public authorities and considered vitally important for the efficient functioning of the economy as a whole.

and expenses of creditors and shareholders are potentially interconnected (e.g. the sale of a business tool requires neither the consent of the shareholders of the bank nor of any third party other than the purchaser). For this reason, it is important to properly regulate legal principles and criteria in positive law and to establish legal safeguards that could optimally balance private and public interests, which would accordingly help protecting public interest against potential counterparty claims.

Thirdly, given that the banks in distress experience financial difficulties, additional funding is needed. This has led to the establishment of provisions on the international level, namely that public authorities must have the power to impose bail-in instruments²⁵ for banks, which essentially means that the application of these legal instruments prior to liquidation of the bank can write off capital instruments and convert them into the bank's capital (shares).

Fourthly, international financial standards have encouraged the banks to apply a variety of resolution tools available to them and to assure the assumption of the banks' going concern. Moreover, the provisions were established for bank resolution procedure to be applied in accordance with the "least cost" principle²⁶ or creditors' "no-worse-off-principle". Accordingly, no creditor shall incur greater losses than would have been incurred if the bank had been liquidated under normal insolvency proceedings; otherwise it could destabilise the financial system. Additionally, steps should be taken in order to ensure that systemically important functions of the bank are rapidly transferred and continued where necessary. Notably, when no alternative private sector solutions could be reasonably expected, including capital injections of shareholders or third parties, this would suffice to recover the viability of the entire bank.

Fifthly, a new approach (different from the general insolvency approach) was established to consider the satisfaction of creditor claims and a hierarchy of claims in the bank insolvency procedures. Bank resolution regime is inconceivable without considering the negative impact on creditor and shareholder rights, such as interference in the contractual relations (netting agreements, collateral agreements, financial collateral arrangements under which ownership is transferred). As a result, legal protection of creditors and shareholders becomes problematic, encouraging scientists to reconsider whether the existing regulation of bank resolution procedures adequately balances public and private interests. On the one hand, the bank resolution regime is based on public interest purposes, while maintaining financial stability and legal protection of deposits. On the other hand, bank insolvency procedures are indissociable from the limitations of private interests – shareholder, creditor ownership rights.

25 The idea of bail-in originated from the fact that bank rescue by using public finances (bail-out) creates the burden for public finances, distorts competition and undermines market discipline. If a failed bank's assets are insufficient to protect the claimants that society wishes to protect then the question of who should cover a shortfall arises. This amounts to a choice between the taxpayers and the financial services industry. Huertas F.T. *The case for Bail-ins*. International Institute of Finance, 2012. P. 1.

26 In the United States, following the Federal Deposit Insurance Corporation Act, it became a requirement that an insolvent bank and any related bank resolution procedure was based on the "least cost" principle for the Deposit Insurance Fund. An exemption may be requested only if it could affect the country's payment system disruptions or its meltdown, or affect severe adverse consequences for the economy, financial stability, and if the Federal Deposit Insurance Corporation agrees on the course of resolution.

As long as no equal approach has been adopted towards the treatment of bank insolvency procedures, the legal framework, and the international harmonisation, it is useful to examine the appropriate national legal framework of bank insolvency procedures from the comparative perspective. It is necessary to disclose not only how separate jurisdictions succeeded to comply with the international guidelines, but also to research and explore the types of legal models that certain jurisdictions have chosen, to compare the particularities, to find the convergences and divergences and, after examining the positive law of different jurisdictions, to disclose the approaches to the balance of public and private interests, and to suggest the recommendations and proposals.

Based on the above, the primary focus of this dissertation is placed on **the main question of the research**: whether the legal regime of bank resolution appropriately balances public and private interests?

The aim of the dissertation: to analyse theoretical and practical issues of the bank resolution regime in terms of compatibility of public and private interests.

In order to achieve this purpose, the following **research tasks** are formulated:

- 1) To disclose the change of bank insolvency paradigm and the reasons behind it; to analyse general conceptual terms of a new bank resolution paradigm.
- 2) To distinguish the scientific conception of bank resolution regime, as compared to other bank insolvency procedures, and to crystallise the characteristic features, thresholds, to analyse bank resolution tools, by discovering their implementation benefits and shortcomings.
- 3) Following a comparative approach, to examine the public authorities involved in bank resolution procedures, the decision-making mechanisms of bank resolution and the relevant role of public authorities.
- 4) Based on the identified characteristics of the regime governing bank resolution, to analyse the impact of bank resolution on public and private interests and their compatibility in the positive law of various jurisdictions.

The objective of the research: operational and functional implications on the bank resolution regime.

Scope and delimitations of the research. Within the limits of the research, the jurisdictions at issue do maintain distinct models of bank insolvency procedures, with different legal traditions (common law or civil law), variations in the judicial system, etc. It is important to note that the EU, the US and Switzerland are one of the dominant countries in the global banking sector. For instance, the EU and the US banking sector holds two thirds of the global banking industry market (according to the data provided in the international symposium entitled ‘Concept paper for the Symposium on building the financial system of the 21 st century’. New York, 2014). Regardless of the latest bank insolvency crisis and its outcomes, the EU, the US, and the Swiss governments were forced to take the most severe bank resolution measures in the world history so

far, including massive central bank liquidity-providing cases, capital injections, guarantees to banks and redemption of bank assets in order to prevent systemic financial crisis²⁷. In the consequence of that, the abovementioned governments sought to avoid a situation that would result in the collapse of the entire financial system. It should be taken into account that this study will not address traditional banking or financial stabilisation measures, such as central bank liquidity support (monetary policy operations or emergency liquidity assistance), various equity recapitalisation schemes (except for bail-in as a legal tool with regard to the scope of the investigation), government guarantee, or temporary liquidity means. Instead, the study concentrates on the particular analysis of bank resolution tools (*sale of business, bridge bank, asset separation and bail-in tool*) and their comparative analysis. The author's position is based on the premise that, in the context of a modern bank resolution regime, financial stabilisation tools should be perceived only as a measure of last resort and can be used only in the unfavorable case scenario, including taking over the ownership of banks by the state (nationalisation). The study is featured by the fact that the powers of bank resolution and its financing structure is organised in a way that taxpayers do not suffer any losses due to bank(s) insolvency and have access to net income, which can be achieved by successfully restructuring the bank. The study also will not cover the analysis of bank recovery and resolution plans, as in the new bank insolvency paradigm they are treated as preventive bank insolvency management measures rather than bank resolution measures. In addition to the above, the reference jurisdictions have established a valuable and developed practice of bank restructuring and (or) liquidation proceedings, but also, in the consequence of different regulation and different legal traditions, different regulatory models and different solutions of practical problems were chosen. Among other elements, in order to preserve the critical banking functions, the government and the supervisory authorities of these jurisdictions have realised the need for exclusive, special rules governing bank resolution. The crucial part of the regulation was dedicated to developing the powers of public authorities, which should be clearly established in the legal acts and unambiguous regulation. This would enable the bank to transfer viable part of its business or systemically important banking operations, such as other private sector financial service provider, a public sector entity or a bridge bank, and only then liquidate the rest of the bank under normal bankruptcy procedures.

US. *Lex specialis* of bank resolution originated in the US²⁸. The origins of the bank resolution institute influenced other legal systems and their development. The United States is to be investigated since already in early 1991, the US adopted a separate section in the

27 Norton J.J., Arner W.D. International Responses to the Global Financial Crisis. (in) *Financial Crisis Management and Bank Resolution*. Edt. by Labrosse R.J., Caminal-Olivares R., Singh D. Informa. London, 2009. P. 19. The Financial Crisis Inquiry Report. Final report of the National Commission on the Causes of the Financial and Economic Crisis in the United States. Authorized Edition. Public Affairs. New York, 2011. P. 52-67.

28 Swire P.P. *Supra* note 9. P. 478-481.

Bankruptcy Code dedicated to regulating banking insolvency procedures²⁹. Simultaneously, the Federal Deposit Insurance Corporation Act was revised by the policy makers in order that the FDIC, whenever a bank is failing or likely to fail, begins acting as the bank's receiver, while at the same time performing the functions of the regulator. This is exactly the opposite model in comparison with classical bank insolvency regulation model, for instance, found in the EU. In that case, usual deposit insurance activities are limited to the collection of contributions to the fund, payment of compensations to insured depositors, in the event of subrogation, the presence of bankruptcy process. In addition, the Dodd-Frank Act established a new *Orderly Liquidation Authority* (hereinafter – OLA), which is responsible for the administration of all financial companies posing a threat to the systemic risk. The new authority amended the Bankruptcy Code and addressed the *moral hazard* problem created by situations when shareholders, management and unsecured creditors were protected from the consequences they would have suffered in liquidation under the Bankruptcy Code. In addition, according to the US legal practice, among other legal points, several other significant differences between bank insolvency and corporate insolvency legal regimes should be considered³⁰. Additionally, the recent banking crisis has resulted in the diversity of banks failure practices in the US. The *Washington Mutual*, *Bear Stearns*, *Lehman Brothers*³¹ (in doctrine they are often described as the largest and most complicated bankruptcy cases in the history of financial institutions) bank insolvency cases deserve special mention. Thus, the global financial crisis not only started in

29 While The 1991 Federal Deposit Insurance Institutions Improvement Act was well developed, addressing medium-sized bank insolvency problems, current regulation could not solve very large, cross-border banks or excessively complex bank insolvency problems without harming financial stability and without adverse systemic risks, such as the risk of moral hazard. The U.S. Congress recognized the importance of deposit protection in providing stability in the economy following the Great Depression of the 1930s. Federal law grants additional powers to FDIC that lead to critical differences between bankruptcy and the FDIC receivership law. This allows the FDIC to both expedite the liquidation process for banks and thrifts in order to maintain confidence in the banking system and to maximise the cost-effectiveness of the receivership process to preserve a strong insurance fund. FDIC. Chapter 7 – The FDIC's role as a receiver [interactive]. [accessed on 2014-12-20] <<https://www.fdic.gov/bank/historical/reshandbook/ch7recvr.pdf>>.

30 For example, the FDIC can turn into a receivership of a bank and take over the administration of the bank if the latter is not adequately capitalised for a period of more than 90 days. After the entry into force of the Dodd Frank Act a new institution was established, empowered to recognize systemically important financial institutions and execute insolvency procedures not under state laws, but according to the Federal Reserve regulations. In addition, after the latest financial crisis, the US was one of the first countries all over the world to review its bank insolvency procedures and legal regulation, and the scope of systemically significant financial institutions, and to expand the extent of particular corrective actions, in addition, it also founded the bank restructuring fund, developed the competent authority's powers, and broadened the scope of the special bank insolvency law.

31 The *Lehmans* bankruptcy case was extreme, but revealing. While the bank had no liabilities to depositors, its bankruptcy nevertheless perfectly illustrates the challenge faced while attempting to repay creditors' claims. The nominal value of assets of that investment bank was USD 639 billion, and the bankruptcy liquidation costs amounted to USD 2 billion. It is anticipated that in average creditors will recover 18% of their claims. It is predicted that their claim procedures will continue until 2015. S. Linda, Paulden P. Lehman's Year - End Fees, Filings Match Up With Biggest Bankruptcy. Bloomberg. 2012, [interactive]. [accessed on 2014-12-10]. <<http://www.bloomberg.com/news/articles/2012-12-21/lehman-s-year-end-fees-filings-match-up-with-biggest-bankruptcy>>.

the US, but also caused enormous losses to the US economy since the Great Depression in 1930³²; the market crash resulted in multiple deposit withdrawal from banks and rapid freezing of all credit markets³³. While the lawmakers of other countries were still in the process of legal and regulatory reforms in a sense of bank resolution, on 21 July 2010 the US president signed the Dodd-Frank Act³⁴, extremely significant in the context of bank insolvency procedures, which had tremendous impact on the entire financial service industry. As a result, other states analysed the US legal regulation and made efforts to adapt.

Switzerland. Switzerland is to be examined since it is an extremely relevant country in the global banking sector³⁵. Swiss banks were largely created for providing services and exporting capital (capital funded both nationally and in foreign countries)³⁶. By the end of 2012, the off-balance sheet assets of the two largest Swiss banks – UBS and *Credit Suisse* – amounted to CHF 2.5 trillion, a figure four times exceeding the total annual GDP of Switzerland³⁷. The distinguishing feature of this jurisdiction is that the Swiss banking industry is dominated by large, universal banks, with a high degree of bank concentration and, at the same time, banks are exposed to additional risks that can affect the financial system as a whole. Although Switzerland is a particularly strong country in the banking industry, historically, however, bank insolvency crisis was not an uncommon phenomenon. Banking crises occurred in the Great Depression period during 1931–1936, after the Second World War, and during the housing loan crisis in 1990. The recent international banking

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- 32 In the case of deregulation of bank insolvency procedures, the state's response to the banking crisis and the bank rescue was usually taking place by using public finances, meaning the taxpayers' money. This was based on the concern that it might destroy the financial sector, and the real economy can reach its critical state. During the period from 2007 to March 2009, the US Congress employed USD 700 billion for bailout. Through its state assistance programme, the FDIC issued guarantees to financial institutions in the form of loans of more than USD 1.5 trillion; the US Treasury issued guarantees for money market funds to secure the commitments arising from obligations for USD 3.5 trillion, and the Federal Reserve provided multiple liquidity measures to secure against potential liabilities for the amount of USD 7 trillion. Gordon N., Muller Ch. *Confronting Financial Crisis: The case for a Systemic Emergency Insurance Fund*, Yale J. Reg. Vol. 28, No. 151, 2011.
- 33 Ringe G.W., Gordon N.J. *Bank Resolution in the European Banking Union: A Transatlantic Perspective on What It Would Take*, 2014. P. 5.
- 34 The act essentially seeks balancing bankruptcy and consumer protection laws and objectives, while maintaining financial stability and public confidence. Dodd-Frank Act § 1021. 12 U.S.C. § 5511. 21 July 2011.
- 35 Banking area is the most important for Swiss service industry. Switzerland hosts about 300 banks. Banking Barometer. Economic trends in the Swiss banking industry, 2014 [interactive]. [accessed on 2014-12-28] <http://www.swissbanking.org/en/2014_bankenbarometer_en.pdf>. IMF. Switzerland Financial Sector Stability Assessment, 2014 [interactive]. [accessed on 2014-12-28] <<https://www.imf.org/external/pubs/ft/scr/2014/cr14143.pdf>>. Duc-Quang N. *Is Switzerland really the country of bankers?* [interactive]. [accessed on 2014-12-28] <<http://www.swissinfo.ch/eng/is-switzerland-really-the-country-of-bankers-/40473658>>.
- 36 Meier B.H., Marthinsen E.J., Gantenbein A.P. *Swiss Finance*. John Wiley & Sons, Hoboken, New Jersey, US, 2013. P. 37.
- 37 FINMA. *Supra* note 16. P. 4. Swiss National Bank. Financial Stability Report, 2011. P. 14 (box1). Lannoo K. Concrete Steps towards More Integrated Financial Oversight, CEPS Task Force Report, 2008. P. 11, 49. Thevenoz. L. The Rescue of UBS by the Swiss Confederation. (in) Giovanoli M., Devos D. *International Monetary and Financial Law – The Global Crisis*. Oxford University Press, Oxford, 2010. P. 379.

crisis also influenced the Swiss banking system³⁸. Moreover, most notably, Switzerland is a unique country on the European continent, as the legal, political and economic system significantly differs from the other European countries³⁹. The financial sector is built on the basis of self-regulation, based on the assumption that such regulatory approach is the most effective and efficient way to manage and monitor banking activities⁴⁰. Switzerland was one of the first countries in the world, which in 2004⁴¹ began developing special bank insolvency regulation and subsequently was one of the first countries to comply with the requirements of the FSB⁴². Most notably, in response to the 2004 banking crisis, the principles of Swiss banking law underwent certain changes⁴³. The new version of the Bank-

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- 38 Drechel B.S.D. *Banks and the Swiss Economy*. Dissertation for the Faculty of Economics, Business Administration and Information Technology of the University of Zurich. Zurich. Cuvillier Verlag. 2010. P. 16-17.
- 39 The legal system of the Federal Republic of Switzerland (consisting of 26 cantons and lands), is not based on case law, but more on the codified legal system. Switzerland is unique not simply because it is not a member of the EU, but also since it has a particular banking industry and successful economy. Switzerland has a legal system that protects the rights and freedoms from excessive impact of the state. Due to the stable political position, intense democratic traditions, Switzerland has developed into a solid state for accumulating assets from all over the world. Likewise, Switzerland possesses high level infrastructure and differentiated payment and clearing systems, is characterised by sound financial justification because of its education in the banking sphere, business-friendly tax legal base, the stability of the Swiss franc, etc. Bauen M., Rouiller N. *Swiss Banking*. Schulthess. Switzerland, Basel. 2013. P. 4.
- 40 Self-regulation has deep traditions in Switzerland and forms a crucial part of the Swiss banking regulation and financial center in general. It stands out for its flexibility and high degree of differentiation. The literature recognises the following types of self-regulation: optional (or independent) self-regulation; self-regulation acknowledged as a minimum standard, with the binding powers of the legislature. The main advantages of self-regulation are cost savings and avoiding the most problematic level of governmental legal regulation. FINMA. Selfregulation [interactive]. [accessed on 2014-12-13] <<https://www.finma.ch/e/regulierung/Pages/selbstregulierung.aspx>>. Hüpkes, E. "Regulation, Self-regulation or Co-regulation?" *Journal Of Business Law*, No. 5, 2009. P. 427-446. Bauen M., Rouiller N. *Supra* note 39. P. 43.
- 41 The first changes were based on lessons learned from the regional savings banks and cantonal banks' crisis, which took place in 1990. Since 1991 up to 1996 more than half of the regional savings banks (about 180) were liquidated. Since 2004, the new rules in Swiss Banking law came regarding the specific insolvency proceedings of banks and foreign bank branches. General insolvency law was applicable for banks only when the Banking law did not determine the special rules to deal with bank in distress. Burgi J. A., Muller T. *Banking rehabilitation and insolvency reform in Switzerland*. Restructuring and insolvency Handbook, 2011. P. 1.
- 42 It should be noted that even though the new bank insolvency provisions came into force in July 2004, it was not possible to verify the practical procedures because of the global financial crisis. FINMA. *Bank insolvency. The situation in Switzerland and internationally. A report by the SFBC*, 2008 [interactive]. [accessed on 2014-12-10] <http://www.finma.ch/archiv/ebk/e/aktuell/20080128/20080128_e.pdf>. P. 10.
- 43 Historically, the Federal Act on Banks and Savings Banks has been revised on numerous occasions. Its requirements are primarily of a public nature, but part of the provisions are treated as civil or even criminal in nature. It must be noted that the implementing banking regulations (ordinances) and implementing bank insolvency regulations (secondary banking legislation) are more technical in nature and are rather designed for technical reasons, in order to clarify in detail the main principles regulating the primary banking law. Burgi J. A., Muller T. *Banking rehabilitation and insolvency reform in Switzerland*. Restructuring and insolvency Handbook, 2011. P. 1.

ing Law entered into force in 2011–2012⁴⁴. The Ordinance of the Swiss Financial Market Supervisory Authority on the Insolvency of Banks and Securities Dealers of 30 August 2012 (recast) (January 1st, 2015), brought significant technical changes in bank insolvency procedures, which meant that banks would no longer be obliged to liquidate and revoke their licenses if there was a prospect of restructuring a failing bank. Bank insolvency procedures were accompanied by the legal act of FINMA⁴⁵, which came into force on 1 November 2012, and was improved on 1 January 2013. The general legal provisions governing bank insolvency were fully transformed to the *lex specialis*. Finally, it should be noted that the Swiss regulatory reforms were influenced by recent cases of banking insolvency. Two globally and systemically important financial institutions faced financial difficulties (*UBS* and *Credit Suisse*⁴⁶). Although losses related to the bank insolvency procedures were very significant (e.g., *UBS* wrote off non-performing loans worth about USD 53.1 billion), we will mention the entirely successful and unprecedented bank resolution cases in this dissertation.

The EU. The recent bank insolvency crisis fully revealed the loopholes of the EU legal system⁴⁷ in the field of bank insolvency procedures, the absence of transparent and predictable regulation that would allow managing financial restructuring of distressed banks and/or normal liquidation (bankruptcy)⁴⁸. Between 2007 and 2009, most EU Member States had no regimes governing bank resolution that could ensure ordinary bank restructuring

44 FINMA. New Banking Insolvency Ordinance. A key element in the effective restructuring and orderly market exit of banks. 22 October 2012 [interactive]. [accessed on 2014-12-10] <<http://www.finma.ch/e/regulierung/anhoerungen/Documents/fb-biv-finma-e.pdf>>.

45 In June 2007 the Swiss Parliament adopted the Federal Act of the Swiss financial market supervisory authority, which came into force on 1 January 2009. According to this Act, the supervision of banks, insurance companies, and other financial intermediaries was put into the hands of a single supervisory authority - the Swiss Financial Market Supervisory Authority, whose initial task was to protect creditors, investors, and insured depositors. Another significant aim was to assure the effective functioning of financial markets and strengthen the competitive position and reputation of Switzerland. Meier B.H., Marthinsen E.J., Gantenbein A.P. *Swiss Finance*. John Wiley & Sons, Hoboken, New Jersey, US, 2013. P. 17.

46 These Swiss banks are systemically important on account of their size, complexity, business organisation and activities, as well as the importance of the financial system. Financial Stability Board. Update of Group Systemically Important Banks, 2013. P. 3 (Annex 1). FINMA. *Supra* note 16. P. 4-7.

47 It should be noted that this study considers the EU legal system as a whole rather than the individual legal systems of the Member States. At the same time, it should be noted that prior to the entry into force of the Banking Union legislation, some of the EU Member States were encouraging national bank and insolvency laws, changing banking insolvency legislation or were introducing new, specific provisions dedicated to bank restructuring. As an illustration, the legal regimes for bank resolution were implemented in the UK in 2009, in Germany in 2011, and etc.

48 In practical terms, the procedures were largely restricted. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council. Recitals (1), (4). Schillig M. *Bank Resolution Regimes in Europe II – Resolution Tools and Powers*. School of Law, King's College, London, 2012. P. 70. [interactive]. [accessed on 2014 12 13] <<http://ssrn.com/abstract=2136084>>.

and/or the liquidation of failing banks⁴⁹. The EU insolvency law was mainly regulated by national legal systems, and the lack of harmonisation was apparent⁵⁰. When a significant number of banks faced severe distress problems in 2008, including the major market players such as *Fortis*, *Dexia*, the effective bank resolution regime was absent. For the reasons stated above, public authorities of the EU Member States were required to take legal bank restructuring measures in a chaotic way, and they therefore struggled to fight the problems of distressed banks, froze their property and seized bank assets located within their jurisdiction. In addition, national authorities have taken *ad hoc* legislative measures providing government guarantees and capital injections into a failing financial institution⁵¹. The EU bank insolvency regulations developed very dynamically. Before the entry into force of the Banking Union, bank resolution procedures lacked even the minimum level of harmonisation, their substance and procedures diverged significantly, depending on the Member State⁵². Prior to the adoption of the Banking Union's proposals, some Member States individually began adopting the related amendments to the bank insolvency laws at the national level, while the others waited until the harmonisation of the bank resolution

49 Attinger J.B. *European Central Bank. Crisis management and bank resolution. Quo vadis, Europe?* Legal Working paper Series, 2011. P. 36. Sarra J. *Prudential, Pragmatic, and Prescient, Reform of Bank Resolution Schemes*. International Insolvency review. Vol. 21, 2012. P. 18-19.

50 The previous EU Winding-up Directive 2001/24/EC was more concerned with cross-border coordination of insolvency processes, but did not introduce special resolution regimes as alternatives to bank insolvency. Nevertheless, most notably, the Directive did not regulate bank resolution schemes, but similarly did not apply to the needs of the Member State law and practice, there was no harmonisation, the legislation was fragmentary and misleading (for example, competent authorities lacked the appropriate powers for bank resolution, insolvency of the banking groups and trans-national bank insolvency cases were not regulated. The lack of bank insolvency crisis management tools was apparent. Previous law did not take into account the systemically important bank insolvency highlights, reorganisation of individual actions of national authorities was uncoordinated, ordinarily designed to defend national economic interests of depositors and to maximize bank assets in their interest, etc.). Viewed systemically, it could also be assumed that the Directive was unclear in terms of regulating bank restructuring procedure or bank liquidation, and each national legal system had the discretion to determine what was bank resolution and winding-up. This resulted in legal uncertainty and different legal interpretations. Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. Recitals (14), (15), 2 Art.

51 According to the IMF estimates, the recent banking crisis-related losses experienced by the European banks between 2007 and 2010 amounted to approximately EUR 1 trillion or 8 percent of the total EU GDP. In particular, from October 2008 to October 2011, the European Commission approved 4.5 trillion (37% of the EU GDP) in State aid measures dedicated to financial institutions.

52 Some Member States applied corporate insolvency law to banks, and some of them had very general, special insolvency rules for distressed banks. Some countries relied on judicially administered special insolvency procedures (Austria, Greece, Luxembourg, the Netherlands), other countries dealt with bank insolvency procedures in ordinary courts, which *inter alia* administered insolvency proceedings (France, Hungary, Germany, Ireland, Spain). Due to different national laws on bank resolution rules and the associated varieties in administrative practices while dealing with bank restructuring effects, the confidence in the banking sector was decreasing and the volatility of the market increased, as there was no possibility to predict the consequences of the possible insolvency of a bank. Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010. Art. 2.

framework at the EU level⁵³. However, eventually, the need for an efficient bank resolution regime arose. The aim was to ensure a standardised bank resolution mechanism, to manage bank insolvency cases at the home Member States' disposal, which could ensure that the use of internal markets was not limited and the right of establishment of banks was not restricted due to the financial resources designed to manage their failure. Prior to the legal project of the Banking Union, it was possible to classify bank insolvency legal regulation⁵⁴ both in general and special terms, but the main regulation governing insolvency procedure in EU clearly excluded the specific regulation of financial institutions, and banks, from the scope and operation of primary insolvency law⁵⁵. Initially, only the procedural aspects of insolvency law were harmonised at the EU level⁵⁶. Eventually, the EU's legal system should be considered also because of the fact that, in practice, insolvency proceedings were initiated for such significant banks as *Northern Rock*⁵⁷, *Fortis*⁵⁸, *Dexia*⁵⁹. It must be noted that in Lithuania, the two resonant and unprecedented bank insolvency cases were those of bank *Snoras* and *Ūkio Bankas*.

53 Otherwise, this would have resulted in the interference in the internal market and the smooth functioning of the national authorities to collaborate in determining the dilemmas linked with falling cross-border banking groups or individual banks. For example, due to different methods, national authorities do not ensure a uniform level of control or do not have equal chances to restructure banks. In summary, this can differently impact bank funding costs in different Member States and distort competition between banks.

54 Council Regulation (EC) No. 1346/2000 of 29 May, 2000 on insolvency proceedings.

55 Ibid. Art. 1 (2).

56 The principles of universality and territoriality.

57 In September 2007 the Bank of England provided liquidity support and government guarantees for particular liabilities of the bank. In February 2008 the bank was nationalised by the British Government.

58 The Netherlands, Belgium and Luxembourg provided EUR 11.2 billion amount in capital. In September 2008 each country additionally took over 49% of bank shares. Subsequently, the bank was sold in parts, and the main part of the bank's assets was sold to *BNP Paribas* in May 2009.

59 The bank was further re-capitalised by the French and Belgian Governments with over EUR 3 billion bank capital injections. These injections were placed in the framework of State aid in order to reopen access to the financial markets.

THE ORIGINALITY AND THE REVIEW OF THE RESEARCH

The originality of the research. The scientific analysis of bank insolvency law issues is valuable and novel in many scientific aspects. The vulnerabilities of the legal acts governing bank insolvency procedures and the gaps left by legislators become evident only during the banking crisis and/or in the case of systemically important cross-border bank insolvency. As a result, after the latest banking (financial) crisis, these loopholes became particularly sharp and resulted in abundant case-law on bank insolvency, which was not scientifically analysed neither in Lithuania nor in Switzerland. Moreover, this study is distinguished by the fact that in the context of bank insolvency procedures the legal doctrine is regarded as an essential source of jurisprudence. This position is based on the fact that most countries have ordinary, non-specialised courts, which often lack knowledge about banking activities necessary for handling bank insolvency cases. Since there are no specialised insolvency courts in Lithuania and Switzerland and the case-law analysis is lacking, this research provides novelty and explores new possibilities.

Based on the above-mentioned analysis and the problematic perspectives of existing banking and insolvency law, systemic and practical aspects of the research are beneficial. What solutions were adopted to resolve the legal dilemma in different jurisdictions, and have the problems been resolved? Given the intimate link between the international nature of modern economy (globalisation), the spread of international (multinational) banks and the prevalence of banking group influence on the development of the world economy, bank insolvency law and research analysis is now the international point of reference. The lack of legal certainty and clarity affects the integration of unresolved problems into larger conflicts related to the variety of legal interpretations. Hence, the effect of the function of the law in terms of governing public relations and regulatory harmonisation of conflicting interests and functional performances is not ensured. On the contrary, the hypotheses that could prevent the stability of social ties are not eliminated, and this seems inconsistent with the individual development of certain relations and the extension of interpretations. To summarise, that does not meet the purposes of legal science and modern, sustainable business development trends, that is why the analysis of the research will also be useful in this particular regard.

Despite global attention for the research subject, to date Lithuania and Switzerland clearly lack the analysis of scientifically approved information, different regulatory models and approaches in different jurisdictions. After performing a qualified and comprehensive scientific study on the subject at issue, assumptions could be established for addressing these gaps, by improving the analysis in the field of legal and regulatory framework of bank insolvency procedures, by presenting the relevant proposals and recommendations. The originality of this scientific topic finds its expression in the complexity of the investigation. Moreover, in the nearest future Lithuania will have to implement particular Banking Union directives and transpose them into national law⁶⁰, meanwhile the SRM regula-

60 The BRRD Directive was adopted on 15 May 2014, and had to be transposed into national law by 31 December 2014. However, it should be noted that the Member States shall apply the bail-in provisions from 1 January 2016 at the latest, but some of the transposition of the relevant provisions of the Directive will continue until 31 May 2016. The fact that the Directive coordinates general aspects of bank

tion will be directly applicable, that is why this study could form the basis of a review of the Lithuanian legal system.

In Lithuania and Switzerland, the extensively escalated bank insolvency law is still at the level of legal uncertainty. The supervisory response is further prevented by 'secret' decisions of the supervisory authority and the strongly restricted scope of the studies conducted by the competent authorities related to the analysis of the insolvency procedures in Lithuania. Henceforth, the resonating practical processes taking place in the society and poor justification of scattered individual opinions also highlight the intended theoretical novelty of the dissertation. The complexity and significance of the research is determined by the reasons stated in this introductory part. In addition, the introduction itself likewise describes the grounds for research. It is anticipated that this qualitative scientific study will encourage to produce other reliable studies and help formulating uniform case-law meeting social needs. It is assumed that the research conclusions will serve the Lithuanian and the Swiss scientific legal doctrine and could be employed for pedagogical and educational activities. Among other things, the interest in the subject and the need for the analysis was also noted at the time of the author's lecturing work at Mykolas Romeris University on the subjects of bankruptcy law and banking law⁶¹. It is assumed that the author presents a comprehensive study on bank insolvency law, which will encourage the scientific community to perform additional research in the aforementioned area and will prompt a discourse that will empower and foster bank insolvency law and banking law in general. What is more, the doctrine of the structure, development and improvement of the bank insolvency procedures also serves the interests of the related public and private interests and their legal protection through providing greater legal certainty in this field. So far, in Lithuanian and Swiss private law, the current status of education is disappointing. Additionally, the dissertation proposes an important topic both in practice and in theory.

It should be further noted that a well-functioning legal system of the state encourages both the operation of financial markets and financial intermediaries. The established presumption found in the literature states that countries can be divided into categories by comparing the efficiency of the national legal system, especially that of financial transactions.⁶² Such a position is based on the fact that different financial systems have different regulatory levels, especially with regard to the protection of creditor and shareholder rights and the related regulatory rules. Thus, the financial development of each state also depends on the level of sound legal measures as a whole and their efficiency. Among other elements, the research

resolution, and the technical features will be implemented through the EBA draft regulatory technical standards (EBA shall submit those draft regulatory technical standards to the Commission no later than the end of 2015, 3rd July.) is also an equally significant aspect. These rules will specify bank resolution procedures and content, and the legal obligation resulting from the Directive. In order to encourage restructuring and supervision, EBA publishes guidelines and specifies the methodology. Although the DGS directive has entered into force, the transposition of some of the relevant provisions of the directive will continue until 31 May 2016.

61 E.g. the new banking law study programme approved by the MRU Business Law Department on 27 April 2012 by the minutes No. 1VRTK-8 covers the topic "The global financial crisis and the legal consequences of a bank failure", and is also closely related to the subject of financial markets designed for Master students.

62 Haan D.J., Oosterlo S., Schoenmaker D. *European Financial Markets and Institutions*. Cambridge University Press, UK, 2009. P. 25.

might be relevant for lawmakers, especially governments performing particular operations in the context of bank insolvency procedures. First, the government aims to protect ownership rights and guarantee the execution of contracts. Second, governmental regulation is needed to encourage the appropriate legal provisions on the protection of investor funds, so that their money is used in the most appropriate manner, and that the investors are able to adopt suitable investment decisions by using their funds. Third, governments organise legal regulation and supervision of financial institutions in order to maintain bank solvency.

The study is mostly based on comparative law methodology. It was presumed that most regulatory questions could not be resolved by laws without sound comparative legal assistance⁶³, whether it takes the form of a general study or any kind of comparative analysis, or an analytical report on a particular topic. Among other things, comparative law specialists normally provide suggestions to be adopted and implemented in their national legal system, taking into account the relevant problems at issue and their solutions that proved successful in other countries, including differences in judicial procedures, powers of different institutions, economic capacity, and the general social context. An equally important fact is that comparative law is based on the interpretation of national legal rules. In addition, comparative law plays a significant role for the courts while interpreting and applying the law. Finally, comparative law plays a significant part in legal education⁶⁴. Limiting general legal education to the studies of national law would be unexcusable, as modern society is very mobile, and it also helps better understanding one's own domestic legal system and learning from others.

The author expects that this study will serve as a practical and useful tool to courts dealing with such types of cases, to legislators in terms of improving and developing legal regulation, and to legal theoreticians and related experts. It is also assumed that the study will assist in analysing scientific problems.

The review of references. No comprehensive research on bank insolvency law and procedures, in particular in the field of bank resolution, has been conducted in the Lithuanian jurisprudence so far. Nor is there any comprehensive research on these issues in Switzerland. In Lithuania, general insolvency law has long been overlooked and as such is in the embryonic state⁶⁵. In principle, the subject of bank insolvency law has been largely abandoned. Examination of the literature reveals that bank insolvency law remains *terra incognita* in the Lithuanian educational system. Besides the author's publications on bank insolvency procedures, some research work could be found in several research papers in Lithuanian language. In their publication entitled 'Bankruptcy Law', *Kavalnė* and *Norkus* give a general insight in banking and other financial institutions and their bankruptcy features, providing a brief description of bank liquidation procedures, key elements, and general characteristics of bank bankruptcy⁶⁶. *Toločko* and *Černius* provide a general description of bank reorganisation, liquidation and bankruptcy procedures⁶⁷. Some causes and consequences of commercial bank

63 Comparative law seems to present itself as a science pure and is enormously valuable for private law. Zweigert K., Kotz H. *An Introduction to Comparative Law*. Second Edition. Oxford Clarendon Press, UK, 1992. P. 4-5.

64 Hantrais, L. *Improving Policy Responses and Outcomes to Socio-Economic Challenges: An International Social Research Methods Case Study*. SAGE Publications Ltd., London, UK, 2014.

65 Kavalnė S., Norkus R. *Bankroto teisė*. Antroji knyga. Justitia, Vilnius, 2011. P. 13.

66 Ibid. P. 331-335.

67 Černius R., Toločko V. *Teisinė bankų veiklos aplinka*. Lietuvos bankininkystės, draudimo ir finansų institutas. Vilnius, 2002. P. 26.

insolvency were analysed by Šadžius from a economical, historical perspective⁶⁸. Šenavičius⁶⁹ published the original idea of the Banking Union in the context of public administration (before the political agreement on the Banking Union legislation was reached). The author of the article briefly refers to the essential elements of the Banking Union.

It is necessary to point out that scientific publications referred above are committed to fragmented extent. However, they do not primarily analyse specific issues. In the above-mentioned works, bank insolvency procedures are examined restrictedly in order to introduce to conventional regulatory trends without reflecting the recent change of paradigm. Consequently, due to a significant change in the legal base of bank insolvency procedures, previous researches no longer satisfy the existing rules and regulatory circumstances. None of the individual studies examine bank insolvency procedures using a complex approach: examination of banking law, finance, corporate and insolvency law. None of the aforementioned studies have comprehensively accomplished and considered the bank resolution regime or examined the conditions for establishing bank insolvency, nor have they investigated the protection of shareholders', depositors' and other creditors' rights, etc. In conclusion, this relevant subject receives little attention in the Lithuanian and Swiss doctrine and practice.

Compared to the Lithuanian legal doctrine, foreign legal sources devote much more attention to regulation of bank insolvency procedures, uncertain aspects of bank insolvency treatment, and various regional and international unification trends related to bank insolvency legal relations. Swire⁷⁰, Hüpkes⁷¹, Asser⁷² and Hoelscher⁷³ are the pioneers of bank insolvency procedures. In addition, problematic aspects of bank insolvency law were discussed by a number of other notable scientists, such as Lastra⁷⁴, Bliss and Kaufman⁷⁵, Marinč and Vlahos⁷⁶. It should be noted that the vast majority of international legal scientists dealt

68 Šadžius L. Lietuvos komercinių bankų raida 1988-2004, Socialinių mokslų tyrimų institutas. Vilnius, 2005. P. 268-323.

69 Šenavičius V. *Europos Sąjungos viešosios politikos tendencijos bankų sektoriuje*. Viešoji politika ir administravimas Mykolo Romerio universitetas, Kauno technologijos universitetas. Vilnius. No. 3, 2013. P. 405-416.

70 Swire P.P. *Supra* note 9.

71 Hüpkes E. The legal aspects of bank insolvency. A comparative analysis of Western Europe, the United States and Canada. Kluwer Law International. MPG Books Ltd, Great Britain, 2000. Hüpkes E. *Resolution in an international context-what's new?* Schweizerische Zeitschrift Wirtschafts- und Finanzmarktrecht. Schulthess Juristische Medien AG, S.486, 2013. Hüpkes E. *Insolvency-why a special regime for banks?* Current developments in monetary and financial law, Vol.3. IMF, Washington DC, 2005.

72 Asser T.M.C. *Legal Aspects of Regulatory Treatment of Banks in Distress*. Washington DC, International Monetary Fund, 2001.

73 Hoelscher D. *Supra* note 2.

74 Lastra R.M. Bank failures and bank insolvency law in economies in transition. Kluwer Law International, 1999. Lastra R.M. Cross-border bank insolvency. Oxford university press, New York, 2011. Lastra R.M. *Responses to the Financial Crisis*. Journal of International Banking Law and Regulation Vol. 26, No. 7, 2011. P. 307-312.

75 Bliss R., Kaufman G. *US Corporate and Bank Insolvency Regimes: An Economic Comparison and Evaluation*. Federal Reserve Bank of Chicago Working Paper, 2006.

76 Marinč M., Vlahu R. *The Economics of Bank Bankruptcy law*. Springer – Verlag Berlin Heidelberg, Berlin, 2012.

with the problem of compatibility of public and private interest in bank resolution regime indirectly, by investigating various legal principles or institutes. For example, they have analysed the “too big to fail” doctrine, the interaction of private and public authorities (Deposit Insurance Agencies, Ministry of Finance, the judiciary system, the Central Bank), by legally assessing the systemic banking insolvency crisis, examining creditors’ and shareholders’ rights, etc. At the same time, from the banking crisis up to now, regulation of bank insolvency has been swiftly progressing. The most relevant pieces of legislation were adopted quite recently, providing the author with an excellent opportunity to provide a critical insight into bank insolvency law-related doctrine of different jurisdictions.

However, only some scientific papers analyse and disclose the legal aspects of bank insolvency related to the research object. In particular, the interaction of public and private interests is examined by Hüpkes⁷⁷, Alexander⁷⁸, Hadjiemmanuil⁷⁹. Individual issues of bank resolution regime, such as the bail-in mechanism, are analysed by Huertas⁸⁰, Smits⁸¹, Coffe⁸². Legal and regulatory reforms of bank insolvency are discussed by Sarra⁸³, Boonstra⁸⁴, also Giovanoli⁸⁵. Furthermore, a variety of authoritative publications of international organisations and public institutions, such as *the International Bank of Settlements*, *the World Bank*, *the International Monetary Fund*⁸⁶, and others analyse bank resolution and liquidation-related and regulatory problems. It is equally important to note that due to the extreme sensitivity of the topic, various scientific studies, often in collaboration with the academics, were commissioned by *the European Commission*⁸⁷,

77 Hüpkes E. *Special bank resolution and shareholders’ rights: balancing competing interests*. Journal of Financial Regulation and Compliance, Vol. 17, No.3, 2013.

78 Alexander K. *Bank Resolution Regimes: Balancing Prudential Regulation and Shareholders Rights*. Journal of Corporate Law Studies, 2009. Vol. 9, No.1. P. 197-227.

79 Hadjiemmanuil C. *Special Resolution Regimes for Banking Institutions: Objectives and Limitations*. London School of Economics and Political Science. Law department. Working Paper No. 21, 2013.

80 Huertas F.T. *Supra* note 25.

81 Smits R. *Is my money safe at European banks? Reflections on the „bail-in“ provisions in recent EU legal texts*. Capital Markets Law Journal. Oxford University Press. Vol. 9, No. 2, 2014.

82 Coffe J.C. *Bail-Ins Versus Bail-Outs: Using Contingent Capital to Mitigate Systemic Risk*. Columbia Law and Economics Working Paper No. 380, 2010.

83 Sarra J. *Prudential, Pragmatic, and Prescient, Reform of Bank Resolution Schemes*. International Insolvency Review. Vol. 21, No. 1, 2012. P. 17–66.

84 Boonstra W.V.B. *Will better regulation and better supervision contribute to a more stable banking sector?* Economic research Department, Rabobank, Nederland, 2014.

85 Giovanoli M., Devo D. *International Monetary and Financial Law. The Global Crisis*. Oxford University Press, 2010. (in) Giovanoli M. *The International Financial Architecture and its reform after the global crisis*.

86 Parker D.C., IMF. *Closing a Failed Bank: Resolution Practices and Procedures*. Washington, D.C, 2011. IMF, WB. *An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency*. IMF, European Department, 2009. Cihak M., Nier E. *The Need for Special Resolution Regimes for Financial Institutions- The Case of the European Union*, 2009. WB. *Principles and Guidelines for Effective Insolvency and Creditors’ Rights Systems*, 2001.

87 EC. *A roadmap towards a Banking Union*. Communication from the Commission to the European Parliament and the Council, COM.510 final, 2012. EC. *An EU Framework for Crisis Management in the Financial Sector*. Brussels, 20.10.2010 , COM(2010) 579 final. EC. Staff working document. Proposal for a BRRD directive. Impact assessment. Accompanying the document. Brussels, 6.6.2012.SWD (2012) 166 final.

the European Council⁸⁸, the European Parliament⁸⁹, the Financial Stability Board⁹⁰, etc. The study is also based on authoritative conference materials⁹¹ or publications issued on their basis⁹².

Ultimately, it must be noted that the object of the research is rather limited in the Swiss jurisprudence. Excluding above mentioned *Hüpk* scientific works, only a few materials can be distinguished as a scientific projects. Some cross-border bank resolution aspects of the EU dealt within *Grünewald*⁹³ dissertation (the thesis is written based on undeclared EU legislation before a compromise was taken in the EP – aut. note). DGS related issues in the context of financial stability discussed by *Reiser*⁹⁴. The interaction of banks and the Swiss economics is addressed in the *Drechel*⁹⁵ dissertation.

The published references were addressed and taken into account up to 1 January 2015.

Interdisciplinary nature of the research. This study has an interdisciplinary character. This is determined by the selection of the object under investigation and the specific nature of bank insolvency law. This branch of law couples the accomplishments of several scientific disciplines. Among them, the most important ones are economic and legal sciences. Occasionally, the study discusses theories based on economic criteria, impact assessment, and the definitions provided by the science of economics. For example, the assessment of bank insolvency conditions is related to the economic analysis and criteria, or the effect of bank insolvency on the market and its participants. However, the study takes into account the fact that it has been prepared by a legal researcher and will be defended in front of the Committee of Doctoral Legal Studies, which is why the scientific analysis is concentrated and based on traditional private law instruments. Particular attention is paid to addressing the current and potential regulatory mechanisms.

88 European Council. *Towards a Genuine Economic and Monetary Union*. Report by President of the European Council Herman Van Rompuy. EUCO 120/12 and EUCO 205/12, 2012.

89 EP. Economic and Monetary affairs. Directorate General for Internal Policies. *Banking Union: The Single Resolution Mechanism*. Compilation of notes, Monetary Dialogue. Brussels, 2013. EP. Prepared by A. Sibert. Economic and Monetary affairs. Directorate General for Internal Policies. *Bank Resolution Regimes*. Brussels, 2012.

90 FSB. *Key Attributes of Effective Resolution Regimes for Financial Institutions*. 2011. FSB. *Thematic review on resolution regimes. Peer review Report*, 2011 and 2013.

91 Sarra J. *INSOL International Insolvency Review, Reform of Bank Resolution Schemes*. John Wiley & Sons, Ltd, International Insolvency Review, Vol. 21, 2002.

92 Haentjens M., Wessels B. *Bank Recovery and Resolution*. A conference Book. Hazelhoff. Center for Financial Law. Eleven International Publishing. The Netherlands, 2014. The EUROFI Financial Forum, organised in association with the Lithuania EU Presidency. *Improving the resilience of the financial sector to foster EU economic recovery*. Summary of discussions. Vilnius, Conference book, 2013. Bank of England. Speech given by Paul Tucker. *Resolution and future of finance*. At the INSOL International World Congress, the Hague, 2013

93 Grünewald S.N. *The Resolution of Cross-Border Banking Crises in the European Union – A Legal Study from the Perspective of Burden Sharing*. Dissertation. University of Zurich, Zurich, 2014.

94 Reiser N. Deposit Insurance and its Contribution to System Stability. *Swiss Review of Business and Financial Market Law*, Vol. 86, Nr. 1, 2014.

95 Drechel B.S.D. *Supra* note 39.

Defensive arguments of the dissertation:

1. The paradigm of bank insolvency procedures has changed recently in the jurisdictions relevant for the purposes of the research. The change resulted in the particular aspect, namely that private interests of shareholders and creditors have become subordinated to the public interest, which is to secure the continuity of banking services and at the same time the stability of the financial system. Bank resolution in the first place and then the ensuing ordinary liquidation of the bank helps to ensure the optimal balance of public and private interests.
2. Public administrative authorities initiate resolution of failing or likely to fail banks, while the court plays a secondary role. Although actions in the field of bank resolution affect the bank's shareholders and creditors, the administrative model of resolution decision-making is more rapid and efficient, as compared with judicial solutions of bank resolution, by maintaining financial stability and better protecting credit discipline in the market.
3. The procedural rights of the creditors and shareholders of the bank that is failing or likely to fail are essentially limited to the *ex-post* option of judicial review, so that the legal framework for opposing the decisions of the competent resolution authorities is very limited. Such limitation of individual rights is necessary in order to achieve wider purposes of financial stability, but at the same time it should be compatible with fundamental rights (*the right of judicial review, the right to compensation*) of related persons and the legal principles developed in case-law (*principles of legitimate expectations and proportionality*).
4. After the shift in the paradigm of legal regulation governing bank insolvency in the relevant jurisdictions, bank resolution measures are sufficient to prevent bank insolvency *ex ante*—and to effectively deal with the consequences of bank insolvency *ex post*.

The approval of research results. The results of the research are published in three peer-reviewed, official Lithuanian publications⁹⁶. The principal results of the thesis were presented in different international conferences and accordingly published in their official collections of materials⁹⁷.

96 January 2014, “*Bank Resolution Mechanisms According to the Lithuanian Case Study*”, peer review journal *Jurisprudence*. September 2014 “*Bank Liquidation As Interference of Public and Private Interests*”, peer review journal *Jurisprudence*. November 2014 “*Financial Arrangements under the Single Resolution Mechanism. Several Problematic Aspects*”, peer review journal *Justitia*.

97 (i) Legal aspects of bank restructuring. Practice and research in private and public sector – 2013: 3rd international scientific conference: conference proceedings, 11–12 April 2013. Vilnius, Mykolas Romeris University; (ii) Protection of uninsured depositor rights in bank insolvency proceedings. Social transformations in contemporary society: proceedings of an international scientific conference for young researchers. Mykolas Romeris University. Association of Doctoral Candidates. Vilnius, Mykolas Romeris University, 2013; (iii) Towards a banking union: single resolution mechanism enhancing banking industry? SOCIN 2013: international, interdisciplinary conference on social innovations “Social innovations: theoretical and practical insights”. Vilnius, Mykolas Romeris University, 2013; (iv) A legal perspective of the Single Resolution Mechanism. Social Transformation in Contemporary Society, Vilnius, Mykolas Romeris University, 2014; (v) Bank restructuring and insolvency tendencies in Lithuania and the European Union. 2013. New Challenges in the European Area: Young Scientist’s 1st International Baku Forum, International conference in Azarbaijan; (vi) Financial arrangements under the last pillar of the Banking Union a few controversial legal aspects”. SOCIN 2014: interna-

The outcome of the research was also delivered in different universities, public lectures, debates and workshops⁹⁸.

In addition, in May 2013 the author co-organised, managed and presented a report at the national scientific conference “Fraudulent bankruptcy: causes, typology, legal consequences”, hosted by Mykolas Romeris University, under the presentation title “Fraudulent bankruptcy features of the banks. Lithuanian case study”, and the author also discussed certain aspects of bank insolvency procedures in the same workshop. The results of the research were also relied on in 2013 and 2014 in cooperation with the expert in the Council of the EU in Brussels, in the Lithuanian Presidency team responsible for an extremely important field of the EU legislation, namely the Banking Union project⁹⁹. The author also relied on the results of the research by reading lectures in civil law and banking law at Mykolas Romeris University, and by conducting his practical and professional activities. To continue, the research results were also deliberated and reflected in the work of the Lithuanian Insolvency Law Network. It is also necessary to highlight that the author relied on the results of the study while preparing and submitting a legal opinion together with the Business Law Department of Mykolas Romeris University on a resonant case heard in the Lithuanian Constitutional Court, revealing the interpretative peculiarities of the legal regulation concerning setting-off counterclaims, hierarchy of bank creditors in the event of bank insolvency and the related issues of Lithuania bank insolvency law¹⁰⁰.

tional, interdisciplinary conference on social innovations “Social Innovations: theoretical and practical insights 2014”, 2014. Vilnius, Mykolas Romeris University.

- 98 11 November 2014, University of Bern, “Sciex Fellows Event 2014”. The presentation title “Why bank insolvency cases are so special?” 16 December 2014 in the Swiss Comparative Law Institute, Lausanne, the public event of “Rencontres informelles de l’Institut Suisse de droit compare”, where the topic of “Regulatory convergences and divergences of a new bank resolution paradigm in the EU and Switzerland” was introduced. Moreover, the results of the thesis were delivered to the Ph.D. student society at the University of Basel, 30-31 October 2014, at the transferable skills seminar “Bring Your Science to the People: Media Strategies and Skills for Communicating Science”. Eventually, on 19 June 2015, the results of the thesis were presented at the international symposium of Mykolas Romeris and Basel Universities, entitled “Innovations and developments in the business law. EU and Switzerland approaches”, under the title “Bank insolvencies: a unique bank resolution regime?”.
- 99 The author’s core responsibilities were also directly related to Bank Recovery and Resolution Directive, Single Resolution Mechanism and the Deposit Guarantee Schemes Directive. The Lithuanian Presidency of the Council of the European Union, has achieved significant results in the regulatory context of bank insolvency. One of the most significant results was the agreement with the European Parliament on the Bank Recovery and Resolution Directive laying down the rules for bank resolution. The Directive will have to be transposed into national law and will take effect in January 2015 (with some restrictions). In addition, a part of the abovementioned elements of the Directive will be incorporated in the Single Resolution Mechanism Regulation. On 18 December 2013 the Lithuanian Presidency had also reached a compromise agreement in the European Council. The Directive and the Regulation, *inter alia*, regulate the legal relations of bank resolution and bank insolvency procedures, harmonise the legal procedures and the basic rules in the EU.
- 100 On 5 July 2013 the Constitutional Court of Lithuania delivered a ruling on the constitutionality of (i) creditor ranking in bank insolvency; (ii) the possibility to set-off claims against an insolvent bank only to the extent of the insured amount under the deposit insurance scheme; (iii) the restrictions on challenging decisions related to the split up of the bank, if the insolvent bank’s assets are split into ‘good’ and ‘bad’ bank prior to insolvency.

RESEARCH METHODOLOGY

The research is based on the qualitative methodological approach¹⁰¹. This approach, relying on qualitative methods, allows perceiving the bank resolution regime and liquidation procedures together with the relevant obstacles. The research was largely based on theoretical and empirical methods: linguistic, systematic, logical, critical, document analysis.

The study is further based on methodological legal research outlines (basic methodological principles) better suited for dynamic form of law¹⁰². The research is dominated by active methodology, conventional science, conceiving law as an entirety of legal rules, accurately reflected in national legislation. The research also employed the methods of typical scientific knowledge, hermeneutics (interpretation), all helpful for understanding, interpreting and executing the law. Legal science is determined not only by the facts, as *inter alia* it implies interpretations and application of the existing knowledge to new fields of research. Thus, the object of the research is mainly based on the theory of analysis and understanding and characterised by qualitative methods, by combining experience and effort to explain the genuine meaning. The author of this study construes the text, crystallises and defines bank insolvency relations, by exploring the balance of public and private interests in the bank resolution regime. Based on such methodological grounds and according to the formulated aims and objectives of the study, various methods of data collection and data analysis were applied. The research is in compliance with the jurisprudence: (1) to determine social certainty of the facts, phenomenon and their characteristics; (2) to explain these facts and expose causal connections; (3) to assess the factual basis of the regulation at issue and to examine its value.

- 1) *The method of linguistic analysis* was applied for interpreting the diversity of national laws, court judgments, internationally acknowledged guidance and relevant readings, including the wording of international and the EU, US, Swiss laws and legal concepts.
- 2) *The method of document analysis* was employed by collecting and examining the regulation, non-binding international legislation, explanatory documents of competent authorities, court judgments and legal doctrine, such as special scientific publications, monographs, textbooks, journals in Lithuania, the US, Switzerland and the EU. The aforementioned method was also used for the purposes of the research to analyse different publications of international bodies and public institutions. The abovementioned method had no improper influence on the approach selected by the researcher. Initial research data was obtained from general law, insolvency law, banking and financial law, administrative law, deposit insurance law, and other legislation governing failing or likely to fail banks in the relevant jurisdictions. The same method was also used for collecting the data for

101 Bitinas B., Rupšienė L., Žydyūnaitė V. Kokybinių tyrimų metodologija. Jokužio leidykla, Klaipėda, 2008.

102 Mackuvienė E. *Teisės mokslo ir jurisprudencijos moksliskumo problema*. Socialinių mokslų studijos. Vol. 1, No.5, 2010. P. 301.

the dissertation in the EU, the US, Swiss and Lithuanian universities libraries and databases or internet references.

- 3) *The method of systemic approach* was used to estimate and classify the prevailing bank insolvency procedures, more specifically bank resolution procedures, their legal context and regulation at national and international level. This method allowed the author to examine the bank resolution regime as a complex legal phenomenon together with social, economic context and assisted in determining the correct position of bank insolvency law in the legal systems, the systemically connection between *lex generalis* and *lex specialis*.
- 4) *The logical method* was applied by consciously reviewing the available facts and details related to bank resolution relationships, by inferring interim and final conclusions of the research.
- 5) *The method of generalisation* was applied in conjunction with the logical method, in order to highlight the features of the regime governing bank resolution, classify common and specific components, abstracted in the conclusions and recommendations.
- 6) *The teleological approach* encouraged the author to disclose the objective reasons underlying regulation of different bank resolution tools; in addition, this method was adopted in examining and revealing the purposes of bank insolvency law and the limits of interpretation. Similarly, this method served the analysis of national and international laws, different court judgments, and was useful in identifying the factors and circumstances triggering bank insolvency cases, impact on shareholders' and creditors' rights, public institutions' activities and decision making mechanisms. The method proved helpful for revealing the meaning of legal texts and diagnosing limits of interpretation. It should be noted that this method was used in parallel with the historical, linguistic and systematic methods of analysis in determining the position of the legislator with regard to a particular issue of the research.
- 7) *The comparative method* remained crucial for distinguishing diverse classes of banks, different types of bank insolvency procedures, legal constructs of different countries and distinct legal traditions, as well as for the evaluation of enduring scientific concepts, their legal framework and practice. In principle, the method implies a comparison of the EU, US, and Swiss legal systems and countries. It is an intellectual activity with the law as its objectives, limitations and the comparison as its process. This method allowed crossing the boundaries of one legal system and investigating more acceptable and reliable solutions applied in other jurisdictions. It also enabled the author to align the specific features of regulation and the implementing institutes applied in different countries and to identify innovative approaches and controlling ideas in order to maintain the argumentation of the research. This method reveals differences and similarities of the legal systems and purifies universal problems. It determines original alternatives for resolving enduring puzzles. To be noted, the method was used both in terms of *macro* (to compare the spirit and style of various legal systems, legislative practices and procedures) and *micro* (compare a range of specific, selected legal systems, the particular rules used to solve relevant problems or particular conflicts of interest)

approach¹⁰³. The study draws an admittedly flexible dividing line between macro and micro comparison. The research was performed by relying on and processing legal materials and procedures. The aforementioned method explores how the related rules have been designed and developed by legislators or courts of different jurisdictions, in an attempt to identify and clarify the practical context of application, so that the reader can understand the reasons for particular solutions of the relevant problems in foreign legal systems.

- 8) *The method of analytical and critical thought* was used to analyse the weaknesses and implementation dysfunctional, the causes of bank resolution and (or) the liquidation legal regulatory procedures, and consideration of the public and private interests. Relying on this method, it was evaluated how the law is satisfying the protection requirements of a special period of law. The method applied for legal critique and desired law vision.

Some other research methods were employed in the scientific study: the *genetic method* served in establishing the emergence and development of bank insolvency law; the *deductive method* was relevant for analysing general rules established in legal norms and by specifying their practical application; the *inductive method* assists in examining the case-law specific matters and the appropriate conclusions; the *historical method* was applied for revealing the genesis of the bank resolution regime, the meaning of legal rules and the factors determining the variety of regulation and interpretation of the law and the development of regulation in different countries, and the factors influencing insolvency of the banks, seeking to identify the fundamental elements of the legal relationship; while the *statistical method* was useful for processing the statistic material.

THE STRUCTURE OF THE RESEARCH

In line with the formulated tasks of the research, the operative part of the study consists of four main chapters.

In the first chapter, which is the opening chapter of the study, author addresses and analyses the general provisions, preconditions for and the conceptual framework of bank insolvency procedures. This chapter clarifies several terminological aspects of the thesis, defines the essential features of banks, highlights the public interest-related functions of the banks, overviews the influence of the recent banking crisis on the economy, and comments on the roots of the bank insolvency proceedings. Moreover, this chapter demonstrates why bank insolvency dilemmas are irrelevant from the perspective of general insolvency law. This section explores the conception of bank insolvency procedures, analyses the interrelation of bank insolvency procedures, problematic issues related to the establishment of bank failure, by distinguishing quantitative and qualitative as well as discretionary criteria. This chapter concludes with a summary of the types of bank insolvency procedures in different jurisdictions, reviews and summarises the unification of regional and international trends, and analyzes the recent change in the paradigm of bank insolvency law.

103 Zweigert K., Kotz H. *An Introduction to comparative law*. Second Edition. Oxford Clarendon Press. Great Britain, 1992. P. 4-5.

The second chapter is devoted to the analysis of the bank resolution regime itself. Given that the regulation of bank resolution should be designed not only to protect the private interests (shareholders and creditors), but must also to serve broader objectives of public regulatory nature that are vital for the effective functioning of the economy, this section analyses the concept of bank resolution in different jurisdictions and the related administrative practices. The concept of bank resolution is revealed and the reasons determining the importance of bank resolution are analysed. Relevant focus is placed on the resolution conditions of banks in different jurisdictions, by detailing the specific objectives of resolution. Eventually, given the fact that the efficiency of the legal measures for bank resolution is necessary in order to avoid preventable damages in the banking industry, this part of the thesis is dedicated to the crystallisation of specific bank resolution tools (sale of bank business, the bridge bank, bail-in, asset separation tool) and their implementation schemes, depending on the objective to preserve financial stability and minimise the economic and social impact of bank insolvency.

The third chapter analyses the public authorities that aim to ensure swift measures of bank resolution and to guarantee sovereignty, seeking to avoid conflicts of public and private interests. Particular consideration is given to decision-making and controlling mechanisms in the field of bank resolution, the right to judicial review (the right to due process and effective remedy), and the procedures and objectives underlying valuation of assets and liabilities. This chapter researches the optimal regulatory model that would be the most productive in addressing the possible decision-makers in the field of bank resolution: administrative authorities, creditors or courts? This chapter *inter alia* assesses the decision-making models in different jurisdictions, overviews the key public authorities and their role in the bank resolution procedures.

The fourth chapter, which is the most crucial chapter, administers the main question of the research, analyses bank resolution procedures and their impact on the bank's shareholders and creditors. It explains that the restriction of fundamental rights of individuals is necessary for the sake of broader financial stability objectives, by assessing the proportionality of such limitations. The resolution objectives are examined in cases where the application of resolution measures and legal powers can limit shareholders' and creditors' rights and whether the interference of the resolution-related actions with the rights of creditors and shareholders complies with the fundamental rights of individuals and is proportionate. The review also establishes the rights and interests of shareholders and creditors from different perspectives. The presented case-law analysis identifies the fundamental legal principles and legal safeguards best balancing private and public interests in the bank resolution regime. This chapter discusses the impact on individual property rights, by analysing the loss allocation order, the implementation of creditors' claims and priority of claims. It also discusses the options of different treatment of creditors, investigates legal safeguards (by analysing the impact on shareholders and creditors), explains the concept that creditors should not incur losses that exceed the ones incurred in case of straight liquidation of the bank (based on ordinary bankruptcy procedure) supporting the balance of public and private interests in bank resolution procedures.

The study is finalised by presenting the relevant conclusions and recommendations.

I. THE LEGAL CONCEPT OF BANK INSOLVENCY PROCEDURES

Banks perform vital economic functions, and their primary mission is to provide financial “lifeblood” to the real economy¹⁰⁴. In order to understand the precise notion of banks, in the spirit of the dissertation, and particularly in the context of bank insolvency regulation, to analyse the object of the research, to detect and investigate the main question of the research, it is necessary to conceive what a ‘bank’ is and especially a bank as a business entity and why its legal determination is different from that of other entities. In Lithuania, the methodological material in the field of banking law is lacking¹⁰⁵. According to the well-established conventional belief, a bank is a financial institution that accepts deposits from the public and re-lends the collected money. However, it should be noted that even the simplest conception of a bank as a legal person is much more complex and challenging and banking functions are considerably wider than those of the remaining conventional businesses. Therefore, in a society the ‘mainstream’ approach to banking is too narrow and worth of a broader scientific judgment.

Despite very rapid dynamics in financial services¹⁰⁶, banks still play a vital role in na-

104 Theissen R. Are the EU Banks safe? What functions do banks have? Eleven International Publishing, Netherlands, 2013. P. 30.

105 This conclusion is based on the analysis of electronic researches and dissertations information system in Lithuania, virtual Lithuanian university libraries, subscription databases, publicly available data of the competent authorities, taking into account conferences or other events organised on a national level in the field of bank insolvency law. In addition, financial literacy determines a reliable and sound banking system, therefore, financially well-educated individuals are more likely to be engaged in sound financial planning and adopt better financial decisions. Financial education contributes to better financial solutions, market discipline and the maintenance of financial stability. Sabourin P.J. *Rethinking the Role of Deposit Insurance: Lessons from the Recent Financial Crisis*. (in) *Supra* note 27. P. 137.

106 The dynamics is reflected by the fact that, on the one hand, recently the range of financial services has greatly expanded. In addition to unlicensed financial services, such as lending, payment card releases, financial guarantee and surety of financing, etc (for instance, the full list of unlicensed financial services in Lithuania is contained in Article 3(1) of the Financial Institutions Act), and conventional, licensed financial services, such as deposits or other repayable funds from unprofessional market players, commercial banks start actively supplying other licensed services, such as investment services and other activities related to the provision of financial services: cash operations, non-maturity deposits, termed deposits, securities, shares, and a long list of other financial contracts treated as financial assets of the bank. The doctrine still equates *other financial assets* to the bank’s contractual rights. Contractual bank rights are legally based financial means to obtain cash or another financial asset from another counterparty or to exchange financial assets or financial liabilities with another legal person under the conditions that are potentially more useful for the property holder, or the issuer. The bank’s contractual rights include debts and capital securities viewed as an asset from the perspective of their holder and as liabilities from the perspective of the issuer. On the other hand, it should be noted that the global development of e-commerce has accordingly influenced the banking sector: electronic banking services and products, including electronic payment, were rapidly developing, which could in turn create new opportunities for banks to expand their markets from the traditional deposit collection and lending activities to new products and services. Thirdly, the extent of bank financial intermediation activities has highly increased, and despite the growing capital market activities, mobilising capital for the parties concerned, banks still remain the primary source of liquidity for enterprises. Hüpkes E. *Supra* note 3. P. 3-5. Chorafas N.D. *Supra* note 8. P. 28.

tional economies¹⁰⁷ and implement unique features. Recently, the regulatory framework of the banking sector has been globally reviewed. Bank capital and liquidity reserves were increased and it was recognized as a more suitable macro-prudential policy tools¹⁰⁸. In parallel, legal and regulatory reforms of bank insolvency were implemented within individual jurisdictions both at regional and international level with an attempt to reduce the likelihood of future bank insolvencies and similarly to enhance the resilience of credit institutions, even under the most unfavorable economic conditions (regardless of the determinant reasons – disorders of the entire system or several insolvency events specific to a particular bank). Nevertheless, it is not possible to create a regulatory and supervisory legal framework for banking that would prevent banks from experiencing financial difficulties¹⁰⁹.

This chapter analyses the general conceptual aspects of legal relations surrounding bank insolvency: it reveals the connection between banks and the public interest, provides the definition of bank insolvency procedures, identifies the types and the principal objectives of bank insolvency procedures. It also deals with the impact of the banking crisis on the economy as a whole and the development of the bank insolvency legal systems (harmonisation and unification at international and regional level). Furthermore, this chapter distinguishes legal and economic features that affect the specific regulation of insolvent banks, compared with conventional general insolvency regulation. While looking for an answer to these questions, first of all, it is necessary to analyse the reasons why *lex generalis*

107 For example, banks of the EU financial system account for approximately three-quarters of the real economy. The EU banking market consists of 28 national banking systems. Each national banking system has its unique features, different number of banks at various levels of concentration and different levels of intensity of competition among banks. It should be emphasized that the contribution of banks to the GDP of the EU by 2007 was growing intensively. It continued to grow in 2007, when total bank assets increased, and GDP ratio was about 300%. By December 2008 the number of banks in Europe have attained the highest level. 23.37% of all banks were located in Germany, 9.61% in Italy, and 8.55% in France. It should also be noted that in 2007, the profit achieved by European commercial bank groups was higher compared to the profit obtained by the US commercial bank groups (excluding investment banking groups and their profit). Barnier M. *The G20 must remain committed to global implementation of financial reforms*. The EUROFI Financial Forum. *Supra* note 92. P. 37. Olgu O. *European Banking, Enlargement, Structural Changes and Recent Developments*. Basingstoke, Palgrave Macmillan, 2011. P. 90-91, 131, 140. Swiss banking sector contributions to the entire national economic performance is approximately 6.2%. Also, Swiss banks are among the world leaders in offshore banking. In 2012, according to the data of the Swiss National Bank, Swiss bank accounts contained about CHF 5.3 trillion in cash. According to the data of 2012, the banking industry in Switzerland collected around CHF 11.2 billion of income taxes to the Swiss budget. In addition, 5.8% of all Swiss employees operate in the financial services sector and the financial sector's contributions to the country's GDP is around 10.5%. Bauen M., Rouiller N. *Supra* note 39. P. 3. Nguyen D. Q. *Is Switzerland really the country of bankers?* Swissinfo [interactive]. [accessed on 04-10-2014] <<http://www.swissinfo.ch/eng/is-switzerland-really-the-country-of-bankers-/40473658>>. In the US, from 1978 up to 2007, the monetary funds held in the financial sector increased from USD 3 trillion to 36 trillion, i.e. more than twice, compared to the country's GDP. Furthermore, a significant change of nature in banking and banks themselves was obvious. From conservative private partnerships to companies with shares publicly traded on the stock exchange. On the eve of the financial crisis, the profit of the financial sector accounted for 27% of the profit of all the remaining US corporations. The Financial Crisis Inquiry Report. *Supra* note 28. Conclusions of the Financial Crisis Inquiry Commission. Preface. (xv-xxviii). Čihák M., Nier E. *Supra* note 15. P. 4.

108 Chorafas N.D. *Supra* note 8. P. 105-123.

109 Bonstra W.V.B. *Supra* note 84. P. 17.

is insufficient for effective regulation of bank insolvency procedures. In order to provide a scientifically-based answer to these questions, it is first necessary to analyse and identify the specific features of banking activities, mainly the public interest inherent in such activities, the reasons why banks around the world are treated and regulated in an exclusive manner. Only after a general analysis it would be possible to accurately disclose the nature of the bank resolution legal regime and to explore the problematic aspects of the object under research.

At the beginning of the research, it is equally important to perceive that banking is characterised by high degree of assimilation in definitions. Therefore, in order to fully understand the uniqueness and complexity of the regulatory framework governing bank insolvency, it is useful to distinguish and define several aspects of banking and related terminology used in the dissertation. First, in modern times traditional commercial banks normally concurrently carry out many special functions characteristic to non-traditional (investment) banks. Second, it is assumed that activities unrelated to banking, such as asset management, or insurance services may not adversely affect the stability of the financial system (if the banking system remains unaffected). Therefore, such types of banks are outside the scope of this study. Third, this study concentrates on and examines traditional commercial banks as deposit-taking and credit-financing institutions. According to the common understanding widespread and dominant in Europe (this understanding is also followed in this study), the definition of a bank may in some cases include investment firms, and in a rare occasions it involves other financial institutions incorporated into banking groups or holding structures¹¹⁰. In certain exceptional cases it includes banks, *inter alia*, operating on a cross-border basis. Fourth, it should be noted that the study occasionally uses the terms of a *bank*¹¹¹ and *credit institution* interchangeably. According to the legal systems of the relevant jurisdictions coming within the scope of the research, these notions are essentially indistinguishable. According to the most relevant EU legislation 'a credit institution' is understood as a company that accepts deposits or other repayable funds from the public and grants credits on its own account, and this concept includes investment firms, except for central banks and credit unions¹¹². Although Bank Recovery and Resolution Directive draws a clear distinction between the extent of business structure of investment firms (investment banks¹¹³) and credit institutions, both companies come within the scope of the Directive and accordingly fall within the concept of

110 BRRD. 2 art.

111 The study follows the concepts of a 'bank' commonly accepted in the EU. The term 'bank' means credit institution, a company that accepts deposits or other repayable funds from the public and grants credits on its own account, except for investment firms, central banks, credit unions (save for the Central Credit Union). Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (1), 2 (5) art. Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (1), 4 (1) (1) art.

112 Directive 2013/36/EU of the European Parliament and of the Council of 26 June, Art. 2 (5). Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013, 4 Art. (1) (1).

113 See more Gleeson S. *International Regulation of Banking. Investment Banking*. Second Edition. Oxford University Press, UK, 2012. P. 209-281.

a credit institution. However, for the sake of structural convenience of the dissertation, an investment firm as well as traditional banks are understood as a “bank”, whereas a banking group is understood as defined in the EU law, i.e., a parent bank, a legal entity belonging to a banking group, and its subsidiaries. A cross-border banking group is a banking group whose entities have been established in more than one Member State¹¹⁴. A banking group is a parent company and its subsidiaries, consisting of entities operating as credit institutions and their parent companies, including financial holding companies and mixed financial holding companies for investment firms and financial institutions¹¹⁵.

In the Swiss legal system, the term “bank”¹¹⁶ has been used in legislation since 1935, i.e. the time of adoption and entry into force of the first Swiss banking law¹¹⁷. Under the existing banking act, a bank can only be understood in terms of a legal person meeting the following requirements: legal personality, license, operating in the financial sector, and particularly on a commercial basis, with the purpose of collecting deposits from the public or publicly recommending the latter. A ‘bank’ is also a company seeking to fund an undefined number of people or companies (with its own funds and the funds collected from depositors) and having no personal, advance economic ties with such entities¹¹⁸. Thus, according to the Swiss legal framework, a bank is a legal person that accepts deposits from the public on a commercial basis (deposit business) and issues loans to its customers (lending business)¹¹⁹. Basically, this is a classic concept of banking, associated with the fact that a bank receives interest and its conduct relates to various banking operations. The *US legal system* distinguishes national and state banks, whereas a bank refers to any state or national bank, an association of banks, an investment firm, a savings bank, a commercial-industrial bank or similar financial institution collecting deposits, with a director or a board determining the primarily financial mode of operation of the bank. A bank includes some other banking institutions which (a) collect deposits (except for trusts and mutual funds); (b) are bound by the laws of any state or act in accordance with the Code of District of Columbia, including any co-operative or non co-operative bank whose depositors are insured according to the Federal Deposit Insurance Act¹²⁰.

Based on the conception of a ‘bank’ existing in different jurisdictions we can conclude that the primary objective of the bank’s business is that a bank pays lower interest on deposits of public interest, as compared to the interest received by the bank for issuing credit

114 BRRD. 2 Art. (26), (27), (31).

115 Regulation (EU) of the European Parliament and of the Council No. 806/2014. *Supra* note 53. Art. 3 (23).

116 Legal entities may use these terms alone or in a combination of words, if they hold the operational license issued by the Swiss supervisory authority.

117 Swiss Federal Act of 8 November 1934 on Banks and Savings Banks (January 1st, 2015). Art. 1 (4).

118 *Ibid.* Art. 1-3.

119 It should be noted that in the Swiss Banking Act, banks are commonly divided into banks, private banks, saving banks, the scientific literature presents a much broader classification of banks, based also on some other criteria. In the Swiss doctrine, the following basic types of banks could be distinguished: private banks, cantonal banks, foreign banks, savings banks, regional banks and agricultural cooperative banks, commercial banks, investment banks, securities dealers, internet banks. See also Bauen M. Rouiller N. *Supra* note 39. P. 4.

120 FDIA. 3 Section (1). Dodd-Frank Wall Street Reform and Consumer Protection Act. H. R. 4173. 2010. Section 2, 18 (A). Codified in 12 U.S.C. 1813.

to customers. The profit margin of a bank amounts to the difference between the interest received and the interest paid. At the same time, it should be noted that, in addition to traditional banking business activities, modern banking is indissociable from currency trading, metal trading and securities trading. Banks also provide investment advice to its customers, and sometimes act as customer asset managers, and perform local and international customer payments¹²¹. Such banking transactions are based on the commission paid to the bank, (as opposed to the interest-based transactions) and they are therefore excluded from the bank's balance sheet¹²². Although, depending on the jurisdiction, banking sector is characterised by individual features and entails various differences, recently traditional banking business and the functions of financial institutions in general have been gradually deforming¹²³. Therefore, rapid change of primary activities exercised by banks forced legislators and state policy-makers to review their legal regulation, including, but not limited to bank insolvency law, and accordingly to take into account the existing general developments and the level of development of the banking system.

1.1. The Impact of Banking Crisis on the Economy

A financial crisis is an index point referring to the development of the *financial system*¹²⁴ and leading to the decline of the latter. It usually begins shortly after business cycle upturns¹²⁵. Banking crisis forms an integral part of the financial crisis and can significantly affect the real economy¹²⁶. In broader terms, *the recent financial crisis*¹²⁷ is commonly un-

121 See more 1 chapter 2 sec.

122 Bauen M., Rouiller N. *Supra* note 39. P. 5.

123 See more 1 chapter 4 sec. 3 subsec.

124 For each country, it is highly important to have a well-functioning financial system, which can direct the cash circulating in a particular country for productive use, thus smooth functioning of the financial system is an essential prerequisite for sustainable economic development. The financial system consists of all financial intermediaries and financial markets and their inter-relationships, related cash flow 'to' and 'from' households, governments, businesses, foreigners, as well as the financial infrastructure. The main objectives of the financial system are to channel funds from certain profitable sectors of the economy producing surpluses to the sectors struggling to raise capital. To this end, the financial sector performs two primary functions: (i) reduces information and financial transaction costs; (ii) promotes trade, economic diversification and development and risk management (diversification). In practice, the financial system is always a mixture of certain financial markets and financial intermediaries. Haan D.J., Oosterlo S., Schoenmaker D. *Supra* note 62. P. 3. IMF classifies the financial system according to degree of performance of financial transactions, based on direct relations between two entities (in long term), generally a bank and the client. Such transactions take place on the basis of the principles governing free competition, where parties do not normally have specific knowledge about each other, and information is not available to the public. IMF. *World Economic Outlook*. Chapter 4. Washington DC, 2014.

125 Kindleberger P. C., Aliber Z. R. M. *Panics and Crashes- A History of Financial Crises*. Sixth Edition. London, Palgrave Macmillan, 2011. P. 4, 15, 21.

126 Drechel B.S.D. *Supra* note 39. P. 121.

127 It is believed that the global financial and economic crisis began in the form of the US subprime crisis, with higher than usual risk of mortgage loans and mortgages linked to securities markets (mortgage-backed securities) in August 2007. At a later time, these events resulted in bank liquidity insufficiency in the United States, and then in some other countries around the world. The most significant bank

derstood as the global financial crisis which has manifested itself as a massive economic recession that officially outbroke in December 2007¹²⁸ and peaked in 2008-2009¹²⁹. The recent financial crisis had a tremendous effect and resulted in enormous economic and legal consequences all over the world¹³⁰. It is argued that the crisis of this magnitude occurs once in a hundred years and could be compared to the US banking crisis during the *Great Depression* period in 1929-1933¹³¹. However, no doubt that it was the largest financial crisis in the world in more than 60 years. Some studies can reveal and prove it to be the largest financial crisis in the world history. For instance, a special US financial crisis inquiry commission found “panic and uncertainty in the financial system faced people into the longest and deepest recession in the history”¹³². It is believed that the recent financial crisis is the product of evolution of market and financial services because, in the past fifteen years, the structure and the key features of the global financial system have changed dramatically. However, legal regulation of the financial markets¹³³ was unable to keep pace and revealed

insolvency cases worth to be mentioned are *Northern Rock* bank insolvency in September 2007, *Bearn Stearns* rescue by public finances in March 2008, failure of the one of the largest investment banks in the world *Lehman Brothers* in September 2008. These and other cases of bank insolvency opened a new page in the history of bank insolvency procedures and the related regulatory reforms. Moreover, the situation degenerated into a systemic crisis, one of the largest economic crises in the last hundred years, when by reason of large systemic risks insolvency of one financial market participant triggered a chain of insolvencies of many other corporate and personal structures. The insolvency of the investment bank *Lehman Brothers* was the result of serious deterioration of the financial conditions throughout the financial system, so that the IMF has described the financial situation as raising serious doubts about the viability of the entire financial system. IMF. *Global Financial Stability Report: Financial Stress and Deleveraging- Macrofinancial Implications and Policy*. Washington DC, 2008. Ferran E., Moloney N., Hill G. J., etc. The Regulatory Aftermath of the Global Financial Crisis. International Corporate Law and Finance Market Regulation. Observations about the crisis and reform. Cambridge University Press, Great Britain. 2013. P. 11. Marinč M. ir Vlahu R. *Supra* note 76. P. 5.

- 128 The Financial Crisis Inquiry Report. *Supra* note 28. P. 390. Preface. (xi-xii). See more www.fcic.gov
- 129 Savona P. Kirton J., Oldani C. *Global Financial Crisis. Global Impact and Solutions*. Ashgate, England. 2011. P. 5.
- 130 Ferran E., Moloney N., Hill G.J. etc. *Supra* note 127. Preface (ix).
- 131 Savona P., Kirton, J., Oldani C. *Supra* note 129. P. 4. See more Carlson M. *Alternatives for Distress Banks during the Great Depression*. Journal of Money, Credit and Banking, Vol. 42, No. 2-3, 2010.
- 132 The Financial Crisis Inquiry Report. *Supra* note 27. P. 389. The financial crisis inquiry commission was established on the basis of ‘Fraud Enforcement and Recovery Act’, on public law grounds. This piece of legislation was adopted by the US Congress and approved by the US President in May 2009. The commission consisted of 10 independent individuals, a panel consisting of private US citizens with relevant experience in economic, financial market regulation, banking, consumer protection and other relevant areas. In essence, the Commission analysed the insolvency cases of financial institutions, in particular 22 separate topics related to the insolvency of financial institutions, including regulation of bank insolvency procedures, by reviewing millions of pages of documents, interviewing more than 700 witnesses and organising 19 public hearings in Washington, New York and in other places in the US.
- 133 The doctrine distinguishes *the modern financial market* according to the following features (i) international, characterised by large capital movements; (ii) prevailing fierce competition between financial service providers and market participants; (iii) increased costs for investors, financial institutions and regulators in monitoring and managing the activities of the financial market players and the risks inseparable from the dramatically increased quantity of compound products; (iv) no longer a barrier between historically independent financial products, sectors and players; (v) differences between li-

lack of control. That fact was recognized by the G-20, launching wide-ranging political and legal reforms in order to stabilise and strengthen the global financial system¹³⁴. It should be noted that in June 2010 the G20 Summit committed to design and implement the systems whereby authorities would have the powers and tools to restructure or resolve all types of crisis-stricken credit institutions, so that the burden ultimately did not pass on taxpayers. The states were also obliged to review bank insolvency legal regimes in order to orderly liquidate cross-border credit institutions even characterised by large and complex structure¹³⁵.

Scientific literature usually describes banking crisis as a component of the financial crisis phenomenon. The banking crisis has been described as a sort of financial situation, resulting from particular bank insolvency, or a combination of several bank insolvencies or illiquidities, which may accordingly pose a threat to the bank and/or the continuity of its business in short or long term¹³⁶. A banking crisis usually begins from a credit lending boom, during which private financial institutions assess lending risks on an irrational and inappropriate basis or issue loans funded by weak, short-term lending. For this reason any general economic downturn may lead to significant changes in bank assets management (asset depreciation) and lead to financial panic in a given market, so that the bank can no longer implement its commitments in a successful and timely manner¹³⁷. After analysing scientific literature it could be said that, first of all, we can distinguish a situation in the financial market, when the harmonious functioning of the entire banking system is essentially deteriorating by reason of one large bank insolvency case. Secondly, the market situation worsens when a large number of banks are in distress, or, thirdly, a sense of panic dominates the financial system¹³⁸. Meanwhile, a financial crisis covers a much wider range

quidity of deregulated financial markets and regulated markets; (vi) rapid technological development. The doctrine distinguishes *the modern financial market* according to the following features (i) international, characterised by large capital movements; (ii) prevailing fierce competition between financial service providers and market participants; (iii) increased costs for investors, financial institutions and regulators in monitoring and managing the activities of the financial market players and the risks inseparable from the dramatically increased quantity of compound products; (iv) no longer a barrier between historically independent financial products, sectors and players; (v) differences between liquidity of deregulated financial markets and regulated markets; (vi) rapid technological development. Haan J., Oosterloo S., Schoenmaker D. *Supra* note 62. P. 61-103.

- 134 In April 2009 the G20 leaders adopted a statement at the summit, which was designed to discuss financial markets and global economic issues. It was found that it was necessary to have a well-functioning financial system with adequate legal regulation as a prerequisite and a precondition for sustainable economic development. The financial system consists of all types of financial intermediaries and financial markets and their mutual relations, taking into account both the flow of funds from households as well as governments, businesses, foreigners, and the financial infrastructure. The main tasks of the financial system: (i) minimise information and transaction costs; (ii) facilitate trade, comprehensive economic development and risk management. *Ibid.* P. 3.
- 135 FSB. *Reducing the moral hazard of systemically important financial institutions*. 2010 [interactive]. [accessed on 25-03-2014]. <http://www.financialstabilityboard.org/publications/r_101111a.htm>.
- 136 It is believed that all financial crises start from a liquidity crisis. Companies have no access to sources of financing, and the reason behind this is that the money-lending financial institutions face financial difficulties or are not creditworthy. Gleeson S. *The Role of Government, Central Banks and Regulators in Managing Banking Crisis*. (in) *Supra* note 27. Chapter 6. P. 92.
- 137 Gelpern A. *Supra* note 137. P. 207.
- 138 Lastra R.M. *Cross-border bank insolvency*. *Supra* note 74. P. 346.

of crises, such as currency or sovereign debt crisis, asset price bubble, stock market decline. Therefore, a financial crisis can cause financial consequences for the banking system or other side effects¹³⁹. *In the strict sense*, a banking crisis is perceived as a particular period when important segments of the banking system become insolvent or illiquid. Basically, this means that banks are facing serious financial difficulties including, but not limited to, massive withdrawal of deposits from banks, financed corporation bankruptcies, massive government intervention seeking to address bank solvency problems or growing number of financially insecure financial institutions¹⁴⁰. Other researchers describe a banking crisis in terms of a certain scenario, when bank insolvency or cessation and/or suspension of banking activity leads to the suspension of many or even all bank operations in a given market and decreases capital deficiency¹⁴¹. The bank insolvency crisis has always been associated with extremely high social costs¹⁴² or payments made by default and even sovereign debt crises¹⁴³. Therefore, there is a close link between the financial crisis and private sector solutions which may lead to the rapid spread of adverse effects of the financial crisis in the private sector to the public sector. This ratio reveals the relationship between state and private sector assets and liabilities (balance sheet)¹⁴⁴.

The impact of bank insolvency crisis on the economy may occur through the following: (i) direct costs to the public; (ii) real effect on the economic activity of the country; (iii) the impact of the country's monetary and currency policy; (iv) dysfunction of services of the bank as a financial intermediary; (v) banking difficulties and modifications of behaviour with regard to customers and other interested parties¹⁴⁵. The following question arises: which legal measures help mitigating this negative impact on the economy? In response to the latest banking crisis, public authorities had only a small choice of legal instruments and bank resolution methods at their disposal, such as: (i) a central bank of a certain country could start acting as a lender of last resort¹⁴⁶ and rescue the bank (or banks) from insolvency by providing additional liquidity reserve to a certain bank, which, in spite of the fact that in most cases it holds eligible assets to pledge for its obliga-

139 Ibid. P. 353-389. Calomiris C. *Banking Crises and the Rules of the Game*. NBER, Working Paper No. 15403, Cambridge, 2009. P. 5-6.

140 Drechel B.S.D. *Supra* note 39. P. 8-9.

141 Caprio G., Klingebiel D. *Bank Insolvencies: Cross-Country Experience*. WB, Policy Research Working Paper No. 1620, 1996.

142 *Supra* note 27. P. 39. For example, some researchers estimate that the losses of bank assets arising from bank liquidation procedures are very significant and frequently amount to almost 30% of the actual bank asset value. These numbers significantly exceed ordinary bankruptcy costs of a non-credit institution (from 10 to 20% of asset value). *Supra* note 76. P. 42-44.

143 The most notable examples of the recent crisis with regard to the sovereign debt crisis are those of Greece and Ireland. BIS estimated and evaluated that as for June 2010, default commitments of the private and public sector borrowers four key eurozone economies, namely Greece, Ireland, Portugal and Spain, which suffered a severe sovereign debt crisis, was USD 1.6 trillion. French and German financial injections (lending) for banks accounted for 61% of total lending, including 15% for public debt repayment. Private investor funds financed the remaining part. BIS. Quarterly Review. International Banking and Financial Market Developments, 2010.

144 Lastra R.M. *Supra* note 74. P. 346.

145 Drechel B.S.D. *Supra* note 39. P. 123.

146 *See more*. 3 chapter 1 sec. 2 subsec.

tions, but for any reason is unable to obtain financing from the market; (ii) in the wake of an insured event and under deposit guarantee schemes, to make use of the existing government guarantees by paying compensations to depositors; (iii) to protect depositors and other banks (e.g. by buying or insuring bank assets, recapitalising the bank or using other forms of financial support) by securing financial sustainability; (iv) to apply general insolvency law and try to restructure and/or liquidate the bank; (v) to apply early interventions tools, i.e. immediate corrective action for bank activities, and similar legal sanctions, preventive measures (statutory prudential regulation, bank supervision and pro-cyclical measures). Among other things, it is important to emphasize that, within the scope of this research, the banking crisis is identified with situations of systemic crisis¹⁴⁷, whereby the financial difficulties faced by one or more banks may jeopardise the balanced synthesis of all banking activities. Such financial difficulties may manifest in different forms of bank insolvency: solvency (credit) crisis, liquidity crisis or market crisis.

1.2. Why Banks are Unique Legal Persons? Does Public Interest Affect the Functions of the Bank?

Banks perform functions¹⁴⁸ that are extremely important for the real economy as a whole and that are sometimes referred in the doctrine as critical¹⁴⁹. Legal theory distinguishes three main groups of special features of banking activities related to the following aspects: (i) banks usually hold many liquid liabilities (generally in the form of deposits), compensated according to the nominal value, whenever requested by the creditor; (ii) financial services provided by banks, which are vital for the functioning of the entire real economy¹⁵⁰; (iii) specific functions performed by some banks as legal persons, by connecting the monetary policy created by the state and the monetary policy and economic processes of the state; (iv) specific bank insolvency procedures and regulations, compared with typical, general insolvency procedures of business entities¹⁵¹. Naturally, a legitimate

147 See more 1 chapter 6 sec. 5 subsec.

148 Critical functions are exercised to achieve the effective functioning of the financial and economic system. Hüpkes E. *Resolving Crisis in Global Financial Institutions: The Functional Approach Revisited*. *Supra* note 27. Chapter 18. P. 295-296. Regarding the concepts of critical bank functions and core business lines. See more EBA. *Technical advice on the delegated acts on critical functions and core business lines*. EBA/Op/2015/05.

149 *Critical functions* of banks in the EU legislation are defined as activities, services and operations the discontinuance of which is likely in one or more Member States to lead to the disruption of services that are essential to the real economy or the disruption financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations. *Core business lines* mean business lines and associated services which represent material sources of revenue, profit or franchise value for an institution or for a group of which an institution forms part. Directive of the European Parliament and of the Council 2014/59/ES. Art. 2 (35).

150 For the purposes of this dissertation, *the real economy* is understood as highly interrelated phenomena - economic production and consumption of goods and services, developed in a certain economy. Additionally this term is associated with exposure to the financial markets. EBA. *Supra* note 148. P. 5.

151 Hüpkes E. *Supra* note 3. P. 3. Theissen R. *Supra* note 104. P. 30-33. Haan J., Oosterloo S., Schoenmaker D. *Supra* note 62. P. 204-211. Gleeson S. *Supra* note 113. P. 4-6.

question arises whether banks should be treated different from entities operating in other sectors of economic activity? It is also important to examine this issue in view of the fact that special bank insolvency regulation is primarily based on the exceptional importance of banks for the national economy.

The doctrine is consistent on the fact that the banks are the most widespread financial institutions¹⁵² in the world and perform multiple functions. Banks provide vital services for individuals, family farms, businesses, public institutions, governments and the economy as a whole¹⁵³. These services manifest in many forms, such as deposit collection and storage¹⁵⁴ for commercial purposes, lending¹⁵⁵, i.e., supplying money to the market in the form of loans, bank guarantees¹⁵⁶ and other financing activities. There is no doubt that for depositors and borrowers banks are extremely important as financial intermediaries. For example, banks provide financial risk management services to their customers and help ensuring their financial risk, such as interest rate or currency risk¹⁵⁷. In addition, banks are critical because they handle the smooth functioning of the state's payment system¹⁵⁸. Banks also provide unique services to their customers, such as foreign currency exchange, or trade in precious metals¹⁵⁹, international orders and other international transactions, control and administer the funds and savings of both ordinary customers, businesses and public institutions¹⁶⁰. It follows that banks are different from ordinary business entities also by reason of particular, prudential regulation, such as requirements with regard to their structure¹⁶¹, specific licensing, supervision of operation, specific financial statements, accurate auditing¹⁶², etc.

152 Bliss R.R., Kaufman G.G. *Supra* note 75. P. 3.

153 Gleeson S. *Supra* note 136. P. 6.

154 Deposit safekeeping does not imply that deposits are directly kept in storage. Safeguarding is a duty undertaken by the bank and the obligation to repay the same equivalent of cash or securities to depositors, persons confident that the bank will pay and return the assigned assets in full on the depositor's demand. Deposits are mainly used to finance other bank customers' loans.

155 Most of bank loans amount from 25 to 75% of total bank assets. Gleeson S. *Supra* note 136. P. 6.

156 When a bank (the guarantor) undertakes to pay a determined sum of money to the debtor's creditor on creditor's demand.

157 Boonstra W.B. *Supra* note 84. P. 4.

158 It is crucial that the payment and settlement system operates smoothly, continuously and operationally in each country. The payment system is a method used to carry out the payment. It can take the form of an insignificant cash payment and complex international electronic networks. Kancerevyčius G. *Finance and Investments*. 3 edition, Smaltija, Kaunas, 2009. P. 330.

159 Bauen M., Rouiller N. *Supra* note 39. P. 5.

160 Theissen R. *Supra* note 104. P. 30-33.

161 For example, according to the requirements of the Lithuanian Law on Banks, commercial bank shall have the following bodies in place: the General Meeting, the Supervisory Board (note that in addition to the general competence provided for in the Law on Companies, the competence of the Supervisory Board is also distinctive: approval of the action plan, ensuring adequate internal control, setting the procedures for lending, which can take place only after the approval of the bank's supervisory board, etc., issues referred to in the articles of association), the Board, the Chief Executive Officer. In addition, a commercial bank is required to have a system of internal control and an internal audit service, permanent loans, internal audit and risk management committees. Republic of Lithuania. Law on the Bank of Lithuania. Official Publication Valstybės žinios. 2004, No. 54-1832. (recast) 2014-08-05. Art.30-36.

162 Bauen M., Rouiller N. *Supra* note 39. P. 51-54.

Conventional bank business models differ from traditional corporate entities also due to the nature of the assets disposed by the bank¹⁶³. According to their nature, bank assets are based on long-term value (mainly banks provide long-term credits to loan recipients), but funded by short-term deposits¹⁶⁴. Liabilities of the bank, for example, towards depositors, are temporary and must be discharged immediately and without interruption, on demand. However, the majority of the bank's capital is accumulated by collecting contributions from depositors, giving rise to the unique protection of the depositors' rights¹⁶⁵. It should also be noted that banks have high standard of liquidity commitments¹⁶⁶. Moreover, banks remain the primary source of funding (and hence securing liquidity and financial flows). To guarantee the supply of liquidity to the market, banks have certain competitive advantage over other financial institutions. Banks also have developed information technologies, which are designed to monitor the borrowers in order to reduce information asymmetry between the creditor and the debtor¹⁶⁷. In some cases bank customers attempt to borrow money directly from the bank as their primary source of business financing, or from financial markets by issuing shares and/or debt instruments and they therefore rely on bank intermediation and advice. Thus, supply of liquidity, customer tracking features and specialised knowledge (human resources) allows the banks to acquire a strong position not only on the loan granting market, but also execute modern capital market transactions, such as securities underwriting, trading and derivative transactions¹⁶⁸. Finally, banks must be able to manage the investment portfolio to avoid liquidity risk for the bank¹⁶⁹. Banks provide direct and indirect credit and liquidity services to the market (as a source of money), which is the basis for efficient functioning of a market economy.

Another significant qualifying factor is that some banks are directly related to the entire banking system and the implementation of national monetary policies (usually this process takes place in collaboration with the government). The recent financial crisis has confirmed that when faced with solvency problems, banks inevitably encounter additional political and legal risks. Politicians can very easily lead to unexpected, secondary, negative consequences associated with the financial situation of a particular bank, especially related

163 Kaufman G.G. *Too big to fail in banking: What does it mean?* Journal of Financial Stability, Vol.13, 2014. P. 217.

164 Haan J., Oosterloo S., Schoenmaker D. *Supra* note 62. P. 204.

165 When a bank is facing financial distress and in order to avoid direct bank liquidation (bankruptcy) with the help of a bank resolution tool, the bank's assets and deposits can be swiftly transferred to other solid banks operating in the system. The key purpose of a DGS is to protect depositors against the consequences of insolvency of a credit institution. DGSs should primarily be used to repay depositors. Directive 2014/C/ 105/01 of the European Parliament and of the Council on Deposit Guarantee Schemes Adopted by the Council on 3 March 2014 (recast). Recital (14). The contract between the bank and the depositor has long been regarded as a debtor and creditor agreement. *Foley v Hill* [1848] II HLC, 27 1002.

166 The most common example is that of a bank deposit together with loan portfolio, i.e. certain assets which are often difficult to sell in the short term and which are characterised by longer term of demand.

167 Haan J., Oosterloo S., Schoenmaker D. *Supra* note 62. P. 204.

168 *Ibid.*

169 Boonstra W.V.B. *Supra* note 84. P. 4.

to escalating the financial situation of a particular bank¹⁷⁰. They are often “keen” to protect the banks and the financial stability of the banking system, but without explicit knowledge or reliable information they often disinform the society, attempting to initiate urgent and poorly prepared, “politicised” legislative proposals or solutions.

Banks could be distinguished from other business entities for particular legal consequences associated with determining bank insolvency conditions and general bank solvency risk management, especially with increased systemic risk¹⁷¹ (also known as systemic crisis or contagion effect in the scientific literature and some legal acts)¹⁷². This ba-

170 The most popular example is a case in Lithuania, and the findings reached by the Lithuanian Parliament. The findings included a ‘hypothetical’ approach of the interim parliamentary investigation commission and the analysis of the draft resolution adopted by the Parliament. It was found that the explanatory meeting of 30 May 2012 of the interim parliamentary commission investigating the efficiency of supervision of commercial banks operating in Lithuania and the situation of the bank ‘Snoras’ undergoing bankruptcy, in accordance with Article 10(1) of the Statute of the Seimas of the Republic of Lithuania and Article 7(2) of the Law of the Republic of Lithuania on interim parliamentary commission, was regarded as not having taken place, the minutes No. LK-26 of the meeting was declared illegal, and the findings were not adopted. The legal force of such parliamentary commissions is questionable, as they submit legally undefined findings having no legal effect. 2012, June 27th, Seimas Commission on Ethics and Procedures, Conclusion No. 101-I-25.

171 Concerns about systemic contagion are equally valid for depositors, borrowers, other creditors, and the entire payment system. The legal doctrine describes ‘contagion’ as a social phenomenon, whereby as soon as one bank goes bankrupt, depositors begin to interpret its insolvency as a sign of the enduring financial difficulties across the entire financial sector. Such a situation may accordingly result in an adverse response and the immediate deposit withdrawal from other banks operating in the country. In this case, the panic regarding the distressed banks generates very high costs. This phenomenon can also lead to recession and cash shortage in the market, reduce lending, which could cause severe injury to the relevant economy, especially for small and medium-sized enterprises. *See more* 1 chapter 6 sec. Marinč M., Vlahu R. *Supra* note 76. P. 23.

172 A few relevant examples should be highlighted. First, information about the financial situation of the bank ‘Snoras’ and certain leaks of this information were an unexpected factor in Lithuania’s financial system. This prompted instant reaction of the supervisory authority. After the article in the newspaper ‘Lietuvos Rytas’ (entitled ‘The President ordered to destroy Lithuanian capital-based banks’), the liquidity situation of the bank ‘Snoras’ was developing rapidly. Until today there is no answer to the question who leaked the information. The General Prosecutor’s Office initiated an investigation on the possible leaks of privileged information about the bank ‘Snoras’ in relation to the possible abuse of office, after obtaining information from the Department of National Security on the results of the investigation requested by the Prosecutor General on 17 November 2011. Also, the investigation was initiated after the news publication of the daily newspaper ‘Lietuvos Rytas’ regarding the financial difficulties faced by the bank ‘Snoras’ financial difficulties. The second example relates to Bulgaria. In 2014, several Bulgarian banks found themselves at the threshold of insolvency, after six people were arrested for disseminating ‘misleading information’ on the situation of the country’s financial institutions by technological means. The messages were distributed on the internet and mobile phones, stating that the Bulgarian ‘First Investment Bank’, the third largest in the country, and ‘Corpbank’ experience severe financial difficulties and are in default. The rumours instigated panic in Bulgaria, customers gathered at the bank doors to withdraw their money as soon as possible. A serious threat appeared to systemic risk. The government tried to calm the depositors down by announcing that the banks were sound. But this was insufficient. Deposit withdrawal continued, and the Bulgarian Government announced that the EU approved EUR 1.7 billion credit line to settle the tensions in the banking system. *See more Supra* note 170. Business news. Finance. *Banko griūtis - Bulgarijoje, vertinimai - Lietuvoje*. 2012 03 02. [interactive]. [accessed on 02-11-2014] <<http://vz.lt/article/2014/8/10/banko-griutis-bulgarijoje-vertinimai-lietuvoje>>.

sically means that insolvency problems at one bank can lead to depositors running to other banks, which can accordingly destabilise the country's financial system and even affect banks operating in other countries. Therefore, in all cases of bank insolvency it is vital to maintain public confidence in the entire banking system. In the absence of trust, a systemic banking crisis may begin shortly. In addition, bearing in mind the fact that, along with the processes of globalisation and technological progress, the world has an accelerated access to information and now it spreads very quickly. Information related to the bank's financial problems may also spread very quickly. It can affect systemic contagion of the financial system, as even without checking the information, individuals may assume that other banks face similar financial difficulties and insolvency risks and, for example, may start withdrawing deposits, conclude no new business transactions, etc.

Following the practice of traditional insolvent banks in different jurisdictions, which was intended to provide effective legal regulation of bank insolvency, the IMF and the WB study¹⁷³ argues that bank insolvency may cause much more extensive negative legal consequences than standard cases of business entity insolvency. It can cause social expenditure¹⁷⁴, the use of public finances to restructure or rescue banks, as banks are often the primary public entities and other fund savings, and indeed a crucial source of credit for the entire economy. In addition, it can be said that the public interest also manifests in the need to take into account indirect costs associated with the decrease of lending in a given country, lower economic growth, higher unemployment and lower investments¹⁷⁵. As discussed in other sections¹⁷⁶ in more detail, bank resolution regime can be seen as a premise for cost and benefit optimisation. That thesis is primarily based on the fact that the reorganisation of a bank allows continuing its operations while maintaining the going concern assumption.

Banking activities, as well as other business activities, are associated with risk-taking, but in particular circumstances excessive risk taking inevitably affects the entire financial system to a significant extent, thus banking risk could be compared to the public interest¹⁷⁷. Both lawyers and economists and most lawmakers consider that financial stability is in the public interest. Moreover, the banking crisis can develop very quickly, and bank assets can soon lose their value, while depositors can start withdrawing their savings. As long as banks perform distinctive and exceptional economic functions in the society and the legal system, bank insolvency procedures remain under the umbrella of the public interest to have a sound banking system and smoothly operating banks. Banking activities

173 IMF, WB. *Supra* note 86. The research involved 17 jurisdictions and 6 independent experts, including, but not limited to, the investigation of the relevant jurisdictions. P. 75-76.

174 See the empirical study on more detailed costs incurred in the case of bank insolvency. Among other things, the study describes all of the largest interventions and bank resolution costs during the recent financial crisis. White P., Yorulmazer T. *Bank Resolution concepts, Trade-offs, and Changes in practises*. FRBNY Economic Policy Review, 2014. P. 3, 6. IMF. *Bank Resolution Costs, Depositor preference, and Asset Encumbrance*, 2013. No. WP/13/172. P. 4-7.

175 Dewatripont M., Freixas X. *Bank resolution: a framework for the assesment of regulatory intervention*. Oxford Review of Economic Policy, Vol. 27, No. 3, 2011. P. 413.

176 *See more* 2 chapter 3 sec.

177 Hüpkens E. *Supra* note 3. P. 5.

are mostly based on trust. Therefore, the public interest¹⁷⁸ concerned with the protection of banks determines that banks not only must comply with special legal regulation of bank insolvency¹⁷⁹ procedures, but also special prudential regulation and supervision¹⁸⁰. These rules assist in enhancing the smooth operation of the banks, and thus in assuring the safety of the public interest and bank solvency¹⁸¹. Among other things, it contributes to strengthening bank solvency requirements. The purpose of such regulation is to ensure that banks are optimally managed and that the regulatory system ensures compliance with the statutory requirements. The world has gradually come to an opinion that strict licensing of banking activities and the ensuing conditions of prudential regulation are only primary factors in order to protect against bank solvency problems (e.g., in ensuring adequate levels of capital ratio and proper bank management). Nevertheless, after repeated surges of global financial crises it finally became apparent that efficient bank management and market forces alone cannot ensure financial stability¹⁸². For this reason, it was necessary to establish qualitative criteria for bank insolvency procedures, in particular, in order to restructure the functioning part of the bank and to liquidate the inactive assets of the bank.

Prudential regulation has a dual objective: firstly, such regulation seeks to ensure financial security of banks and solvency of the financial system as a whole, and secondly, it is aimed at removing trade barriers and ensuring equal competitive conditions in the

178 Public interest in the context of financial services consists of several elements. Consumers always expect that the financial services industry is ready to provide reliable, high-quality services at attractive prices. Instability is inherent in market speculation, but the real economy must be protected from the most serious adverse consequences and instability in the financial sector. Therefore, many countries seek that the financial services industry operates profitably and is competitive internationally, as this significantly contributes to the state treasury, i.e. the 'pulse' of the society as a whole. Financial stability is aspired by every modern society. Public interest can be ensured with the help of reliable and predictable legal regulation. Kay J. *Narrow Banking: the Reform of Banking Regulation*. Centre for the Study of Financial Innovation, 2009. P. 3.

179 Hüpkes E. *Supra* note 71. P. 8-9.

180 The provisions governing initial bank capital and supervisory review. Prudential regulation of banks includes the following key elements: (i) the particular capital ratio regulations, which ensure that banks comply with the minimum own funds (equity) standard according to their risk level, in order to cover unexpected solvency losses (such as balancing the interests of firms that repackage loans into securities and other traded financial instruments, and the companies that invest in these securities or instruments (investors)). In order to fulfill this requirement, the bank must keep a significant part of its assets; (ii) certain limits on ill-founded bank risk-taking in order to promote certain lending concentration, for example, to restrict lending to people related to the bank, liquidity mismatches and the net assets in foreign jurisdictions; (iii) prudential standards must ensure that the bank will be able to fulfill its obligations to creditors and depositors without the forced sale of assets or another destructive method that helps to collect funds (liquidity requirements). Prudential regulation also includes bank accounting standards, including, but not limited to, asset valuation criteria, loan classification, and foresees binding provisions (to predict loan losses) and provisions for overdue interest (or even the suspension of their calculation). Theissen R.P. *Supra* note 104. P. 27-29. Boonstra W.V.B. *Supra* note 84. P. 2-3.

181 Traditionally, the aim of prudential regulation is to mitigate social costs by creating a variety of prudential measures, including deposit guarantee schemes, capital adequacy requirements, asset composition rules, fit and proper requirements for the bank staff, board members, senior management.

182 Hüpkes E. *Supra* note 3. P. 11.

banking sector. However, the objective of prudential regulation and supervision is not to reduce the risk of bank insolvency to zero, as accepting risk forms an integral part of banking. In line with their chosen strategy, the banks are free to define their investment and lending policies that they consider to be the most appropriate. Thus, we conclude that prudential regulation is not designed to help avoiding insolvency of the bank¹⁸³. In all cases, the aim of prudential regulation is to minimise risk-taking *ex ante* in order to reduce the probability of bank insolvency.

Another distinctive feature of the public interest is the interaction between bank insolvency and bank liquidity ratio. As mentioned above, the banks operate on the financial market also as liquidity providers, and thus supervisory authorities seek that the banks comply with the minimum safety and risk requirements. One of such requirements is capital adequacy. Financial institutions usually entail very high level of financial leverage, i.e. they finance their assets mainly from debt (liabilities) rather than from equity. The recent financial crisis has revealed quite clearly the importance of bank liquidity dilemma. Whenever a bank is confronted with solvency problems, its capital acts as a “buffer” of loss. This is due to the fact that when faced with distress problems, banks can still borrow from the central bank, which means, in essence, that central banks of many countries still hold the role of lenders of last resort¹⁸⁴. Inability to achieve liquidity requirements could lead to potential bank insolvency even in the case where bank assets exceed its liabilities comparing with a whole healthy asset, i.e., the bank becomes insolvent because it is illiquid. Inability to carry out its obligations towards the creditors on demand often results in insolvency of financial flows. At the same time, a bank is insolvent also from the perspective of the balance sheet test, if it would be allowed to remain in operation even after facing liquidity problems. Thus, drawing the line between bank illiquidity and bank insolvency is extremely important in legal terms, and it is very difficult to identify during the banking crisis¹⁸⁵.

Banks are still the primary “players” of the financial system and provide liquidity not only to households, businesses, but also to other financial and public institutions. Recently banks have expanded their business from traditional forms of lending to transactions carried out in a modern capital market, thereby retaining their position in the financial system. Greater consistency and efficiency of the central operational functions of a bank and financial solvency essentially means better services provided by banks in the field of financial intermediation, which accordingly leads to a better match between the interests of depositors and investors with all the ensuing positive economic indicators.

183 Lawmakers realised that even very high capital requirement may be insufficient in the case of a banking crisis. Avgouleas E. *Breaking-up Mega-banks: a New Regulatory Model for the Separation of Commercial Banking from Investment Banking*. Financial regulation at the Crossroads: Implications for the Supervision, Institutional Design and Trade. Wolter Kluwer, Netherlands, 2011. P. 198.

184 Over the past two centuries, this role has been developed with the assistance of the CB. Such legal regulation is dedicated to ensure that banks experiencing temporary liquidity problems and the associated financial difficulties may receive financial support on a temporary basis. *See more* 3 chapter 1 sec. 1 subsec.

185 *See more* 1 chapter 7 sec.

1.3. *Lex generalis* or *Lex specialis*. Why General Insolvency Law is Unsuitable for Banks?

The importance of insolvency law has expanded into various economic sectors, including banking. Despite the globalisation of business, national insolvency law remains an important branch of the law for the entire market economy, although international unification of insolvency law is still lacking both in terms of procedural and substantive insolvency law¹⁸⁶. Effective insolvency procedures serve for the predictability and legal certainty of the outcome of such procedures. Accordingly, market participants want to acknowledge the outcome of their outstanding claims or pledged property in advance, whenever the borrower becomes insolvent. Legal rules governing bank insolvency diverge from general insolvency law in many respects. Some of the reasons for this are worth examining.

Perhaps the most serious economic reason is that if regulated by the general insolvency law, bank insolvency procedures fail to prevent the risk for the global economic system spreading over the counterparties of an insolvent bank¹⁸⁷. The recent banking crisis revealed very clearly the intimate relationship between finance, banking stability and security of the real economy. Therefore, smooth and operative market exit of insolvent banks unable to meet the requirements of supervisory authorities is necessary for the efficient financial system¹⁸⁸. Bank insolvency may lead to certain legal challenges and problems for the entire legal system of the country. It requires specific legal requirements and regulations laid down by law in order to mitigate the ensuing consequences. If competent authorities had no specific legal measures at their disposal to solve the problems of insolvent banks, they would have to rely on general insolvency law only, and it is highly likely that the response and intervention in the bank would be overdue or would have a destabilising effect¹⁸⁹. Intervention must be based on pre-regulated rights and predictable and foreseeable procedure enabling the competent authorities to respond as soon as faced with the first signs of deteriorating financial situation of a particular bank. The recent banking

186 The original meaning of insolvency law is to resolve the core issue of competing priorities, as in the context of limited resources only a part (usually a small part) of creditor claims may be satisfied. It is important to ensure that if the borrower is no longer able to meet their obligations, the debtor's assets are used to the maximum extent to meet the financial requirements of the creditors. Peter H., Jeandin N., Kilborn J. *The challenges of insolvency law reform in the 21st century*. Shulthess, Basel. 2006. P. 11.

187 For example, if a counterparty fails to absorb fund shortages caused by the bank's failure to fulfill its contractual obligations, such as foreign exchange contracts, repurchase agreements, contractual relations arising from securities trading, swaps/options, futures or forward transactions, this can result in non-compliance with the obligations towards other banks, and other cases of default, also threaten the stability of the entire financial system.

188 BCBS. *Basel Core Principles for Effective Banking Supervision*. Principle 22, 2012 [interactive]. [accessed on 12-10-2014] <<http://www.bis.org/publ/bcbs230.pdf>>.

189 The current crisis has demonstrated the need for early and comprehensively quick intervention by the competent authorities and the need for such an intervention as long as the bank is still solvent. In addition, the financial crisis has revealed that when systemically important banks face the risk of insolvency, general insolvency procedures fail to meet the general public interest objectives because critical economic functions, such as collection of deposits and lending, are lost. Prior to the recent financial crisis, governments lacked the necessary legal measures and straight liquidation was not a promising option, and they were therefore forced to give large sums of public finances in order to rescue banks from insolvency and thus avoid significant damage to the whole economy.

crisis has shown that bank insolvency problems need to be addressed promptly – typically over the weekend – and in a way that would allow banks to continue their essential operations and minimise future restructuring and/or liquidation costs of the bank. Given that bank insolvency problems are attached to public interest¹⁹⁰ objectives, after analysing foreign legal doctrine the following reasons support the conclusion that *lex generalis* is inappropriate for dealing with bank failures¹⁹¹.

General reasons:

- *The genesis of inclusion of particular legal rules in legislation.* In the most EU Member States, the *lex generalis* rules of general insolvency law were applicable to banks before the financial crisis¹⁹², whereas *lex specialis* existed only in more exceptional cases¹⁹³. The inception of special legal rules in the EU legal order can be related to the legislative project of the Banking Union.
- In contrast to many European lawmakers who regularly applied general insolvency insolvency rules to banks, already in 1857 the US Congress adopted special bank insolvency regulation and procedures applicable to national banks at the federal level (state banks fell outside this scope)¹⁹⁴. In addition, in parallel with the federal bankruptcy law, the majority of the US states adopted state laws aimed at more efficient banking supervision and resolution of banks in distress¹⁹⁵. Therefore, already since the nineteenth century the US Bankruptcy Act was applied to banks with certain provisions designed for solving problems faced by banks in distress. More comprehensive and consistent legal rules governing bank insolvency mainly came into existence only after creating the deposit insurance system, when more than nine thousand banks (one-third of the banking industry) were declared insolvent during the Great Depression¹⁹⁶. In 1933 FDIC, a public authority acting as a receiver of insured insolvent national and state banks was granted exclusive rights with respect to bank insolvencies¹⁹⁷. Only the

190 For example, the Lithuanian Supreme Court has noted that the financial sector, which includes a significant part of the banking industry, is one of the most sensitive sectors, and its situation can significantly influence national economy, population and confidence of economic entities in the domestic financial system and the sustainability of this system. Therefore, it is necessary to allow proper and timely implementation of financial system stability measures. These legal provisions show that the stability of the financial system is in the public interest, and strict compliance with loan terms, depending on the specificity of the crediting business, has an essential value. Judgment of the Lithuanian Supreme Court of 20 February 2012 in civil case No. 3K-3-58/2012.

191 Lastra R.M. *Cross-border bank insolvency*. *Supra* note 74. P. 34-37.

192 Garcia G.H., Lastra M.R., Nieto J.M. *Bankruptcy and reorganization procedures for cross-border banks in the EU: Towards an integrated approach to the reform of the EU safety net*. LSE financial markets group paper series, 2009. P. 11-17.

193 In exceptional cases the UK, Germany, and the Netherlands were the first EU Member States that revised their regulation in the light of the financial crisis, by adopting special legal rules governing bank insolvency. Hüpkes E. *Supra* note 3. P. 6-7. Schillig M. *Supra* note 47. FSB. Thematic review on resolution regimes. Peer review Report. 2013.

194 Swire P.P. *Supra* note 9. P. 478-481.

195 *Ibid.* P. 479.

196 FDIC. Chapter 7. The FDIC's Role as Receiver. P.2. [interactive]. [accessed on 20-11-2014] <<https://www.fdic.gov/bank/historical/reshandbook/ch7recvr.pdf>>.

197 Hüpkes E. *Supra* note 3. P. 8.

creation of the FDIC gave rise to special legal rules governing bank insolvency procedures, whereas bank insolvency law became a topic of legal interest and a subject in legal science¹⁹⁸. In addition, in 1991 the United States included a new chapter in the Bankruptcy Code designed for bank insolvency procedures, in particular by extending its scope to state banks, and by creating the new framework for regulating prompt corrective action, together with the relevant amendments of the federal deposit insurance legislation. Additional powers were granted to FDIC¹⁹⁹, by separating FDIC legal functions in the field of deposit insurance and administration and by establishing new rights and obligations. Particular bank resolution measures were adopted (such as sale of business, asset separation, bridge bank) with the key objective to maximise the assets of bank creditors and to minimise any loss to the Deposit Insurance Fund. Eventually, on 21 July 2010 legal rules governing bank insolvency were revised once again and the Dodd-Frank Act²⁰⁰ entered into force, bringing a very significant change with it. The main purpose of the Act, by avoiding rescue of the distressed banks with taxpayers' money, new rules were adopted for insolvent banks and non-bank financial institutions, with the task to solve systemic risks problems mostly created by large banking groups or systemically important financial institutions, which accordingly threatened the stability of the entire financial system²⁰¹. Among other things, the said Act created a new orderly liquidation institution²⁰² whose provisions had priority over the Bankruptcy Code and other applicable bankruptcy laws, in order to restructure and/or liquidate a bank.

- In 1934 Switzerland created its first federal banking law. The Federal Council came to the conclusion that banks required special legal regulation in view of their status as a “public service provider” and that the country’s economic growth depends on the amount of capital banks can attract for investment²⁰³. However, special legal regulation of bank’ bankruptcy and restructuring accelerated only in 2003 when the lawmakers found considerable flaws in the existing Swiss bank insolvency law and resolution procedures. In 2003, the Swiss Parliament passed amendments to the banking laws²⁰⁴ and designated a special Chapter 11 for legal measures (aiding to combat bank insol-

198 The main reasons for bank insolvency regulatory reforms were massive deposit withdrawal scenarios, depositor irrationality, excessive commissions of administrators and a tendency to delay insolvency procedures as long as possible. In addition, the insolvency administrator was normally appointed by politicians. Bank insolvency procedures lasted for an average of six years. However, in some cases they took as long as 21 years. Even after depositors recovered part of their claim, that part was significantly lower than the original claim. Creditors were able to recover only 58% of the claim in average. Therefore, a need arose for the government to rebuild trust in the banking system. *Supra* note 192. P. 3-4.

199 For example, to close a bank after finding insufficient level of the bank’s assets and pending obligations, and identifying unsound and unreliable banking conduct, or potential losses that could deplete the bank’s capital, etc. Bliss R., Kaufman G. *Supra* note 75. P. 46.

200 This legislation essentially aims to balance the objectives of bankruptcy and consumer protection laws, by at the same time maintaining and protecting financial stability and public confidence. Dodd-Frank Act § 1021. Codified 12 U.S.C. § 5511. July 21, 2011.

201 Marinč M., Vlahu R. *Supra* note 76. P. 116-117.

202 Dodd-Frank. Title II, Section 201.

203 Swiss Federal Banking Commission. *Supra* note 42. P. 5.

204 Swiss Federal Law on Banks and Saving Banks of 8 November 1934, RS 952.0.

gency issues) and Chapter 12 for regulating bank liquidation procedures. Special bank insolvency law came into force on 1 June 2004. A year later, a new piece of secondary legislation governing bankruptcy of banks and securities dealers was approved²⁰⁵ (hereinafter-Swiss Ordinance). Ultimately, the new banking legal provisions on deposit guarantee schemes together with Swiss banks and securities brokerage law entered into force in 2006²⁰⁶. Nevertheless, the main legal acts on bank insolvency were revised in 2011 and 2012. This resulted in new bank resolution rules and regulations, reviewing the specific requirements for SSFI, etc. Secondary bank insolvency legislation has also been changed accordingly only at the end of 2012, combining bankruptcy and resolution procedures in order to establish efficient and coherent legal regulation²⁰⁷.

- *Specific financial arrangements associated with bank loss-absorbency.* At the international level, it was decided²⁰⁸ that, in view of insurmountable consequences of the financial crisis, particular bank insolvency procedures must be financed by the banking industry and not with taxpayers' money. Therefore, in the context of international reforms, in some cases it was necessary to finance the resolution of banks by industry funds and to create special financial arrangements (funds) that could assist in reducing the costs of failing banks imposed on taxpayers. Such financial arrangements, such as the creation of the resolution fund, contributions to the latter from the industry were outside the scope of general insolvency law. It is crucial to sustain predictable, steady, clear and potential bank distress solutions, rules and legal instruments on the market where the bank operates, particularly at the time of the banking crisis. The purpose is to prevent bank bailouts using taxpayers' money and this common objective is most often outside the scope of general insolvency law. In addition, decisions regarding the future of an insolvent bank must not only be made swiftly, but also the consequences need to be predictable, by avoiding surprises. Therefore, it could be recognized that national leaders and authorities unkeen to adopt crucial decisions would feel more supported and encouraged if they refuse to rescue banks using public finances and taxpayers' money. Especially if they acknowledge the consequences of possible actions in advance and at the same time feel more secure with regard to the decisions that they make.

Until the recent financial crisis and regulatory reforms relating to the shifted paradigm of bank insolvency law, the substance and procedures of the laws and other regulations governing bank insolvency differed significantly²⁰⁹. In addition, after analysing the historical evolution of special legal rules in particular jurisdictions relevant for the research, it

205 Swiss Federal Banking Commission Ordinance on the Bankruptcy of Banks and Securities Dealers of 30 June 2005 (Bank Bankruptcy Ordinance, RS 952.812.31). (recast of 1 January, 2015). Chapter 1.

206 Swiss Federal Ordinance on Banks and Savings Banks of 17 May 1972 RS 952.02.

207 FSB. Thematic review on resolution regimes. Peer review Report. 2013. P. 45.

208 See more 1 chapter 5 sec. 1 subsec.

209 Institution of ordinary bankruptcy proceedings and bank liquidation may pose the following risks: (i) endangering financial stability; (ii) cancellation of critical banking functions; (iii) affect depositor protection to a certain extent (e.g., in the case of uninsured depositors); (iv) breach of the public interest, as it is controversial whether bank resolution rather than liquidation better suits the public interest. This idea is based on the fact that in the face of insolvency, a failing bank should first and foremost be rescued through restructuring measures, by trying to save the bank from failure as an entity able to continue its activities, by using private funds to the largest extent possible, e.g. bank sale or merger, write-off of bank's liabilities, conversion of debt into securities.

can be assumed that, except for the US, complete, unique legal rules for governing bank insolvency procedures have appeared quite late, already after the start of the international financial crisis. At the same time, *a priori* there is no reason to disapply general insolvency law for banks. Normally, most aspects of bank insolvency procedures, such as property assessment and collection arrangements, validation of creditors' claims, decisions related to controversial claims and their recognition, asset allocation procedure of an insolvent entity in standard bankruptcy proceedings are regulated in a similar manner as in the case of other conventional enterprises. This presumption is opposed by the arguments set out below.

Procedural reasons:

- *The need for swift decisions.* The expectations of depositors, financial markets and the public after a particular bank faces distress are linked to a prompt solution of problems faced by a bank that is failing or likely to fail soon, especially in the case of insolvency of a systemically important bank. Interested parties expect that the competent authority will adopt a decision on the bank that is failing or likely to fail within a few days or even over a weekend. Therefore, clarity and legal certainty are crucial factors to reassure stakeholders and ensure the stability of the financial system. Faced with the need for adequate bank insolvency solutions, courts have difficulties in achieving a positive outcome based solely on general insolvency law²¹⁰. As in the *Lehman* bankruptcy case, it is very likely that in the case of bank liquidation the courts will face the requirement to sell nearly all of the viable assets of the failing bank in the first days after submission of the petition²¹¹. Such a requirement is often based on the fact that the value of bank assets may fall drastically in a few days, if the ambiguities regarding the distressed bank subsist. Even the insolvency of one large bank could lead to a systemic crisis²¹². Consequently, according to the general legal rules governing insolvency, ordinary restructuring of a business entity under general insolvency law, e.g. the procedures for acquiring debtor's assets often take much longer. In this case, in accordance with general insolvency law, a bank facing financial difficulties will first be required to prepare a recovery plan and then seek the consent of the persons concerned and the creditors. In all cases, the application with regard to the sale of the debtor's (the bank) valuable assets to third parties in the first few days would be delayed, depending on the individual restrictions of general insolvency law in most jurisdictions. For example, under German or Lithuanian general insolvency law, application for the sale of assets also requires the consent and approval of the creditors' committee before the court starts examining insolvency procedures. Creditor resolutions may be disputed in court, which complicates the decision-making process. Rare exceptions exist, however. For example, in the *Lehman Brothers* bankruptcy case, the judge was able to approve and authorise the administrator performing the sale of the assets of the entity in bankruptcy, based on the restrictions placed on the powers of the court within the context

210 See more 3 chapter 1 sec. 4 subsec.

211 The sale offer in the bankruptcy proceedings of Lehman Brothers Holdings Inc., 17 September 2008, (Docket No 60) was submitted only when two days have passed after the commencement of bankruptcy.

212 Lehman Brothers Holdings Inc., dated 17 September 2008, (Docket No. 60). The SIPA Liquidation of Lehman Brothers Inc. James W. Giddens, Trustee [interactive]. [accessed on 10-12-2014] <<http://www.lehmantrustee.com/>>.

of the general Bankruptcy Code. The judge approved the sale of the debtor's assets, despite the fact that it would predetermine any subsequent solution for bank recovery plan and potentially reduce the possibilities for private individuals to object the decision. The judge based his judgment with regard to the sale of property on the existence of "urgent and necessary circumstances of the case"²¹³ outside the limits of general insolvency law. It was found that the debtor's assets would otherwise inevitably lose their value and will lead to irreparable damage, if such a request was unsuccessful and remained unimplemented swiftly. The restrictions of asset sales or of continuous economic and commercial activity of the bank faced with financial difficulties in the case of bankruptcy lead to certain limitation of procedural rights held by the creditors, as their consent is no longer required. In addition, creditors often tend to lose their opportunity to appeal against the decision and raise objections with regard to the sale (veto right) within a reasonable period.

- *Outstanding financial stability objectives.* General insolvency law is not adequate to meet and reflect the importance of financial stability. The main purpose of general insolvency law is to fulfil creditor claims to the maximum possible extent, in view of the legally mandatory hierarchy of creditor claims. Therefore, the fundamental features of general insolvency law seem to run counter the features of the legal regime governing bank resolution, by prioritising creditors (for example, creditors without a collateral, or depositors) in order to avoid massive deposit withdrawal from banks. The aim to maximise the compensation of creditors' claims is determined by macroeconomic factors²¹⁴ and the necessity to maintain financial stability and to prevent the spillover effects of financial risks, which may occur due to lack of confidence in banks (the domino effect). General insolvency law gives no opportunity for banks to continue with their vital services, thus providing the legal opportunity to terminate a part of the bank's operations in the event of liquidation, as according to the general insolvency law, all of the obligations are suspended after the application to initiate bankruptcy proceedings is accepted. General insolvency law procedures that existed at the time of the recent bank crisis were aimed at direct liquidation of the debtor, by liquidating the assets, therefore leading to the inability to guarantee the continuity of only certain parts of the debtor's business, as this may increase creditors' losses.
- *Bank asset sales procedure.* The primary objective of general insolvency procedures is to provide a legal „plan“ to distribute the debtor's assets to the creditors. Then, the creditors or the bankruptcy administrator determines ways to distribute the assets of the debtor (usually on the basis of a quorum of creditors, at the creditors' meeting or committee). The asset allocation procedure may take place only in a particular situation, under a pre-planned bankruptcy strategy, based on creditors' approval. Most often the liquidation procedure works by submitting the draft resolution for creditors' approval. Consequently, it allows only predictable bankruptcy, according to the strictly

213 See more. United States Bankruptcy Court. Case No. 08-1420 (JMP). SIPA Liquidation Proceeding. Lehman Brothers Holdings. The Sale order, dated 20 September 2008. Docket No. 258. Case No. 08-13555, Case No. 08 -01420. [interactive]. [accessed on 10-12-2014] <<http://www.lehman-docket.com/>>.

214 See more Savona P., Kirton J., Oldani C. *Supra* note 129. P. 37-51.

defined procedures²¹⁵. Meanwhile, in the case of bank insolvency, legal bank resolution measures and tools play an extremely important role, which should be predictable in their structure and content. Only the statutory procedure governing bank asset sales process allows performing predefined and predictable asset sales²¹⁶.

- *Setting the threshold for bank failure.* In all cases, in determining the insolvency of a certain bank, it requires actions and appropriate decisions of the supervisory authority. Which is why general insolvency law seems defective and not always suitable for determining the triggering event of bank insolvency. Different methods, conditions, qualifying criteria concern determination of insolvency, and the legal consequences arising from the determination of insolvency. In contrast, legal regulation governing bank resolution is associated with particular insolvency procedures designed to solve bank solvency problems in view of the particular features of banking activity, by granting legal measures outside the limits of general legal rules governing company insolvency and by avoiding direct formal bankruptcy procedures, which may generate adverse effects often caused by the termination of the activities of the bank or after its closure²¹⁷.
- *Different objectives of the general and special law.* The ultimate goal of special bank insolvency law procedures is to reduce the probability of the future banking crisis and to increase bank resilience to unfavorable economic conditions, at the same time taking into account the specific features of banks and their functional roles²¹⁸. Meanwhile, the major goal of the general insolvency proceedings is the maximum satisfaction of creditors' interests after liquidating the debtor's assets. The competent authority may delay liquidation of the distressed bank²¹⁹ by means of forced liquidation, but at the same time lack the specific legal measures at its disposal to reduce the losses resulting from the insolvency of a particular bank in the most effective way. The liquidation of a bank becomes practicable only if the resolution measures of an insolvent bank are unable to efficiently address the distress problems encountered by the bank, allow maintaining depositor confidence in the stability and reliability of the banking system and otherwise protecting the public interest²²⁰. Many significant differences exist between general bank insolvency law and the special bank resolution regime. These differences will be clarified in the remaining chapters of the thesis, but at this point the most important ones should be mentioned, illustrating the examples based on the analysis of the US legal system.
- First of all, general bank insolvency procedures (reorganisation and liquidation) in accordance with the US Bankruptcy Code are different from bank resolution procedures in view of their purposes. The provisions of the Bankruptcy Code are designed to maximise the return from debtors to creditors or revive and rehabilitate the debtor, often

215 UNCITRAL Legislative Guide on Insolvency Law, 2005. P. 238-247.

216 EC. Brussels, 28.09.2008. C(2008) 5619. Merger Procedure article 7(3) Decision. Bradford&Bingley. Case No. COMP/M.5363.

217 See more 1 chapter 8 sec.

218 For more information on the objectives of the legal regime governing bank resolution see Part 2, Chapter 3.

219 For example, concerns about systemic contagion. Marinč M., Vlahu R. *Supra* note 76. P. 23.

220 Čihak M., Nier E., IMF. *Supra* note 15. P. 42.

without taking the potential impact on the third parties taking part in the insolvency procedures. Meanwhile, bank resolution procedures allow and sometimes even encourage public authorities to grant some advantage to certain classes of creditors (such as depositors) or external factors²²¹ (such as the impact on the economy and on the financial markets)²²². In addition to that, bank resolution procedures empower governments to take action to reduce the adverse impact not only on creditors but also on the wider economy²²³. Second, the special bank insolvency procedures should also be assessed taking into account the lessons learned from the recent banking crisis. At the international level, it was agreed that the government should not be forced to choose between two options that are equally unattractive: rescue of banks, even those holding the status of a systemically important financial institutions through public financing (bail-out), or initiation of disorderly liquidation. Instead, the government must have the legal tools to solve the financial problems of the distressed bank in a more robust way. Such a step serves to maintain market discipline by ensuring that not taxpayers, but shareholders and creditors will first suffer losses, and the management responsible for bank insolvency will be replaced, by mitigating the consequences on the general financial system of the potentially destabilising effect caused by the collapse of the bank²²⁴. Third, the essential difference between general insolvency law and special legal regime of bank resolution stems from the content of the bank insolvency process. For example, under the US Bankruptcy Code, bank liquidation and reorganisation is a judicial process, which primarily relies on the legal interpretation rules developed in the case law, by interpreting and construing the rules of the Bankruptcy Code. However, bank resolution procedures are developed and administered by administrative authorities, which have the capacity and the rights to fulfill and issue implementing secondary legislation supporting the implementation of primary legislation. The court may review such decisions taken by the competent authorities to the extent permitted by law. Moreover, the United States, where a legal precedent is treated as a source of law, case law decisions are mandatory for the administrative authorities²²⁵. The fourth fundamental difference relates to the financing of bank insolvency procedures. For example, Chapter 11 of the US Bankruptcy Code provides that bank resolution is primarily financed by using the debtor's assets, by withdrawing or converting the debt, which typically consists of private funding sources having priority over debtor's creditor claims arising prior to the opening of insolvency proceedings (such as administrative costs), or a prioritised judicial review²²⁶. The US Bankruptcy Code is also constructed so as to enable the debtor to continue its activities and timely restructure the debtor's obligations. Meanwhile,

221 Systemic risk exception may be a good example. 12 U.S.C. Section 1823(c)(4)(G).

222 Cohen R., Goldstein M. *The Case for an Orderly Resolution Regime for Systemically-Important Financial Institutions*, PEW Financial Reform Project, 2009.

223 See more. Catharsis K.F. *The real effects of bank insolvency and resolution*. *Journal of Financial Stability*, Vol. 16, 2015.

224 Bernanke B.S. Chairman, Board of Governors of the Federal Reserve System, *Remarks on the Squam Lake Report: Fixing the Financial System*, 2010. P. 9.

225 Board of Governors of the Federal Reserve System. *Study on the Resolution of Financial Companies under the Bankruptcy Code*, 2011. P. 4.

226 11 U.S.C. Section 364 (a)-(d). *See more* 3 chapter, 3 sec.

special bank insolvency law empowers administrators controlling the resolution procedures to grant funding for the process²²⁷. This financing gap can become extremely important in the case of a systemic crisis, where market confidence is weak, and the acquisition of funding from private sources is unlikely.

- Special legal rules serve to decrease the insolvency costs arising from bank insolvency. In the event of insolvency, the bank incurs charges that are much higher, compared to typical business entity insolvency costs²²⁸. Therefore, the state needs to produce accurate and detailed legal rules designed to regulate bank insolvency procedures and to reduce the costs arising from the insolvency of the bank. For example, according to some researchers, bank asset losses in the case of forced liquidation are vital and amount to almost 30% of the real value of the bank assets, which considerably exceeds the numbers in the case of bankruptcy of a regular business entity, which is not a financial institution (10 to 20% of property value)²²⁹. A similar conclusion can be drawn after analysing the case of the failed bank ‘Snoras’²³⁰. It should be noted that simply administrative and legal costs in directing liquidation procedures account for about 10% of the failed bank’s total asset value²³¹. In addition, bank bankruptcy procedures (liquidation) take considerable amount of time. Over time, until the assets are realised, their value decreases significantly. Among other things, the need for special rules and higher costs of insolvency proceedings is determined by very broad and specific range of reasons for bank insolvency. By way of illustration, several most relevant causes can be noted within the context of the research: unsustainable business models based on excessive debt and excessive reliance on short-term wholesale funding, excessive number of employees or overly exaggerated bank structure, weak-all risk management system, the lack of internal or external audit services, the cases of improper reflection of operations, especially those of the valuation of assets, in the accounting, loans to persons related to the shareholder, intentional criminal acts, etc.²³²
- *Special equity criteria and ratios*. The recent banking crisis pointed resulted in many bank insolvency cases, in particular relating to banks with capital deficiency²³³. Typi-

227 12 U.S.C. Section 1823 (c), Dodd-Frank Act Section 204 (d).

228 See more *Supra* note 28, 138, 170.

229 Marinč M., Vlahu, R. *Supra* note 76. P. 42-44.

230 The activity reports of the bankruptcy administrator of bank ‘Snoras’ show that during the three-month period only, e.g. up to 30 June 2013, the payments effected in the bank amounted to LTL 16.9 million, including LTL 6.4 million of operating costs, LTL 9.4 million (incl. VAT) of payments to consultants, etc. [interactive]. [accessed on 02-01-2014]. <<http://www.snoras.com/files/tinyMCE/files/LT%207%204%20-%20Annual%20report%20-%20FINAL.pdf>>.

231 Marinč M., Vlahu R. *Supra* note 76. P. 42-44.

232 EC. The information report. MEMO/12/478, 2012, June 22nd, Brussels.

233 In the light of the banking crisis, available capital was lacking both in quantitative and qualitative terms, and unprecedented support of national authorities was therefore required. States began to implement the new international bank capital standards, as agreed at the G20 level (the so-called Basel III requirements). It must be noted that Europe is one of the driving forces in this field, as it applies these rules for more than 8 thousand banks in Europe, which own 53% of the world’s assets. *Ibid*. See more Masera R. *Bank Capital Standards: A Critical Review*. Special Paper 215. LSE Financial Markets Group Paper Series. December 2012. P. 5.

cally, bank insolvency is not an abrupt matter, as there is an *ex-ante* stage²³⁴ prior to insolvency, starting with early supervisory intervention, when formal and informal measures are applied²³⁵. In contrast to companies, creditors have no right to initiate bank insolvency procedures. Most often a bank is gradually approaching insolvency, first by breaching certain legally established prudential requirements, no longer meeting capital requirements, which automatically requires intervention of the relevant supervisory authorities²³⁶ prior to the bank becoming insolvent. For example, if bank shareholders fail to increase bank capital to the required standards²³⁷ (or act formally rather than in terms of content), in this case, in order to maintain financial stability and confidence, a supervisory authority may suspend the activities of the bank and impose a moratorium and only then engage in active search for the most appropriate solutions to deal with the problems of an insolvent bank (e.g., “bad loans” solution²³⁸). Furthermore, various rules exist for calculating the capital as well as solutions to the problems²³⁹ (regarding “bank capital requirement test” *see more* at p. 152-155).

Above discussed development of bank insolvency legal regulation allows to state that the general insolvency law during the recent banking crisis were not sufficient to deal with failing or likely to fail banks effectively. In summary, it must be assumed that general insolvency law has two fundamental shortcomings when applied to the banks. First, it fails to concentrate on the financial system and the stability of its protection, and secondly, it

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- 234 Bank pre-insolvency stage is intended to reduce excessive bank risk-taking. The essence of intervention at this stage is that the regulatory authorities must have the powers to take specific measures in response to the rapid loss of market confidence, which could lead to the fact that certain banks will lose access to the short-term inter-bank lending market and the wholesale capital markets, which can appropriately increase systemic risk in the banking system. On the one hand, through the intervention of regulators, market-based solutions are still real. If the market solution is not possible, such as borrowing from financial markets, intervention may be the first step carried out by the competent authority or the central bank's takeover of a failing bank and the transfer of bank shares and other equity, including contractual rights and obligations to the state-controlled bridge bank or a private buyer. Next steps – typically a bank is declared insolvent and is being wound up, also, official administration procedures start. Alexander K. *Supra* note 79. P. 65-66. Marinč, Vlahu. *Supra* note 76. P. 37.
- 235 Hoelscher D.S. *Supra* note 2. P. 97.
- 236 The report of the Bank of Lithuania on the bankruptcy process of the bank SNORAS AB. [interactive]. [accessed on 10-02-2013] <http://www.lb.lt/seimo_posedyje_ab_banko_snoras_bankroto_proceso_apzvalga_1>. Unlimited risks, the bank's capital fails to support the required additional capital levels, unrestricted interest paid to non-professional market participants and so on. Irregularities in breach of these criteria are accordingly related to the sanctions of the supervisory authority applied to the bank.
- 237 According to Article 41(1) of the Law of the Republic of Lithuania on Banks. The authorised capital of the bank is created and reduced or increased in accordance with the Law of on Companies, if the Law on Banks does not provide otherwise.
- 238 Campbell A. *Bank insolvency and the problem of nonperforming loans*. Journal of Banking regulation, 2007, UK. P. 25-45. With the increasing number of ‘bad loans’, the cash flows received by the lender from periodic credit repayment decrease, so that the credit issuer (the bank) may fall short of resources and be forced to seek additional financial resources in order to properly discharge its liabilities (e.g. return funds to depositors); otherwise the bank itself could face the risk of insolvency.
- 239 Friedman J., Kraus W. *Engineering the Financial Crisis. Systemic Risk and the Failure of Regulation*. Capital Adequacy Regulations and the Financial Crisis: Bankers' and Regulators' Errors. University of Pennsylvania Press, US, 2011. P. 57-86.

intervenes behind time²⁴⁰. The legal doctrine analysed by the author has revealed that the recent banking crisis and the enduring general insolvency law applicable to the ordinary course of business were not adequate to accurately regulate banking crises. This position is based on the fact that, in addition to the above-mentioned special role in the economy, general insolvency law is not suitable for not reflecting the specific functions of the bank and the related public interest objectives. The insolvency case of the US investment bank *Lehman Brothers* perfectly revealed that phenomenon. Moreover, some other shortcomings were detected: firstly, the financial role and participation of the state in the rescue and/or restructuring of a failing or likely to fail bank was insufficiently regulated and, secondly, the legal regulation was inconsistent, or poorly developed, for example, without taking into account banking activities featured by administrative qualities. In the light of the analysis of the characteristics exposed by the relevant jurisdictions, it was necessary to review legal regulation governing bank insolvency. Such regulation should establish the legal regime for bank resolution that could provide a reliable set of legislative measures for public authorities to intervene quickly and early enough in the activities of a failing credit institution, in order to ensure the continuity of particularly important financial and economic functions of the bank and at the same time to minimise the economic effects of the collapse for the economy and the financial system. The main purpose of *lex specialis* is to ensure the distribution of losses to the shareholders and then to creditors, provided that creditors are not exposed to greater losses than they would have experienced if the bank had been wound up under standard bankruptcy procedures in accordance with the “least cost” or “no creditors worse-off” principle. In the context of reforms, improvement or development of specific legal norms, it was important to give broad powers to competent authorities in order to ensure, for example, constant access to deposits and continue payment transactions, in particular cases – to sell viable parts of the bank’s assets, and to foresee a clear and known-to-all hierarchy of different creditor claims (loss distribution) in advance. Therefore, special legal rules are essentially associated with the modern bank resolution regime. On the one hand, the creation of special bank insolvency law is based on a premise that it can help avoiding destabilisation of financial markets and minimise the costs for taxpayers, avoid destabilisation of financial markets during the banking crisis. On the other hand, *lex specialis* can produce both positive and negative effect and provide substantial benefits or losses for the state and for the society. Increasing stability of the banking industry, together with effective regulation of bank insolvency problems may induce economic growth and at the same time result in the opposite effect – insufficient, ineffective legal regulation may foster the banks to increase social costs to consumers in other forms, e.g. they will be less willing to lend money and/or will charge higher credit support (administrative) costs to borrowers: both enterprises and households. Moreover, otherwise, it may result in a situation where new and inefficient legal regulation may at least partially increase the risks related to banking activity. Other sections of the dissertation further investigate the success of creating a special regime for bank resolution and implementing international financial standards in other jurisdictions.

240 Hüpkes E. *Supra* note 3. P. 9.

1.4. Interaction of Insolvent Bank (s) and Public Interest

1.4.1. Historical Origins and Background of Bank Insolvency Procedures

As already explained, since the beginning of the recent financial crisis until now, regulation of bank insolvency procedures in the EU Member States but also in Switzerland and the US underwent turbulent periods. Numerous legal and regulatory reforms were agreed at the international political level²⁴¹ (however, not all jurisdictions had the time to implement international financial standards to their full extent). In order to fully explore the research object, the legal regime of bank resolution must be viewed also from the historical perspective. Firstly, this is necessary in order to produce a definite perception of why bank insolvency is an unavoidable economic phenomenon²⁴², secondly, it will help identifying the primary cause of bank insolvency impartially, and thirdly, hence will crystallise the diverging interests of the parties involved in bank insolvency procedures.

First of all, it should be noted that banks go bankrupt since their inception in the civil society. The word “*bankruptcy*” is found in virtually all of the world’s languages and countries²⁴³ and means personal insolvency. In general terms, debtor’s insolvency reflects their debt repayment potential²⁴⁴. The word “*bankruptcy*” is inseparable from the history of the first bank failure. The origin of the word “*bankruptcy*” is associated with the Italian compound *banca rotta*. The phrase essentially means a ritual act of breaking a banker’s table. Breaking a banker’s table assumed their insolvency²⁵³.

First banks appeared in ancient civilizations, however, they had no legal form of an enterprise, so at that time different temples and estates run by local managers and land-owners performed the main financing role. However, the banks were expanding gradually in view of the modernisation of civil circulation and different modes of payment, which modified the banks themselves. Gradually, banks have acquired their legal status, and their activities have evolved from primary money exchange to a wider range of banking services, such as collecting deposits and lending money (loan issuance). These changes took place in the Middle Ages, at most times in Italian state-cities. Bank failures can thus be linked to Italy, in particular, to the Italian city of Genoa, where banking services, such as money exchange, shifted to extra banking services, such as deposit capture, storage, and lending money to other entities. This phenomenon emerged in 1200. The trend final-

241 The FSB requirements shall be fully implemented by 2016.

242 Both authoritative global organisations operating in the regulatory environment of financial services and interpreting bank insolvency legal relations, and the legal doctrine admits that bank insolvency is an inevitable phenomenon in a market economy. The BCBS has acknowledged that in a market economy, bank insolvency is one of the inevitable consequences of the risk-taking business. Therefore, swift and orderly, well-organised liquidation of a financial institution, when the latter fails to comply with the requirements of the supervisory authority, is a necessary and efficient financial system instrument. The Committee has also noted that sometimes inadequate legal regulation of bank insolvency procedures leads to a deterioration of the bank’s financial difficulties and in some cases leads to negative legal consequences and increased social costs. BCBS. BIS. Core Principles for Effective Banking Supervision. 2012 [interactive]. [accessed on 25-03-2014] <<http://www.bis.org/publ/bcbs230.pdf>>.

243 Bankruptcy (English), bankrott (German), bancaroota (Portuguese), etc.

244 Norkus R. *Nemokumas ir jo sąvokos dualizmas Lietuvos teisėje: ar reikalinga teisinio reguliavimo reforma?* Justitia, Vilnius, 2013. Summary.

ly prevailed in Venice at about 1300²⁴⁵. Therefore, in the early days of civilization deposits were brought in (credited) to a current bank account, which is best described by the word 'till' of that time. Deposits intended for storage only were classified as *depositum regulare*, while deposits held in the current account were classified as *depositum irregulare*. According to legal nature of *depositum irregulare*, the depositor used to lose ownership of the deposited property, i.e. the input. Thus the depositor's property was replaced with the bank's commitment to pay interest for the opportunity to use the depositor's cash. The banker, at the depositor's request, had to return the deposit with equivalent assets, which could take the form of other assets, but necessarily of the same quality and quantity²⁴⁶. Therefore, the bank usually stored only a small part of the net cash received in the form of deposits and available to depositors on demand. Eventually, banks began lending to third parties for longer term, which presupposed that if the lending was too risky, for example, if the borrowers delayed their payments to creditors, the depositors were unable to recover their money. As a result, since the inception of the first banks the banking business model has been inherently risky. Depositors did not have any exclusive rights or other legitimate preferences over other creditors of the bank, and they were simply treated on the same level with other creditors and not secured by the state from insolvency risk.

It should be emphasized that even these days, bank solvency problems are not uncommon. Bank insolvency at the time was an intractable process, and even gained the name of *una gran furia*²⁴⁷. A common cause of bank insolvency was that banks, among other things, were lending to sovereign states, which often simply failed to repay their loans and failed to meet their obligations (e.g., the state was involved in a military conflict in another country and often faced shortage of funds and then simply discontinued the performance of its liabilities to banks). Even in that particular period default caused a chain reaction in the financial system. It also led to a variety of financial default towards other creditors and depositors, which inevitably resulted the first bankrupt banks²⁴⁸. The events taking place at about 1345 could be given as an example. The three most important banks of that time, who had branches throughout Western Europe went bankrupt because they exploited their credit resources by irresponsible lending and not weighing the financial risk with regard to the Kingdom of England and the Kingdom of Naples²⁴⁹.

245 Roover R. *New Interpretations of the History of Banking*. Edt. J. Kirshner. Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe, University of Chicago Press, Chicago, 1974. P. 201. Mueller R.C. *The Venetian Money Market, Banks, Panics, and the Public Debt, 1200-1500*. Johns Hopkins University Press, London. 1997. P. 8.

246 Haebtjens M., Wessels B. *Supra* note 92. P. 4. For example, following a cash injection, subsequently the repayment of the contributed amount could be required in another equivalent, such as cheese, or *vice versa*.

247 R.C. Mueller. *Supra* note 245. P. 126.

248 Bankruptcy means inability to pay debts. Vaitkevičiūtė, V. International Dictionary. Lexicon, Vilnius, 2001. Multiple versions of the relation between the words "bankruptcy" and "insolvency" could be found all over the world. In some places they are used as synonyms, and – in the others they are distinguished. Typically, insolvency is an initial stage of bankruptcy. In the Western countries, the term 'insolvency' is more common, and it is therefore used in this dissertation. Generally, the circumstances under which a bank may be declared insolvent, and the regulations of the supervisory authority and prudential regulation establishes the procedure for estimating and assessing insolvency.

249 Roover R. *Supra* note 245. P. 206.

Another example of 1302 was that of bank *Ammanati* which went into bankruptcy. The latter had different borrowers and bank account holders not only in important Italian cities like Rome, but also in Spain, Portugal, France, England, and Germany²⁵⁰. The general situation in the banking sector of that time is best illustrated by the extract from the letter of Venetian senator Tommaso Contarini, which was published after another bank collapse in 1584. He wrote: “In 1200 years of the republic we can tell that a total of 103 banks were created in the country, of which 93 banks failed [...] and only seven of them successfully continued their activities.”²⁵¹

In view of the above, we can conclude that banks were always challenged with insolvency problems. After examining the cases of bank insolvency of that period, we can identify that bank insolvency procedures were quite similar and were characterized by the following key features: (i) during bank insolvency procedures, ordinary depositors had to share bank assets with other creditors on the basis of *pro rata* principle; (2) transnational, i.e. cross-border bank insolvency was a common phenomenon at that time; (iii) bank insolvency crises were “international” in a sense. Even then cross-border cases of bank insolvency raised serious coordination problems. For example, it is known that about 1338, after the collapse of the largest bank in Venice, banks in Florence raised their claim and initiated proceedings with regard to the bank’s assets only after a year or two²⁵²; (iv) when most banks were confronted with insolvency issues, in particular, a bank was usually declared a moratorium as a measure to temporarily suspend the bank’s activities²⁵³. It should be noted that under a moratorium the distressed bank could not be declared insolvent. Among other things, during the moratorium, the bank was prevented from opening insolvency proceedings, realising the assets and starting the liquidation procedure; (v) the analysis of bank restructuring procedures existing at that time demonstrated that any agreements between creditors had to be confirmed by the sovereign and/or the sovereigns; (vi) in complex and systemically significant cases of bank insolvency that could produce huge negative impact on the society, and also in extreme cases, the state assumed direct responsibility by appointing a liquidator for banks (by initiating straight bank liquidation), and sometimes the state was even acting as a lender of last resort and rescued banks from insolvency through public finances. For example, at the time of massive withdrawal of deposits from banks following the insolvency of *Pisani Tiepolo* in 1576, the government, in order to prevent bankruptcy of the bank, adjusted 65,000 ducats to it²⁵⁴. It is believed to be the first case of bank rescue and resolution in the world, through bail-out; (vii) some other significant differences prevailing in bank insolvency regulation are also worth mentioning. For instance, in Venice all insolvent persons unable to duly fulfill their obligations were excluded from social life and often from their political and economic life in the city. In other Italian districts, penalties associated with personal insolvency were more physical rather than substantive in nature. For example, an insolvent person (including bankers) had to hit

250 Wessels B. *International Insolvency Law*. 3rd ed. Kluwer, Deventer, 2012. Para 10033.

251 Mueller R.C. *Supra* note 245. P. 121-122.

252 *Ibid.* P. 123.

253 *Ibid.* P. 124.

254 *Ibid.* P. 126.

their own naked buttocks at least three times. The “punishment” was executed on the stone of “shame” placed in public, and the executed person had to spell out the words *cedo bonis* (“I am transferring my assets”) aloud.

1.4.2. Lessons to be learned from the recent banking crisis – the fundamentals of the changed paradigm

The banking crises are likely to be associated with chaotic and controversial situations threatening the public interest. Among other things, financial difficulties faced by the bank (or banks) intercede with political and social problems. If a competent authority is late to take action in relation to the bank, interventions and supervisory actions are delayed, particularly in the absence of a proper legal framework, which may result in ambiguity and uncertainty regarding the future financial system of the state and lead to protests and increased panic²⁵⁵. Inadequacy or inaccuracy of legal regulation may cause politicians’ ‘competition’ and lead to social chaos in a certain country, which may accordingly affect economic decision-making. The causes and consequences of the recent banking crisis could be mentioned as an illustration of that. Some scientists are of the opinion that only a catastrophic collapse of the market could force lawmakers and regulatory authorities overcome the difficulties of the financial community and to carry out comprehensive legal and regulatory reforms²⁵⁶. On 5 February 2008 an acknowledged economist Martin Wolf spoke to the Financial Times that “either we have learned from this financial crisis or another financial crisis will hit the global economy in the near future”²⁵⁷. This statement also applied in the scientific context. The financial crisis has given many lessons both to practitioners and academics which need to be systematized at scientific level, considering that science cannot distance itself from practice. Due to the large-scale experiences of the recent international crisis, this section concentrates on the lessons relevant for the scope of the study. *Why lawmakers were forced to review the legal framework governing bank insolvency?*

First of all, the recent banking crisis has proved that bank insolvency can result in significant *adverse consequences both for the society and individuals*, and that there is a common threat both for the developed and for the emerging economies²⁵⁸. It became evident that *maintaining* public confidence in the banking system is one of the essential elements around the banking sector and stands above private interests. Once trust in the financial sector is lost, it can spread general panic and the contagion of global financial problems may spread throughout the banking system²⁵⁹. Furthermore, such events may cause credit

255 Hoelscher D. *Supra* note 2. P. 3.

256 Coffee J.C. The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated (January 9, 2012). Cornell Law Review, 2012; Columbia Law and Economics Working Paper No. 414. P. 2.

257 Wolf M. Why it is so hard to keep the financial sector caged [interactive]. [accessed on 10-12-2014] <<http://www.ft.com/intl/cms/s/0/9987c5c4-d41f-11dc-a8c6-0000779fd2ac.html#axzz3LQKpw3c8>>.

258 See more Hardy C.D. *Supra* note 23.

259 Huertas T. *Resolution and Contagion*. Special Paper No. 188. LSE Financial Markets Group Paper Series, 2010.

problems, payment system malfunctions and may even lead to a currency crisis and/or government defaults²⁶⁰.

Second, *fiscal costs born by the state* in a situation of a banking crisis may increase seriously, especially in cases of inadequate and ineffective regulation of bank insolvency law²⁶¹. That respectively means that the states is or will be forced to deal with solvency problems on an *ad hoc* basis, using ordinary deposit guarantee schemes, open-ended liquidity support, partial recapitalisation of the debtor, rescue through bail-out. This significantly increase fiscal responsibility of the state, as the latter is faced with enormous fiscal expenditure, compared to countries with strict regulatory framework²⁶². A strict regulatory framework, in particular, refers to restriction of bank's activity in the case of persistent liquidity problems, by requiring the bank to significantly increase the level of capital, and – failing that – to remove the management, to sell the bank to a solvent financial institution, to provide public money or to initiate liquidation²⁶³. The banking crisis has shown the importance of the ability to manage an orderly liquidation also of the bodies other than the systemically important financial institutions, whatever form or legal status they may take. In the absence of specific legislative measures for bank resolution and special legal regime for bank restructuring, banks continue to be rescued by public finances on a mass scale, and this will inevitably lead to significant and negative moral hazard in the banking sector²⁶⁴. It was absolutely necessary to diversify legal regulation in order to balance public and private interests, by distinguishing bank crisis prevention, management, and bank resolution, as this distinction would help jurisdictions to maintain financial stability and restore the viability of banks in the wake of the financial crisis²⁶⁵.

Thirdly, it has become evident that we live in a “credit” society, and “credit” is the blood of modern economy. The banking sector is considered as one of the *most sensitive sectors of the economy*. We are talking about a situation that could vitally affect the country's economy, the confidence of the population and economic operators in the country's financial system, the sustainability of such systems, and the need to ensure proper and timely implementation of the stability of the financial system, by providing measures to strengthen the application of measures to increase the stability of the financial system²⁶⁶. In addition, it should be noted that, as a rule, the safety and soundness of banks need to be defined in the constitution of the relevant society and in the related constitutional princi-

260 Moro B. *Lessons from the European economic and financial great crisis: A survey*. European Journal of Political Economy. No. 31, 2014. P. 9-24.

261 Marinč M., Vlahu R. *Supra* note 76.

262 *Ibid.* P. 72.

263 *Ibid.*

264 Hüpkes E. *Resolving crises in global financial institutions: the functional approach revisited*. (in) *Supra* note 27. Chapter 18.

265 *Ibid.* P. 293.

266 Republic of Lithuania. Financial Sustainability Act. Official Publication Valstybės Žinios. 2009. No. 93-3985. Preamble.

ples, forming a fundamental criterion of a harmonious society²⁶⁷. In addition, banking can be treated as a public service²⁶⁸.

Fourth, bank solvency problems are *related to sovereign debt crises*²⁶⁹. Banking crises often correlate with sovereign debt crises. Financial difficulties faced by a particular bank can run off the movement of capital from a given market, cause potential and actual fiscal problems to a large group of people and create additional financial burden for the state. Such a situation negatively affects the pre-defined state budget²⁷⁰. In some cases, it may lead to the insolvency of the sovereign itself²⁷¹. Severe banking crises can convert into public debt crises or *vice versa*²⁷². On the one hand, the state is not legally responsible for the debts of companies operating within its jurisdiction, including banks, or the financial obligations of individuals both in international and national contexts. On the other hand, the state operates like a modern

267 For example, according to the Constitution of the Republic of Lithuania, *inter alia*, its Article 46(3), in regulating financial-economic activity for the benefit of general welfare of the people, the legislator needs to establish legal regulation that would ensure the safety, stability and reliability of the country's financial system. See Ruling of the Constitutional Court of the Republic of Lithuania of 24 May 2013 on the compliance of certain provisions of the Republic of Lithuania's Law on financial collateral arrangements, the Republic of Lithuania's Law on restructuring of enterprises, and the Republic of Lithuania Enterprise Bankruptcy Law with the Constitution of the Republic of Lithuania. Case No. 135/2010.

268 The first Swiss banking law of 1934 states in its explanatory memorandum that banking activities developed into public services. This provision is based on the fact that economic growth depends on the amount of capital available for investment purposes that banks can supply to the market. In addition, state monetary policy and implementing measures and the payment system is directly related to the public interest. Swiss Federal Banking Commission. *Supra* note 200. P. 5.

269 Gelpert A. *Supra* note 137. P. 207-288.

270 Waibel M. Bank insolvency and Sovereign Insolvency. (in) Lastra R.M. Cross-Border bank Insolvency. Oxford University Press, 2011. Chapter 13. [interactive]. [accessed on 05-12-2014] SSRN <<http://ssrn.com/abstract=1732786>> P.2. Yadav Y. *Empty creditors and sovereign debt: what now?* Capital Markets Law Journal, Vol. 9, No. 2, 2014. P. 10. Dubel J.H. *Creditor Participation in Banking Crisis in the eurozone – A Corner Turned? Empirical analysis of current bank liability management and restructuring policies with conclusions for the European bank restructuring and resolution framework.* Berlin, 2013.

271 For example, in October 2008 the three largest Icelandic banks collapsed within one week. These three banks accounted for about 90% of Iceland's banking sector. It was the largest banking crisis in history. At a time when the banks became *de facto* insolvent, their liabilities to creditors exceeded USD 60 billion, i.e. eight times than the total GDP of the country. Iceland's central bank failed to provide emergency liquidity assistance to banks (become a 'lender of last resort') due to lack of financial resources to guarantee such an extent of foreign capital commitments. Among other things, this led to serious devaluation of the Icelandic currency.

272 For example, the Greek banking sector assumed large amounts of domestic government securities and bonds. When it became evident that the government's finances were in destitute condition and government bonds depreciated significantly and became practically worthless, the government had to address the banking sector concerns at the time of its own financial decline. By contrast, banks in Spain and Ireland primarily led to the insolvency of the government itself. For example, banks in Spain and Ireland accumulated a large real estate portfolio. Therefore, they were the most vulnerable to any drop in the housing market. At the time of sharp real estate market decline the government had to bail out banks by using public finances and suffered enormous costs in the result. Boomerang L.M. *The Biggest Bust.* Penguin Books, London, 2011. P. 83.

corporation – a limited civil liability entity. It should be noted that some exceptions exist, i.e. when the state is generally liable for the obligations towards creditors by means of its property.

First, the state is legally responsible for the provision of obligation guarantees entered by private sector, if the state acts as guarantor in this type of a borrowing relationship. Such assurances can be accommodated both according to international and national law. Secondly, the state often issues guarantees to the private sector *to stabilise the economy in turbulent times*²⁷³. Third, liability can arise while the deposit insurance fund performs its obligations under an insured event, which usually occurs after the bank becomes insolvent *de jure*. Deposits are typically secured by the deposit guarantee scheme (DGS). At the time of the banking crisis, the object of the DGS is to avoid abrupt withdrawal of deposits from other financial institutions operating in the country, therefore, rescue, reorganisation or liquidation of an insolvent bank (by paying money to the insured depositors) may lead to a situation where the state must employ public finances, due to the insufficiency of funds contained in the DGS to cover bank resolution or liquidation costs endured by depositors. In this instance, the state requires additional funding, which may appropriately entail additional and significant fiscal costs for the state.

Fifth, the recent banking crisis has highlighted bank capital failure or the *defective nature of capital quality criteria*²⁷⁴. Capital ratio is one of the primary conditions for identifying bank insolvency²⁷⁵. Bank capital acts in the form of a safety guarantee required for highly vulnerable-banking activities. The higher the capital of the bank, the more it can reduce insolvency-related losses of the bank²⁷⁶. Most often banks become insolvent at a time when their capital does not match their business risk profile, so that accurate and timely management of the risks associated with bank capital levels is crucial. Low bank capital ratios could endanger the bank's conduct in two primary instances. First, banks may follow a strategy of excessively rapid growth, which is financed by high costs and leads to unpredictable and unstable bank liabilities. For example, bank asset growth exceeds the available capital, and the governing bodies are forced to buy more securities or to issue more loans in order to compensate for the increase in interest expenses caused by excessive growth. Second, capital ratios decrease when bank income declines due to significant losses resulting from the issue of high-risk loans or excessive number of loans granted or securities issued²⁷⁷. Bank capital quality indicators were one of the key reasons leading to

273 IMF, WB. *Supra* note 86. P. 11. Several competent authorities issued collective guarantees for all liabilities of the bank, in order to calm the fears and disturbances in the market. The essential feature of a successful comprehensive guarantee is its reliability. It is politically difficult to determine whether a guarantee is valid and founded.

274 During the recent banking crisis, the capital held by credit institutions was insufficient both in terms of quantity and quality, which required unprecedented support from national authorities. The EU already applies new international standards for bank capital (the so-called Basel III requirements). Masera R. *Supra* note 233.

275 *See more* 1 chapter 8 sec.

276 Friedman J., Kraus W. *Engineering the Financial Crisis. Systemic Risk and the Failure of Regulation*. University of Pennsylvania Press. Philadelphia, US, 2011. P. 57.

277 William C. Handorf. *Bank risk management, regulation and CEO compensation after the Panic of 2008*. Journal of Banking Regulation, Macmillan Publishers Ltd, Vol. 16, No.1, 2015. P. 40.

a massive bank rescue with bailout²⁷⁸, by granting some form and degree of state support. For instance, if only between October 2008 and October 2011, the European Commission approved EUR 4.5 trillion in state aid to financial institutions²⁷⁹. Consequently, during the financial crisis, financial difficulties and problems affected not only borrowers (businesses, individuals, the state), lenders (banks), but also the states. Accordingly, cases of public finance-based rescue preconditioned the “too big to fail” problem²⁸⁰. The doctrine is mainly based on the fact that some financial institutions are too big and too complex or largely interconnected and their insolvency can cause both national and international ‘contagion’, and their liquidation is therefore not possible (by initiating ordinary bankruptcy proceedings). The society considers that some banks are simply ‘too big to fail’, namely ‘too big to terminate their activities and be liquidated, which created moral hazards²⁸¹. The idea is based on the fact that taxpayers will nevertheless bear the ultimate burden of financial problems caused by bank rescue. Besides, it is likely that in all ‘too big to fail’ cases banks will still need full or partial public support of the state to survive without debt and to avoid general destabilisation of the financial system. It is believed that this problem could be resolved through upgrading or creating a special bank resolution regime, according to which bank liquidation would be undertaken only in extreme cases, by maintaining and securing the systemically important functions at the same time²⁸².

Sixth, banks operating in several states *on a cross-border level have mostly been rescued at the national level*, subject to national public interests only, which often gave no optimal results²⁸³. Within the context of insolvent cross-border banks, legal and practical difficulties related to the solution of problems caused by distress doubled due to different legal systems, involvement of different types of public authorities, whereas communication and collaboration between those institutions was very complex and inefficient²⁸⁴. A need arose to legally establish certain principles for cooperation, such as non-discrimination of for-

278 Sovereign debt crises in Greece, Ireland, Portugal and Spain deserve particular attention. These four eurozone economies suffered from the sovereign debt crisis by facing USD 1.6 trillion losses. BIS. Quarterly Review. International Banking and Financial Market Developments, 2010.

279 EC. Press release. New Crisis Management Measures to Avoid Future Bank Bail-Outs. 2012, June 6th.

280 See more 6 chapter 2 sec.

281 Reiser N. *Supra* note 94. P. 13. Howell E., Kaplow L., Shavell S.M. etc. Analytical Methods for Lawyers. 2nd ed. Foundation Press, US, 2010. P. 48.

282 BCBC. Report and Recommendations of the Cross-Border Bank Resolution Group. 2010. P. 3.

283 BCBS. Report and Recommendations of the Cross-border Bank Resolution Group. Basel, Switzerland. 2010. P. 6-9.

284 The *Metliss* case best illustrates the principle of mutual recognition of insolvency and acceptance and differences of the legal systems, which respectively leads to more serious legal obstacles problems. A long time ago, the national Greek Home Loan Bank issued bonds under English law. Then, the bank merged with another bank under the Greek government decree, which *inter alia* established the creation of a new National Bank of Greece, replacing the former national bank as the successor of all its rights and duties. However, English courts did not accept this change in the foreign law for the parties to the contractual relationship. The case perfectly illustrates how important it is to plan cross-border bank insolvencies in advance and to have clear rules for mutual cooperation and recognition of rights. Attinger J. B. *Supra* note 49. P. 5-8. See more *National Bank of Greece and Athens v Metliss* [1958] AC 509.

eign creditors, appropriate intervention measures, adequate legal safeguards for creditors, reliable rules for the protection of depositors' rights, etc²⁸⁵. At the international level, as noted by the BCBS, unified bank insolvency legal regime would help resolve cross-border cooperation and inefficiency problems, by creating a coordinated, national legal regulation for bank insolvency in all jurisdictions²⁸⁶. According to the Committee's analysis, such compatibility would help maintaining the continuity of the critical bank functions in all countries where the bank operates, and would ensure financial stability²⁸⁷. Although cross-border bank insolvency procedures are outside the scope of this dissertation, it should be noted that recently, banks were freely allowed to operate globally²⁸⁸, without admitting, however, that banks fail in the first place and that insolvency procedures are first and foremost initiated at the national level²⁸⁹. This essentially means that bank assets and liabilities, along with the losses resulting from the banking crisis, *were distributed among the states and creditors concerned with the activities of a particular bank*. In addition, during the recent banking crisis, the complexity of banking groups turned out to be 'deadly' for the supervisory authorities and for the private sector itself²⁹⁰.

After analysing the banking group structure, *the problem of cross-border bank insolvency* procedures is not surprising. The regulatory structure of the banking groups determined splitting of the bank group into several legal persons and this in no way reflected the economic functionality of such entities. The core business lines of the bank did not meet the legal structure. Therefore, any legal system based on a single legal entity approach in terms of insolvency recognition, admitting only each separate legal person as having legal personality and possessing rights and obligations, was unable to reconcile the different

285 Haan S., Vinals J. IMF. Resolution of Cross-Border Banks - A proposed Framework for Enhanced Coordination. Prepared by the Legal and Monetary and Capital Markets Departments, 2010. P. 4.

286 For example, in the case of insolvency of the banking group Fortis, Belgian and Dutch public authorities failed to coordinate their efforts properly, to find solutions to financial difficulties faced by a cross-border and to create a financial burden-sharing system. A more successful example was that of the banking group *Dexia*. Belgium, France, Luxembourg were able to control and coordinate their actions by entering into an agreement on the joint guarantee mechanism. This allowed avoiding straight bank liquidation at national level, and cross-border bank resolution procedure became possible. However, a problem arose in relation to the protection of shareholders' rights. According to the Belgian law, the consent of the shareholders was necessary, which respectively blocked bank resolution. BCBS. Cross-border Bank Resolution Group of the BCBS. Report and Recommendations, 2010. 33-37 para.

287 Ibid.

288 The main factors of globalisation of financial services: regulatory liberalisation of the financial sector and legal deregulations (most countries have now removed legal barriers to enable the establishment of a financial institution abroad), risk diversification (the ability of financial institutions to expand abroad allows diversifying risks, reducing dependence on the home market and pursuing new business opportunities in a foreign market), provision of core services to business entities (as the activity of business entities expanded abroad, large banks followed this path to support and profit from such business entities and their development plans), brand value (internationally recognised brand represented at the local level in foreign markets can quickly gain market share abroad). Ibid. P. 7.

289 Hüpkes E. *Supra* note 148. P. 293-294.

290 In the case of Lehman Brothers collapse, it became apparent that no one could explain the elementary question as to the number of commitments the bank had throughout the financial sector. The bank had 3,000 legal entities operating in fifty countries. No one could tell the exact institution and the amount of money under risk (risk of losses). Attinger J. B. *Supra* note 49. P. 7.

and complex aspects of the banking group. Therefore, the legal regulation of cross-border banking groups became one of the preconditions for the new legal regime on banking resolution based on the following objectives (i) that the states should improve their national laws so that the competent national authorities have the duty to maximise the coordination of resolution activities with their counterparties in other jurisdictions, in correspondence with the interests of creditors and domestic financial stability; (ii) it is recognised that the state will be in a better position by coordinating their resolution actions with other countries, whose legal regime governing resolution will be harmonised with that of the other states to the maximum possible extent, by implementing international financial standards²⁹¹. In normal economic circumstances, the differences between the form that a bank may take and the functions it performs (in the sense that many banks expand their business lines and operate in several countries across national borders and the activities are carried out through more than one legal entity) are not so important, but at the times of banking crisis their role becomes extremely significant²⁹². During the crisis, national authorities paid insufficient attention to the risk management at the banking group level, and to the financial challenges faced by the bank as an economic unit. Instead, the authorities primarily focused on individual legal entities within their jurisdictions and the legal protection of the bank assets and liabilities.

Last but not least, it is necessary to emphasize the *management problems encountered by banks as corporations*, especially in terms of an event prompting bank insolvency, e.g. by adopting excessively risky business decisions. First of all, the recent banking crisis has highlighted the key disparities between banks and non-financial corporate governance. It was influenced by the fact that, compared to conventional business entities, the internal structures of the bank organise more interested counterparties. It is equally important that banking business became mysterious and complex, and could develop quite rapidly²⁹³. Most of the bank's creditors (debt holders) consist of depositors and subordinate debt holders. Despite numerous additional interests of creditors, the board was frequently representing only a narrow view supported by shareholders. Shareholders' interests are very different from those of the other creditors of the bank, since shareholders often pursue short-term benefits. In contrast, traditional bank lenders tend to pursue long-term and rarely varying objectives and interests. In addition, in most cases, faced with the recent banking crisis, the board of directors did not play the leading role of the key decision-maker (e.g., it neither took enough time nor employed enough resources to implement its duties, there was no diverse ethnic or cultural origin, such as gender, social, cultural, educational background, and etc.²⁹⁴). Shareholders' conflicts of interest, disagreements on bank profitability models appeared together with a number of troubles between auditors and shareholders, etc. The nature of the banking business recently became much wider, the services gained more complexity, and regulators were therefore unable to respond timely

291 *Supra* note 188. Executive summary.

292 Lastra M.R. *The role of the IMF as a global financial authority*. LSE Financial Markets Group Paper Series. Special Paper 192. European Yearbook of International Economic Law, Vol. 2, 2011.

293 Dewatripont M., Freixas X. *The Crisis Aftermath: New Regulatory Paradigms. Why is the governance of banks different from non-financial firms?* Centre for Economic Policy Research, London, 2012. P. 13.

294 EC. Corporate governance in financial institutions and remuneration policies. Green Paper. COM (2010) 284 final. Brussels, 2010. P. 6.

and adjust legal regulation to the consequences of bank development. Bank management was ill-founded, *inter alia* also due to excessive bonus and payment schemes for the executives (e.g., in the absence of a connection between the level of bank assets and wages), the unwillingness of the board to change managing bodies (e.g., even in the case of lack of consideration for maintaining bank solvency, by focusing exclusively on the pursuit of profit instead), insufficient competence fitness for function (lack of expertise) of the managing bodies, interdependence of the directors and the board (e.g., intellectual independence), inadequate risk management (e.g., without specifying the level of risk that is acceptable to the bank, inability to perceive the risks assumed, etc.).

1.4.3. The Problem of the Banking Sector Structure – a Preventive Measure for the Protection of Public Interest?

The globalisation of financial services stimulated the creation of a large number of international banking groups and it was one of the grounds of recent banking crisis, *inter alia* threaten to public interest²⁹⁵. Banking groups are based on global network of bank branches and subsidiaries operating in several countries that employ multiple currencies in different time zones²⁹⁶. It should be noted that since 1990 banks (both commercial and investment banks) grew inexorably²⁹⁷. Accordingly, the size of banks, the number and variety of transactions and the assets managed by the banks were also increasing rapidly. These events were worldwide and occurred in all developed market economies. Among other things, banks were often growing by reason of various bank mergers and acquisitions and the increasingly widespread banking intermediation functions in the financial markets. Commercial banks united into joint bank groups, usually operating on a cross-border level. Thus, the world was hit by a strong banking concentration trend, pointing to large and universal banks²⁹⁸. This situation eventually led to some banks or banking groups becoming so significant that if an individual bank faced financial problems in the relevant jurisdiction, it was not possible to apply direct liquidation procedures, i.e., allow ordinary bankruptcy procedures, and they could no longer be supported by taxpayers' money (namely too big to fail). Recently, in addition to better bank insolvency regulation, legislators and policy-makers have focused on preventive measures of bank insolvency procedures (prudential requirements, additional capital requirements, supervision, advance planning of resolution, namely resolution plans, early intervention legal framework) and their potential positive impact on the economy. *The question is whether narrowing banking activity could be an alternative means for mitigating the practical problems and effects caused by the operation of bank insolvency procedures, and whether it can contribute to the successful operation of the bank resolution regime?*

295 Chorafas N.D. *Supra* note 8. P. 40.

296 Lastra R.M. *Cross-border bank insolvency. Supra* note 74. (ix).

297 Kay J. *Supra* note 178. P. 51.

298 Jone D.K. Critchfield T. Consolidation in the U.S. Banking Industry: Is the „Long, Strange Trip“ About to End? FDIC Banking review. Vol. 17, No. 4. 2005. Waibel M. *Supra* note 268. P. 20. Theissen R. *Supra* note 100. P. 40.

Some regulatory proposals argue and propose the necessity to reduce the volume of bank activity by restoring the US *Glass-Steagal*²⁹⁹ legislative restrictions or by applying taxes, or additional capital charges according to the size of the bank and its interconnection with other credit institutions³⁰⁰. Other regulatory proposals attempt to reduce bank insolvency risks, in particular, by improving bank management and internal control structures, by managing various bank insolvency-related risks³⁰¹. It is worth noting that preventive insolvency measures and their practical implementation through supervisory actions and legal processes may reduce the probability of bank insolvency risks, by ensuring greater resilience and sustainability of banks and lessening the likelihood of bank insolvency. In the context of insolvency, it is relevant to distinguish the bank structure problem as a preventive measure and to clarify it, as this would serve to predict the future of the science and the regulatory prospects. Such a distinction would contribute to the mitigation of moral hazards arising from bank insolvency procedures, distortions of competition, and to the reduction of flawed banking practice, which could potentially lead to systemic risks. Furthermore, more effective supervision of constricted banking activities would potentially facilitate market monitoring and would help better distinguish the sources of systemic risk. Finally, although this preventive measure remains problematic in the doctrine (the need to exclude specific banking activities from the banking sector and to delegate them to public institutions is still under a question mark), it is however seen as a legal instrument to manage public services or the means to create and develop public infrastructure, inevitably influencing private interests³⁰².

Nowadays, universal, traditional commercial banks normally not only accept deposits, but also issue guarantees and trade in securities and derivatives³⁰³. The development of banking was quite different in the Anglo-Saxon legal system and the European continental legal system. In the US, combining commercial and investment banking became possible only after 1999³⁰⁴. At the time, the Glass-Steagall Act³⁰⁵ was repealed and replaced by the Gramm-Leach-Bliley Act³⁰⁶. Under previous regulation valid from the time of the Great Depression, each financial institution was under a duty and obligation to choose whether to engage in deposit-taking and lending only, or whether to undertake broader banking

299 US Banking Act of 1933, 48 Stat 162 (1933).

300 Lichtenstein C.C. *Lessons for 21st-century central bankers: differences between investment and depository banking*. International Monetary and Financial Law. The Global Crisis Oxford University Press, 2010. P. 217-233. G30. Financial Reform: A framework for Financial Stability. Washington DC, Group of Thirty, 2009. Turner L. *The Turner Review: A Regulatory Response to the Global Banking Crisis*. London, Financial Services Authority, 2009.

301 Hüpkes E. *Supra* note 19. P. 105. Samolyk K. *The Future of Banking in America. The evolving Role of Commercial Banks in U.S. Credit Markets*. FDIC banking review. Vol. 16, No. 2, 2004. P. 29-65.

302 *Supra* note 76. P. 89.

303 Lichtenstein C.C. *Lessons for 21st-century central bankers: differences between investment and depository banking*. International Monetary and Financial Law: The Global Crisis. Edt. Giovanoli M., Devos D. New York, Oxford University Press, 2010. P. 228.

304 Gramm-Leach-Bliley Act of 1999, 13 Stat 1338 (1999).

305 Glass-Steagall Act, ch. 58, 47 Stat. 56 (1932). Codified 12 U.S.C. §§ 347a-347b, 412 (1988).

306 Lawson N. *Capitalism Needs a Revived Glass-Steagal*. Financial Times, 15 March 2009. Barth J.R., Brumbaugh R.D., Wilcox J.A. *The Repeal of Glass-Steagall and the Advent of Broad Banking*. 14 Journal of Economic Perspectives, 2000. P. 191-204.

activities, e.g. operating as a financial services agent or a broker-dealer. Therefore, for a long time, legislators treated investment and commercial banking as a separate business line³⁰⁷. After repealing this kind of regulation, the concentration of the US banks highly increased and became obvious³⁰⁸. The different banking structure culture among bank business models is best revealed by the US Supreme Court, in its judgment *Investment Company Institute v Camp*³⁰⁹. The primary requirement of the case was to separate securities lending activities from other banking activities and to maintain the banks as financial institutions collecting deposits, and at the same time to distinguish banking from securities lending business. This meant that depositors may suffer significant losses due to more risky investment banking business. Investors operate primarily on the basis of a relationship of trust in the bank and in line with the instructions and orders of the bank. Therefore, loss of customer confidence can cause ‘significant and severe harm to the bank for a transitional securities market during the period of deflation’³¹⁰, which could in turn lead to massive withdrawal of deposits from banks and result in a significant number of bank insolvencies.

Some recent regulatory proposals have suggested getting back to narrow banking or the Glass-Steagall regulatory principles, which basically means that banks accepting deposits would be distinguished from banks investing in shares, financial instruments and complex structural financial products³¹¹. The central idea of the suggested regulation is that investment banking services should not be permitted for self-financing financial institutions collecting deposits from the public or other commercial banks³¹². On the one hand, ‘narrow banking’ consists of the obligation for banks to invest all private retail customer deposits in reliable assets. On the other hand, such legal regulation would eliminate the inconsistency between ‘bank’ terms and different definitions and reduce the liquidity risk of banks engaged only in deposit collection activities, also simplify legal regulation (except for the cases of fraud) and remove the necessity for financial safety nets. As noted in the Turner Review report, any State would face difficulties in pursuing such reforms, while other states haven’t taken the equivalent measures to separate banking activities, in addition, it is unlikely that such regulation would result in the adoption of a decent international political agreement, due to very different historical traditions of banking in the individual jurisdictions³¹³.

307 Pennacchi G. *Narrow Banking*. ARFE Journal. Annual Review of Financial Economics, Vol. 4, 2012. P. 3-15.

308 Kay J. *Supra* note 178.

309 *Investment Company Institute v Camp*, 91 S Ct 1091 (US S Ct 1971).

310 *Ibid*.

311 Kay J. *Narrow Banking: The Reform of Banking Regulation*. CSFI. Erasmus Press, London, 2009. Kay J. Should We Have ‘Narrow Banking’? Future of Finance: the LSE Report, 2011. Speech by Mr. Erkki Liikanen, Governor of the Bank of Finland and Chairman of the High-level Expert Group on the structure of the EU banking sector, at a conference on “The future of central banking”, Copenhagen, 30 January 2013.

312 Grauwe D. *The Banking Crisis: Causes, Consequences and Remedies*. CEPS Policy Brief, No. 178, Centre for European Policy Studies, Brussels, 2008.

313 Financial Services Authority. *The Turner Review: A Regulatory Response to the Global Banking Crisis*, 2009.

It should be noted that the EU has now submitted new regulatory proposals, which are still in the initial stage of the legislative process. The EU legal system is willing to separate banking businesses and diversify them. *The Liikainen report*³¹⁴ proposes some structural changes in the banking sector and the initiatives similar to the former legal regulation in the US. These legislative proposals aim to abolish universal banking trends in the EU banking sector. This means that the new regulatory framework would not allow any bank to offer all possible banking services, i.e. to implement universal banking functions. Banking activities would be diversified, by making it possible to identify and distinguish between high-risk criteria for the operation of banks and banking risk as such, for example, by putting high-risk banking activities outside the banking sector. A more detailed review of this reform is outside the scope of this research, in addition to the fact that the scientific opinions on the matter still vary greatly and are in the stage of active deliberations³¹⁵. At the same time, current and future legislative measures cannot fully eliminate financial and/or banking crises and avoid bank insolvencies, as this would run counter the nature of banking, which is risky in itself³¹⁶. However, such legal reforms could mitigate the legal consequences caused by the insolvency of one or more banks. In addition, some of the risks associated with the event triggering bank insolvency are increasing, and cybercrime is particularly worth mentioning³¹⁷. Therefore, on the one hand, it can be assumed that in the future new banks (with diversified activities) and their entirely different earning patterns are likely to eliminate weaker, universal banks from the banking system. On the other hand, prohibition or restriction of banking activities associated with high risks for both banks and non-banks (investment firms³²⁶) may serve as a useful tool to combat bank insolvency problems.

In conclusion, it must be considered that the structural changes of the banking business actively debated in the EU would not be a *fait accompli*. It is doubtful whether the 'narrowing' approach to banking activities could be fulfilled in practice as a completely harmless phenomenon for the financial markets, as in this case the state itself would have to inevitably intervene directly in the specific activities of banks, and the primary idea of banking, based on customer (corporate or individual) confidence in the system would be distorted³¹⁸. Some opinions state that such reforms would simply undermine the current risk profile of the financial system and would be less efficient than the current financial system³¹⁹. The key arguments questioning this trend of regulation relate to the

314 Liikainen Group. Final report of the European Commission's high-level expert group on reforming the structure of the EU banking sector, Brussels: European Commission, 2012 [interactive]. [accessed on 15-10-2014] <http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf>

315 Symposium on Building the Financial System of 21st Century: An Agenda for the Europe and the United States, March 21-23, 2013. Zurich Symposium Report. P. 5.

316 Bonstra W.V.B. *Supra* note 84. P. 17.

317 Frizell S. J.P. *Morgan Says 76 Million Households Hit By Cyber Breach*. *Time.Com*. MasterFILE Premier, 2014. P. 1. EBSCOhost [interactive]. [accessed on 2014-12-19]. James M. *Fear over cyber attack on City after „Russians hack JP Morgan data”*. *Evening Standard*, 28 August, 2014, Newspaper Source. EBSCO host [interactive], [accessed on 19-12-2014].

318 Lichtenstein C.C. *Supra* note 300. P. 228-233.

319 Goodhart C.A.E. *The Optimal Financial Structure*. Special paper 220. LSE Financial Markets Group Paper Series, 2013. P. 6.

potential conflicts associated with the disorders of the banking supervision system and uneven bank activity management, the requirement to create different deposit insurance schemes for different banks, the emergence of the different role of the central bank as a lender of last resort, and the creation of additional administrative burden. It is doubtful whether the current revised and/or the newly created legal regime governing bank resolution would assist in fighting against bank insolvencies and could be replaced by sort of bank self-regulation. We can also talk about other problematic aspects, such as whether voters, through their appropriate representation in the Parliament, would support the idea of such a banking structure, or whether such a narrowed banking system is safe, especially in the context of financial stability, or whether the depositors would be willing to actively monitor bank activities, or whether such banking system would be able to finance the existing economy³²⁰.

1.5. A New Paradigm of Bank Insolvency Procedures

As mentioned above, during the recent banking crisis many jurisdictions did not have sufficient and efficient legal regulation of bank insolvency, especially bank resolution tools that could actually deal with distressed banks and other financial institutions in financial difficulty³²¹. For example, when a bank *de facto* becomes insolvent, the competent authorities of certain jurisdictions had no right to terminate the ‘unnecessary’ bank contracts, extend the valuable bank contracts, sell the assets of the insolvent bank or transfer bank liabilities to another legal entity. That idea was principally based on the fact that the solution of problems faced by financial institutions was based on complicated and expensive compulsory winding up procedures or bank rescue by using public finances. Therefore, public authorities were confronted with the disadvantage of the alternative: either to apply very unpredictable general corporate insolvency proceedings under *lex generalis*, or to save the bank from liquidation by bail-out. Most of the jurisdictions referred to the general insolvency regimes, which was usually administered by the courts. *Lex generalis* was often applied too late or was simply too slow in solving the financial problems of banks in difficulty, thus causing massive losses and highly decreasing general confidence in the banking sector. Banking supervision, as well as legal regulation of banking crises and bank resolution was not harmonised neither at regional nor international level. Individual bank resolution procedures and their regulation in different countries highly varied and bank resolution measures were lacking³²². For example, supervisory authorities did not apply consolidated supervision for banks operating globally, treated banking groups as a single economic entity, the powers of competent authorities were non-harmonised and limited, and very different conditions existed with regard to determining bank insolvency or legal measures for bank resolution, etc. In addition, the competent authorities did not have the legal framework that would require *ex ante* preparation of recovery plans for potentially insolvent banks and/or exit strategies. It is important to mention that before the recent

320 Theissen R. *Supra* note 104. P. 41.

321 BCBS. *Supra* note 15. P. 41.

322 Hüpkes E. *Supra* note 71. Blair W. Standards and the rule of law after the global financial crisis. (in) Ferran E., Moloney N., Hill G. *The Regulatory Aftermath of the Global Financial Crisis*. Cambridge University Press, 2012. P. 2.

banking crisis, the legal sources for harmonisation of international bank insolvency procedures and soft law measures were lacking. It can be assumed that the vacuum of legal regulation of international financial standards *inter alia* resulted in the insufficient regulation of bank insolvency procedures in individual jurisdictions. Various international regulation initiatives were emerging in order to stabilise and strengthen the international financial system, and thus reform the regulation of bank insolvency law, in order to achieve the due balance of public and private interests. In this section, we will assess the processes of harmonisation and unification of legal relations surrounding bank insolvency in the international and (regional) EU context.

1.5.1. Current Trends and Developments of Bank Insolvency Procedures. An International Perspective

First of all, it is important to note that new international financial standards are based on 'soft' law³²³, i.e. determined by international organisations and inter-governmental relations. It is assumed that the choice of such regulatory direction generates several concerns. First, various major international standard-setting organisations and institutions lack legislative powers, thus the recommendations adopted by them do not in themselves possess and have legal power. In order for a recommendation to become legally binding, the rules must be incorporated into national legislation and the relevant administrative practice of national legislators in the relevant jurisdictions. Second, international financial standards (IFS) related to bank insolvency procedures are not now based on international treaties, and thus, at least theoretically, their implementation is linked to 'voluntary' implementation of standards initiated by national authorities. At the same time, this does not diminish the fact that IFS in the sphere of bank insolvency procedures have largely contributed and do contribute to the elimination of gaps in the legal regulation within the context of bank insolvency, as IFS reflect a certain legal and political consensus among different countries of the world, in line with the will of the largest global financial centers-states. Besides, IFS were adopted in the presence of national supervisory authorities or experts from different jurisdictions, and only after the meetings (usually recorded by minutes) the jurisdictions were encouraged to implement this non-binding legislation at national level³²⁴. It is also assumed that in an extremely dynamic industry of financial

323 In the context of bank insolvency, *soft law* is characterised by the fact that it avoids such terms as rules or legal regulation (it often uses the terms standards or code of conduct instead) and execution (instead of implementation), convention (instead of international agreement) and so on. Soft law is a category of legal rules created by legal doctrine. The main reason for using soft law is – that it facilitates taking into consideration the complex legal framework, along with the broader social and political context. Both binding and non-binding rules can amount to soft law. Giovanoli M. *Supra* note 85. P. 34. Terpan F. Soft Law in the European Union - The changing Nature of the EU Law. *European Law Journal*, Vol. 2, No. 1, UK, 2015. P. 68-96.

324 Occasionally, scientists believe and claim that international financial standards are not that non-binding. This judgment is based on the fact that IFS reflect the agreements that came into being after intense negotiations and afterwards were adopted at national level, in consequence of the expressed consent and will). In some cases, the IFS recommend compliance, and sometimes even important sanctions are agreed for non-compliance. On the other hand, because of unclear regulation of the IFS a number of legal problems may arise in practice (i) legitimacy (no clear legal basis), uncertain

services, 'soft' law is more operational, more flexible and more efficient than positive law. The market itself supports bank insolvency regulation through IFS³²⁵. It should be emphasized that the Member States of the IFS-setting bodies aim to achieve these standards at the national level, often before their implementation is agreed by the heads of the state. For instance, the FSB members committed to maintain financial stability by all means implement IFS and conduct periodic reviews of implementation of those standards in national law. Finally, there is a growing trend with regard to the meaning of international financial standards for the states in the relevant context of economic and trade relations, particularly, having the United Nations standards and the recommendations prepared by the World Trade Organization in mind³²⁶.

Though various non-periodic discussions on the issues of improving and problem-solving of bank insolvency procedures were maintained since the early 1990s, nonetheless, their results were very limited in scope, often limited to an abstract diagnosis of problematic issues and not their solutions³²⁷. Given the large-scale financial crisis of 2007-2009, it has become clear that it is necessary to strengthen the legal regime governing resolution of credit institutions and to improve banking supervision³²⁸. There was a strong need to restore public confidence in the financial system, in particular, by improving the protection of depositors and consumers, and thus to facilitate the European and global economic recovery. Since 2007, the beginning of the global financial crisis, up to now many regulatory reforms have been seeking to improve the legal regulation of bank insolvency or to make it more effective. Various initiatives triggering regulatory reforms were assumed by different international organisations: the International Monetary Fund, the World Bank, the Financial Stability Board, the Basel Committee on Banking Supervision, also various cross-border bank resolution group initiatives appeared, etc. Furthermore, significant works were undertaken under the initiative of the United Nations Commission on Inter-

legitimacy of standard-setting bodies and decision-making by setting standards for procedural rules, transparency of the consultation and the related rulemaking process, final approval of the created international standards; (ii) the degree of discretion and flexibility of implementation of each country; (iii) general public law principles, such as proportionality and subsidiarity; (iv) procedural safeguards, such as the likelihood of revision of the standards, the right to defense and personal remedies. Bismuth R. *Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Standards in WTO Law*. *Journal of World Trade* 44/2. 2010.

- 325 Bernanke B. *What should economists and policymakers learn from the financial crisis?* Department of Economics & STICERD public discussion in association with the Bank of England [interactive]. [accessed on 11-10-2014] <<http://www.federalreserve.gov/newsevents/speech/bernanke20130325a.htm>>.
- 326 Ramanna K., Sletten E. *Why do Countries Adopt International Financial Reporting Standards?* Harvard Business School Accounting & Management Unit, Working Paper No. 09-102, 2009. Brummer C. *How International Financial Law Works (and How it Doesn't)*. *Georgetown Law Journal*, Vol. 99, 2011; Georgetown Law and Economics Research Paper No. 11-15.
- 327 In 1992, the BCBS formed a working group that published a report entitled 'The Insolvency Liquidation of a Multinational Bank'. The Financial Stability Forum mandated the BCBS to draw up guidelines dealing with insolvent bank issues. In 2002, the report 'Supervisory Guidance on Dealing with Weak Banks' was published. BIS. *The Insolvency Liquidation of Multinational Bank*. 1992 [interactive]. [accessed on 13-10-2014]. <<http://www.bis.org/publ/bcbs10c.pdf>>. BIS. BCBS. Supervisory Guidance on Dealing with Weak Banks. Report of the Task Force on Dealing with Weak Banks. 2002 [interactive]. [accessed on 13-10-2014] <<http://www.bis.org/publ/bcbs88.pdf>>.
- 328 See more Blair W. *Supra* note 322. P. 96-102.

national Trade Law (hereinafter – UNCITRAL). The awareness that international harmonisation of bank insolvency procedures by way of international treaties is not possible in the short - term, first of all, it was necessary to adopt certain soft law standards or regulatory guidelines and to find a common approach to the existing practical problems of bank insolvency procedures³²⁹.

International regulatory forces would not exist without the G-20³³⁰ leaders' meetings – forums that were formed at the beginning of the financial crisis. Subsequently, the meetings were held both in September 2009 in Pittsburgh, in October 2009 in London, in November 2010 in Seoul and in November 2011 in Cannes. The meetings of G20 resulted in the decisions to support consistent efforts to improve legal regulation governing bank insolvency, by developing and formulating international agreements and the common legal base with regard to problem-solving of distressed banks (particularly cross-border ones), and by determining the main characteristics in the form of 'soft law' guidelines, that would eventually become part of the bank resolution legal regime in all jurisdictions³³¹. The question then arises as to how such initiatives evolved and what they were intended for. While at the international level, the focus was placed on systemic financial risks caused by the insolvencies of systemically important financial institutions³³², the discussions also largely involved ordinary bank insolvency procedures. The primary objective of international legal regulation was that the competent authorities would no longer be required to choose between the two unacceptable alternatives: disorderly liquidation of the bank and bank bail-outs by public finances³³³. Within the scope of the research³³⁴, the present section will concentrate on the trends of changing international regulation taking place since the inception of the financial crisis and will aim to reflect the shifting paradigms.

At the initial stage, it was envisaged that as early as in June 2012 the G-20 will begin to assess country progress with regard to the implementation of those IFS provisions in their jurisdictions. It should also be noted that at the international level, a number of authorita-

329 At the summit, the G-20 leaders adopted the declaration on financial markets and the world economy in April 2009. The G20 leaders urged 'in the light of the recent developments in the resolution of financial institutions to review financial institutions resolution regimes and bankruptcy laws, in particular for the orderly winding up of large and complex structure of cross-border credit institutions'.

330 The G20 is an informal political leadership group, consisting of 19 countries and the EU, with a mission to strengthen, reform, review the functioning of the international financial architecture, especially in the regulatory guidelines, based on the IFS agreed at international level. See more Giovanoli M. *Supra* note 85. P. 14-17. [interactive] [accessed on 13-10-2014] <www.g20.org/about_G20>.

331 Hüpkes E. „Living Wills“ – An International Perspective. The Bank Recovery and Resolution Directive. Europe's Solution for "too big to fail"? (in) Edt. Dombret A., Kenadjian P. Institute for Law and Financial Series. Vol. 13, 2013. Walter de Gruyter GmbH, Berlin, Germany. P. 73.

332 For example, at the Seoul summit of heads of state , the G20 leaders adopted a political programme of the FSB aimed at reducing the moral hazard arising from the insolvency of systemically important financial institutions. FSB recommendations and timelines [interactive]. [accessed on 2014-11-15] <http://www.financialstabilityboard.org/publications/r_101111a.pdf>.

333 Hüpkes E. *Supra* note 71. P. 3.

334 In this study, the author does not intend to provide detailed scientific analysis of all legal reforms carried out since the beginning of the financial crisis and the change of international financial architecture. Only particular legal aspects of the changes are considered, by giving some remarks directly related to the subject-matter and the main question of the research. This section focuses on the discussion of the key standards in the context of the international bank resolution legal regime.

tive international organisations have also taken the initiative to identify the critical legal issues arising from the recurring cases of bank insolvency, and to formulate the principles of bank insolvency law, which can be applied to solve the relevant problems. Since then, the G30³³⁵ group together with INSOL International³³⁶ regularly prepare and publish progress reports on the regulation of bank insolvency procedures. The report touches topical issues related to the problems that may arise in cross-border bank insolvency cases in the financial sector, making it clear that jurisdictions still lack effective legal regulation³³⁷.

After the real estate and mortgage lending crisis, which began in 2007, but gathered pace only in September 2008 after declaring insolvency of the Lehman Brothers investment bank, the G20³⁴⁸ and other leaders recognised that efficient bank insolvency legal regulation was a necessary precondition in order to protect financial stability and limit moral hazard³³⁸. State leaders urged to review special laws governing bank resolution and liquidation and were supported by all key organisations setting international financial standards.

1.5.1.1. Financial Stability Board Initiatives and Key Attributes of Effective Bank Resolution Regimes

In October 2009 the Financial Stability Board³³⁹ (FSB) replaced the Financial Stability Forum³⁴⁰ and announced a set of rules on the key preferred features of bank insolvency

335 G30 is a group established back in 1978. This is an international non-profit organisation, consisting of high-level public and private sector representatives, as well as academics. The organisation's primary goal is to promote the solution of international economic and financial problems, analyse and address the issues and decisions having international repercussions, taken both by private and international sectors. The organisation works in conjunction with market practitioners and national policy-makers. Group members meet in plenary session twice a year to discuss pre-selected, relevant economic, financial and policy development issues. The group has a broader audience in seminars and symposiums. For example, it periodically organises international banking seminars. The debate culminates with the release and publication of a special report. *See more* [interactive] [accessed on 13-10-2014] <www.group30.org/about>

336 A world-scale authoritative international association that brings together the restructuring, insolvency and bankruptcy professionals. In a sense, it is a federation of both accountants and lawyers operating in the field of insolvency and of national associations. Currently, the network consists of 44 member associations with more than 9,800 professional members. *See more* [interactive] [accessed on 13-10-2014] <www.insol.org>.

337 UN Commission on International Trade Law. Working Group V (Insolvency law). *Insolvency of Large and Complex Financial Institutions*. Note by the Secretariat, 2012. P. 3.

338 IMF. *Resolution of Cross-Border Banks*, 2011. P. 5.

339 The Financial Stability Charter, which established the FSB, announces that the Financial Stability Board is to be created to coordinate at the international level of national financial authorities and international organisations, to develop and promote efficient financial services legal regulation and follow implementation, and maintenance and other financial sector policies. In cooperation with other international financial institutions, the FSB seeks to resolve the central issues prevailing in the financial systems and to ensure global financial stability. *Financial Stability Board Charter*. 1 Art. [interactive]. [accessed on 10-11-2014] <http://www.financialstabilityboard.org/publications/r_090925d.pdf>.

340 The Financial Stability Forum was established back in 1999 by G7 states coordinating the actions of various international organisations' activities in the field of finance. After the summits held in Wash-

procedures³⁴¹, to be followed in addressing the problems of insolvent banks, cross-border cooperation in the case of bank insolvency and banking crisis management. The most important aspect of those principles was the requirement that national authorities formulate the principles in short-term in order to develop mutual cooperation and exchange of information. Since then, the FSB regularly publishes evaluation results, the thematic overview, last dated April 2013, assessing the implementation of FSB recommendations by different jurisdictions and transposition of international financial standards into national law³⁴². The aim of the periodic report is to evaluate progress and legislation gaps.

In November 2011 the leaders of the largest countries endorsed one of the most important international act – the Financial Stability Board (FSB) document entitled “Key Attributes of Effective Resolution Regime for Financial Institutions”³⁴³. The document has developed into a new international financial standard for legal regulation of bank insolvency procedures. It set out the fundamental legal principles and twelve attributes, which the FSB considers to be necessary for efficient bank resolution. These features are applicable in particular to all financial institutions and their conversion regimes, especially those financial institutions which may be systemically important and which perform critical functions at the international level, but at the same time, to conventional banks³⁴⁴. According to that document, the concept of financial institutions includes: banks, insurance companies, investment and securities firms and financial market infrastructures (all types of financial intermediaries). The document also regulated resolution procedures of financial groups, conglomerates and holding companies. It is assumed that only after the implementation of these features in the national legal systems of individual countries, the authorities would be able to restructure credit institutions, so that the risk of loss is not transferred on taxpayers by reason of the aid granted to secure smooth operation of the

ington and London in November 2008 and April 2009, the forum was transformed into the Financial Stability Board. The reform provided greater clarity and consistency for the international financial architecture and the IFS. However, scientists are frequently making reservations about the effectiveness of the FSB because the legal status of this organisation is not in line with international law. While a formal charter establishing the FSB was adopted, the FSB is an institution which does not have legal personality under international law (in the absence of an international agreement and its ratification by the relevant national parliaments) or by private law (because it is not seen as a counterparty, lacking the will of a legal person and with no founding documents or registration). Therefore, until this uncertain situation with regard to legal personality exists, the FSB is treated as an international organisation established entirely on organisational grounds. Researchers state that the FSB cannot legally operate in full scope in relations with third parties, such as open bank accounts, enter into contracts, including labor contracts, moreover, it no claim for default can be brought against this organisation in court, and etc. Giovanoli M. *Supra* note 85. P. 19.

341 Financial Stability Forum. *Principles for Cross-border Cooperation on Crisis Management*. 2 April 2009.

342 FSB. Thematic review on resolution regimes. Peer review Report. 2013 [interactive]. [accessed on 10-11-2014]. <http://www.financialstabilityboard.org/publications/r_130411a.pdf>.

343 Key Attributes. *Supra* note 90 [interactive]. [accessed on 10-11-2014]. <http://www.financialstabilityboard.org/publications/r_111104cc.pdf>.

344 Effective ways to address financial difficulties faced by banks require States to have in place bank resolution legal regimes with comprehensively regulated resolution powers of competent authorities, in order to resolve the financial problems of any financial institution (regardless of its type, size, complexity, systematic effect). FSB. *Supra* note 90. Key Attributes 4. Annex IV.

bank, and that the key economic features of these bodies are maintained. These guidelines provide specific legal characteristics and principles for the allocation of losses to shareholders, unsecured and otherwise exposed creditors, while maintaining vital economic and financial banking functions.

After a systematic analysis of the FSB regulatory guidelines, we can conclude that solvency problems of financial institutions can be resolved in efficient and reliable manner only if (i) taxpayers' money is not used; (ii) the competent authorities have the necessary legal measures and practical skills to apply them so that the critical functions of the bank are preserved; (iii) the resolution of the bank is deemed to be reliable and efficient if the application of adjustment path does not result in unacceptable negative and broad consequences for the financial system and the real economy³⁴⁵. The Guidelines provide for the following primary functions of the states: (i) to amend national bank insolvency laws based on the characteristics and key attributes of resolution regimes governing financial institutions, set out in the abovementioned document; (ii) the requirements for the jurisdictions to ensure the consolidation of unified bank insolvency problem-solving techniques in national legislation, as well as bank recovery and resolution planning *ex-ante*, especially taking into account international, systemically important financial institutions; (iii) requirements for banks, making it clear as to when it should be established that banks are systemically important at the international level, which respectively implies that banks need to secure an additional possibility of recoupment in case of financial difficulties, and must increase ordinary tier-one equity capital from 1% to 2.5% according to the risk-based common equity; (iv) the requirements related to the wider and more effective supervision of financial institutions for all SSFI³⁴⁶. Bank insolvency procedures should be harmonised so that they meet these requirements and ensure compliance. While most of those rules have already been implemented in various legislative projects in different jurisdictions, but selective disclosure of the key FSB aspects³⁴⁷ is still relevant, in so far as it concerns the research object.

The scope of the bank resolution regime. It should be noted that the scope of FSB attributes also includes financial institutions other than banks. Although not all international regulatory initiatives consistently treat categories of financial institutions, which should be subject to a special legal regime of resolution, in general we can state that the FSB does not distinguish or categorise financial institutions – the features concern all financial institutions, by including other financial institutions, i.e., investment companies. The basic principles of the FSB attributes apply to all types of financial institutions in order to improve their distress problems – both faced by banks, investment firms and insurance companies and other financial institutions³⁴⁸. This approach leaves certain discretion for the states to implement the attributes in their national law. In the US, according to Part II of the Dodd-Frank Act, it applies to both systemically important banks and non-banking financial institutions, i.e., investment firms³⁴⁹. Under the EU Banking Recovery and

345 Ibid. Annex II.

346 Ibid. Preamble.

347 See more Hüpkes E. *Supra* note 331. P. 73-80.

348 FSB Progress Report, 2013. P. 5.

349 Dodd-Frank. 201 Section.

Resolution Directive and the scope of the SRM regulation the directive applies not only to credit institutions but also to investment firms³⁵⁰. In Switzerland, the scope of special bank resolution regime includes licensed banks (the concept of banks includes private banks and savings banks³⁵¹), securities dealers (investment firms) and authorities distributing central mortgage bonds³⁵². The FSB' based its position with regard to such scope on the fact that in any case effective legal regime for the resolution of investment companies and securities companies would require explicit rules of bank resolution regime, requiring separation and identification of customer assets located also outside banks, so that resolution authorities are able to transfer customer assets to successfully operating third countries or make use of the bridge bank³⁵³. Scientists have diverging opinions on this issue. The central idea prevailing in the doctrine is that clear rules should be set with regard to the separation of assets of financial institutions and they should be applied not only to securities companies, but also to any financial institution managing customer assets, and that they are particularly relevant in cases where the property is held in different jurisdictions³⁵⁴. The FSB and the BCBS did not engage into a wider discussion on the subject, but expressed their wish to clearly and unequivocally treat financial institutions and investment companies as those to 'which authority subject to the rules and in accordance with the law'³⁵⁵. It is thought considered that this requirement of the FSB for the separation of assets should be applied not only to investment and securities distributors, but also to any financial institution holding customer's property, and this is especially true in the case when the property is located in different jurisdictions.

Administration of the bank resolution regime. The legal regime of bank resolution needs to be administered by a competent administrative authority or several authorities that have the expertise, the resources, the operational capacity and are independent to effectively apply the resolution measures³⁵⁶.

Extensive powers of resolution authorities. Broad powers are envisaged for resolution authorities. Such powers, *inter alia*, include rules to achieve bank sale or transfer of shares from a failing financial institution by legal means, e.g. by fully or partially transferring assets and liabilities to a third party, acting directly or through a bridge financial institution, without the obligation to obtain the consent of shareholders or interested parties for such a transaction. The authorities must also have all the required rights to convert bank debt instruments into capital, in order to recapitalise the bank funded by creditors, using any of the following ways: (i) recapitalisation of a legal person that is no longer economically viable and lost going concern assumption or (ii) capitalisation of the newly established legal entity or temporary financial authority to which the critical functions and assets of the financial institution in difficulty were transferred, seeking to close the non-

350 BRRD. Art. 1.

351 Swiss Federal Act on Banks and Savings Banks. Status as of 1 January 2009. 1 Art.

352 Swiss Ordinance. Art. 2.

353 FSB. Progress Report, 2012. P. 10.

354 Haentjens M., Wessels B. A Conference Book. *Supra* note 92. P. 15.

355 FSB. *Supra* note 353. P. 10-12. BCBS Report, 2010. P. 32. National authorities are advised to specify how customers' cash and securities are separated by in case of financial institution insolvency.

356 FSB. *Supra* note 90. Key Attributes 2.

viable part of the legal entity (the remaining part of the business would then be wound up, and the company eventually closed).

Application of the bail-in tool. Banks in distress require additional funding. The FSB has analysed and observed that in most jurisdictions, according to the existing financial arrangements with regard to the loss resulting from bank insolvency, although financial aid is granted to a failing bank from private funds, in order to eliminate the financial shortfall, this funding is not sufficient in all instances, that is why public finance capital injections, even though temporary, remain in demand³⁵⁷. The FSB states and provides rules to calculate bank debt, i.e. by excluding equity capital, uninsured depositors and safeguarded investor funds under DGS from the debt write-off measure. The FSB stated that the resolution authorities must have the power to impose the bank bail-in measure, which means that the application of this legal instrument enables writing off unsecured and uninsured creditor claims and their respective conversion into bank capital³⁵⁸. Such legal regulation is consistent with the BCBS recommendations³⁵⁹. Although this mechanism is not yet fully established in all jurisdictions, the FSB noted and found, among other things, that most jurisdictions are soon planning to implement the requirements of the FSB, whereas the leading jurisdictions in the banking sector (such as the United States, Switzerland, and the EU) have already implemented this mechanism³⁶⁰. For example, the EU Banking Recovery and Resolution Directive entitle all Member States to write off all bonds, convert them into shares and reduce them to zero³⁶¹. This legal mechanism forms one of the key aspects of the Directive. Once this mechanism is implemented to its full extent, it should be considered as one of the measures that will have a significant impact on higher borrowing costs for all banks, as bond holders will assume higher risk potential and more risky financial requirements, and accordingly will require higher interest rates on bonds. To ensure a smooth transitional period in the EU legal system, the Directive requires transposition and implementation of the bail-in tool in the national jurisdictions of the Member States no earlier than in 2016³⁶². It should also be noted that the EU legislators of the bank resolution legal regime were long unable to reach compromise, especially with regard to the hierarchy of creditors, sequence of claims, especially with regard to the seniority of securities holders and uninsured depositors, with intensive discussions taking place as to whether equity holders should always be fully written-off before satisfying depositors' claims.

Legal certainty and the right to terminate a contract³⁶³. The FSB admits the importance of legal certainty and continuity of financial performance of contracts at the time of bank resolution, including netting and continuity of collateral agreements, if the financial situation of the financial institution is in line with the conditions governing

357 FSB Progress Report, 2013. P. 6. FSB. Key Attributes 6.

358 Ibid.

359 BCBS Report 2010. P. 23.

360 FCB Progress Report, 2013. P. 5.

361 BRRD. Art. 37-51.

362 Ibid. Art. 131.

363 The right to terminate a contract, termination or other close-out, set off, netting arrangements rights in financial contracts held by counterparties of a bank, that may be triggered on the occurrence of an event or circumstances set out in the financial contract, such as an insolvency event or the entry into resolution of the bank.

bank resolution regime or the competent authority implements any conversion rights and powers. The essence of this principle is to create legal regulation that would not lead to the possibility of such an effect, which would empower any interested financial counterparty to speed up the procedures at the time of resolution, by means of early termination of contracts with the bank. Significant obligations must be placed on the counterparties, making them fulfill their duties to the bank when it becomes insolvent. Thereby, in order to guarantee that when transferring assets and liabilities to the private purchaser or bridge bank, the resolution authorities have sufficient time to identify the contracts to be transferred, it might be appropriate to impose proportionate restrictions on the counterparties' rights to complete, advance or otherwise terminate the financial contracts pending transfer. Such restrictions are necessary for the public authorities to obtain a real understanding of a failing bank balance, net of possible changes in the value and scale of bank assets, resulting from the intense exercise of termination rights. In order to ensure the minimum effect on the contractual rights of the parties to the transaction, termination rights should be restricted only with regard to the crisis prevention measure or crisis management measure. Whereas the right to terminate a contract by reason of other defaults, including the non-payment or failure to supply of the guarantee payment should remain in force. It should be emphasized that the resolution authorities may temporarily suspend the rights arising from the financial contracts of the bank. The aim is to avoid termination of high-value financial contracts and effects resulting in property sale at low price, giving priority to contract extension. For example, an agreement for transferring contracts to a healthy financial market participant or a temporary financial institution in a way that would not disrupt payments or discharge of obligations under a contract³⁶⁴. The recent bank insolvency cases demonstrated that termination of contractual relationships and the ensuing legal consequences may have pro-cyclical effects: when bank recovery and restructuring measures are officially applied, this may accordingly influence the contractual rights of the bank with regard to other counterparties and termination of contracts, and could only further weaken the solvency situation of the bank and cause market instability. As a result, the FCB fundamental principles recommended a temporary solution – contract termination, netting agreements³⁶⁵, set-off agreements³⁶⁶ in the case of bank conversion may be performed only if deemed appropriate in regard of the restructuring conditions or if the reorganisation authority has already launched its restructuring powers or initiated the first restructuring steps. This idea is based on the principle of contractual independence, because the parties are vested with independent obligations, under which the contract must be continued. Account must be taken of the 'financial contract integrity' in a way that termination of contracts and possible set-off

364 FSB. Key Attributes 4.

365 'Netting arrangement' means an arrangement under which a number of claims or obligations can be converted into a single net claim, including close-out netting arrangements under which, on the occurrence of an enforcement event (however or wherever defined) the obligations of the parties are accelerated so as to become immediately due or are terminated, and in either case are converted into or replaced by a single net claim, including 'close-out netting provisions' and 'netting' BRRD. Art. 2 (98).

366 Set-off arrangement' means an arrangement under which two or more claims or obligations owed between the institution under resolution and a counterparty can be set off against each other; *Ibid.* Art. 2 (99).

(especially of mortgage transactions, such as RAPO transactions) are permitted only if such termination is apparent from the failure of the parties to fulfill their obligation under the contract, and not because of the exercise of some restructuring powers³⁶⁷. Among other things, it is noted that when the contracts transferred to another legal entity, they must be assigned in full³⁶⁸. Subsequently, the BCBS recommendations further proposed that national authorities secured the powers to perform (or force to continue) financial contracts by transferring them to a third party that is a solvent financial institution. Such an approach would be more acceptable than early termination of contracts with the parties for netting purposes³⁶⁹. In 2013 the FSB progress report found that the law in the majority of jurisdictions still lacked effective solutions or legal safeguards that could minimise the negative impact on the rights of the parties³⁷⁰.

Hierarchy of creditors' claims. The fifth attribute identifies a clear need for legal certainty of bank insolvency procedures and regulatory predictability, especially in implementing comprehensively regulated legal bank resolution tools and in determining that conversion powers should be exercised in strict compliance with the statutory requirements for hierarchic filing of creditor claims. The proposal suggested granting some flexibility to the competent authorities by departing from general insolvency law, which is based on the principle of equality (*pari passu*) of the same class of creditors, whenever there is a need to prevent the spread of systemic risk of financial institutions or to maximise the benefit for all the creditors as a whole, considering that at the time of resolution all creditors of the bank meet their requirements at least to the same level as that in the case of liquidation (*least cost or creditors worse off*). It was also found that the judicial review possibility of creditors, particularly with regard to the size of the financial requirements, and the related judicial appeal mechanisms can in no way restrict or terminate the implementation of the legal resolution tools. The use of legal conversion measures must give creditors the right to compensate the damage by paying a compensation, if the claim is legally justified³⁷¹.

Funding mechanisms for private bank restructuring. This attribute requires jurisdictions to create privately funded financing arrangements, preferably by collecting fees from the industry, which could provide temporary financing and facilitate the resolution of financial institutions³⁷².

Aspects of cross-border bank resolution. This attribute estimated legal regulation that should facilitate the resolution of a financial institution operating on a cross-border basis. It is recognised that cross-border financial institutions remain controlled on the basis of national law and administered by national authorities. Therefore, it is necessary to provide statutory powers for competent authorities and, where possible, to take action in order to reach a global resolution solution for groups of financial institutions, in collaboration with the resolution authorities in foreign jurisdictions. Jurisdictions must provide

367 BCBS Report, 2010. P. 23.

368 FCB. Key Attributes 4, 3 and Annex IV. BCBS Report, 2010. Recommendation No. 9.

369 BCBS Report, 2010. P. 40.

370 Ibid. P. 6.

371 FSB. Key Attributes 5.

372 FSB. Key Attributes 6.

transparent and expeditious procedures in their national laws in order to influence the resolution tools applied by foreign competent authorities³⁷³. The FSB encouraged the conclusion of specific institutional cooperation agreements between the country of the parent financial institution and the country of the subsidiary financial institution, to be used in the preparatory stage of the banking crisis, or for its management, in particular when the crisis affects internationally significant financial institutions³⁷⁴.

Cooperation in the case of cross-border bank group insolvency. In the event of insolvency of cross-border banking groups, bank resolution strategies need to be split into two main parts: a single model and a multiple model. According to the first scenario, bank resolution tools are solely directed against the parent company or holding companies of the group (the holding) that are directly related to the banking group. In this case, the companies (subsidiaries) will manage to stay on a going concern basis. In the second case, according to the multiple strategy the entire group of banks fails in a given area and within its boundaries. Then reorganisation measures are applied by two or more resolution institutions. For example, a single entity approach was apparently preferred in a bilateral Memorandum of Understanding between the Bank of England and the US FDIC³⁷⁵. The EU directive was based on a coordinating and multiple approach³⁷⁶. Specific rules must be applied to international, systemically significant financial institutions. The FCB recommended creating a cross-border crisis management group to supervise GSIFI activities. This group could consist of supervisory authorities, central banks, resolution authorities, the ministries of finance and other public authorities responsible for the operation of guarantee schemes of financial authorities' group both in the subsidiary and in the parent state³⁷⁷. The FSB also recommends concluding specific cooperation agreements with institutions operating across borders, between the most related financial institutions of the banking group. For example, the EU Banking Recovery and Resolution Directive created resolution colleges³⁷⁸ where a general restructuring and supervisory authority was to take the lead, in this case – in the case of the EU – the European resolution college, the European Banking Authority³⁷⁹. One of the most important aspects of cross-border cooperation is information sharing. The competent authorities were recommended to reach an agreement on mutual co-operation agreements. The FSB found that, in any case, the jurisdiction must have explicit rules for confidential information sharing with foreign jurisdictions for bank resolution purposes³⁸⁰.

373 FSB. Key Attributes 7.

374 FSB. Key Attributes 9.

375 Federal Deposit Insurance Corporation and Bank of England. *Resolving Globally Active, Systemically Important, Financial Institutions*. 10 December, 2010. P. 6-9.

376 BRRD. Art. 80-83.

377 FSB. Key Attributes 8, 9.

378 On a banking group level, resolution authorities must set up resolution colleges for the fulfillment of the tasks and, where necessary, ensure cooperation and coordination with third country resolution authorities. The resolution colleges constitute a system in which a group-wide resolution authority, other authorities and, where appropriate, the competent authorities and the consolidating supervisor perform statutory duties. BRRD. Art. 87.

379 Ibid.

380 FSB. Progress report. P. 6.

Recovery and resolution plans and assessment of solvency problems. The FSB encourages to organise *ex-ante* assessment of bank viability, at least of the financial institutions that are internationally regarded as systemically important³⁸¹. Sustainability assessment shall consist of continuing and reappearing insolvency planning processes, designed to identify and resolve potential restrictions of substantive law. The FSB attributes require that all parent and subsidiary credit institutions of global systemically important financial institutions and the competent resolution authorities comply with bank crisis management principles by providing pre-banking crisis preparation and planning³⁸². Such an evaluation should be led by the competent authority of the parent country, in coordination with the competent authority of the subsidiary credit institution³⁸³. According to the key principles of cross-border cooperation on crisis management, published in October 2009, financial institutions were obliged to adhere to the ‘emergency’ plans, sometimes called ‘contingency insolvency cases to encourage the planning’. These bank recovery and resolution plans should be regularly reviewed in order to ensure that they remain realistic, justified and competent. The FSB provides that emergency plans should consist of potential financing plans for banks under intense practicable and adverse banking market scenarios. It should be noted that already in 2011 the FSB recommended that all international systemically important financial institutions needed to develop and maintain ‘recovery and resolution plans’, by providing a list of the ‘essential elements’ *ex ante*³⁸⁴. The BCBS issued the same recommendation³⁸⁵.

Bank recovery and resolution plans include early planning phase of the financial institution’s insolvency, where at the time of radical changes in the banking system the bank would be able to stay off insolvency or prevent liquidation, by maintaining the viability of bank activities. For example, under the EU Bank Recovery and Resolution Directive, financial institutions should take the initiative to prepare these recovery and resolution plans in accordance with the rules enshrined in the Directive³⁸⁶. Resolution authorities should assist in preparing resolution plans. Such plans should provide a specific resolution action plan (‘insolvency roadmap’) in order to avoid insolvency procedures for banks and find solutions at a point of insolvency when the institution can no longer be considered as perspective and financially viable³⁸⁷. In its last progress report, the FSB announced that most jurisdictions lacked the rights and powers to require banks to make changes in their management structure in order to improve their problem solution³⁸⁸.

Applicable law. Most of the above-mentioned attributes associated with insolvency law of financial institutions leave broad discretion to the states and their resolution authorities to establish optimal legal regulation. However, in line with the FSB features, it is admitted that the competent authorities are required to ensure at least minimum trans-

381 FSB. Key Attributes 10.

382 FSB. Key Attributes 8.

383 FSB. Key Attributes 10.

384 FSB. Key Attributes 11. Annex III.

385 BCBS Report, 2010. Recommendations No. 6.

386 BRRD. Art. 10.

387 BRRD. Art. 5-13.

388 FSB. Progress Report, 2013. P. 6.

position of the resolution attributes listed in the document into their national law. The rules must be consistent with the constitutionally protected fundamental remedies in the respective countries. It is important to note that in its guidelines the FSB prioritises *ex post* compensations for potential losses suffered by financial institutions and related to resolution actions, rather than the option of *ex-ante* loss compensation, as they believe that such regulation may unduly restrict the process of implementing the resolution measures. This raises an important question whether the implementation of the bank resolution tools at national level will not result in the conflict of various competing public and private interests and whether it will secure fundamental human rights and allow avoiding their violation, e.g. by securing the inviolability of property rights. These aspects will be explored in subsequent sections in more detail.

In summary, it can be said that the FSB provided legal justification for model legal regulation of bank resolution procedures, by also publishing resolution progress reports, evaluating the success of jurisdictions in implementing the recommendations and the incorporation of international provisions into national law. On the one hand, it can be considered that the FSB key attributes will serve as a tool to solve the problems that existed prior the recent banking crisis, e.g. the 'too big that fail', allow minimising taxpayers' money when rescuing distressed banks, and avoiding public support during conversion. Financial institutions will not suffer higher funding costs, market discipline will not be undermined, fair competition between financial institutions of different sizes will be ensured and public finances will not be adversely affected³⁸⁹. On the other hand, some aspects deserve criticism. FSB is not a typical international organisation or authorised supervisory authority. It is an informal structure without institutional powers based on public law and it cannot legally impose the implementation of the standards adopted by the FSB, for example, by applying sanctions. In any case, since April 2009 the countries involved in the activities of the FSB officially and voluntarily committed themselves to implement these international financial standards in the field of financial stability³⁹⁰. However, it is difficult to scientifically understand and explain such an organisational structure as that of the FSB. On the one hand, the organisation represents the interests of its members, acting on the basis of emergency international administrative law. Other scientists are of an opinion that the FSB represents the network of transnational governments³⁹¹. In essence, in the absence of any international agreement governing bank insolvency procedures, the FSB remains a primary, authoritative creator of legal bank insolvency procedures at the international level, which is engaged in monitoring, but also provides advice on regulatory development and implementation of regulatory policies³⁹².

389 FSB. Report of the Financial Stability Board to the G-20 Progress and next steps towards ending "Too-Big-To-Fail". 2013 [interactive]. [accessed on 10-12-2014] <http://www.financialstabilityboard.org/publications/r_130902.pdf>.

390 FSB. Framework for Strengthening Adherence to International Standards. 2010 [interaktyvus]. [žiūrėta 2014-09-26] <http://www.financialstabilityboard.org/publications/r_100109a.pdf>.

391 Giovanoli M. *Supra* note 85. P. 20. Kingsbury B., Krich N., Stewart R.B. *The emergence of a global administrative law*. University Public Law and Legal Theory Working Papers, Paper No. 17. New York, 2005. Kingsbury B. *The Concept of Law in Global Administrative Law*. ILLJ Working paper 2009/1. Global Administrative Law Series, NYU School of Law, Public law Research Paper No. 09-29.

392 FSB Charter. 2 str. (1) (a) (b).

1.5.1.2. Basel Committee on Banking Supervision

Basel Committee on Banking Supervision (BCBS) at the International Bank of Settlements is the oldest and certainly the most notable international organisation³⁹³ setting global international standards for the regulation of financial services. Since the beginning of the recent financial crisis, BCBS was actively preparing reports and legal regulatory guidelines on bank insolvency procedures, including the development of bank resolution regime. BCBS activity was mostly focused on cross-border banking regulation. The Committee recalled that prudential requirements were not enough to avoid banking crises. In other words, in order to protect financial institutions from public aid dependency and the financing of the Central Bank acting as a lender of last resort, a credible bank resolution legal regime must be created³⁹⁴. The first BCBS report and recommendations regarding regulatory improvement of bank insolvency was published in March 2010. The report was based on the case studies of *Fortis*, *Dexia*, *Kaupthing* and *Lehman Brothers* banks. After examining these bank insolvencies, ten recommendations were submitted, suggesting ways to improve the effectiveness of the resolution powers of competent national authorities. It was concluded that banking group insolvency situations have been resolved at national level so far, according to the so-called principle of territoriality. The Committee noted that according to such legal regulation the problems of the banking group resolution could be treated as a whole, including branches of foreign financial institutions, according to the so-called principle of universality. BCBS also suggested the method combining both of the abovementioned principles. The principle of territoriality has been recognised as the most feasible one, to be followed in any case at the time of the banking crisis. Legislative changes in the national law were also suggested, so that the two principles complement each other. The BCBS concluded in its findings that national authorities must contain legal bank resolution measures that could ensure proper conversion of all kinds of financial institutions, contributing to (i) the minimisation of systemic risk; (ii) adequate protection of consumer rights; (iii) mitigation of moral hazards; (iv) market efficiency and better productivity.

BCBS recommendations were signed and approved in June 2010 at the G20 Toronto summit, and the respective states undertook to implement them in their national law. In

393 The BCBS was established in 1974 by the ten largest countries engaged in the field of financial services and governors of the central banks. It is the Committee for banking regulation and supervision, dealing with practical issues in the field. The idea emerged after experiencing serious turbulence on the international currency and banking market. The first committee meeting was held again in February 1975. Since then meetings have been organised regularly, three to four times a year. The Committee strongly increased the legal number of members in March 2009– and June 2009. All the relevant jurisdictions are members of the Committee. Normally the Committee meets in BIS, Basel, Switzerland, where the permanent secretariat is located. The Committee provides a forum for regular cooperation among its Member States in matters of banking supervision. The committee pursues its objectives by implementing three primary goals: (i) exchanging information on national supervisory arrangements; (ii) improving the effectiveness of international banking business supervisory techniques; (iii) establishing minimum standards for banking supervision in the areas of demand. Compendium of documents produced by the Basle Committee on Banking Supervision. 1999. Bank for International Settlements, Basel, Switzerland. P. I. Koch B. E. *Supra* note 13. P. 40-42. Basel Committee on Banking Supervision Resolution policies and frameworks - progress so far. 2011. P. 1.

394 BCBS. Report and Recommendations of the Cross-border bank Resolution Group, 2010. P. 3.

June 2011 the BCBS published a progress report reviewing the implementation of legal arrangements governing bank restructuring in different jurisdictions³⁹⁵. It was noted that many jurisdictions have already adopted new legislation or made the necessary legislative amendments in order to improve their bank resolution regimes in line with the BCBS recommendations.

BCBS has arrived to the conclusion that the recent regulatory reforms revealed that countries have already established special legal rules governing bank insolvency to regulate critical banking insolvency procedures, created a distinct legal regime for bank resolution and special resolution tools, which are to be considered as operating in the public interest: aimed at financial stability and legal protection of retail depositors. The report mentions difficulties in determining bank insolvency and diverging conditions for such determination in different jurisdictions as one of the fundamental problems. Furthermore, in some jurisdictions, certain resolution tools still require court approval, which is contrary to the IFS³⁹⁶. The competent authorities in many countries still lack legal authority to solve bank insolvency problems, and even though the law regulates resolution tools, there is a lack of specific fundamental rights protection and legal safeguards for the affected shareholders and creditors, including the right to terminate the unnecessary agreements, extend the necessary agreements, sell bank assets and transfer the obligations. In such a situation, bank resolution could be costly and challenging. The Committee identified lack of legal powers for the competent authorities as one of the most significant gaps to restructure systemically important financial institutions and successfully complete the resolution of other ordinary financial institutions. Another important aspect relates to the fact that the competent authorities in most countries lack legal authority to allow temporary suspension of early contract termination provisions of the financial contracts and their implementation. This is crucial in order to transfer such contracts to the solvent financial institution, a bridge bank or another public entity. The report also discusses problems arising from trans-national banking groups.

BCBS recommendations undertaken to implement by the G20 states in their national law are an extremely important guidance document for regulating international bank insolvency procedures. Progress reports reveal that the increasing number of countries have already implemented a particular bank resolution regime and created special legal norms. At the same time, this does not mean that the jurisdictions were able to fully address the recommendations. Reforms are still ongoing, and there is much work to do to ensure the financial stability of large financial institutions and to encourage the conservation of the relevant functions carried out by financial institutions (stabilisation and continuity of authority). As the FSB, the BCBS is a legal person with undefined legal status. In any case, BIS has its own infrastructure and staff³⁹⁷. BCBS is a member of the FSB, and in any case is accountable to the FSB despite the reporting agreements or independence³⁹⁸.

395 BCBS. *Supra* note 15.

396 *Ibid.* P. 2.

397 However, BCBS for the time being haven't published any documents on its internal structure and functioning.

398 *See more* Giovanoli M. *Supra* note 85. P. 29.

1.5.1.3. The International Monetary Fund and the World Bank

The International Monetary Fund (IMF) is not only an international monetary authority *par excellence*, but also a center of the international financial system³⁹⁹. It is an international organisation whose operation is guaranteed by the IMF Articles of Agreement⁴⁰⁰, seeking to promote financial stability and world monetary order. In addition, it should be noted that the IMF mandate has been expanded recently and now the IMF is clearly aimed, *inter alia*, international financial stability⁴⁰¹ objectives. It must also be noted that the IMF is the only institution that is totally legitimate according to international law, with detailed functions (supervision, conditional financial assistance, technical support), adequate financial resources and personnel, and plays a significant international role in the international financial system⁴⁰². The IMF has published major reports related to legal regulation of bank insolvency.

In April 2009 together with the World Bank⁴⁰³ the IMF published one of the most prominent studies of that time, entitled 'An Overview of the Legal, Institutional and Regulatory Framework for Bank Insolvency'⁴⁰⁴. The study was launched in 2004, but it was officially confirmed after the start of the international financial crisis, and at that time it was unable to influence the legal and institutional regulation of bank insolvency. The study was focused on the overview of traditional deposit-taking bank insolvency procedures in different jurisdictions, by comparing national legal regulation. The study reviewed multiple jurisdictions, legal, institutional and regulatory frameworks in the context of bank insolvency procedures. Finally, it provided recommendations for effective regulation of bank insolvency procedures in national law in order to prevent problems caused by bank insolvency procedures and the related difficulties. The primary objective of the guidelines was to resolve the difficulties arising from bank insolvency and financial stability issues. The study consists of two parts. The first part discusses the legal regulation that the state must adopt in order to be able to implement and coordinate international bank insolvency procedures and initiatives and to ensure financial stability. The second part examines the interaction between bank insolvency procedures and their features at the time of systemic crisis. After analysing different legal systems from a comparative perspective, the study proposes the concept of bank insolvency procedures, their composition, and provides the interpretation of the objectives pursued by such procedures. The study is useful also in the sense that it clearly distinguishes bank restructuring and bank liquidation institutes,

399 Lastra M.R. The role of the IMF as global financial authority. European Yearbook of International Economic Law. Vol. 2, 2011. LSE Financial Markets Group Paper Series. Special paper No. 192. P. 1-2.

400 Articles of Agreement of the International Monetary Fund. Washington DC. 2011 [interactive]. [accessed on 15-11-2014] <<https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf>>.

401 Ibid. Art. 1, Art. 4.

402 Lastra M.R. *Supra* note 399. P. 4.

403 WB works with other TFS-setting bodies and their members, i.e. individual countries to strengthen legal, institutional and regulatory supervision in the financial sector. WB supports financial sector development, progress and stability through various aid and lending instruments, bilateral technical assistance and other instruments, such as the joint IMF/WB Financial Sector Assessment Programme and the TFS initiative. IMF, WB. *Supra* note 86. P. 3.

404 Ibid.

provides a detailed analysis of the pre-insolvency stage of the bank, and examines formal administrative procedures and operational principles.

In September 2009 the European Department of the IMF published a working document to review the need for a particular legal regime of bank restructuring in the EU⁴⁰⁵. It contains valuable comments with regard to the regulatory design of bank insolvency and the fundamental legal principles, by discussing the main lessons learnt from the financial crisis, and a number of cross-border bank insolvency issues. In addition, the document states that the international financial crisis has clearly demonstrated the legal consequences of the vacuum in the banking resolution regime and the defectiveness of the legal regulation governing bank insolvency procedures. Among other things, this document suggests ways for effective legal regulation of bank restructuring and the legislative instruments to be available during the banking crisis and the optimal tools to manage the banking crisis. The document focuses more on the analysis of the EU financial sector, while touching other regulatory jurisdictions from theoretical and practical perspective.

In June 2010 the IMF published a report entitled 'Cross-border bank resolution - proposed legal regulation that could enhance coordination of the competent authorities'⁴⁰⁶. The report emphasized the importance of harmonisation of the global bank resolution regime. In the report, countries that have already implemented the proposed legal regulation are treated as 'ensuring a harmonised legal regulation'. It should be noted that the cooperating authorities may share the financing burden of an insolvent bank and agree on joint restructuring actions with cross-border implications.

Unlike the G20, the IMF is not a selective organisation in the form of a member club of the world's most influential countries. It is a full-fledged international organisation engaged in comprehensive financial regulatory functions and implementing international monetary policy at the institutional level and with general membership. For this reason, the IMF better represents the interests of countries, compared to the G7 or the G20 framework, but has limited quotas in the decision-making mechanism⁴⁰⁷. The IMF is not only involved in the preparation of the international financial architecture and standards, as a member of the FSB, but also assumes responsibility in relation to the overall monitoring and maintenance of the international financial system. Moreover, it is linked to the review of implementation of international financial standards in individual countries in the context of bank insolvency procedures.

1.5.1.4. United Nations Commission on International Trade Law (UNCITRAL)

The central mission of UNCITRAL is to provide certain regulatory models (recommendations) and model laws to national legislatures, members of UNCITRAL⁴⁰⁸. Such

405 IMF. *Supra* note 15.

406 Haan S., Vinals J., IMF. *Supra* note 285.

407 Compared to the relevant UN rule of 'one country-one vote' (with the right of veto at the UN Security Council), the financial capacity of participants is based on the weighting of votes for adopting decisions related to financial matters. The Member States participating in the IMF pay fees based on their economic criteria. See more. IMF. Governance. Country representation [interactive]. [accessed on 12-11-2014] <www.imf.org/about>.

408 Currently, the organisation consists of 60 Member States elected for a 6-year period and representing

legislative models⁴⁰⁹ can potentially eliminate regulatory gaps in national legislation and commit the courts to take into account these recommendations and to apply 'soft law' (a source of law) in areas falling within the scope of UNCITRAL principles⁴¹⁰. In 2004, the Commission released the first and second legal principles of the 'Legislative Guidelines for Insolvency Law'⁴¹¹. These guidelines discussed national insolvency procedures and the fundamental problems of their application. The principles set out in the Guidelines apply only to ordinary business entities (financial institutions are outside their scope). Part 3 of the amendments to the same guidelines, published in 2010, discusses the treatment of corporate groups in case of insolvency both nationally and internationally⁴¹². It should be noted that these amendments have expanded the scope and incorporated financial institutions. The central feature of this model law is the principle that the courts of one jurisdiction 'recognise' the insolvency proceedings of another jurisdiction. On the one hand, some of these principles are not suitable for banks (mainly those operating on transnational level), but on the other hand, some of these principles are very much related to the financial institution insolvency procedures: (i) they clearly distinguish core and secondary insolvency procedures with regard to the debtor according to the place of operation of the legal entity; (ii) they govern the principles of cooperation between the competent authorities, calling for direct communication and information exchange on overlapping insolvency procedures; (iii) they provide for certain discretionary legal protection, whereby model law prohibits discrimination against foreign creditors; (iv) they recommend signing cooperation protocols between the competent authorities, and cooperation is ensured through negotiated protocols concluded between competent authorities with regard to certain cases. Protocols often take the form of formal contracts negotiated on the basis of representation of experts representing the parties concerned with insolvency proceedings. In addition, such protocols are approved by relevant courts.

It should be emphasized that the legal principles of UNCITRAL⁴¹³ are the result of the research-intensive work of the most prominent scientists representing different legal systems of the world. These principles codify and present the most flexible decisions that

five regional groups. One of the working groups is Insolvency Law working group. For more detailed information see Clift J. UNCITRAL. Senior legal officer of UNCITRAL. Insolvency Law. INSOL International presentation.

409 The aim of *model law* is not to harmonise national insolvency law. The main problems addressed by model law related to the recognition of foreign insolvency procedures, the coordination of insolvency procedures by reason of insolvency of the debtor, protection of foreign creditors' rights, rights and obligations of international insolvency representatives, such as insolvency administrators, cooperation between public authorities in different countries. Model law is not based on an international treaty and creates no binding international obligations. Its activities are largely dependent on the functioning at the local level.

410 Koch B.E. *Supra* note 13. P. 37.

411 United Nations Commission on International Trade Law. Legislative Guide on Insolvency Law. United Nations, New York, 2004. 1, 2 d.

412 Wessels B. International Insolvency Law. 3rd edition. Kluwer. Deventer, 2012. 10425 para [interactive]. [accessed on 10-12-2014] <<http://www.uncitral.org/pdf/english/texts/insolven/Judicial-Perspective-2013-e.pdf>>.

413 UNIDROIT. International Institute for the Unification of Private Law. Unidroit Principles of International Commercial Contracts. 2010. International Institute for the Unification of Private Law, Rome.

are most suited for international commercial trade. The problems discussed in this report are rather dedicated to ordinary companies, with banks and other financial institutions falling within the scope of the Guidelines only in particular cases. However, by their legal nature, UNCITRAL principles are very similar to those identified by the BCBS in its review of cross-border banking group insolvency. It is equally important that the BCBS recommends to use the UNCITRAL guidelines for banking groups facing insolvency⁴¹⁴. It should also be noted that currently UNCITRAL working groups are actively working on the *United Nations Convention on insolvency*, particularly concerned with regulation of cross-border group insolvency. The ongoing debate now concerns the best ways to reflect the FSB bank resolution attributes in the Convention, especially in the case of insolvency of systemically important cross-border banking groups⁴¹⁵.

1.5.2. Major Regulatory Reforms and Developments in the EU. The Banking Union Perspective

Recently the EU legislative bodies have reached an agreement on the Banking Union⁴¹⁶. The legislation reflects a definite trend to unify bank insolvency procedures and their application in Europe⁴¹⁷. It was the largest legislative EU project since the creation of the euro⁴¹⁸. This means not only that the Banking Union legislation must ultimately replace national bank insolvency law and legal rules and unify them. This is both an attempt to strengthen and empower the competent authorities of the EU Member States, by granting them minimum powers in the case of the banking crisis, to recapitalise or restructure banks, creditor claims, in order to avoid direct bank liquidation and mitigate the effects caused by bank insolvency on the financial system. For example, it provides more legal measures to first restructure and only then liquidate banks: separation of the bank assets, bank (or bank business) sale, partial debt write-off or conversion of debt into securities, bridge bank. It should be noted that eventually the new EU legal framework governing

414 BCBS report, 2010. P. 26.

415 Baer G. IS Subcommittee update. UNCITRAL Working Groups approves insolvency convention study. *Insolvency and Restructuring International*. Vol. 8., No. 1, 2014.

416 The development of the Banking Union, in particular, was aimed at creating an integrated EU financial framework to ensure financial stability and to reduce the costs incurred in the event of bank failure. The Banking Union is based on a comprehensive and detailed set of rules for financial services. It should be emphasized that at the time of Lithuanian Presidency, tremendous progress was achieved in the development of the Banking Union in the EU (negotiations with the EP on bank recovery and resolution and deposit insurance framework directives were completed, and the Council reached an agreement on a Single Bank Resolution Mechanism Regulation).

417 Before the Banking Union, bank resolution and/or liquidation procedures in the EU were not harmonised. The essence and procedures of the Member State laws and regulations governing bank insolvency vary widely. BRRD. Recital (4).

418 Barnier M. The EU and US: leading partners in financial reform. Speech at the Peterson Institute for International Economics, Washington DC, June 13, 2014. [interactive]. [accessed on 10-12-2014] <http://europa.eu/rapid/press-release_SPEECH-14-465_en.htm>. Constâncio V. Banking Union: meaning and implications for the future of banking. Speech by Vice-President of the ECB, at Banking Union Conference organised by the Master in Banking and Financial Regulation, Navarra University, Madrid, 24 April 2014.

bank insolvency will be fully transposed into the national legal systems of the EU Member States and that the regulations are directly applicable, which fundamentally changes the pre-existing bank insolvency legislation. Thus, the Banking Union works as a new tool for managing the banking crisis in the EU.

How legislative idea of the Banking Union was born? The recent international financial crisis has provoked reforms in the European Union's financial sector in the field of legal regulation and bank supervision, and the Banking Union project was to become the key tool for managing the banking crisis. In 2007-2009, at the peak of the financial crisis, most of the EU Member States were lacking an adequate legal regime for bank restructuring that could successfully ensure orderly restructuring and/or liquidation of a financial institution that is failing or likely to fail (including banks). Before the financial crisis, the EU Member States dealt with the problem of insolvent banks using general insolvency law. At the beginning of 2008, as soon as significant number of large banks, including, but not limited to such large and systemically important banks as *Fortis, Dexia and Royal Bank of Scotland*, were failing or likely to fail, the absence of effective bank resolution and recovery regulations in the EU Member States became evident. In the result of such a situation, authorities launched random efforts (such as freezing, seizing and confiscating the assets of the bank under their jurisdiction in order to settle with creditors and pay compensations to depositors) to strengthen banks, which in some cases resulted in sovereign debt crises. Furthermore, when certain banks faced with financial difficulties, national authorities mostly relied on desperate *ad hoc* measures, e.g. by providing government guarantees and applying additional capital injections to failing financial institutions⁴¹⁹. In the center of the deepest global economic recession since the World War II, the financial crisis has demonstrated obvious regulatory gaps and the fact that the EU lacked a precise and predictable legal framework governing proper reorganisation or liquidation of a credit institution facing financial difficulties without threatening financial stability⁴²⁰. The EU's financial crisis has become a serious challenge for national and European institutions and their ability to manage the problems of bank insolvency procedures. At the same time, the European Union's financial markets became strongly integrated, so that collapses in one Member State could shortly be felt in other Member States⁴²¹. Already since 2007, the beginning of the financial crisis, acknowledged world's economists and lawyers launched a discussion on the necessity to initiate legal regulation reforms in the EU. Until the time when legislators and the relevant EU institutions placed legal bank regulation on top of the agenda. However, in practice, the academic community remains concerned with the following questions: *What is the object of the Banking Union? What is it for? Funded by who? Controlled by who? What is its legal basis?*

419 According to the IMF estimates, the financial crisis related losses incurred by European banks between 2007 and 2010 amounted to nearly EUR 1 trillion, or 8% EU GDP. In addition, it should be noted that during the period from October 2008 to October 2011 the European Commission approved EUR 4.5 trillion (37% of EU GDP) of state aid measures to financial institutions. Alexander K. *Enhancing European Bank Resolution and Recovery*. ERA Forum, Vol. 14, No. 1. Academy of European Law. 2013. P. 459.

420 BRRD. Recital (5), (56).

421 SRM. Recital (1).

In October 2010 the European Commission published a Communication⁴²² setting out the particular plans to improve the EU's financial sector crisis management system. According to the envisaged system, public authorities would have standard and efficient tools and powers to prevent the banking crisis, to preserve financial stability and minimise the risks of bank insolvency procedures, especially taxpayers' loss. In June 2010 the EP, acting on his own initiative, adopted report-recommendations for cross-border banking crisis management. The EP stressed the need to develop an EU-wide system for distressed bank management and recommended to achieve greater integration and consistency, addressing issues related to cross-border financial institutions insolvencies which are subject to the conversion requirements and procedures. In December 2010 the Council of the European Union (ECOFIN⁴²³) adopted its conclusions⁴²⁴ calling for the creation of the EU system, among other things, designed to prevent, manage, and resolve banking crises. The conclusions underlined that the system should be applied to improve banks of all sizes, promote cross-border cooperation and be based on three pillars of bank insolvency procedures (preparatory and preventative measures, early intervention and restructuring and resolution tools and powers with regard to credit institutions). The aim of these measures should be to preserve financial stability by protecting public and market confidence; giving priority to prevention and preparation for bank insolvency; provide credible bank resolution tools; enable fast and decisive bank resolution action; reduce the tendency to act less responsibly and minimise the total cost of public funds, to ensure fair burden-sharing among financial institutions, stakeholders; contribute to a smooth resolution of cross-border financial groups; to ensure legal certainty of bank insolvency procedures and to reduce the distortions of competition in default situations.

National governments of the EU Member States realised that in certain cases banks and other systemic financial institutions can not be permitted to fail, i.e., be liquidated by ordinary bankruptcy procedure. In the event of a large bank failure, those functions could not be terminated without causing significant systemic damage. The actions that governments were bound to undertake with regard to banks in a tense situation – capital injections, backup of illiquid assets, issued guarantees on assets and discharge of liabilities and liquidity support – succeeded in stabilising the financial system to a certain extent.

422 EC. An EU framework for Crisis Management in the Financial Sector. COM (2010), 579. Brussels, 2010. The communication provides guidance followed by the EC on the basis of the work done to date on crisis management and legal regulation of bank resolution. The communication notes that the EC will continue its preparatory work along these lines, so that in spring 2011 it would submit legislative proposals. The proposal was accompanied by an impact assessment and was the last step of the EC in implementing the principal international regulatory reforms agreed at the G20 level. Public consultation on technical details of the legislative framework under consideration was launched in December 2010. In addition, Section 6 of the Communication discusses further work related to bank insolvency law reform and cross-border banking groups.

423 The European Economic and Financial Affairs Council is responsible for the EU's policies in the following key areas: the economy, politics, tax issues and financial services regulation. Its areas of expertise include legal and practical matters, such as: the EU's single currency, problems of the euro, coordination of action at the international level between the G20, the IMF and the WB. Also other financial services regulatory issues related to international regulation. The ECOFIN Council is composed of all the EU Member States' economic and finance ministers. [interactive]. [accessed on 10-12-2014] <www.consilium.europa.eu/council/council-configurations>.

424 CoE. ECOFIN, 2010. Findings No.17006/1/10.

Nevertheless, such action aimed at supporting failing credit institutions and creditors required enormous public financial costs. The EU governments committed to provide public funds amounting to around 30% of the EU's GDP, while state aid amounted to 13%⁴²⁵. Such intervention by governments significantly affected the level playing field in the EU internal banking market. Therefore, the EC demanded that, where applicable, the costs related to credit institution's insolvency be shared and measures be taken to limit such competitive distortions in accordance with the relevant provisions of the EU Treaty. A need arose not only to improve deregulation, which would reduce the chance that the financial difficulties faced by some banks become critical, but also the need for reliable, predictable, well-defined regulation of bank insolvency procedures. Only then market discipline associated with bank failures and threats would be restored, the moral hazard reduced, implicit protection against bank failures achieved, which was usual practice in the banking sector during the financial crisis.

Finally, in September 2012 the EC launched the Banking Union idea. The first stage legislative proposals were focused on the creation of the eurozone banking supervision mechanism. Three documents were included in the project: (1) Regulation on the specification of the supervisory functions to the ECB; (2) Replacement of the Regulation on the establishment of the European Banking Authority (EBA); (3) Communication from the EC to the EP and the Council on the guidelines of the Banking Union, providing an action plan for the remaining elements of the Banking Union, i.e. a unified system of bank resolution and a single DGS. The purpose of the proposal with regard to the Banking Union was firstly that the Banking Union, in particular, was to strengthen banking sector stability and confidence in the euro. In the long term, it was expected that the Banking Union could contribute to the strengthening of the economic and monetary union. Secondly, under the proposal for a unified banking supervisory mechanism (hereinafter - SSM), entrusting the euro area banking supervision to the ECB, was based on the need to promote the internal market in financial services, which essentially formed the basis for the EU's economic recovery. The EC considers that if banking supervisory expertise remaining at national level limits the effectiveness of supervision, then, in the context of the single market, it does not allow for the direct application of bank recapitalisation using the funds of the European Stability Mechanism⁴²⁶, and the ECB was therefore proposed as the one to perform core banking supervisory functions. In addition, in view of the new role of the ECB, revision of the Regulation of the European Banking Authority (EBA) was suggested. The EC was seeking to preserve the role and tasks of the EBA (namely to develop uniform rules on financial services – single rulebooks for financial services –, ensure convergence of supervisory practices and cooperation between national supervisory authorities).

After the transition to the unified eurozone banking supervisory mechanism, the next stage was supposed to address overall protection of depositors' rights and integrated banking crisis management tasks. A single bank crisis management system should ensure priority for banking resolution by using private funds of the banking industry, in order to save taxpayer money. The system is aimed at the EU-wide harmonisation of bank

425 According to the information supplied by the European Commission's services and the Member States via the Economic and Financial Committee until December 2009.

426 Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism.

resolution tools and procedures. Each EU Member State shall establish a bank resolution authority and bank resolution funds consisting of contributions from banks. In this case, the EC believes that in the context of the Banking Union bank resolution could be more efficient as an integrated tool, especially in the case when bank resolution includes cross-border banks. *Banking Union comprises the following elements*: the Single Supervisory Mechanism⁴²⁷, Bank Recovery and Resolution Directive⁴²⁸, the Deposit Guarantee Schemes Directive⁴²⁹, the Single Resolution Mechanism⁴³⁰ and is based on common EU banking regulatory package – single rulebook, which essentially consists of supervision of bank capital requirements (the Capital Requirements Directive and Regulation (CRDIV/ CRR⁴³¹)). The Banking Union legislation replaced and unified the non-harmonised EU legal framework. The following part of the dissertation provides only a concentrated review of the key elements of the Banking Union, in so far as this is useful for the purposes of the research. Some other elements and institutes of the Banking Union will be presented in other parts of the dissertation.

A Single Rulebook for Financial Services

The recent banking crisis has highlighted the differences of transposition of the former Capital Requirements Directive⁴³² into national law, in particular in the area of prudential regulation, which posed a threat to the EU internal market. For this reason, the European Commission proposed a single rule book as one of the regulatory elements of the unified financial system for the purpose of application of unified banking prudential requirements in the EU⁴³³. New rules were created to enable credit institutions and investment firms to pursue their activities, determine their supervisory system and prudential banking regulation, in order to strengthen the solvency and credibility of credit institutions, e.g. by enhancing capital requirements based on Basel III framework. The applicable

427 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17).

428 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014.

429 Directive 2014/C/ 105/01 of the European Parliament and of the Council on Deposit Guarantee Schemes Adopted by the Council on 3 March 2014 (recast).

430 Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

431 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

432 Directives 2006/48/EB and 2006/49/EB.

433 If prudential requirements are imposed in the form of a regulation, direct application of these requirements would be ensured. This would guarantee a level playing field, by avoiding differences in national requirements, which could result in the result of the transposition of the Directive.

prudential requirements relate only to the operation of banking and financial services and are designed to ensure financial stability of market operators, and high-level protection of depositors and investors. The new legal regulation, *inter alia*, aims to strengthen management of credit institutions. In order to limit excess risk-taking of credit institutions (for example, operational efficiency of managing bodies in the field of risk oversight, by ensuring that the supervisory authorities strictly monitor and evaluate risk management).

A Single Supervisory Mechanism

The SSM will form the supervisory system of the ECB and national supervisory authorities. ECB will be in charge for the effective functioning of the entire SSM. In cooperation with national supervisory authorities, the ECB will directly supervise large and systemically important banks in the participating Member States (at least three major banks in each Member State of the eurozone, while other banks will be supervised by national authorities). Smaller banks will be directly managed by national supervisory authorities, in accordance with the ECB guidelines and recommendations. Non-eurozone Member States will be able to choose whether to participate in the SSM or not⁴³⁴. In such case they would have to notify their intentions to the other Member States, the EC, the ECB and the EBA, and to amend their legislation respectively, to make it clear that national supervisory authorities will follow the ECB instructions. Other key elements of the Regulation are further reviewed when analysing the role of supervisory authorities in different jurisdictions⁴³⁵.

Deposits Guarantee Schemes Directive

Another important regulatory proposal in the context of the Banking Union was the amendment of the Deposit Guarantee Scheme (DGS) Directive. The essential elements of the DGS proposal were to harmonise and simplify the scope of the Directive; to maintain a harmonised depositor compensation amount (EUR 100,000); to reduce the deposit payout term to 7 working days; to establish a harmonised DGS funding mechanism (obligatory *ex-ante* contributions, with *ex post* additional contributions of credit institutions, in case of insufficiency of the former, and finally, in the case of shortage of funds, alternative financing arrangements should be set up); to introduce risk-based contributions of credit institutions to the DGS, etc.

The goal of the DGS is to maintain depositor confidence and financial stability at the time of economic turbulence, by ensuring rapid payout to depositors in case of credit institution failure. The recent financial crisis has demonstrated that the application of the pre-existing fragmented DGS, depositors cannot benefit of equal conditions for guarantees in the EU, some systems lack sufficient funding, and for this reason the Member State and ultimately the taxpayers must bear the burden of a failed credit institution. The aim is to ensure that the deposit insurance fund holds enough resources and, where necessary,

434 See more 3 chapter 1 sec. 2 subsec.

435 See more 3 chapter 1 sec. 2 subsec.

depositors swiftly receive the insurance premium. DGS are intended to improve the protection of depositors' rights.

Other important aspects of the new regulatory framework. The new version of the Directive aims to harmonise and simplify all DGS in the EU, i.e. to establish a precise definition of a deposit, by clearly excluding financial instruments of a capital nature from the scope of insurance (deposit certificates, bonds, structured financial products, collective investment entities, pension fund deposits) and deposits of public authorities with regard to the transactions subject to a judgment in criminal proceedings on money laundering, and deposits of other financial institutions⁴³⁶. The new regulatory framework contains a provision preventing the EU Member States from discretionary application of exceptions, save for deposits held in personalised pension schemes of small and medium-sized enterprises and occupational pension schemes and deposits of local authorities with an annual budget of no more than EUR 500 000 for deposits⁴³⁷. Another particular feature is that the pre-existing level of deposit coverage in the amount of EUR 100 000 has been maintained, but the Member States are allowed to guarantee higher deposits in certain social circumstances (such as marriage, divorce, retirement, dismissal, redundancy, disability, death, deposits resulting from private residential real estate transactions, deposits based on insurance benefits or compensations for the damage caused by crime or case of wrongful conviction⁴³⁸). The new DGS provisions reduce the 20 working days payout period for depositors (with the possibility of extension for another 10 days in exceptional circumstances). The DGS ensures that the depositors receive their money within seven working days. The repayment term shall run from the date when the respective administrative or judicial authority decides on the insolvency of the bank⁴³⁹. At the same time, a transitional period is set until 31 December 2023, by fixing the following repayment terms: (i) up to 20 working days until 31 December 2018, (ii) up to 15 working days from 1 January 2019 to 31 December 2020, (iii) up to 10 working days from 1 January 2021 and until 31 December 2023⁴⁴⁰. Moreover, during the transitional period, if the DGS is unable to repay the required amount within 7 working days, by ensuring that depositors have access to the respective insured deposit amount to cover their subsistence costs within 5 working days after making the request⁴⁴¹.

DGS financing. As practice has shown, the *ex-ante* financing (when banks pay regular contributions in advance) is insufficient, and the funding *ex-post* (when banks pay contributions only if the activity of another bank is impaired) could adversely impact the liquidity of credit institutions and jeopardise stability in case of economic tension. Therefore, the Directive establishes a provision that by 2021 all DGS of EU Member States must achieve

436 DGS. Art 5 (1).

437 Ibid. Art. 5 (2).

438 Ibid. Art 6 (2).

439 In the DGS Directive, bank insolvency relates with a moment in time when a judicial authority, taking the reasons into account, adopts a decision suspending the rights of depositors to raise claims against the credit institution, or if an administrative authority finds that, in their opinion, for reasons directly related to the credit institution's financial circumstances, the respective credit institution is unable to repay the deposit at that time and or to do so in the nearest future. Ibid. Art. 2 (1), (h) (i), (ii).

440 Ibid. Art 8 (2).

441 DGS. Art. 8 (4).

a targeted level of funding, starting from a particular bank covered deposits amount. The Member States shall ensure that no later than 10 years after the Directive enters into force, the available DGS financial resources would reach at least 0.8% of covered deposits target level in the Member States⁴⁴². To ensure DGS funding, the following multi-tier method is proposed: *ex-ante* funding reserve, and if insufficient, credit institutions will have to pay *ex-post* contributions; while alternative financing arrangements are suggested as a measure of last resort. More risky credit institution would have to pay higher premiums (risk-based contributions).

Use of DGS funds. In principle, the funds are used to repay depositor losses, but Member States may also decide to use DGS to finance the prevention of credit institution collapse, early intervention and bank resolution measures, including transfer of deposits to another reliably functioning financial institution. In determining regular contributions in all cases account should be taken of the business cycle phase and the possible effect of pro-cyclical contributions on the framework of annual contributions.

Bank Recovery and Resolution Directive

The Bank Recovery and Resolution Directive⁴⁵⁹ (BRRD) establishes a single package of legislative measures for bank resolution that Member States may apply when a bank is failing or likely to fail. The aim of the new regulatory framework is to ensure that bank resolution will be financed by banks, and taxpayers' money will not be used for that purpose. The financing of resolution measures is primarily based on private sources: capital, Additional Tier 1 capital, Tier 2 capital, subordinated debt, etc. If these measures prove sufficient and separation of the bank would be required, then common resolution funds would be used. National resolutions funds are established for this purpose, and financed by contributions paid by banks. Resolution funds would be constituted from the *ex-ante* (or additional *ex-post*) bank contributions, the amount of which is expected to reach at least 1% target level of covered deposits over 10 years.

It also foreseen that banks will be obliged to draw up recovery and resolution plans *ex ante* to ensure that in case of a deteriorating situation and the application of resolution tools the systemic effects will be minimised. The new bank resolution regime (as opposed to ordinary bankruptcy procedure) provides for orderly liquidation of the bank, in particular by means of bank resolution tools and then passing to liquidation. In the case of orderly liquidation, the original bank would be preserved on the basis of the going concern assumption or could be transferred to the bridge bank, which would enable the authorities to transfer some or all of the failing bank's assets (including deposits or mortgage) to the temporary bank and to liquidate the distressed assets.

The BRRD establishes a new prevention, early intervention, bank resolution tools: for instance, the power to appoint a temporary administrator in order to replace the governing body and senior management or to work with them on a temporary basis; the requirement that the managing body of a credit institution examines the situation, determines the measures to address the identified problems and to draw up an action programme to

442 DGS. Art. 10 (2).

overcome the problems, and to adopt the implementation schedule; the requirement to remove or replace one or more of the managing bodies or senior management members, if it is established that the person concerned is unable to meet their obligations; the requirement to change the business strategy; the requirement to replace the existing legal or operational structure of the bank and to obtain all the information, etc.⁴⁴³.

The Directive provides for new bank resolution tools: *asset separation, sale of the bank; bridge bank, bail-in* tool (write-off and partial conversion of capital and creditor liabilities to share capital). Where the losses cannot be passed to other creditors, the resolution financing arrangement may make a contribution to the bank under resolution subject to a number of strict conditions including the requirement that losses totalling not less than 8 % of total liabilities including own funds have already been absorbed, and the funding provided by the resolution fund is limited to the lower of 5 % of total liabilities including own funds or the means available to the resolution fund and the amount that can be raised through *ex-post* contributions within three years. The exceptions of eligible liabilities of the bank could be applied only in the following cases: *Option 1 (general rule)*. 8% of the liabilities of the bank in resolution (including own funds) have already been written off or converted. *Option 2 (clause)*. At least 20% of the *risk-weighted assets* have already been written off. To apply the clause, it is necessary that the amount accumulated in the fund would reach at least 3% of the covered deposits. The discretionary exemption may not exceed 5% of the total liabilities of the bank in resolution. The resolution fund and other creditors (if their situation is not affected more negatively than it would be in case of bankruptcy) contribute to the application of exemptions. If the bank resolution fund lacks sufficient funds and after writing off all other liabilities (other than the liabilities to insured depositors) alternative funding sources are possible (such as the State, the European Stability Mechanism). The discretionary exemption applies only in exceptional cases, i.e. if this is required for financial stability.

Single Resolution Mechanism

In July 2013 the European Commission submitted a proposal to a European Parliament and the Council for a regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (hereinafter – SRM and the Fund)⁴⁶². The goal of the SRM– is to create a single bank resolution mechanism with centralised decision-making and control in the field of bank resolution, by establishing a single resolution board, to ensure a clear, uniform and consistent approach throughout the EU internal market.

Relationship between the proposal and other banking union initiatives. The SRM proposal forms an integral part of the Banking Union and is closely linked to the SSM and BRRD. The SRM requires a common and effectively functioning banking resolution system operating on the same level as the SSM. According to the SSM, from January 2014 the ECB performs banking supervision of the eurozone Member States. In case of insol-

443 BRRD. Art. 27 (1).

gency of cross-border banks, the ECB should resolve them in cooperation with many national authorities, which could obstruct solving bank insolvency problems and reduce efficiency. Another element of the Banking Union – the BRRD – is designed to regulate bank resolution at the national level. The SRM is also based on the conversion principles and instruments of the BRRD.

The legal basis of the SRM is Article 114 of the Treaty on the European Union, concerned with the creation and functioning of the internal market. According to that article, legislation shall be adopted under ordinary legislative procedure. The SRM Regulation will be directly binding on all Member States and applied to the banks of the Member States participating in the SSM and supervised by the SSM (currently – all eurozone banks). The banks of all Member States participating in the SSM will be involved in the SRM (in the European Union, this will comprise about 6,000 banks). The Member States not participating in the SSM retain the ability to join the SSM or SRM.

Single Resolution Board. A new EU agency – the Single Resolution Board – (the Board) is established for resolution of eurozone banks, by granting it legal personality. The main tasks of the Board is to prepare banking resolution projects, ensure their uniform application throughout the banks supervised by the SSM, monitoring of bank resolution schemes and their implementation at the national level, administration of the Single Resolution Fund (–the Fund), preparation of resolution plans and tools. The Board, acting together with the national authorities, will coordinate the preparation and implementation of bank resolution plans, but national authorities will not be able to veto or refuse to execute the decisions of the Board. The Board will provide guidance on the bank resolution scheme, and its decisions will be adopted in executive and plenary sessions.

*Single Resolution Fund*⁴⁴⁴. Any losses or other costs associated with the legal measures for bank resolution and their application, in particular, will be allocated and covered from shareholder and creditor funds and only as a measure of last resort, where necessary, by using financial industry funds. A single resolution fund is to be established for financing resolution. Banks will contribute to the fund and the fund size will amount to at least 1% of the total covered bank deposits of the Member States participating in the SRM (according to preliminary estimates, about EUR 55 billion could be accumulated over 10 years). *Ex-ante* contributions to the Fund will be determined by deducting equity funds and covered deposits from all bank liabilities (banks with larger comparative deposit share in the bank balance sheet will pay lower contributions to the Fund, but higher premiums will be paid to the Deposit Guarantee Fund. The Member States and the EU budget will not contribute. The SRB will administer the Fund. The fund will replace the national resolution funds of the SSM participating Member States. In the event of shortage of funds, additional *ex post* contributions may be imposed on banks. The fund will be able to borrow or lend funds to other non-participating national funds (lending is not obligatory). The use of the European Stability Mechanism (ESM)⁴⁴⁵ funds is not directly foreseen in the SRM proposal.

444 See more Ambrasas T. Financial Arrangements under the Single Resolution Mechanism. Several Problematic Aspects. *Justitia*, No. 79. Vilnius, 2014. P. 24-27.

445 The ESM was created by an inter-governmental agreement of the euro zone Member States, with the purpose to provide financial assistance to euro-zone countries facing financing problems threatening the financial stability of the entire euro zone.

National funds are to be gradually integrated into the general resolution fund. After completing this integration, banks would start making contributions directly to the Fund.

Use of the SRF. It is established that the Fund cannot be directly used to absorb losses. The Fund will be subject to the EU state aid rules, and can be used for bank resolution only after the shareholders and other unsecured creditors of the converted bank have already absorbed the losses to 8%, based on all liabilities of the converted bank. The Fund may be used for the following purposes: providing guarantees for the assets or liabilities of the converted bank, for issuing loans to the bank in resolution, for property redemption, capitalisation of a bridge bank, for paying compensations to shareholders and creditors if, following asset transfer, shareholders and creditors receive less than they would in the case of normal bankruptcy procedures. Such application may be extended if the bank is sold⁴⁴⁶.

Entry into force of the SRM. The SRM has been in operation since 1 January 2015, except for the application of the bail-in instrument, which is foreseen for 2016.

In summarising the preceding part of the research section, it should be noted that in 2008 many international organisations had not yet achieved any concrete regulatory results and the regulatory community long lacked international, comprehensive, coherent bank insolvency regulatory standards. In June 2010 the G20 summit in Toronto committed to design and implement the legal systems whereby public authorities were vested with the powers and tools to restructure or resolve all types of crisis-stricken credit institutions, and the burden ultimately not being transferred on the taxpayer. The G20 leaders urged 'to review the legislation governing resolution of financial institutions and insolvency laws in the light of the recent developments for the orderly winding up of a large and complex structure of cross-border credit institutions'⁴⁴⁷. In November 2011, the FSB document entitled 'Key Attributes of Effective Resolution Regimes for Financial Institutions' was approved⁴⁴⁸. This document arranges fundamental international principles and features of the IFS that are essential for the effectiveness of the credit institutions' resolution regime. It is assumed that after implementing these elements, public authorities will be able to methodically replenish credit institutions so that the risk of loss resulting from failure of distressed banks would not be transferred on taxpayers, by preserving the particularly significant economic functions of these credit institutions. The key attributes of financial institutions provide for a sufficiently comprehensive idea of the legal framework governing bank insolvency procedures. Some jurisdictions have already followed the recommendations by incorporating them into their national law, while others are still in the legislative process. International organisations are responsible for the progress of jurisdictions in implementing international financial standards. Although the reforms of the international financial architecture and adoption of standards took place mainly on the basis of 'soft law', all the major economies of the world undertook direct commitments to implement these IFS. Significant challenges are based on differences between national legal regimes and legal traditions, which is another reason for a comparative analysis of this study. For ex-

446 Ambrasas T. *Supra* note 444. P. 24-27.

447 The declaration of G-20 leaders adopted at the summit on financial markets and the world economy in April 2009.

448 FSB. *Supra* note 90.

ample, different treatment of creditor hierarchy may force national conversion authorities to seek compromise in cooperation with each other, if in one country 'local' creditors are treated exceptionally and their rights are protected to a lesser extent than in other national legal regimes governing conversion. Furthermore, legal barriers with regard to information sharing can lead to restrictions, e.g. by affecting overall resolution planning *ex-ante* (bank recovery plans), and disrupting the efficient cooperation of banks during the crisis.

1.6. Conceptual Framework of Bank Insolvency Procedures

1.6.1. The Theoretical Basis for Bank Insolvency Procedures

Like corporates, in order to gain profit, banks assume certain risks associated with their business activities. It is entirely reasonable that in the course of their conduct, banks may face financial difficulties or become insolvent. In some cases, bank managing bodies can restore its profitability and sustainability on their own initiative. In extreme cases, they are guided and instructed by the competent supervisory authorities subjecting them to risk-reducing steps. In other instances the managing bodies of the bank are financially incapable to reinstate the successful operation of the bank or are simply unwilling to try and solve the financial problems of the distressed bank⁴⁴⁹. When a bank is faced with financial difficulties, the supervisory authority is under a duty to initiate the solution of solvency problems faced by banks in accordance with the existing bank insolvency regulation⁴⁵⁰ in the relevant country, seeking to find an optimal bank resolution strategy.

Bank insolvency procedures are a complex economic, social and legal phenomenon, characterised by complexity, i.e. very close connection between substantive and procedural legal rules of various branches of law. Bank insolvency procedures include *inter alia* the removal of the bank managing bodies and/or introduction of sanctions against them, the suspension of the rights of shareholders and the direct bank takeovers by official authorities or any other officially empowered entity (e.g., a temporary administrator)⁴⁵¹. Bank insolvency procedures should be viewed as all kinds of official actions with a legal basis, a conduct directed against an ailing bank, if the latter meets the statutory requirements and the specific insolvency '*threshold*'. When the bank's financial situation meets the statutory requirements for bank insolvency, the bank is subjected to insolvency proceedings⁴⁵².

According to the jurisprudence, bank insolvency procedures are divided into the following stages of the banking crisis: prevention, early intervention, resolution and liquidation⁴⁵³.

449 IMF, WB. *Supra* note 86. P. 14.

450 *Ibid.*

451 *Ibid.* P. 15.

452 Lastra R.M., Schiffman H.N. *Supra* note 74. P. 85.

453 Fonteyne W., Bossu W. Cortavarria-Checkley L. etc. Crisis Management and Resolution for a European Banking System. Crisis Management and Resolution for a European Banking System. IMF Working Paper No. WP/10/70. IMF. European Department, Legal Department, and Monetary and Capital Markets Department, 2010.

After the recent banking crisis, it has been internationally agreed that, depending on the event or events that triggered bank insolvency and special characteristics of the event, the following bank insolvency crisis management hypotheses are distinguished, by strictly implementing one of the bank insolvency procedures:

(a) *Bank recovery procedure*. This procedure consists of specific legal instruments aimed at restoring the bank's financial sustainability and vitality, to determine whether the bank is or may be experiencing severe financial difficulties in the near future, but has not yet reached the stage that already requires regulator's intervention⁴⁵⁴. Bank recovery procedure reflects in the bank recovery plan, which are regarded as a particular preventive control measure, and the banks have a duty to prepare them at the time when a bank is still financially healthy. They also act as a precautionary measure, because bank recovery and resolution plans must be updated periodically⁴⁵⁵, even if the bank is financially healthy. In addition, bank recovery is associated with compliance with certain preventive criteria. The criteria may be both qualitative and quantitative. Thus, bank recovery procedure is implemented before insolvency stage and will not be further analysed within the scope of this study. In the legal doctrine, this procedure is considered as a primary and precautionary bank insolvency resolution measure.

(b) *Bank resolution procedure*. A broader analysis of the procedure is provided in the second part of the thesis. It is worth noting that, if the bank recovery procedure fails to achieve the expected results, the competent authorities apply formal sanctions, take legal action against the bank facing financial difficulties and implement *bank resolution tools*. The supervisory authority can apply resolution measures only when the bank meets the resolution threshold⁴⁵⁶. In the international context, according to the BCBS, the term 'bank resolution' is conceived as '*any action commenced by the national supervisory authority together with or without private sector involvement, and that mainly aims to preserve financial stability and/or to solve the serious financial problems that cause danger to the viability of the bank credit facility, and in the absence of such a bank resolution regime, the financial institution would not be able to stay longer viable (it should be compulsorily wound up due to bankruptcy procedure) and there is no reasonable prospect that it would happen in the future*'⁴⁵⁷.

(c) *Bank liquidation procedure*. Finally, if after applying certain bank resolution measures the financial institution remains financially non-viable and unsustainable, a classic bank liquidation procedure remains the only solution for the bank in distress. Basically, it is a normal bankruptcy procedure applicable to other business entities under the common insolvency law regime. According to this scenario, the regulator would be forced to close and liquidate the failing financial institution, based on the relevant insolvency (bankruptcy) law in force in a particular country and in accordance

454 Henry P., Pnevmonidis I. *Triggering events for recovery and resolution plans: towards better financial crisis management*. SZW 2013 S. 536, Schulthess Juristische Medien AG, 2013. P. 4.

455 Under the BRRD Directive, banks must update their recovery and resolution plans at least once a year: (a) after changes in the legal or organisational structure, operational or financial position; (b) where this may significantly impair recovery plans or when it is necessary to change the recovery plan.

456 See more 2 chapter 4 sec.

457 BCBS. *Supra* note 15. P. 7. See more 2 chapter 1sec. 2 subsec.

with the rules and provisions of that law. Regular insolvency laws remain directed at the liquidation of an insolvent business entity and maximisation of creditors' claims, whereas bank resolution rules are more focused on the preservation of the individual bank's assets and functions, such as maintaining the depositors and the critical banking functions.

1.6.2. Classification of Bank Insolvency Procedures in the EU, US and Switzerland

Bank insolvency procedures are classified differently, according to the national law of the relevant jurisdiction. However, identification of a particular type of bank insolvency procedure and their efficiency is an important step in the context of the bank resolution strategy. As soon as the particular insolvency procedure is settled for the bank, it grants public authorities the power to act promptly as soon as an individual bank faces financial difficulties⁴⁵⁸ and allows moving away from the ordinary corporate governance rules, which are often associated with the requirements to obtain shareholder consent. When the public authorities are exercising their powers, the actions related to insolvency procedures may, for example, affect state capital injections into the bank facing solvency issues or result in the requirement against the bank to collect additional capital from external sources, or transfer bank property to another investor without the consent of shareholders, which accordingly may affect the economic rights of shareholders and creditors. In case of an opposite scenario a public authority decides that it will not intervene in the bank and adopts a decision to liquidate the bank directly. In this case, traditionally a bankruptcy administrator is appointed, who takes control over the bank's assets and business operations of the bank seized, and the bank is finally wound up. Declaring and identification of a certain type of insolvency procedure means, *inter alia*, that the shareholder control rights are terminated and that shareholders and creditors require the residual assets of the bank to the extent of their financial claim.

Why is it important to distinguish types of bank insolvency procedures and to classify them? In particular, at first sight, the definition of types of bank insolvency a priori seems uncomplicated, but each has certain degree of complexity and are often confused with each other in practice. Second, depending on the criteria and conditions triggering bank insolvency, potential bank insolvency crisis has different stages. Third, this helps distinguishing more clearly a financially unsound bank from a successfully operating bank. Fourth, after identifying the actual financial situation of the distressed bank, a further solution that is most suitable for the interests of all the parties concerned may be

458 Bank insolvency triggering provisions and criteria are analysed in more detail in sec. 8 subsec. 1. It should be noted that for the purposes of the thesis, the term 'financial difficulties' is understood as a situation in which the bank is experiencing financial difficulties, but continues its normal activities, and at the same faces financing or capital deficiency, however, the relevant authorities or court has not yet declared its insolvency. The financial difficulties period ends by bankruptcy of a bank or its return to normal legally eligible capital and financial indicators. The legal regime of bank resolution could be distinguished only after determining the type of bank insolvency procedures, as one of the public authorities' intervention measures to restore normal bank business conditions or liquidate the bank and thus restore normal business conditions for all other banks operating in the country.

chosen. In addition, in practice, the competent authorities are often faced with an ambiguous and uncertain situation where it is not entirely clear how to correctly determine the financial viability of the bank and prospects. For example, when banks operate in different jurisdictions, a competent authority may face a variety of different terms and differences that can inadequately or insufficiently describe the degree of viability of the bank, bank resolution regime or provide for forced liquidation conditions of the bank. The terminology may be widely understood and interpreted, e.g.: *failing* or *likely to fail*, *insolvency event*, *in danger of default*⁴⁵⁹ or *default risk*⁴⁶⁰. Therefore, the precise classification of bank insolvency procedures would definitely contribute to minimising this problem. Another important aspect is that the society and practitioners sometimes still confuse *bank insolvency* and *bankruptcy* and these terms are often used as synonyms. Bank bankruptcy often means identification of insolvency by legal procedures, performed by a court or a competent supervisory authority⁴⁶¹. This is an extreme solution to bank solvency problems or possibly the last stage of bank resolution⁴⁶². In general, in banking terms, insolvency has a slightly different meaning than in the case of typical business entities: *the conditions and procedures for identifying insolvency, persons concerned and involved in the procedure are different*.

The legal doctrine, in particular, distinguishes banking crisis stages and/or strategies, which are broadly classified into: preparation and prevention, early intervention, bank resolution, bank liquidation⁴⁶³. In the broad sense, before the latest banking crisis, the IMF and the WB codified the types of bank insolvency procedures in different jurisdictions. The conclusion was that, in case of potential bank insolvency risk, and if a particular bank satisfies the conditions that trigger bank insolvency, the competent authority may adopt the following decision on the bank's future: (i) *prompt corrective or protective measures*, in the US

459 UK Banking Act. Section 7 (2).

460 Dodd-Frank. Title II, Section 203 (b) (1).

461 Ambrasas T. *Bank Liquidation As Interference of Public and Private Interests*. Jurisprudencija, Vilnius, 2014. P. 6-11.

462 Ibid.

463 In order to enhance preparation and prevention, first of all, during the recent banking crisis, the states began strengthening their banking supervision system. The goal is to collect better information on the bank risks in the financial sector and better control them. Another objective relates to contingency planning due to the scale of banking risks and the use of legal conversion tools *ex ante*, and the mandate for protection against far too complex banking operations to ensure their potential problem solution. *Early intervention* means early corrective actions designed to correct and solve insolvency problems in the early insolvency stage. These procedures can help banks return to normal business operations, while avoiding resolution and/or liquidation. *Bank resolution* means mainly administrative, non-judicial procedures and legal instruments for bank restructuring, or management of the interrupted activity of a failing bank, while preserving the insured depositors and other services that are vital for maintaining financial stability, e.g. the smooth operation of payment systems. In bank resolution, legal bank resolution tools are employed. *Liquidation* means ordinary bankruptcy procedure. EC. Staff Working Document. Impact Assessment. Proposal for a directive of the European Parliament and of the Council. Brussels, 6.6.2012. SWD 1666 final, 2012. P. 8. Dewatripont M., Freixas X. Bank resolution: a framework for the assessment of regulatory intervention. Oxford Review of Economic Policy, Vol. 27, No. 3, 2011. P. 413-415.

and Swiss legal systems⁴⁶⁴, or early intervention measures in the EU⁴⁶⁵. This bank insolvency stage is characterised by developing financial difficulties of the bank, no official bank insolvency has been declared yet, and the supervisory authority undertakes intervention actions in accordance with the statutory provisions of prudential regulation to reduce the risk of insolvency of the bank to the maximum extent, as long as the conditions for insolvency ‘threshold’⁴⁶⁶ are not met: (i) *official administration procedures* (during these procedures, the competent public authority, whether a banking supervisory authority or a court-appointed administrator, or a temporary administrator appointed by the supervisory authority bank, takes over the direct control of the bank from its managing bodies, in order to protect the bank’s assets, assess the actual financial situation in the bank and then perform all the nec-

464 In Switzerland, FINMA can impose the following early intervention measures: restrict the activities of managing bodies, appoint a temporary administrator, revoke the powers of managing bodies or remove them from the daily management of the bank, remove both internal and external auditors, restrict some of the bank’s business activities, prohibit the bank to make and receive payments or take over the bank’s securities trading, close the bank, adopt a resolution on the suspension of liabilities or delay the discharge of obligations to a certain date, with the exception of guaranteed collateralised debt and mortgage-backed bonds. In the US, early intervention measures are associated with the use of prompt corrective FDIC measures, where appropriate, in order to resolve the problems of an insured financial institution facing financial difficulties. Depending on whether the bank is well-capitalised, adequately capitalised, or critically undercapitalised, the supervisory authority can apply the following primary sanctions: (i) limit the allocation of capital; (ii) limiting the costs of the managing bodies; (iii) apply a moratorium to insufficiently capitalised institutions; (iv) require a capital restoration plan; (v) restrict guarantee obligations; (vi) restrict transactions with bank affiliates; (v) limit interest rates; (vi) limit the bank’s asset growth; (vii) improve the work of the managing bodies, such as the appointment of a new director; (viii) require the sale of assets, etc. Swiss Banking law. Art. 26. FDIA. 38 Section. Codified 12 U.S.C. 1831o.

465 In the EU, if a bank infringes or is likely to infringe prudential requirements, and in the event of a rapidly deteriorating financial condition, including deteriorating liquidity situation, increasing level of leverage and the number of non-performing loans or concentration of exposures, as valued on the basis of a set of indicators, the competent authority has a right to apply the following measures: (a) require the managing body of the bank to implement one or more of the arrangements or measures set out in the recovery plan or to update such a recovery plan; (b) require the managing body of the bank to examine the situation, identify measures to overcome any problems identified and draw up an action programme to address those problems and a timetable for its implementation; (c) require the managing body of the bank to convene a shareholders’ meeting of the bank, or if the managing body fails to comply with this requirement, convene the shareholders’ meeting directly, and in both cases set the agenda and require certain decisions to be considered for adoption by the shareholders; (d) require the removal or replacement of one or more members of the managing body or senior management, if those persons are found unfit to perform their duties pursuant to Article 13 of Directive 2013/36/EU or Article 9 of Directive 2014/65/EU; (e) require the managing body of the bank to draw up a plan for negotiation on debt restructuring with some or all of its creditors according to the recovery plan, where applicable; (f) require changes to the bank’s business strategy; (g) require changes to the legal or operational structures of the bank; (h) obtain, including through on-site inspections and provide to the resolution authority all the information necessary in order to update the resolution plan and prepare for the possible resolution of the institution and for valuation of the assets and liabilities of the bank; (i) if the competent authority considers that the replacement of senior management or a managing body is deemed to be an insufficient measure to remedy the situation, Member States shall ensure that competent authorities may appoint one or more temporary administrators of the bank. BRRD. 27, 28, 29 str. Directive 2013/36/ES Art. 13, Directive 2014/65/ES Art 9.

466 Lastra R.M. *Cross-border bank insolvency*. *Supra* note 74. P. 64.

essary reorganisation operations of the bank or initiate involuntary liquidation procedures for the bank); (iii) *resolution and/or liquidation of the bank*, if the facts can establish that the bank is or may be excessively indebted, i.e insolvent, also whether it fails to meet capital ratio requirements, or faces severe liquidity problems after the expiry of the deadline set by the supervisory authority for the correction of such financial difficulties.

In the EU legal system the following bank insolvency procedures could be distinguished: *preparation and prevention*, *early intervention* and *resolution and/or liquidation procedures*. Although the two first procedures are outside the limits of this study, as they are treated as *ex ante* preventive insolvency measures, after a significant shift in paradigms, it is worth noting that the powers of the competent authorities are characterised by three main elements: (i) preparatory steps and plans, to minimise the possible insolvency risk (preparation and prevention); (ii) the mandate to respond to the emerging financial difficulties of the bank at an early stage, in order to stop the deterioration of the bank to avoid insolvency (early intervention); (iii) if bank insolvency poses a threat to the public interest, definite legal measures to reorganise the bank, while preserving the critical functions and limiting taxpayer losses as far as possible (bank resolution); (iv) ordinary insolvency proceedings, winding-up procedure in accordance with the national legal systems of the EU Member States. Bank liquidation is associated with the realisation of the bank's assets⁴⁶⁷. Bank liquidation procedures in the EU legal system are defined collective insolvency proceedings initiated and supervised by administrative or judicial authorities of a Member State for disposing the assets under the supervision of those authorities, including cases where such procedures are terminated by a compromise agreement or another similar measure⁴⁶⁸. All of the above-mentioned legal instruments all together establish a banking recovery and resolution framework. Since it is impossible to determine in advance the exact risk posed by an individual bank for financial stability, the authorities exercise these powers with regard to any bank, despite its size and business volume, whereas preparation of banking recovery and resolution plans *ex-ante* is regarded as a management tool and is not associated with bank insolvency procedures⁴⁶⁹. It should be noted that early intervention provisions⁴⁷⁰ and the temporary administrator institute also fall within the scope of official bank administration procedures⁴⁷¹. It should also be highlighted that the EU legal system distinguishes *bank reorganisation procedures*. These measures are directed at preserving or recovering the financial situation of credit institutions or investment firms⁴⁷² and they could affect pre-existing rights of third parties, including measures involving the possibility to suspend payments, enforcement measures or reduction of claims; such measures include application of resolution measures and the use of resolution powers provided in Directive 2014/59/EU. Finally, the main type of bank insolvency procedures is bank resolution⁴⁷³.

467 BRRD. Art. 2 (54).

468 Directive 2001/24/EB. Art. 2.

469 Directive 2013/36/ES. Art. 74.

470 BRRD. Art. 27.

471 BRRD. Art. 29.

472 Regulation (EU) No. 575/2013. Art. 4 (1) (2).

473 See *more 2* chapter, 1 sec.

Bank insolvency procedures in **Switzerland**, characterised by the absence of special insolvency law, are initiated on the basis of the general corporate insolvency law regime⁴⁷⁴. In addition to formal insolvency procedures for banks (early intervention and preventive measures) applied before the insolvency stage⁴⁷⁵, bank restructuring⁴⁷⁶, and bank bankruptcy procedures⁴⁷⁷ are distinguished. It is important to note that preventive measures can be employed both independently and collectively, during restructuring or liquidation (bankruptcy proceedings) of the bank⁴⁷⁸. Legal rules governing bank insolvency procedures are applicable to both banks and securities dealers and non-bank financial institutions⁴⁹⁹. Bank restructuring procedure is initiated if FINMA discovers that (i) the financial situation of the bank is such that creditors will attain a better position after bank restructuring than at the time of bankruptcy; (ii) the bank restructuring plan is economically realistic⁴⁷⁹. If a bank faces financial difficulties, the restructuring procedure is not automatic. This right is conferred immediately after FINMA adopts a formal ruling on the initiation of the bank restructuring procedure after the restructuring plan has already been approved⁴⁸⁰. FINMA approves the restructuring plan after: (i) careful consideration of the financial situation and assets of the bank; (ii) if it can be reasonably assumed that in the case of restructuring creditors would be in a better position than in the case of bankruptcy; (iii) in the restructuring plan, the interests of creditors are prioritised over shareholders' interests; (iv) the legislative and economic relations between the bank's assets, liabilities, contractual relations are adequately included and addressed in the restructuring plan⁵⁰²; (v) the restructuring plan requires no approval from the board of the bank and the restructuring plan must enable the shareholders to reduce the share capital or to create new capital, by converting bank debt into capital⁴⁸¹. Bank liquidation procedure is inevitable, if bank restructuring is not viable. In this case, FINMA revokes the banking license, passes a resolution on winding up and makes it public and appoints one or more liquidators, who also report to FINMA. It should also be noted that a separate bank resolution regime applies internationally for systemically important banks. An additional regulatory system is now under way, by creating a favorable legal environment for the successful restructuring of the banks at the time of the crisis. The main purpose of this particular – regulation is to ensure the continuity of banking services, or regular, orderly liquidation of systemically important functions, to protect from the adverse effects on the international and national financial systems and economies concerned and to avoid the use of state aid for their insolvency as far as possible⁴⁸². The reforms are not yet implemented to their

474 Swiss banking law. Art. 34. Swiss Debt Enforcement and Bankruptcy Act of 11 April 1889 (July 1st, 2014) Art. 197-220.

475 Swiss Banking law. Art. 26.

476 Swiss Banking law. Art. 28-32.

477 Ibid. Art. 33-37.

478 Ibid. Art. 25 (2).

479 Swiss Ordinance. Art. 40.

480 Ibid. Art. 41.

481 Ibid. Art. 31.

482 FINMA. Position paper on Resolution of G-SIBs. Resolution of global systemically important banks. 2013 [interactive]. [accessed on 10-11-2014] <<http://www.finma.ch/e/finma/publikationen/Docs/pos-sanierung-abwicklung-20130807-e.pdf>>.

full extent. FINMA is still working on this regulatory puzzle to improve the efficient and timely restructuring of these particular entities and their timely conversion planning and identification of restructuring conditions during the banking crisis.

There are three bank insolvency procedures in the US, in the form of legal tools to deal with distressed banks. A financial institution may be reorganised under the bankruptcy code (in this case, the bank usually remains in operation), liquidated under the bankruptcy code or its financial difficulties are solved in accordance with the special legal rules governing bank insolvency (resolution)⁴⁸³. In general, all of the three options are treated as bank resolution measures or, in other words, bank insolvency procedures. According to a general rule, both the concept of bank reorganisation and bank liquidation are regulated by and associated with the United States Bankruptcy Code, Chapters 11 and 7. After the establishment of the special bank resolution regime in the Dodd-Frank Act, a special Ordinary Liquidation Authority was established. That Authority was designed for banks that may have systemic implications, by applying special rules. The Bankruptcy Code and the related provisions remain the primary legal source dealing with bank difficulties and serve as a reference for traditional commercial banks⁴⁸⁴. Bank insolvency procedures are carried out on the federal level under the supervision of the federal bankruptcy court⁴⁸⁵. In the context of bank insolvency procedures in the strict sense of the word, resolution is equated to a specific bank resolution regime, historically employed for processing insolvency cases of special financial institutions only, namely deposit-taking financial institutions. Bank reorganisation is subject to the provisions governing corporate reorganisation and primary law provisions of the US Bankruptcy Code, Chapter 11⁴⁸⁶. That Chapter provides that the debtor can negotiate with the creditors (sometimes even before submitting a petition for insolvency proceedings) to reach consensus and to materialise the reorganisation plan that would allow the restructuring of the debtor's obligations so that the company would be able to implement them. The negotiations are taking place in parallel with the judicial procedure, and the federal bankruptcy judge manages the case. When the reorganisation plan is approved, the company, often after obtaining the approval of the managing bodies, undertakes the operations set under the reorganisation plan. In this case, the debtor can often delay the bankruptcy procedures and continue business operations⁴⁸⁷. Another procedure is *bank liquidation*. These procedures are subject to corporate liquidations provisions contained in Chapter 7 of the Bankruptcy Code as sources of primary law. That Chapter provides that the debtor's assets should be liquidated under the appointment of the liquidation trustee, appointed exclusively with the approval of the US court or credi-

483 *Liquidation* in the US legal system means that the bank's assets will be sold, and the received funds will be distributed to creditors according to the hierarchy of creditor claims. Reorganisation means that the bank's assets are inviolable, but commitments are rearranged by eliminating or reducing junior, subordinated claims, while converting priority claims into subordinated claims, and extending some of the subordinated claims. The US Bankruptcy Code. 11. U.S.C. § 1126 (2006). Chapter 11.

484 11 U.S.C. § 109 (2010).

485 Lubben S. J. *Financial Institutions and Bankruptcy*. Seattle University Law Review, Forthcoming; Seton Hall Public Law Research Paper No. 1726944, 2010. P. 1264.

486 *Ibid.* Section 1101-74.

487 Board of Governors of the Federal Reserve System. *Study on the Resolution of Financial Companies under the Bankruptcy Code*, 2011. P. 3.

tors' majority voting⁴⁸⁸, while liquidation procedures are conducted according to the hierarchy of creditor claims.

In the US, the liquidation process as an ordinary bankruptcy procedure is court-based. A federal bankruptcy judge administers the insolvency procedure. The debtor has a right to choose whether to initiate reorganisation or liquidation proceedings. These procedures and various legislative provisions governing the former have some exceptions. The rules of the Bankruptcy Code do not apply to particular financial institutions that do not meet the requirements for insolvency and the conditions for initiating bankruptcy proceedings. For example, insured deposit-taking financial institution⁴⁸⁹ or branches of foreign banks⁴⁹⁰ fail to meet such requirements. Another exclusive example concerns financial brokers-dealers falling outside the scope of the provisions of the Bankruptcy Code governing liquidation and reorganisation⁴⁹¹.

Another classic bank insolvency procedure in the US is bank resolution. If the bank is ensured by the DGS, then FDIC takes over the administration of the bank that is facing severe financial problems. FDIC also acts as a receivership, according to the Federal Deposit Insurance Act⁴⁹². Typically, in such case the bank is closed by the appropriate competent administrative authority (supervisory authority, currency control authority, the US Office of Thrift Supervision) and the FDIC is appointed as a receiver of the closed financial institution⁴⁹³. The purpose of such bank resolution regime is to set out the Federal Deposit Insurance legislation in detail and seek to resolve the financial difficulties of the bank based on the 'least cost' principle with respect to the FDIC⁴⁹⁴. The FDIC, as a receiver of the insolvent bank, after taking over control of the bank has a number of options to address the bank's financial problems (see more in the chapter on bank resolution tools). However, the purchase and assumption transaction is the most common bank resolution method, by partially or fully transferring bank assets or liabilities, deposits and loans to another financial institution⁴⁹⁵. By such transactions, the customers of the failing financial institu-

488 11 U.S.C. Section 701-2.

489 11 U.S.C. Section 109 (b) (2).

490 11 U.S.C. Section 109 (b) (3) (B). International Banking Act of 1978, 12 U.S.C. Section 3102.

491 11 U.S.C. Section 109 (d).

492 If a financial institution is failing, the role of the FDIC, as the receiver, is similar to that of a bankruptcy administrator. The bankruptcy administrator may wind up an insolvent bank or transfer all or part of its assets to the assuming bank. The main function of the FDIC is to maximise the failing bank assets and satisfaction of creditor claims in accordance with the least cost principle to FDIC. Federal Deposit Insurance Act, 12 U.S.C. Section 1811.

493 See more. Who Is the FDIC? [interactive]. [accessed on 05-12-2014] <<https://www.fdic.gov/about/learn/symbol/index.html>>. 12 U.S.C. Section 1821(c).

494 12 U.S.C. Section 1823(c) (4) (A) (ii). Under certain circumstances, a resolution method diverging from 'the least cost' principle is possible only in view of a 'systemic risk' exception. This exception applies only when both the Management Board and the FDIC Board of Directors obtain no less than two-thirds of the votes of their members and the State Secretariat of the Treasury, in consultation with the President, determines that non-compliance with the 'least cost' principle can cause serious negative consequences for economic conditions or financial stability and the actions or assistance by way of derogation from 'the least cost' principle would allow avoiding or mitigating such negative effects. 12 U.S.C. Section 1832 (c) (4) (G).

495 FDIC. *Supra* note 493.

tion automatically become customers of the acquiring financial institution. Meanwhile, the remaining creditors are entitled to raise claims against the FDIC with regard to the commitments unrelated to deposits, but they have no other rights to take action against the administrator. Bank resolution procedure is not court-based, as it is administrative in nature, but some aspects can be appealed against and be subjected to judicial review⁴⁹⁶. Finally, a new bank resolution system is found in the US legal system, based on the exclusive authority of the Ordinary Liquidation Authority (OLA). This Authority implements its functions in the field of resolution with regard to systemically important financial institutions (large structures, complex)⁴⁹⁷. According to this regulation model, the scope of the regime involves non-banking financial institutions if their financial difficulties may potentially cause systemic risk to the entire national economy. The operating principles are broadly similar to the FDIC resolution procedures dedicated to deposit-taking financial institutions. The key distinctive feature is that such a reorganisation procedure helps avoiding bankruptcy procedures (direct liquidation). OLA is launching its functions only in the case the Treasury Secretariat, acting on the basis of the recommendations of the supervisory authority board and the FDCI guidance, determines (after consulting the President of the United States) that the insolvency of financial institutions will have serious negative repercussions for financial stability of the US and that the initiation of such action with help mitigating the adverse effect with regard to a particular bank⁴⁹⁸. When it is not possible to identify the circumstances mentioned above, general insolvency law and the FDIC bank resolution regime shall be applied (according to the special FDICA provisions)⁴⁹⁹.

All of the above bank resolution methods in general may be identified as bank insolvency procedures. The role of bank insolvency procedure is twofold. First of all, they have their economic objective, i.e. resolution of banking activity as a business entity or reorganisation of the bank or a part of it, by transferring bank assets and right of claim to another entity, or forced bank liquidation procedure, which is subject to both general insolvency law and special insolvency legislation exclusively concerned with the legal relations of the insolvent bank. Second, bank insolvency procedures may lead to either business continuity of the bank as a legal person or liquidation of a bank as a corporate entity and the end of the company. Bank insolvency procedures may be conducted separately, but can also be used in an integrated way, combining them into a single bank insolvency procedure.

1.6.3. General Objectives of Bank Insolvency Procedures

By reason of the unique features of banks, financial difficulties should also be addressed with a different approach than corporate insolvency problems. Another reason is that corporate insolvency law and procedure is concerned with different aims and purposes, compared to general insolvency law. Corporate insolvency laws and procedures aim to achieve two main objectives: (i) fair and predictable procedures and equal treatment

496 12 U.S.C. Section 1821 (c) (7).

497 Dodd-Frank Act. Title II.

498 Dodd-Frank. 203 Section.

499 Dodd-Frank. 204 (a) Section.

of creditors in accordance with creditor hierarchy and addressing coordination problems in order to avoid creditors ‘racing’ for the assets of the debtor⁵⁰⁰; (ii) maximisation of the debtor’s assets in order to satisfy the interests of creditors⁵⁰¹.

After the global shift of the paradigm of bank insolvency procedures it has become apparent that the general objectives of public interest pursued by bank insolvency procedures have become more important than the objectives pursued by general insolvency law. For example, one of the main objectives of bank insolvency procedures is the least costs to deposit insurance institutions⁵⁰². However, general insolvency law remains imperative in the context of bank resolution rules and applies in cases where special bank resolution regime and the related rules do not apply⁵⁰³. This section reviews the general objectives of bank insolvency procedures, *Section 2 of Chapter 3* analyses the specific targets of the bank resolution regime according to the positive law of the relevant jurisdictions.

After analysing foreign sources of literature and legal doctrine, it can be stated that when a certain bank faces financial difficulties, in addition to a variety of private interests, the competent authorities must reflect and ensure the fundamental public interests: (i) *stability of the financial system*; (ii) *protection of insured depositors’ rights*; (iii) *continuity of the critical banking functions and business lines*; (iv) *reduction of moral hazard to the minimal level*; (v) *restriction of competition distortions*. Furthermore, some additional objectives of bank insolvency procedures can be identified in the scientific literature and studies conducted by international organisations⁵⁰⁴: (vi) *smooth functioning of payment and settlement systems*; (vii) *preservation of financial intermediation and lending functions*; (viii) *operational efficiency*; (ix) *the minimisation of ‘too big to fail’ problem*. All of these objectives are correlated, but it must be assumed, however, that the primary objective of the bank insolvency procedures is financial stability and the remaining objectives– are of secondary nature. *In economic terms*, the objectives of bank insolvency procedures relate to the bank activities as a whole, or maintaining the continuity of the viable part of the bank, by putting the bank into resolution, transferring the bank’s assets and creditors’ claim rights. *In legal terms*, the objective of bank insolvency procedures is the elimination of the legal person from civil circulation, while executing bank resolution procedures and/or involuntary bank liquidation procedures⁵⁰⁵. Thus, the objectives of bank insolvency procedures may trigger two insolvency scenarios for the bank: business continuity of the bank as a legal entity or liquidation of a bank as a legal entity and the

500 The expanded list of general insolvency law objectives is provided in Marinč. M., Vlahu R. *Supra* note 76. *Bankruptcy Procedures and Their Ex-Post Efficiency*. P. 15.

501 The main principles of bank insolvency procedures and their application can be compared with the corresponding principles of corporate insolvency law. See more. UNCITRAL. *Legislative Guide on Insolvency Law. Principles for Effective Insolvency and Creditor Rights Systems*. WB, Washington D.C., 2001. *Orderly and Effective Insolvency Procedures-Key Issues*, Legal Department, IMF, Washington, D.C., 1999.

502 Bliss R., Kaufman G. *Supra* note 75. P. 47.

503 For example, in line with the EU legal system, before applying a particular bank resolution tool, the competent authorities should assess prospective positions of shareholders and creditors’ rights and assess whether direct bank liquidation is more feasible under normal insolvency scenario.

504 IMF, WB. *Supra* note 86. P. 16.

505 *Ibid.* P. 15.

end of the company. Bank insolvency procedures can operate independently, but can be applied comprehensively.

Stability of the financial system. There is no universally accepted definition of financial stability. In general, it should be understood as the stability of the financial system. The changes themselves and the stability of the financial system can be defined through the combination of various elements. *Garry Schinasi* gives one of the most accurate definitions. He identifies three primary segments of the financial stability system: (1) financial intermediaries, such as banks, insurance companies, common investment funds, pension funds, hedge funds, which collect savings from consumers and make them available to investors; (2) financial markets, such as stock exchange and bond markets, where consumers and investors operate directly or through the relevant stakeholders; (3) financial system infrastructure, which in essence is effective institutional and legal regulation (including payment and settlement systems, accounting standards, competent supervisory authorities through which intermediaries and markets operate)⁵⁰⁶. From the totality of those elements, we can identify financial stability.

The main purpose of bank insolvency law is to provide safeguards for the stability of the financial system and for the prevention of the adverse impact of ‘contagion.’ Most of the bank’s liabilities often form part of a large group of depositors, most of them are individuals who fail to take and manage financial risk or reduce it correctly. Even if a deposit guarantee system can assist in protecting the depositors, by indirectly transferring costs on the insured entity to the state budget or on the banking industry, but eventually, the financial difficulties of the bank may result in payment system disorders, bank default on contracts and the disruption of the related services or, in extreme cases, even the suspension of services. Therefore, this may cause a domino effect, which manifests itself in the form of transfer to the counterparties of the financial losses suffered by the bank. Public confidence in the banking system may also be lost and a serious threat to financial stability could be provoked. Even the insolvency of a single bank may trigger a systemic banking crisis, destructing the remaining part of the sound banking system and threatening the functions of banks as financial intermediaries across the financial system⁵⁰⁷. Thus, before preparing a resolution strategy for a particular bank, the competent authorities need to aim for the prevention of such adverse effects by all means and make every effort to maintain the financial stability in the country.

Avoiding provision of public financial support for banks from taxpayers’ money is equally important, since, as agreed at the international level, losses resulting from bank insolvency must first and foremost be distributed to creditors. It is important to avoid additional, unnecessary losses to creditors⁵⁰⁸ and to avoid systemic risks to financial sta-

506 *Shinasi G. Financial Stability - Theory and Practises. IMF, Washington DC, US, 2006. P. 80.*

507 *Lastra R.M. Cross-border bank insolvency. Supra note 74. P. 29-32.*

508 Particularly important to the owners of bank bonds (as it would be very impractical to identify individual bond holders on the threshold of conversion, applying the discretion of the case by case approach, and for regulators it is essential to ensure that the bank holds no bonds of other banks, except for small amounts), for ranking of creditors and for securing the priority of depositors’ rights (preparation for bank bail-in with private funds, especially at the time of the Cyprus banking crisis, highlighted the fact that lenders lack clarity regarding different creditors’ hierarchy and satisfaction of creditor claims in financially distressed banks, and the type of losses the banks will suffer in case of

bility⁵⁰⁹. A situation when insolvency problems faced by a distressed bank spread over the other participants of the banking system is described by the doctrine as a financial ‘contagion.’ The adverse effects or the ‘contagion’ are the central features and the primary cause of systemic risk⁵¹⁰. Scientific literature identifies two categories of financial contagion: direct and indirect. Direct contagion is when ‘contagion’ spreads from one bank facing financial difficulties to several other financial institutions, by reason of their real mutual commitments. Different lines of credit, guarantees, trade operations are the most frequently encountered forms of mutual obligations are. The failure of one bank could trigger a chain reaction and force other banks write off their assets. Eventually, bank insolvency may lead to drastically decreasing economy of the state. Moreover, it can give rise to the increase of public financial debt and decline in the prices of various assets, especially if banks hold a similar portfolio of assets. This statement is explained by an obvious fact that the payment and settlement system and the interbank market provides additional interconnections between banks. For example, problems arising in the case of payment orders or from participation in wholesale financing may lead to significant losses to other market participants and adversely affect the liquidity of the banking system. Reputational or indirect contagion occurs when consumers suddenly change their views on the insolvency and risk profile of the bank. After assessing the ‘competitor’, i.e. another player in the market with similar performance characteristics, creditors may come to both accurate and incorrect conclusions with regard to the closure of a particular bank. This phenomenon can prompt other creditors with the rights of claim to another bank to withdraw their cash from banks as quickly as possible. Therefore, it is assumed that the financial ‘contagion’ theory, *inter alia*, is based on psychological elements and can severely damage public interest and the solvency of other banks operating in the country, especially if they are very similar in their structure and business models, or could result in radical adverse developments and risks in the financial market.

Protection of depositor rights. Most of the bank’s liabilities depend on different groups of depositors. Moreover, most of them are natural persons. When a bank becomes insolvent, losing their deposits would cause a disproportionate financial burden. In contrast to large companies or institutional investors, retail depositors lack the capacity to analyse and verify how banks control their money. They do not have access to often limited sources of information and lack resources to assess the financial situation of the bank. Therefore, the doctrine considers that depositors cannot adequately determine the level of risk they assume when depositing their contributions to a certain bank⁵³⁴. For these reasons, the states has realised that it is vital to establish a deposit insurance system⁵³⁵. These deposit insurance schemes protect retail depositors by paying compensations up to a particular

insolvency, which was particularly important in the case of uninsured depositors. See more. *Creditor Participation in Banking Crisis in the Eurozone- A Corner Turned?* Empirical analysis of current bank liability management and restructuring policies with conclusions for the European bank restructuring and resolution framework. Study commissioned by the Greens/ European Free Alliance in European Parliament, Berlin, 2013. P. 22.

509 Tucker P. Bank of England. *Supra* note 92. P. 9.

510 Smaga. P. *The Concept of Systemic Risk*. Systemic Risk Center. The London School of Economics and Political Science. Special Paper No. 5, 2014. P. 10-13.

insured amount, if the bank is liquidated. The effective protection of depositors' rights and guarantees could be attributed to the general objectives of bank insolvency procedures.

Continuity of the critical functions performed by the bank. The main purpose is to avoid direct bank liquidation and its removal from civil circulation. This objective can be achieved, as discussed below in more detail, by making the bank in distress to continue all or parts of its critical business until its resolution and subsequent liquidation under ordinary insolvency proceedings. Different from companies, a bank cannot operate on a lost going concern assumption because financial transactions represent a crucial part of the bank's business. Therefore, the competent authorities must undertake all the legal means to support and strengthen the fundamental functions of a failing bank, e.g. deposit-taking operations, lending. Preserving the primary functions of the bank also serves the interests of its creditors, preventing significant asset impairment, which may accordingly affect rapid bankruptcy and the respective closure of the bank. It is assumed that this goal not only assists in protecting the systemically important bank functions, but also secures the bank's assets and maintains the added value of the failing bank.

Moral hazard reduction. Another significant goal is to maintain viable parts of a failing bank while liquidate and close non-viable business operations. If bank insolvency procedures are governed in an effective manner, *inter alia*, they have a punitive impact in the context of standard bank insolvency procedures. Moreover, in the absence of explicit, clear and precise regulation of the bank insolvency procedure it can affect the banking industry. For example, other banks operating on a given market will be more cautious about the related possible bank insolvency risks, which could in turn contribute to a more efficient market discipline⁵¹¹.

Minimising distortions of competition. A failing bank may cause both negative and positive impact and consequences for its competitors, and even for the efficiency of the entire banking sector⁵¹². On the one hand, banks may be given a particular advantage, in comparison with their competitors, and especially in view of the interconnection with the other banks and impact on the real economy. For example, a failing bank may influence collateral default and interbank loan default. If a failing bank will be stabilised through debt write-off measures and temporary liquidity support from the public sector instead of direct liquidation, competitors may assess their claims and the bank assets at less than their market value, especially if they no longer see the operational potential of the bank. On the other hand, if bank insolvency procedures are applied by using public finances, it can lead to inefficient and undue allocation of resources. Therefore, such an approach may prove ineffective in the case when banks receive disproportionate financial support, compared to other competing banks, which accordingly confers competitive advantage against competitors.

Minimising the 'too big to fail' problem (see also Chapter 1, Section 7, subsection 2). The recent financial crisis raised many discussions on how to deal with banks and how to treat them, by reason of their special status, i.e. the importance for the entire financial system. These financial institutions are defined as 'systemically important financial

511 Aghion P, Bolton P, Dewatripont M. *Contagious bank failures in a free banking system*. European Economic Review, Vol. 44, Business Source Complete, EBSCOhost, 2000. P. 713-718.

512 Effect of State intervention on the competition in the banking system is very controversial, compared to other sectors of the economy.

institutions, and thus as ‘too big to fail’, ‘too complex to fail’ or ‘too interconnected to fail’. This regulatory phenomenon is usually associated with political will, which prevents large banks of utmost economic significance from collapsing, although the bank is *de facto* insolvent or has serious financial problems⁵³⁸. It is assumed that the liquidation of a large and complex bank would trigger many difficulties in terms of operational coordination and procedural efficiency, mainly occurring when the bank operates on a *cross border basis*.

Operational efficiency. The physical assets of the bank can depreciate or disappear very quickly, and this is primarily reflected in large, complex institutions engaged in cross-border activities. It is therefore particularly important to take over effective control of the bank in an operative manner, in order to protect the bank assets and to preserve the bank business as far as possible. For this reason, the supervisory authority must timely and correctly determine the cases of violation of bank (in) solvency criteria.

Bank insolvency procedures in all jurisdictions must be based on sound, reliable and stable legal regulation of banking supervision, which, *inter alia*, should ensure the implementation of these basic principles.

1.7. Key Operational Risks of the Bank and Correlation to Financial Difficulties

Banking activity regulation is primarily concerned with quantitative banking risks allowed by the law, in combination with certain restrictions provided in the law⁵¹³. High risk is an integral part of banking, but the effective management of bank insolvency risks is an essential element of successful strategic planning of the bank. Therefore, the inability or unwillingness of the bank directors to adequately identify, understand, control and limit the risks are regarded as one of the cornerstones of the recent banking crisis⁵¹⁴. Prudential regulations of banking are conceived as any procedures, processes and systems, transactions and instructions, and designed to protect a bank from unexpected losses and damages, including additional losses resulting from bank insolvency by the time that such an event occurs⁵¹⁵. Of course, most banks diversify their risks and lending by using a variety of strategies and with a view to reducing the risks and bank liabilities, e.g. by allocating lending to different business entities. Understanding of risks makes their reduction easier and their control more effective. For instance, in certain jurisdictions the law recommends the banks to form internal, individual committees that would monitor insolvency risks *ex ante* and control them appropriately⁵¹⁶.

After examining the legal doctrine, the following key insolvency risks of financial institutions that may influence the bank’s insolvency procedures may be identified: (i) operational risks ; (ii) liquidity risk; (iii) credit risk (iv) legal risk (risks arising from various in-

513 Gleeson S. *Supra* note 113. (vii).

514 EC. Green Paper. Corporate Governance in financial institutions and remuneration policies. Brussels, COM(2010) 284 final, 2010. P. 6. Bishof E. Fitness and Propriety of Bank Directors in the Light of the Global Financial Crisis 2007-2009. European Union Private Law Review, Vol. 9, No. 6, 2013. P. 321-328.

515 Bauen M., Rouiller N. *Supra* note 39. P. 54.

516 For example, in Switzerland bank boards are advised to establish special risk management committees, in addition to other standard bank committees, such as audit, compensation committees, etc.

fringement cases, non-compliance with laws or norms, rules, regulations, the established good practice, or where banks simply complied with their rights and obligations.); (v) systemic risk; While this is not an exhaustive list⁵¹⁷, as the banking sector is dynamic and is going very fast due to the changes in information technologies and speed of this trend, especially because of the specific risks associated with electronic banking and electronic payment systems and new banking products, etc.

Operational risk. This risk can be defined in different ways, but in all cases it results from potential bank losses that can occur due to significant deficiencies in the operating system of a certain bank, its credibility and integrity. Operational risk is significant, because it needs to be covered by the bank's own funds. BCBS defines operational risk as the risk under which a bank may suffer losses due to inadequate or inappropriate internal bank processes, people and systems or external events and related risks involved⁵¹⁸. This definition does not include such risks as strategic risks related to business decision-making⁵¹⁹. One of the main tasks pursued by banking is smooth provision of payment services, which accordingly requires high degree of reliability. Each year, payment systems of the banking sector perform an enormous number of transactions, with great amount of money⁵²⁰. Consequently, the number and percentage of operating errors must be negligible, as otherwise this will immediately adversely affect thousands of private and public interests. Thus, payment services are always associated with operational risk, which basically means that there is a risk that certain transactions may be omitted in due time or wrongly performed in violation of the legal requirements, for example, by reason of human (staff) or technical failures. In addition, operational risk is closely related to the banking system security risk and reputational risk elements, as banks, for example, may experience a range of attacks on both their external and internal systems or bank products⁵²¹. In addition to external attacks, it is equally important that banks face potential employee fraud risk: employees can secretly gain access to sensitive customer data, access information on customer accounts and absorb these data. In addition, when employees falsify data, e.g., for committing falsified data, the bank is also exposed to operational risks, which is explained by the fact that the bank is often responsible for cases of personnel tampering, when there is no customer fault.

517 Traditionally, bank insolvency risks can be identified in view of the banking laws of a certain country. For example, Section 9 (2) of the Swiss Banking Act provides for the following core bank insolvency risks: credit risk, counterparty or bad loan risk, market risk, interest rate risk, payment system risk, legal and operational risks, liquidity risk, reputational risk. BCBS. Core Principles of Effective Banking Supervision, 2012. P. 5.

518 BCBS. Review of the Principles for the Sound Management of Operational Risk, 2014 [interactive]. [accessed on 11-10-2014] <<http://www.bis.org/publ/bcbs292.pdf>>. BCBS. Consultative Document Operational risk - Revisions to the simpler approaches, 2014 [interactive]. [accessed on 2014-10-11]. <<http://www.bis.org/publ/bcbs291.pdf>>.

519 Gleeson S. *Supra* note 113. P. 12.

520 IMF. International Financial Statistics. Balance of Payments, 2013 [interactive]. [accessed on 11-10-2014]. <<http://data.imf.org/?sk=7A51304B-6426-40C0-83DD-CA473CA1FD52>>.

521 Security breaches, although resulting from fraud or violation of the law, can lead to bank defaults and as a consequence the bank can suffer direct losses. For instance, illegal internet hacker attack against a bank's computer system, when hackers access and select the data relating to confidential customer information, in the absence of sufficient and adequate control. *Ibid.* P. 5.

Credit risk. It is associated with various lending operations or non-performing loans⁵²². This risk arises due to unforeseen circumstances which may occur due to the fact that the borrower (for instance, default on the part of borrowers or on bonds, guarantees, financial instruments) is no longer able to timely discharge their obligations⁵²³. Typically, this risk is limited by certain criteria, such as credit limit, the borrower's loan qualification by creating reserves, etc.⁵²⁴. Therefore, banks should carefully assess and make sure in all cases whether their customers can and will be able to comply with debt commitments they have undertaken. This is not only in the interest of banks, but also in their customers' interest. In essence, in legal terms credit risk is associated with the duty of care, when banks are required to draw customers' attention to the risks associated with banking products and services. Nevertheless, it should be noted that the risk of non-performing loans only cannot be fully avoided, as market conditions may change to the customers' detriment and result their insolvency, or customers with housing loans may simply lose their job and become unable to duly fulfill their obligations towards the creditor. Typically, banks try to reduce this risk by pledging customer assets, obtaining various customer guarantees, credits from other sources to finance derivative instruments, etc.

Reputational risk. It is associated with significant and negative public opinion on the activities of a certain bank, which may all together determine that the bank or its customers will suffer loss. Reputational risk consists of a number of actions that can lead to continuous adverse effects on the public image of any bank, its transactions or activities, such as its ability to build and maintain relationships with customers. Reputational risk may arise if bank actions cause massive loss of confidence, which most often manifests itself through the bank's ability to perform their critical functions and continue operations. This risk may be associated with actions taken by the bank in response to third parties acting against the bank. Increased reputational risk is often the result of increased bank operational risks. Reputational risk may arise if the bank's systems or products do not work as expected, or this phenomenon causes negative, spillover effects in the public. Both external and internal cases of violation of bank protection requirements and attacks against the bank may affect the degree of public confidence in individual banks. Reputational risk also appears when bank customers are not adequately informed about and familiarised with services supplied by certain bank products and the conditions of their use. *Errors, unlawful actions, service violations or violations of the bank's internal rules, third-party fraud* may also cause reputational risk to the bank (e.g., breaking into the bank's computer systems or website can change the opinion of the financial market and the information related to the false information about bank products or its financial data can spread very quickly). Reputational risk may affect the banking system as a whole, and can also give rise to systemic risk.

Liquidity risk. One of the most significant banking risks, which may lead to bank failure and can be treated as one of the cornerstones triggering bank insolvency⁵²⁵. The

522 Kauko K. External deficits and non-performing loans in the recent financial crisis. *Economics Letters*, Vol. 115, No. 2, Business Source Complete, EBSCOhost, 2012. P. 196-199.

523 Gleeson S. *Supra* note 109. P. 8.

524 Aysun U. Bankruptcy resolution capacity and economic fluctuations. *Journal of Macroeconomics* Vol. 40, 2014. US. P. 387-399.

525 *See more* 1 chapter 7 sec. 1 subsec.

risk results from a defaulting bank, whereby it is unable to obtain the necessary financing in the market and to meet its obligations at maturity date⁵²⁶. Such a situation is often caused by the bank's liabilities becoming lower than the bank's assets (mainly the loans granted). Liquidity risk is the direct consequence of financial intermediation services and the related banking functions. At the same time, banks are trying to satisfy completely different interests of their customers, e.g. mortgage borrowers, real estate owners require legal certainty with regard to long-term mortgages, while in practice banks are willing to set a payment time limit of at least 30 years. Other bank customers reserve the possibility to withdraw their savings (e.g., deposits) from the bank on demand, that is why the withdrawal rate of deposits or other savings on demand is very high. In other words, banks finance an excessively large number of illiquid assets in the long run, mostly in the form of loans, while liabilities are of a shorter term. Such a situation can accordingly result in various solvency problems for the banks after losing confidence in the market. Therefore, banks are required to form liquidity reserves in their balance sheet accounts, which are usually held at central banks or in the market in the form of readily released traded securities. This allows the bank to convert its assets into cash in a quick and secure manner. In addition, banks may convert less liquid assets into additional financial resources held in the secondary market or by encumbering the assets to the central bank. Nevertheless, bank liquidity reserves are usually lower than bank liabilities payable on demand. Accordingly, if withdrawals exceed its liquidity reserves, a bank must be in a position to immediately raise its capital in the financial markets or, if this is not possible, to ask the central bank for support. In normal economic circumstances, the central bank is required to act as a *lender of last resort*⁵²⁷. It should also be emphasized that banks face market and price risks by reason of the marketable (easily liquidated in the market) securities held by them, such as bonds and ordinary shares (equity). Foreign currency transactions can lead to currency risks and impaired bank asset value. Banks are also exposed to interest rate risks. This is because a disproportion of assets and liabilities of the bank exists in its balance sheet not only because of the liquidity schedule, but also because of the nature of the changing interest rate schedule. For example, the interest rate may vary considerably for savings deposits (it changes frequently), whereas in case of housing loans the interest rate is usually locked for a long number of years.

Systemic risk. In global economic conditions characterized by a very well-developed capital movement, relations between banks play an important role. As mentioned above, because of their critical functions, banks are subject to a special prudential regulation. However, market participants distinguish more risky banks having a special status among ordinary banks. Such banks play a particular role because of their *size* (their transactions, activities, significance of responsibilities in different sectors of the economy), *functions* (in identifying whether bank products and services associated with systemically important banking services and products, or at least with particular categories of consumers, such as family, small and medium enterprises, government agencies and other banks), *indispensability of products and services* (determining the principal customers, counterparties, creditors and debtors, their number, and the ability to cope with the collapse of one bank,

526 Gleeson S. *Supra* note 113. P. 11.

527 Bonstra W.V.B. *Supra* note 84. P. 4.

by substituting the insolvent bank with another counterparty within reasonable time)⁵²⁸. In the legal doctrine, banks performing systemically important functions are described as *systemically important banks*. Until the recent banking crisis, legal regulation of systemically important banks was unclear. Essentially, it was difficult to define *ex-ante*, which bank can cause systemic risk, this question therefore deserves deeper scientific analysis.

Systemic risk is primarily characterised by the fact that financial difficulties in one systemically important bank can cause massive financial instability throughout the financial system⁵²⁹. In addition, *systemic risk* reflects the 'too big to fail' doctrine. However, financial difficulties faced by a certain bank have systemic effects in two cases: (i) *if the bank itself is so large that its insolvency would lead to disruption of the market and of the economy as a whole*; (ii) *situations when risk of contagion appears*⁵³⁰.

The BCBS has defined the concept of systemic risk, by describing it in quantitative criteria: bank size, interconnectedness, substitutability (or infrastructure of the financial institution for the services that the latter supplies), international banking business in several jurisdictions and complexity of the banks⁵³¹. The Committee has defined systemic risk as the one when insolvency of one financial market participant could lead to the default of other market participants, disruptions of financial services, causing a chain reaction that leads to wider financial difficulties and domino effect⁵³². In the event of that risk, financial difficulties experienced by one bank (financial institution) spread over a large number of other banks (financial institutions) or over the entire financial system⁵³³. By definition, systemic risk is unpredictable⁵³⁴.

Scientific literature suggests several different definitions of systemic risk. First, systemic risk is described as the risk or likelihood, manifesting in the eventual malfunctions of the entire system, in the form of an offsetting phenomenon with regard to the disorders experienced by certain parts or individual elements of the financial system. Other researchers view systemic risk as the entirety of adequate macro-prudential⁵³⁵ and mi-

528 Dijkman, M., WB. *A Framework for Assessing Systemic Risk*. Policy Research Working Paper 5282, 2010. P. 7-8. IMF. Monetary and Capital Markets Department, Monetary and Economics Department, Bank for International Settlements and the Secretariat of the Financial Stability Board. *Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations*, 2009. P. 5-9.

529 Aglietta M., Scialom L. *A systemic approach to financial regulation A European perspective*. *Economie internationale*, No. 123, 2010. P. 32.

530 Hadjiemmanuil C. *Supra* note 79. P. 18.

531 These criteria are consistent and in compliance with the criteria identified in the reports of the International Monetary Fund, the Basel International Payments Bank, and the Financial Stability Board. BCBS (2011). *Global systemically important banks: Assessment Methodology and the additional loss absorbency Requirement*. Consultative Document, Rules text, cover note, November. BIS, FSB, IMF. *Macroprudential Policy Tools and Frameworks*. Progress Report to G20, 2011.

532 *Ibid.* P. 274.

533 Smaga. P. *Supra* note 509. P. 2-7.

534 Maino R. *Tackling the „Too Big To Fail“ conundrum: Integrating market and regulation*. LSE Financial Markets Group Paper Series. Special Paper No. 207, 2012. P. 2.

535 Such risk, which occurs suddenly, an unforeseen event that damages the financial system to the extent that economic activity in the wider economy is experiencing negative consequences.

cro-prudential⁵³⁶ supervisory tools. They state that systemic risk is transferred by means of certain mechanisms, and thus in order to identify systemic risks, the channels of the systemic crisis need to be established first. Systemic crisis is determined by the identification of bank insolvency by *causa proxima*, but also the mechanisms for transferring this knowledge both at national and international level. It should be noted that the new technologies have significantly increased the speed of information development with regard to the events related to the financial difficulties of the bank, because many financial activities and services are now supplied by automated computer systems. The increasing emergence of capital worldwide has triggered more active stock market trading, as well as financial futures markets and other financial markets⁵³⁷. The doctrine distinguishes four systemic risk components: (i) predominance of interbank systemic risk; (ii) systemic risk of payment systems; (iii) systemic risk of information transmission; (iv) psychological risk⁵³⁸. Systemic risk means a conjunction of bank default risk associated with bank liquidity, when the banking crisis that has started in a particular market or sector, or jurisdiction may spread to other markets, sectors and jurisdictions, and finally develop into a complex international financial crisis⁵³⁹. Some authors argue that any risk (interest rate risk, foreign exchange risk, credit risk, etc.) can transform into systemic risk, as it negatively affects and expands beyond the bank (financial institutions), influences and/or affects other banks (financial institutions), often causing a 'destructive' domino effect in the money and settlement system⁵⁴⁰. The latest technologies have increased the speed of communication, by disseminating information on the relevant events relating to the activities of one or another bank, e.g. many financial activities are now carried out through automated computer systems⁵⁴⁰.

The EU legislation defines systemic risk or systemic crisis as 'a disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. All types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree;⁵⁴¹. Systemic risk (crisis) gets the sense that it affects many credit institutions to obtain financing. So at the beginning of such a crisis there is a need to take steps to ensure that all credit institutions, which are otherwise solvent, have equivalent access to finance, in order to avoid problems with consequences for the whole economy. These measures include support for central banks to increase liquidity in the Member States and the guarantees for securities issued by solvent

536 The probability that growing losses will increase or will be affected by a certain event, resulting from financial difficulties of several financial institutions.

537 The financial market is a market in which people issue and trade in securities. Securities are fungible, negotiable instruments that reflect certain financial value and are generally categorised as debt and property (capital) securities. In the financial markets, monetary funds come from trade surplus of those who buy the securities, to those who lack funds and who distribute new securities or sell existing securities. The financial market can be considered as a certain set of agreements that allows market trading. The breakdown of central financial markets is as follows: money market, bond market, capital market, derivatives market. Haan D.J., Oosterlo S., Schoenmaker D. *Supra* note 62. P. 65-104.

538 See more Schwarcz L.S. *Systemic Risk*. The Georgetown Law Journal Vol. 97, No. 1, 2008. P. 193-249.

539 Giovanoli M. *Supra* note 85. P. 6.

540 *Ibid*.

541 Directive 2014/59/EU. Art. 2 (30).

credit institutions⁵⁴². In a systemic risk situation, systemic damage can occur, for example, it can affect Member State confidence, financial services in the internal market and credibility. Therefore, avoiding such systemic risk and the respective stability of financial markets is one of the key conditions for the creation and operation of the internal market⁵⁴³.

In the *US legal system* systemic risk is understood as an exceptional banking situation. This risk may lead to serious adverse consequences for the economic conditions or financial stability. In this case, the legal regulation allows derogation from the 'least cost' principle, if this helps reducing or avoiding systemic adverse consequences⁵⁴⁴. The following criteria should be taken into account when identifying systemic risk: the size of the financial institution and the financial conditions; sources of capital; operations in progress, especially those that may considerably impact financial stability, markets; if other financial institutions exist on the market that can provide services similar to those supplied by the failing entity; whether insolvency solutions of certain financial institutions will cause any negative consequences for the entire international market; whether the financial difficulties faced by a financial institution and their resolution (i.e. the insolvency procedure to be selected) will not have potential consequences; the effect of the receiver's appointment on consumers and the financial system, financial markets, banks and other financial institutions; whether solvency solutions of financial institutions will not result in significant negative liquidity problems for other banks or financial institutions⁵⁴⁵. After identifying at least one of those criteria or a set of them systemic risk can be determined.

In the Swiss legal system, systemic risk is assessed in view of the size of the bank, links to the entire financial system and the economy, and the substitutability of the functions and services in short term. The following criteria are also relevant: market share of systemically important functions, the amount of insured deposits, especially the one exceeding the covered part, the ratio of the total assets of the bank and the annual Swiss GDP, bank risk profile, determined on the basis of its business model, balance sheet structure, asset quality, liquidity and leverage criteria⁵⁴⁶.

1.7.1. Regulation of Systemically Important Banks. What's New?

Scientists and lawmakers still disagree and are inconsistent in addressing the extent to which systemically important financial institutions (SIFI) should be governed. Both sides agree on one point, namely that by reason of their size and/or complexity, insolvency of systemically important financial institutions causes much more severe consequences than the failure of a small financial institution⁵⁴⁷. It follows that SSIF insolvency procedures should be subject to different legal regulation. In addition, the latest banking crisis has highlighted that the insolvency belonging to a banking group can rapidly affect the sol-

542 BRRD. Recital (2).

543 *Ibid.* (3).

544 12 U.S.C. Section 1832(c) (4) (G). John B. Taylor, "Systemic Risk in Theory and in Practice," in *Ending Government Bailouts As We Know Them*, 2010. P. 46.

545 Dodd-Frank. 203 (c) (2) chapter.

546 Swiss Banking law. Art. 8.

547 Lastra R.M. *Supra* note 74. P. 270.

veny of the entire group or even cause systemic effects.⁵⁴⁸ The collapse of SIFI was one of the most important aspects of the recent financial crisis. SIFI insolvencies have caused massive losses for creditors and pushed the entire global economy down. Governmental intervention into distressed banks took two main forms: (i) governments used *fiscal capital injections*, state aid or financial stabilisation (sustainability) measures to save the banks, which was not standard practice in normal economic circumstances⁵⁴⁹; (ii) some governments publicly committed themselves to prevent systemically important financial institutions from failing, i.e. to terminate their activities, by withdrawing their licenses and adopting an official decision on insolvency, and eventually to liquidate them for bankruptcy and to eliminate the bank as a legal person from civil circulation. In this section, we will reveal the understanding of SIFI in the doctrine and positive law of different jurisdictions and at the end we will review some practical examples.

Firs of all, the systemic importance of financial institutions arises due to the financial services and financial functions performed by these financial institutions for the general economy⁵⁵⁰. At the same time, SIFI supplies many other functions and services that are systemically irrelevant or may be replaced immediately and easily. There is no universally accepted legal definition of SIFI; this question therefore deserves an extensive scientific judgment. In a general sense, SIFI means any financial institution, when due to the particular importance of this institution, it is likely that public authorities will rescue the failing financial institution from insolvency and intervention will therefore become absolutely necessary, in order to save the financial institution's activities and to avoid significant negative and systemic exposure (risk) for the entire financial system, which is usually the case if an ordinary bankruptcy procedure is applied⁵⁵¹. The word 'systemic' should be understood as systemic effect not only for the financial sector, but also for the real economy, and ultimately for the sovereign functioning of a country or even several countries. This definition lacks precision, but it has its advantages. Primarily because a common decision on bank insolvency problems and the future of the bank may be adjusted to the fact, on an *ad hoc* basis, after considering each situation individually. Supervisors or other competent authorities shall assess each situation individually, by determining what is a financial institution having a systemic effect, and which institutions fall outside this concept, and then choose the insolvency solution accordingly (depending on the evaluation of the bank's assets at the time of intervention, inspection results, etc.). Second, this definition implies that insolvency problems of SIFI can be solved without taxpayer support (for example, using the financial assistance of the central bank as a lender of last resort), with no additional

548 BRRD. Recital (14).

549 The main reason that induced government intervention was that systemic risk is not the risk that the bank itself can estimate, thus in the case of improper evaluation of the bank's financial situation, this could cause the collapse of the entire market or the banking system. In addition, if the prudential requirements require banks to manage their own operational risks and to follow the developments on the market, it does not necessarily mean that a bank will consider and assess all the risks, particularly those with potential to cause wider adverse consequences for the entire financial system. IMF, BIS, FSB. Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations-Background Paper, October 2009.

550 FINMA. Addressing „Too Big To Fail“. The Swiss SIFI Policy. Bern, 2011. P. 5.

551 Attinger J.B. *Supra* note 49. P. 8.

legal regulation allowing better control of the financial institution. Third, some scientists believe that governments in all cases have more economic reasons to save the SIFI rather than directly liquidate it⁵⁵². In the narrow sense, a more detailed analysis reveals that SIFI is an institution whose collapse could cause systemic risk, characterised by the risk of contagion, and therefore affect the failure of other credit institutions⁵⁵³. The likelihood of outspread or contagion may occur in the literal sense (arising from the fact that the collapse of one financial institution can lead to the losses of another financial institution linked to each other because of creditor relations). Exhaustion of capital automatically leads to losses, which may result in wider liquidity or bank capital failure. Indirectly, the risk of spreading is a situation whereby the insolvency of one bank may trigger a chain reaction⁵⁵⁴. Even if a particular financial institution causes no significant direct domino effect on other financial institutions, the collapse of the bank could encourage other market participants to re-estimate solvency risks of certain classes of financial institutions, especially in cases where this is related to any implicit or explicit bank guarantees⁵⁵⁵.

In the EU legal framework, systemically important banks are those exercising systemic and critical functions. Critical functions are defined in terms of activities, services and operations, the termination of which is likely to disrupt the provision of services that are critically important for the real economy, or the financial stability of one or more Member States by reason of the size of the financial institution or group, the market share controlled by it, external or internal interconnectedness, complexity or cross-border activities, in particular, having regard to the substitutability and extent of such activities, services or operations or their importance for the economy of the EU or of the respective Member State, also the importance⁵⁵⁶ of cross-border activity, and the interconnectedness of the credit institution or group and the financial system⁵⁵⁷. In addition, it must be noted that the EBA has published key guidelines on this issue, by specifying the SIFI criteria. At national level, SSFI shall be defined with regard to the following criteria: size (all bank

552 Ibid.

553 See *more* 1 chapter 6 sec. 1 subsec.

554 Whether a financial institution can be considered as systemically important, is generally determined by public authorities in the early intervention period. For example, in determining whether other financial institutions bear significant financial obligations in the distressed financial institution. When that fact is established, it implies that the collapse of the bank experiencing financial difficulties can lead to significant loss for other financial institutions' capital and liquidity, and thus the chain reaction of contagion. A good example was the insolvency case of the Bearn Stearns investment bank. In March 2008 The Federal Reserve decided to bail-out the bank by using public finances and to prevent the bankruptcy of the investment firm. Public authorities determined that the bank was too connected to fail and that the collapse would unavoidably lead to negative consequences for other banks. For this reason, the Federal Reserve gave a USD 30 billion loan (without the right of recourse) with illiquid security, 'bad' bank assets and securities. In the event of this extraordinary support, after granting state aid, JP Morgan Chase decided and agreed to buy Bearn Stearns.

555 The best illustration of this is the single money market funds. Prior to that, the prevailing myth was that single money market funds were equivalent to the size of deposits.

556 Means activities, services and operations provided to third parties and should not be determined from a merely internal perspective oriented at the business and organisation of the bank. EBA. Technical advice on the delegated acts on critical functions and core business lines. EBA/Op/2015/05. 2015. P. 6.

557 Directive 2013/36/EU. Art. 131, Art. 132 (3).

assets), including the substitutability of the financial institution⁵⁵⁸, and the financial system infrastructure (the value of local payment transactions, private sector deposits in the EU, loans to the private sector in the EU), complexity and trans-national activities (implied value of derivative instruments, inter-jurisdictional obligations, inter-jurisdictional creditor claims), interconnection (interbank liabilities, interbank assets, outstanding debt securities)⁵⁵⁹. Thus, the content and information of the BRRD directive and its annexes places minimum requirements which, inter alia, apply to the banks of systemic importance, e.g. competent authorities are allowed to apply different or highly reduced requirements for particular credit institutions with regard to recovery and resolution plans⁵⁶⁰ and supervisory information, as well as in determining that updates –shall take place at least once a year. In addition, one of the main objectives of the Directive in applying an efficient conversion regime is to minimise the resolution costs of the failing credit institution for taxpayers and to ensure that credit institutions of systemic importance could be restructured without jeopardising financial stability. For example, this can be achieved using the bail-in measure, by securing that the shareholders and creditors of the failing institution suffer appropriate losses and cover the legally defined share of the costs triggered by its collapse. In all cases, when a bank faces solvency problems, the aim is to preserve systemically important functions of the respective credit institution as far as possible⁵⁶¹.

In the Swiss legal system, a systemically important financial institution is defined as a bank, financial group and financial conglomerates dominated by banks, whose failure would cause significant damage to the Swiss economy and the Swiss financial system⁵⁶². This definition requires that the bank conducts systemically important functions. A function is systemically important if it is necessary for the Swiss economy and is indispensable in the short term⁵⁶³. Such systemically important functions are payment transactions, deposit-taking business, securing access of business operators to liquid financing sources, lending business related to lending to entities, non-financial institutions, local housing loans⁵⁶⁴. The bank, as a company, is considered systemically important if it performs ser-

558 Associated with the ability to change the specific functions under similar conditions to a similar extent, with the same quality, at a reasonable cost. Compared to other market participants, within a reasonable period, thus avoiding disruption of the functions that are essential to the real economy and the financial markets. EBA. *Supra* note 555. P. 5.

559 EBA. Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs). EBA/CP/2014/19, 2014. P. 4.

560 A resolution and recovery plan is prepared, if the operations of a credit institution form a significant share of that Member State's financial system, where at least one of the following conditions is met: (a) the total value of its assets exceeds EUR 30 billion, or (b) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below EUR 5 billion. BRRD. Art. 4(10).

561 BRRD. Recital (14), (67).

562 Swiss Banking law. Art. 7 (1). The definition is in compliance with IFS. IMF, BIS, FSB. Guidance to access the Systemic Importance of financial Institutions, Markets and Instruments: Initial considerations, Report to the G20 Finance Ministers and Central Bank Governors, 2009 [interactive] [accessed on 05-04-2014]. <<http://www.imf.org/external/np/g20/pdf/100109.pdf>> P. 5, 8.

563 *Ibid.* Art. 8, para 1.

564 *Ibid.* FINMA. *Supra* note 549. P. 6.

vices that are relevant for the entire Swiss economy and that cannot be replaced by other market participants within a reasonable period. The same definition includes the following criteria: (i) systemically important lines of business, such as: deposits, loans, clearing, market share; (ii) the value of existing deposits not covered by the deposit guarantee scheme; (iii) the ratio between the bank's balance sheet and the GDP; (iii) bank risk profile⁵⁶⁵. In order to minimise the 'too big to fail' scenario, Switzerland newly created supplementary legal regulation to manage SIFI capital ratios and liquidity more effectively, to improve the internal management of the organisation, and the obligation to have a separate risk diversification system in place⁵⁶⁶. For example, legal instruments to enhance capital and liquidity facilitate the supervisory authority in conducting the resolution of the bank, whenever the latter faces financial difficulties, encourage bank managing bodies to reduce systemic risk and to limit the impact bank insolvency. Liquidity risk is mitigated by applying stress tests, using exceptional liquidity requirements for large banks, etc.

In the US legal system, the Dodd-Frank Wall Street Reform and the Consumer Protection Act has given extensive powers to the FDIC in order to mitigate the insolvency risks of systemically important financial institutions, endangering the financial stability of the US, by crossing the boundaries of general insolvency law, where necessary. Possibility to mitigate and resolve SIFI risks is a significant exception to the FDIC mission⁵⁶⁷. It should be noted that the Dodd-Frank Act provides no definition of the SSIFI concept. The term 'systemically important financial institution' in the Dodd-Frank Act is used solely in two sections: 216 and 217. The systematic interpretation of those provisions must take into account the US Bankruptcy Code regulating insolvency of financial institutions. Like the FDIC, that term is most often used in the academic community or by experts, in particular in view of the fact that they are companies belonging to banking groups and holding more than USD 50 billion of consolidated bank assets or the entire non-bank financial institution, as established by the Federal Reserve Financial Stability in accordance with the relevant prudential standards provided for in the Dodd-Frank Act⁵⁶⁸. The answer to the question whether a financial institution is systemically important according to insolvency law, depends on a number of criteria: the size of financial institutions, financial leverage, nature of conducting transactions, relations with other financial institutions (especially, interconnectedness with other financial institutions operating in the same financial market). It should also be considered whether other financial institution will be able to provide the services of the same type and level as those provided by the financial institution now in distress. In addition, the following criteria must be consistent with the Dodd-Frank legislative requirements of Chapter I, which determines duty of regulators to consider and assess when a financial institution is to be considered as 'systemically important', according to the prudential regulatory requirements⁵⁶⁹. As mentioned above, the SSFI is subject to a new resolution regime based on the activity of the exceptional '*Ordinary Liquidation*

565 Ibid.

566 Ibid. P. 6-19.

567 Federal Deposit Insurance Corporation. Office of Inspector General. *The FDIC's Progress in Implementing Systemic Resolution Authorities under the Dodd-Frank Act*. Report No. AUD-14-001, 2013. P. 4.

568 Ibid. P. 36.

569 Dodd-Frank. 113 chapter.

Authority' and the unique implementation of resolution functions with regard to *systemically important financial institutions*⁵⁷⁰.

Finally, whilst banks conduct their activities on an international level, it is important to determine whether SSFI can be regarded as an internationally and systemically important financial institution⁵⁷¹ (hereinafter - G-SSFI). The G-SSFI has three distinctive features. The first one is interconnectedness of financial institutions with another financial institution coming within the same banking group or falling outside the group framework. After determining such a relationship, it could be argued that this increases the risk of contagion and the negative impact of bank insolvency on the economy. Such interconnections reduce the potential of an individual and prevents them from instituting ordinary bankruptcy proceedings, notwithstanding combined connections with other companies of the banking group. After identifying such interconnections, it could be stated that this increases the risk of 'contagion' and the negative impact of bank solvency problems for the economy, accordingly specific regulation is needed. Such a interconnected links reduce the possibilities of starting ordinary bankruptcy proceedings, regardless of component interfaces with other banks in the group. Therefore, there is a need to coordinate the failure impact on the other market participants' interest. In the doctrine, this phenomenon has been described as 'too interconnected to fail'. Another criterion is substitutability. Even a relatively small financial institution may prove vitally important for the functioning of the entire system, if it is unique, by providing underlying services that cannot be easily replaced by other market participants. The complexity of business models or the supply of the respective financial products is another important criterion. If these products are specific and can lead to financial difficulties of other market participants, by assessing the impact and possible outcomes of crisis situations, e.g. that the products of that bank have both psychological and practical consequences. This situation can easily cause a panic reaction in a given market, massive withdrawal of deposits, when the counterparties, the financial institutions having financial difficulties are unable to assess the risks arising from the emergency situation. In addition, some side effects could be distinguished: more extensive balance sheet, and higher financial leverage indicators. The liabilities of such banks often amount to extremely liquid financial products. Finally, such banks are conglomerates with strong links between component companies, internationally accessible banks (staff), etc⁵⁷². Since G-SSFI failure causes a significant threat to public finances and ultimately the public interest, the problem of moral hazard is intense⁵⁷³. For this reason, these banks are not covered by standard bank insolvency law. All of these concerns aggravate the resolution procedure for such financial institutions and require special legal regulation for the proper management of systemically important banks in the time of crisis.

The particular problems of G-SIFI were raised to the international level to develop and apply comprehensive and conclusive solutions by combining the efforts of the governments. Legal instruments for solving the main problems are identified in the following

570 Dodd-Frank. Title II .

571 FSB. Progress in the Implementation of the G20. Recommendations. P. 2.

572 Sommer H.J. Special Issue: Large and Complex Banks. Economic Policy Review. Federal Reserve Bank of New York. Vol.20, No.2, 2014. P. 3.

573 Attinger J.B. *Supra* note 49. P. 8-10.

internationals documents: FSB Key Attributes of Effective Resolution Regime for Financial Institutions; BCBS Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement; FSB, Progress Report on Intensity and Effectiveness of SIFI Supervision. A wider analysis of resolution of these types of credit institutions and of the related problems is out of the study range. However, it should be noted that the lawmakers have addressed many of those problems through modern bank resolution regime, agreeing to the fact that international bank insolvency is a much more complex process than conventional businesses⁵⁷⁴. It should be noted that principally, international regulatory guidelines recommended that national resolution authorities engaged in an *ex ante* resolution impact assessment, in preparing recovery and resolution plans for G-SSFI, by creating inter - institutional, cross-border cooperation agreements. The FSB also recommended requiring more extensive and better loss absorption capacity and the relevant rules for the protection of capital. For instance, increasing requirements from 1 to 2.5% according to the risk-weighted assets of the total capital. It was also decided that these institutions will be more intensively and strictly controlled by supervisory authorities, by providing that the powers of resolution authorities will be exercised in a manner that allows derogation from the general principle of equality (*pari passu*) of creditors, treating the same classes of creditors in different ways, undertaking to apply the no creditor worse off than liquidation principle, with the right to compensation for shareholders, through the bail-in legal instrument, thereby increasing capital and liquidity requirements of such institutions. It is assumed that these measures make it easier for the supervisory authority to restructure the bank facing financial difficulties, encourages the managing bodies of the bank to reduce systemic risks until the time when the bank is still in operation, etc.).

1.7.2. Why Banks Are not Allowed to Institute Ordinary Bankruptcy Proceedings? Doctrinal Reflections on the ‘Too big to fail’

The concept and legal regulation of SSFI correlates with the ‘too big to fail’ doctrine. The solution of problems faced by large and complex insolvent banks turned into a significant legal problem⁵⁷⁵. The main reason for this was that because of their large, systemically important banks, based on unconditional implicit government guarantees⁵⁷⁶, took excessive risks, which together with the lack of bank insolvency regulation led to the international

574 Sommer H.J. *Supra* note 571. P. 14.

575 Kaufman G.G. *Supra* note 159. Abstract.

576 If the bank is experiencing serious financial difficulties, the Central Bank is often expected to assume the role of the ‘lender of last resort’, which traditionally performs the functions of the lender of last resort and emergency liquidity supply functions. It is expected from the lender of last resort, usually acting with the approval and active participation of the government, that the bank will be rescued with public finances. Legal acts often fail to regulate the price role of the lender of last resort. It is assumed that such discretion is intentional, as the bank will not be able to calculate government support *ex ante*. Such an approach implies that the CB reserves the right to intervene in order to protect the stability of the financial system, but in general terms and without any abstract guarantees. It should be noted that the circumstances began to evolve together with the new bank insolvency paradigm. The CB carries out stress tests, and large banks have a duty to prepare recovery and resolution plans *ex ante*, etc. See more 3 chapter, 1 sec., 2 sub-sec.

financial crisis in 2008-2009⁵⁷⁷. Many large banks took excessive risks and applied aggressive financial leverage system. In addition, banks were too much influenced by various speculations in the financial markets. Such a situation has led to the accumulation of barely manageable bank risks in bank accounting. Finally, the solutions to bank solvency problems were guaranteed with taxpayers' money, or, in other words, with the money of the state where the bank was located. If the bank operated in a number of countries (a branch, a subsidiary), the bank's risk-taking activities were partly guaranteed by several governments. This 'easily' obtained financial support mainly reflected the macroeconomic and financial stability objectives of the governments⁵⁷⁸. Such governmentally-secured unconditional guarantees to banks resulted in the 'too important to fail' doctrine, preventing the initiation of bankruptcy proceedings and liquidation for banks on account of highly probable negative consequences for the economy. These large and complex banks were simply too big to be closed down and subjected to normal bankruptcy procedures. A legitimate question then arises, whether certain financial institutions must be treated exclusively and legislators may treat them in an exceptional manner, preventing the 'failure', i.e. winding up of systemically important and most complex institutions? Due to the limited scope of this study, we will only reveal the principal aspects of this doctrine necessary for the subsequent analysis of the bank resolution regime.

Reasons supporting the genesis of the 'too big that fail' doctrine could be highlighted. First of all, as discussed above, costs of bank insolvency *de jure* exceed the average costs incurred by other corporate bodies in case of insolvency⁵⁷⁹. Second, the state, taking into account the particular circumstances of the financial system, may prevent banks from launching direct liquidation procedures in some instances⁵⁸⁰, as the bank's collapse could

577 The doctrine has evolved due to lack of legal regulation of banking activities: (i) lending powers and eligible bank investment expanded; (ii) access to debt and equity-based financing evolved, especially in economic upturn periods; (iii) the asset market prices noticeably escalated; (iv) market participants started massive selling of fixed assets; (v) when property prices were falling throughout the market, the number of bank default cases increased as well, which undermined the confidence of depositors and creditors in banks, and the risk of a systemic crisis emerged; (vii) the TBTF doctrine was developed in order to avoid a systemic crisis. Moosa A. *The Myth of Too Big to Fail*. Palgrave Macmillan, Great Britain, 2010. P. 22.

578 One of the main reasons is the trend to manage banking risks and increase the impact on their leverage, giving unconditional public financial support guarantees. Such guarantees are supplied by the government to the bank, regarded as too important for creditors to be liquidated. Such banks were able to obtain much cheaper funding in the market and, therefore, grow faster than the other financial institutions. They had fewer incentives than other financial institutions to protect against banking risks. Banks and creditors of the respective banks were aware that if they were sufficiently important to the economy or the rest of the financial system and if they encountered financial difficulties, the government was to protect them with a guarantee.

579 K. Alexander. *Supra* note 79. P. 64-65.

580 One of the reasons is the interconnectedness between banks. Once a bank is not allowed to fail, the market creates expectations, inter alia, related to political risk. When financial difficulties are faced by a bank operating on the same market, the state is automatically facing high pressure to prevent the bank from becoming insolvent. Such situation is also associated with time scheduling criteria, as the benefits related to bank liquidation procedures (thus sweeping the entire banking system) become apparent only in the future, and the costs (financial destabilisation and voter excitement) are inevitable in the current moment. Therefore, first of all, bank failure or likelihood of failure should be anticipated as soon as possible. This is important since even the well-planned actions for addressing bank insolvency problems will face adverse reaction both in the market and among depositors. Furthermore, the implementation of the

lead to negative consequences for the entire functioning of the real economy⁵⁸¹. Third, in the absence of a bank resolution regime that would effectively regulate bank resolution, the competent authorities are obliged to undertake intervention measures⁵⁸² with regard to the bank on an *ad hoc* basis. In this case, it is very likely that taxpayers will face the burden, and additional, significant financial risks will arise. Therefore, the ‘too big that fail’ problem was one of the main reasons that encouraged the appearance of the resolution regime for failing or likely to fail banks, and thus this is the ultimate solution to this problem⁵⁸³. Finally, it should be highlighted that until the recent banking crisis the *ad hoc* intervention of competent authorities could sometimes stabilise the situation of the distressed bank and the banking system in the short term, but in the long term, such intervention costs could become very costly. The reasons for this are rather plain. It is difficult to imagine a state that fails to respond to the banking crisis (insolvency of one or several banks) that threatens the entire national economy threatens, as this phenomenon, otherwise known as moral hazard⁵⁸⁴, can lead to negative consequences not only for the banking industry, but also for future generations, after a significant increase in national fiscal costs.

The concept of ‘too big to fail’ is not new and has been extensively analysed by foreign researchers⁵⁸⁵. However, the ‘too big to fail’ doctrine remains a rather ambiguo-

bank resolution plan and of the respective resolution tools is a complex process, with many positive attributes. One of them is that, in case of bank resolution, and not straight liquidation, bank creditors are more confident about the safety and security of their investments and the level of risk attributable to the bank's conduct. In addition, in theory it is possible that the market can manage to prepare for such bank transformation and creditor and bank resolution will not require taxpayers' money. It became evident after establishing a new legal regime for bank resolution. At the same time, bank resolution through public finances can spread the ‘contagion effect’ among creditors and especially large depositors. Finally, only bank rescue will not solve the systemic crisis. When the country's payment and settlement system as the basic infrastructure of the modern economy is under threat, the government is indirectly obliged to act and take action to rescue the bank. Not because it is desirable, but in view of the fact that other alternatives would prove much worse. Barth. A, Schnabel. I. Why banks are not too big to fail – evidence from the CDS market. *Economic Policy*, Vol. 28, No.74, 2013. P. 335-369.

581 BIS. 2012. 82nd Annual Report. 1 April 2011- 31 March 2012, Basel, Switzerland, June 24. P. 75-76.

582 For example, in the EU, especially in the eurozone, direct government intervention by applying financial sustainability measures, providing guarantees or asset relief measures or bank recapitalisation was adopted in accordance with the state aid rules. State aid generated considerable costs. From 2008 to 2012, 75% of all the state aid (about EUR 4 trillion) in the EU was allocated to the eurozone countries. Valiante D. *Supra* note 5. P. 9-12.

583 Tucker P. *Supra* note 92. P. 2.

584 Since ordinary bankruptcy procedures are considered as too expensive by competent authorities, bankruptcy (direct liquidation of the bank) is regarded as posing a threat to the financial system. However, in the absence of other bank resolution options, public working capital (equity) injection is the only option, even though it causes enormous moral hazard and reduces market discipline. Empirical studies confirm that the banks that expect to obtain public support hold lower amounts and substantial equity capital on their balance sheet, compared with the total assets of medium-sized banks. Public support expectations reduce market discipline. In accordance with Basel III requirements, this situation may force banks to seek for better counter-cyclical capital buffers. Nier E, Cihak M. *Supra* note 15. Public Support and Moral Hazard. P. 7-9. FSB. Recommendations and Time Lines. Reducing the moral hazard posed by systemically important financial institutions, 2010.

585 Elijah B., Jagtiani J. *How Much Did Banks Pay to Become Too-Big-To-Fail and to Become Systemically Important?* Springer Science, Business Media, LLC, 2011. Strahan, P.E. *Too big to fail: causes, conse-*

ous legal concept not defined in law⁵⁸⁶. This legal phenomenon is easier to identify *ex post* than *ex ante*⁵⁸⁷. It is essential to distinguish the components of this doctrine principally because special bank resolution regime is one of the solutions to this problem and also in order to see whether this theory can reduce the losses caused by bank insolvency to the related stakeholders⁵⁸⁸. The essence of the TBTF is to avoid massive deposit withdrawals from banks without destabilising the economy. By reason of such financial institutions (determined *ex ante*), the TBTF banks will experience greater benefit than their competitors, whose debts are unsecured *ex ante* and who are therefore encouraged to engage in additional risk taking. It seems that Barth R.J. offered the most accurate definition of the TBTF. According to him, the TBTF is a situation, which at different times, in different jurisdictions and in different economic conditions protects both insured and uninsured depositors, bank guarantees, insured risky assets, depreciation of collateral, providing liquidity to the bank for exclusively long periods, by using public capital injections and thereby benefiting the shareholders of the bank, as otherwise the bank would collapse⁵⁸⁹.

In the banking sector, the 'too big to fail' doctrine has some equivalents, such as: 'too big to liquidate', 'too big to be closed', 'too complex to fail', 'too interconnected to fail'. Each of the terms used reciprocally reflects different causes for bank insolvency and bank resolution. The fundamental objectives of the doctrine are the following: (i) reducing the likelihood of bank insolvency (bankruptcy procedure); (ii) accommodating the state and the

quences, and policy responses. Annual Review of Financial Economics Vol. 5, 2013. P. 43-61. Acharya V.V., Beck T. Evanof D.D. etc. *Too big to Fail or Just Too Big?* (in) the Social Value of the Financial Sector. World Scientific Studies in International Economics, 2013. P. 377-400; Brento M. *Too big to fail-too big to manage.* LSE Financial Markets Group Paper Series. Special Paper No. 191, 2010.

586 Kaufman G.G. *Supra* note 159. P. 214-223.

587 Seelig S. Too big to fail: a taxonomic analysis. (in) Edt. Gup B. Too Big To Fail: Policies and Practisies. Praeger Publishers. P. 219-230.

588 In order to better understand the TBTF problem and the related risks, one needs to analyse the risks assumed by private creditors lending to a financial institution. They face two main risks of losses: (i) the possibility that the bank experiencing financial difficulties will require intervention of the competent authorities or even government intervention; (ii) potential losses caused by interference. Losses may depend on the risk profile of bank assets, bank leverage and liquidity, in other words, a classic credit analysis. Bank recovery and/or resolution also results in certain risks to private creditors. If it is acknowledged that the competent authorities will always intervene and protect creditor from direct liquidation (bankruptcy) of a financial institution, then the creditors' losses arising from government intervention will amount to zero. In this case, creditors will experience zero risk. If the competent authority fails to protect creditors from bank insolvency and will decide not to apply bail-out, then it is likely that creditors will suffer losses due to bank insolvency, and the risk and losses to creditors will reach such level as required by the insolvency procedure. Market expectations with regard to possible resolution of the bank are much higher than in the case of bank rescue with public finances, which often occurs very swiftly. Therefore, if the government decides to bail-out a bank, the market would panic because of the expectation that it had already created. In this context, intervention is understood as actions undertaken by the supervisory authority: (i) intended to rescue the financial institution (e.g., through the injection of new capital) in order to keep it functioning; (ii) concerned with the adoption of a decision on the resolution of the financial institution (e.g., by transferring deposits or creating a bridge bank).

589 Barth R.J. Just how big is the too-big-to-fail problem? Journal of Banking Regulation Vol. 13, No. 4. Macmillan Publishers Ltd, 2012. P. 266.

competent authorities with legal measures to effectively address the insolvency of systemically important financial institutions, without using taxpayer support⁵⁹⁰.

The central aspect of the doctrine is that in certain situations, from a practical viewpoint, competent authorities may be determined to ensure higher protection for all or some depositors or different groups of bank creditors, compared to the others, which is to mitigate the worst case scenario. Such a decision at least partially depends on the economic damage to be incurred, including advanced risk, the effect for other banks operating in the same environment, considering the lost value of creditor claims held by certain depositors and other creditors in the case of bank insolvency. Therefore, the 'too big to fail' regime must first identify the entire banking sector and the potential effects for the latter, and then quantify indirect social harm. Another step is identifying the bank's counterparties, taking into account the categories of creditors potentially exposed to significant losses. Finally, following the cost and benefit analysis, the competent authorities will decide whether to grant public support for the most vulnerable groups of bank creditors (private interests) in order to protect public interest, including the entire banking sector and the economy⁵⁹¹.

During the recent financial crisis, a substantially similar approach was followed in addressing bank insolvency issues both in the case of collapse of significant financial institutions, which automatically used to spread fear in the market due to financial 'contagion'⁵⁹², and in the event of failure of traditionally-sized banks. Therefore, on the one hand, the 'too big to fail' doctrine is associated with the above-mentioned systemic risk. On the other hand, this doctrine refers to the fact that the bank is too big to be wound up with all the ensuing negative consequences⁵⁹³. In addition, if a systemically important financial institution faces insolvency problems, it is likely to cause an adverse domino effect, when a number of other financial institutions could collapse, causing extreme damage to the real economy as a whole. Due to such potential consequences, the state cannot and will not allow a financial institution to fail. On the contrary, the state will be forced to bail-out the distressed bank through public finances, performing additional capital injections or giving loans and guarantees from public finances⁵⁹⁴. Eventually, several legal problems were identified in relation to the doctrine. First, in the absence of an effective bank resolution regime, the financial difficulties encountered by a financial institution could most often be addressed only by means of negotiations, indirect pressure and by concluding private contracts, the formal acts of public law being unnecessary⁵⁹⁵. Second, conceivably the most

590 Tucker P. *Supra* note 92. P. 2.

591 Kaufman G.G. *Supra* note 159. P. 12.

592 *See more* 1 chapter 5 sec. 3 sub-sec.

593 Rolef W. Too Big to fail as a Game of Chicken with the State: What Insolvency Law theory Has to Say About TBTF and Vica Versa. *European Business Organization Law Review*. Vol., 14. No.2, 2013. P. 202.

594 *Ibid.*

595 When highly complex, large financial institutions were confronted with financial difficulties, their fate was regularly determined not by stringent application of legal or regulatory insolvency rules, which accordingly could result in the revocation of the relevant bank license or liquidation procedure, but by hasty acquisitions and mergers, different restructuring and refinancing schemes, often initiated by the ministry of finance or the Central Bank of a certain country. In most cases, this kind of intervention by public authorities involved private sector competitors of a failing financial institution. Hadjiemanil C. *Supra* note 79. P. 5.

visible problem is that application of public finances to maintain a private financial institution in turn weakens the fiscal position of the state⁵⁹⁶. Another indirect issue is concerned with moral hazards and market distortions caused by implicit state guarantee.

Other sections of the dissertation will explore the successes and failures of the bank resolution regime in solving these problems in more detail. It is important to note that before the new paradigm of bank insolvency law, it is difficult to find examples of large, systemically important bank failures at the expense other than consumers' (taxpayers') costs. On the contrary, many examples show that banks were rescued with the assistance of the state or the society, i.e. taxpayers' money. This presumption is explained by the fact that due to its particular size, the bank may simply be too big to undergo ordinary bankruptcy and be involved in immediate liquidation procedures. In essence, this means that in the event of collapse too many depositors would encounter inevitable losses and the bank is too big for the deposit insurance fund to be able to make cash payments to depositors without delay under deposit guarantee schemes, while the state would assume all the negative consequences of the failing bank. In addition, in certain situations several financially interconnected banks may also approach the insolvency threshold. Such a phenomenon can lead to even larger-scale banking crises in the market. The objective of the TBTF is the maximum protection of the insolvent bank's creditors (including its shareholders) against the losses they would incur if bank insolvency problems were addressed through bankruptcy. In this case, the shareholders of the bank retain control over the bank management⁵⁹⁷ and the protection is funded by a third party. In the case of an intervention, bank capital is still positive, and therefore the bank is not declared insolvent *de jure* and thus depositors and other creditors remain adequately protected against potential losses.

1.7.3. Case Study

1.7.3.1. The Swiss Approach

Two Swiss banks (namely UBS and Credit Suisse) are considered as systemically important for financial stability at the international level⁵⁹⁸. Both banks are treated as Globally Systemically Important Financial Institutions. After the recent financial crisis, a decision was made to produce new legislative measures that would facilitate inter alia the reliability and resilience of these systemically important banks during banking crises and ensure financial stability.

The Swiss Government and the Swiss National Bank were required to deal with the distress problems of the UBS bank. The bank had the 'too big to fail' status. In 2007 UBS was the world leader in asset management services, one of the largest investment banks in the US, also a leader in retail and wholesale trading, and the largest commercial bank in Switzerland. Although it was hard to believe, but after the US Government failed to rescue the systematically significant investment bank Lehman Brothers by public finances and it was forced to initiate bankruptcy, on 15 September 2008 the Swiss Federal Banking Com-

596 Dewatripont M., Freixas X. *Supra* note 463.

597 Kaufman G.G. *Supra* note 163. P. 2.

598 FINMA. *Supra* note 550. P. 5.

mission, in close consultation with the Swiss National Bank, called the two largest Swiss banks – UBS and Credit Suisse – to take immediate steps to increase their capital base. The requirement was based on the necessity to ease the financial markets and to maintain the financial strength of those banks and to prevent their *de jure* insolvency. Credit Suisse started reducing its commitments prior to market developments in the US, and managed to additionally collect CHF 10.4 billion capital from private investors and maintain the Basel Tier 1⁵⁹⁹ level 633 capital requirement, which was around 10%. UBS failed to achieve the same, which is why on 16 October 2008 the Federal Banking Commission announced a bank rescue⁶⁰⁰ and recovery plan, consisting of two main parts. First, the government provides CHF 6 billion Tier-1 share capital for UBS⁶⁰¹ (recapitalisation), and the central bank buys illiquid assets of the bank worth up to USD 60 billion. The main legal problem faced by the Central Bank was that the government was not directly vested with a legal obligation to issue guarantees to each systemically important bank. Despite debt relief and write-off measures, both banks remained adequately capitalised even according to Swiss standards, which always required higher capital reserves than international standards.

Another real risk was related to almost complete loss of liquidity in most markets and increased difficulties in financing the related operations. Ultra-tight interbank money markets, depositor concerns and short-term lender anxiety threatened with bank closure, i.e., by initiating its ordinary bankruptcy procedure with an unacceptable level of risk. The liquidity reserves of the UBS bank were exhausted very soon. On 30 September 2008 UBS wrote off bad debts worth USD 48.2 billion of assets, which made the bank even more vulnerable. Among other things, the management methods of the bank's governing bodies were also highly questionable.

Another important problem was related to short-term financing. Public guarantees and additional distribution of bonds was not considered as an acceptable bank restructuring option. To maintain competitive neutrality, identical rescue/recovery packages were offered to both UBS and Credit Suisse. Both banks were seeking to avoid state aid and attempted, in particular, to appeal to private investors. Credit Suisse successfully lifted its capital level by CHF 10.4 billion in cooperation with several other large institutional investors. UBS was unable to attract additional capital. As a result, the Swiss Central Bank carried out innovative intervention by recapitalising the bank, while acting as a lender of last resort. The Central Bank has developed and funded a 'stabilisation fund' of USD 60 billion⁶⁰². The operating conditions of the Fund and the founding contract stated that the fund was permitted to buy back up to 60 billion of illiquid UBS assets, consisting mainly of: residential and commercial mortgage loans, commercial (housing)

599 Tier 1 bank capital consists of ordinary shares and non-distributed profits of the bank, minus adaptable arrangements, such as the impairment of the carrying amount of goodwill impairment, i.e., recognized as expenses. The equity capital of a corporation is a classic concept. It consists of preferred shares and other financial instruments that meet the regulatory criteria. The last objective of tier 1 capital is to ensure that it will cover losses until the bank is solvent.

600 Since Switzerland is not a member of the EU, the bank resolution definitions are different from the EU and US, and the term 'recovery' is used instead of 'rescue'.

601 Drechel B.S.D. *Supra* note 39. P. 99-100.

602 Panetta F, Faeh T, Grande G. etc. BIS. An assessment of financial sector rescue programmes. BIS Papers No. 48, 2009. P. 22.

mortgage-backed securities, securitised student loans and other asset-backed financial instruments, single-type securities, etc. USB assets were redeemed on 30 September 2008 at book value, which decreased after UBS wrote off part of its debt, based on the value determined by independent experts. Each cash transfer to the stabilisation fund was to be financed with additional 10% UB capital contribution. The remaining 90% were obtained from the Swiss National Bank in the form of loan secured by UBS assets. The loan was issued for a period of 8 to 12 years using the same financing conditions as for other UBS mortgage-based loans. The loan was granted with variable monthly interest based on LIBOR, which was accordingly related to national currency plus 250 basis points⁶⁰³. As a limited liability entity, the stabilisation fund had no shareholder equity. According to the operating conditions of the fund, an entity with unlimited civil liability was to be established under Cayman Islands law. UBS contributed 10% of additional capital for each property transfer to the fund, in accordance with the benefits formula, i.e. a forward repurchase transaction.

After the Swiss National Bank fully financed the loan, the repurchase transaction allowed UBS to repurchase the stabilisation fund for USD 1 billion, by granting the right to 50% capital gain. In other words, UBS assumed the first 10% of losses resulting from the fund. The founding contract of the Fund stated that if the fund eventually earned profit, UBS was entitled to half of it, which amounted to more than USD 1 billion. In addition, the National Bank supplied a state guarantee by means fo UBS shares for a total of CHF 100 million. An interesting aspect of the recovery procedure of this bank is related to the decision-making mechanism according to the Swiss legal system. Neither the Federal Constitution, nor the federal law give the government an explicit right to participate directly or indirectly in providing capital to banks. Such decisions require a resolution adopted and approved by the Parliament by means of an ordinary legislative proposal. Nevertheless, the Federal Assembly (Parliament) meets only four times a year, as it is not a professional parliament. Moreover, in any case, the bank rescue plan could not be discussed in public. Expedition and finality of the recapitalisation transaction were the essential factors guaranteed by the Swiss Constitution, and the government therefore adopted a decree that was legally based on emergency powers. The decree was based on Article 184 of the Swiss Constitution entitled 'Foreign Relations', which allows the government to act whenever "the need to ensure national interests' arises. The decree was also concerned with Article 185 of the Swiss Constitution relating to the provisions governing 'internal and external national security' and authorising the government to adopt resolution if 'the state is in imminent danger or a threat to public policy or internal and external protection arises'⁶⁰⁴. Another unusual aspect of the bank rescue was the fact that, unlike other jurisdictions, the state did not make direct purchase of the bank's shares, but was acting through mandatory convertible notes transaction, which is mainly linked to and based on capital instruments that can never be redeemed before maturity using cash, although they

603 To finance the loan, the Swiss National Bank intentionally applied the first currency swap method at first, in cooperation with the Federal Reserve Bank of New York. In February 2009 the issue of short-term Swiss National Bank treasury bills denominated in the US dollars and with a maturity of less than one year started.

604 Federal Constitution of the Swiss Confederation of 18 April 1999 (Status as of 18 May 2014).

relate to the legal nature of the bank's shares in some respects⁶⁰⁵. Finally, it should be noted that after the fund had bought illiquid UBS assets worth USD 38.7 billion, at the end of the financial crisis, the stabilisation fund managed to successfully liquidate a significant part of the bank's assets on the open market. The government was interested in reselling its UBS market share. The initial public offer of convertible securities ended on 9 June 2009. Since UBS was in the process of distributing new shares, the government agreed to further allocation of the publicly available assets and no longer waited. On 19 August 2009, based on the stabilisation fund contract, the securities were converted into UBS shares. Then the shares were sold to institutional investors for CHF 5.4 billion, by accelerating the accumulated profit by means of private placement. Then UBS redeemed shares at their nominal price and compensated the existing inequality, which amounted to 1.8 billion. This respectively led to USD 1.2 billion gains for the public sector⁶⁰⁶.

1.7.3.2 The US Approach

Lehman Brothers

It was an internationally operating non-bank financial company, which consisted of 2985 legal entities operating worldwide. From the middle of 2007 to the middle of 2008 Lehman Brothers faced severe financial difficulties. The financial difficulties were determined by large asset positions in the mortgage loan market and other lower securitised loan and housing loan segments⁶⁰⁷. On 15 September 2008 the competent US authorities adopted resolutions and ordered the mother (parent) holding company Lehman Brothers to file an application for bankruptcy proceedings against the bank under Chapter 11 of the US Bankruptcy Code. Secondly, Lehman had debts of around USD 613 billion and assets worth USD 639 billion. It was the largest bankruptcy in the US history. First of all, the insolvency of Lehman Brothers revealed negative impact on financial leverage-based⁶⁰⁸, mainly short-term financing. Lehman Brothers had considerable assets in real estate products, most of the transactions were financed by leveraged financial funds, especially in tripartite repo markets. Another problem was that the bank's share price was overrated by credit rating agencies⁶⁴⁷. According to the initial scenario to address the bank's solvency problems, it should have been bought by the Korean national *Development Bank*, and later purchased by *Barclays* and *Bank of America*. However, the transactions did not take place. Before applying for insolvency proceedings, the bank group was divided and sold to different legal entities. The main problem in deciding on the insolvency strategy was that Lehman Brothers, like other investment banks, fell outside the scope of legal regulation governing commercial banks. This situation highlighted the importance of having an effective bank resolution regime that would also apply to large financial institutions operating in

605 See more Thevenoz L. The Rescue of UBS by the Swiss Confederation. (in) Giovanoli, M., Devos, D. International Monetary and Financial Law – The Global Crisis. Oxford, Oxford University Press, 2010. P. 378-391.

606 Ibid.

607 Financial Crisis Inquiry Commission. *Supra* note 28. Report. P. 324-344.

608 In 2007, the financial leverage was 1 to 31. This made the bank very vulnerable even in the case of small decreases in the mortgage market.

several countries. Another problem was related to the need of an emergency fund, which would provide liquidity to banks. In addition, the bank was supervised by the securities commission, which later prevented proper cooperation of different national supervisory authorities, especially when conducting insolvency procedures in accordance with different national rules. For example, Lehman Brothers holding group applied for bankruptcy of the UK branch in the US and PricewaterhouseCoopers was appointed as its bankruptcy administrator, whereas judicial reorganisation procedures were initiated against the Japanese branch. It became apparent that the harmonization of insolvency laws would help promptly restoring public confidence and reducing the adverse side effects. Another special feature of these insolvency proceedings was that the banking group successfully avoided financial brokerage exemptions when applying for bankruptcy. The Bankruptcy Code excluded financial brokers (investment firms) from the scope of Chapter 11, subjecting them to the provisions of Chapter 7. However, *Lehman Brothers* was able to convince the court that the holding company should be subject to the provisions of Chapter 11, and financial brokerage branches must be promptly sold to Barclays with all their operations.

The bankruptcy of Lehman Brothers had a prompt adverse effect on creditor expectations in the financial market. This was based on a previous example in the market, when the government decided to rescue *Bear Stearns* investment bank in March 2008. In addition, in September 2008 the government initiated strengthening of the capital (recapitalisation) of the *Fannie Mae* bank. In the case of *Lehman Brothers*, the investors and creditors had a natural interest to protect themselves from systemically important bank failure at any cost. This created an expectation and they started demanding government protection for creditors. The market situation was even further confused by the publicly financed restructuring of the *Washington Mutual* bank on 25 September 2008. At that time, new issues arose as to whether banks should be rescued with public finances due to their systemic importance. The Government nevertheless decided to solve the financial problems of this extremely large bank (with more than USD 300 billion of assets and close to USD 200 billion of deposits, 2,200 branches in fifteen different states), in accordance with the principle of least cost and least expensive bank resolution method⁶⁰⁹, as defined and regulated by the US Deposit Insurance Agency's insurance legislation and other bank insolvency regulation. This adjusted method of bank resolution caused massive losses to unsecured senior creditors⁶⁴⁹. Finally, JP Morgan bought the insured deposits of Washington Mutual Bank and a part of assets and liabilities of the insured bank branches at a public auction conducted by the FDIC. The auction bidder paid a contribution of USD 1.9 billion. After diversifying the bank into good and bad bank, the bad part was left with the parent holding company's assets and liabilities, such as unprotected depositors (uninsured bank branches operating at loss, including uninsured deposits) whose claims exceeded the amount of USD 100 000. At that time this was quite an unexpected choice of the bank insolvency strategy, because potential losses caused concern to market participants, especially senior creditors, and forced investors to be involved and well analyse the situation of

609 The US legal system establishes two approaches of the 'least costs' principle. The FDIC is always obliged to choose a bank resolution strategy that would minimise the costs falling for the FDIC to the maximum possible level. Any deviation from this principle requires the consent of the fiscal authorities.

the market before investing and depositing financial instruments and funds to distressed banks.

In the financial market, the case of insolvency of *Lehman Brothers* triggered massive overestimation of government actions undertaken for rescuing distressed banks. It became evident that the state could not be able or willing to address solvency problems of a distressed bank in all cases, particularly in the case of the largest, systemically important banks. It was clear that the existing legal regulation was insufficient to effectively deal with insolvency problems of large, systemically important banks. As a result, the market experienced a number of adverse effects. Banks lost their liquidity in the market, while stock prices on the last weeks of September 2008 dropped significantly. The financial panic and the ensuing risk of financial '*contagion*' forced consumers to reduce their borrowing costs and led to the fact that companies, in order to avoid bankruptcy, significantly reduced their investments, stocks and staffing. In addition, different countries were exposed to the debt deflation cycle and the real economy shrunked sharply⁶⁵¹. One of the key moments to resolve the existing situation was related to the review of the legal regime governing banking restructuring. Among other things, there was a severe need to create regulatory methods that could effectively deal with, *inter alia*, SIFI and G-SIFI problems. Preventive regulation of SIFI activities was equally important to eliminate or minimise the risks posed by such banks.

1.7.3.3. The EU Approach

Northern Rock

The exclusive feature of this bank was that it grew very quickly. For instance, in 1997, the bank's assets amounted to GBP 15.8 billion, while at the end of 2006 they amounted to GBP 101 billion. The bank was mainly focusing on the issue of traditional mortgage loans. Another unique feature of the bank consisted in its liabilities and their structure. The bank used the extreme financing model through asset securitisation, i.e. by issuing asset-covered bonds to finance lending, including lending for all wholesale markets. This resulted in the dependence on the wholesale market, which was an exclusive feature of Northern Rock, compared to other banks operating in the UK. While the number of retail depositors was increasing in parallel, it should be emphasized that this increase was not as fast as that of wholesale funding used for long-term borrower activities. Asset securitisation essentially meant that large quantities of mortgage-backed securities could be refinanced each year. Therefore, the bank was marked by an extreme funding model and significant broad financing gaps (the difference between loans and depositors)⁶¹⁰. In order to finance the loans it has granted, the bank was dependent on the capital markets. The scheme worked perfectly in calm economic environment. However, when the world faced the subprime crisis leading to stagnation in the credit market, the bank faced liquidity problems, especially in collecting cash to refinance its business based on short-term funding. In September 2007 the bank received liquidity support from the Central

610 Hyun S.S. Reflections on Northern Rock: The Bank Run that Heralded the Global Financial Crisis. *Journal of Economic Perspectives*, Vol. 23, No. 1, 2009. P. 101-119.

Bank of England⁶¹¹. Despite this Central Bank guarantee, the bank's customers, especially depositors, gathered outside the branches claiming for their deposits and savings⁶¹². These actions were determined by two major factors. First, the depositors realised that if the withdrawal of deposits will continue, the bank will ultimately lose its going concern capability. Second, the society began to escalate the issues that were previously omitted or simply lacked information, namely that depositors were not fully secured by the state. Although the state publicly announced that it will guarantee all the deposits held in the Northern Rock bank at times of instability in the financial markets, it still did not produce the desired effect. The government had to deal with the banking crisis. Northern Rock was characterised by two specific features: (i) the bank was big enough for the society to pay attention to its failure, but not that large for its closure to be able to harm the real economy; (ii) the bank did not engage in significant international trade, it was not transnational and therefore was not facing distress problems to be addressed by several governments or several competent authorities only at the national level. On 22 February 2008 the bank was nationalised and the state took over the ownership of the bank⁶¹³. The bank was nationalised after two unsuccessful attempts to acquire the bank by the private sector buyer and after the bank did not manage to repay the loan granted by the Central Bank⁶¹⁴. The UK bank insolvency legislation also underwent certain changes. In October 2009 the European Commission approved a restructuring plan for the bank, by separating the bank's assets into good and bad assets. The good bank assets consisted of retail depositors and low-risk housing loans, which were to be sold out. Other housing loans and related assets were assigned to the bad part of the bank's assets, which were nationalised and subjected to liquidation⁶¹⁵.

Some aspects of this solution to bank insolvency problems are noteworthy. First of all, it should be noted that the supervisory authority has been particularly open to the general public, since in its report assessing the prudential requirements and activities of the bank, it provided a detailed description and particularities of the financial situation of the bank⁶¹⁶. In essence, the report noted that insufficient functioning of each organisational-structural level of the bank as an organization and defective management of the bank in general revealed the critical state of management and suggested future institutional regulatory reforms that will allow mitigating the consequences arising from bank insolvency. The Central Bank was heavily criticised. Some scientists argued that the Central Bank was excessively concerned with the moral hazard rise and failed to evaluate them properly. In addition, the bank's assets were not as good as originally claimed. Another problem was related to bank insolvency strategic planning. Finally, the Treasury

611 The CB stated that Northern Rock was solvent (had a good quality loan book), but exceeded the capital limits required by the supervisory authority. Bank of England News Release. Liquidity Support Facility for Northern Rock plc. 14 September 2007.

612 Ibid. P. 59-73.

613 Ibid. P. 117

614 Moosa A. *Supra* note 577. P. 44.

615 Walters B. *The Fall Of Northern Rock: An Insider's Story Of Britain's Biggest Banking Disaster*, Petersfield: Harriman House, eBook Collection (EBSCOhost), EBSCOhost, 2008. P. 91-101.

616 The FSA's internal audit review of its supervision of Northern Rock and the FSA management response. Published by FSA, London, 2008.

played its nonchalant role as the custodian of public finances, expecting that economic growth will continue⁶¹⁷.

Several bank resolution options have been discussed. According to the first option, it was considered that the bank manage to refinance itself in the markets or in conjunction with the support from the Bank of England, whereas according to the second option bank liquidation procedures would be initiated or the bank would be recovered by finding a private buyer. However, due to the poor reputation and size of the bank, finding a buyer was an uneasy task. Firstly, the emergence of the bank's financial problems turned to be a particular shock to the markets, as no similar cases that could have verified the effectiveness of the existing bank insolvency regulation were encountered earlier. Secondly, the political risk was relatively high due to recent change of the Prime Ministers, which is why the immediate closure of the bank was unlikely to benefit the government's reputation, especially bearing in mind that at that time the unemployment rate was very high and exceeded the national average. Thirdly, spin-off economic reasons determined the Central Bank's refusal to provide financial assistance to the bank, for example, some technical aspects of the banking money market operations, interbank relations (money market operations at that time allowed banks choosing and setting their level of cash reserves based on the estimated amount of cash required at the end of the month. In the case of a poor forecast, banks were able to earn profits from interest or borrow more on the basis of a flat-rate interest)⁶¹⁸. Another major problem was that after the bank was allowed to start liquidation procedures, in the absence of any special legal regulation that could effectively govern bank resolution at that time, its bankruptcy procedure would have been held in accordance with corporate bankruptcy law. On the one hand, the bank's transactions, assets and liabilities would have been suspended, the court would have appointed a liquidator, who would be forced to prevent rapid sale (without creditors' approval), which automatically means sale at lower prices and property depreciation in the future. On the other hand, it was found that in modern banking ordinary bankruptcy procedure is problematic, because many ongoing but unfinished bank transactions could have been left open for months or even years, thus compromising the real overall bank assets. For example, if a bank fails, rap transactions (funded through initial stock sale and their subsequent repurchase at a slightly higher price) and their performance is suspended and postponed for an unlimited period of time. Repo transactions with the existing mortgage are left to administer through insolvency proceedings, namely the creditors' meetings. It is likely that another problem was lack of readiness on the part of the Central Bank and absence of *ex ante* planning with regard to bank resolution and/or recovery. Planning should be based on two principles: (i) regular planning of supervisory authorities, i.e. the concrete steps to be taken in the event of difficulties faced by a large bank, especially given that the banking structure and products are very different, and should be reflected in the *ex ante* bank rescue plan, with regular information updates, such as accurate evaluation whether the bank's assets should be sold in parts or as a whole,

617 Labrosse R.J., Caminal-Olivares R., Singh D. Financial Crisis Management and Bank Resolution. Edit. Informa, London. 2009. Chapter „ Towards A Coherent Crisis Resolution Mandate? Was the Northern Rock Episode a Crisis? P. 64. Wodd M. Shattered on the Rock? British Financial Stability from 1866 to 2007. Journal of Banking Regulation and Treasury Select Committee. House of Commons. The Run on the Rock. HC 56-I, London, 2009.

618 Ibid. What Went Wrong? P. 125-137.

taking the individual characteristics into account. Such planning would have three main advantages: reduce the distortions of competition arising from the ability of large banks to set specific barriers for new players entering the market; encourage the responsibility of the managing bodies; mitigate the 'too big to fail' problem⁶¹⁹. In addition, Northern Rock insolvency proceedings have highlighted the fact that liquidity shortages can very quickly turn into a lack of capital, if the sale of bank assets is urged at prices related to market difficulties. It follows that banks must hold more assets that can be swiftly converted into cash⁶²⁰. For example, government securities are beneficial in cases when a bank finds it difficult to obtain liquidity from the financial markets, while the market is in panic. Therefore, it has become clear that capital requirements must be reviewed and possibly adjusted to take account of the possible extreme market conditions. Another aspect to be considered is that the bonuses paid to the managing bodies or directors should be limited by legal regulation that would allow the governing bodies to obtain bonuses or other incentives for the successful outcome and implementation of the transaction and not for signing the latter⁶²¹. Senior management is also advised to provide for an obligation to hold bank shares, which would encourage protection, in particular in cases when shares cannot be sold before a specific deadline, in the year after leaving the bank⁶²². In summary, it has become apparent that we need legal regulation that would allow the *de facto* insolvent bank to be taken over from shareholders and managing bodies, while the bank is still legally solvent and continues its operations. In this case, the bank could be sold in parts or as a whole to a buyer, who will be able to restore the financial condition of the bank.

Fortis

Fortis was a Belgian-Dutch banking group. When the bank faced financial difficulties, it first tried to increase its capital by issuing additional shares on the market for EUR 24.2 billion. However, the takeover offer proved to be in the wrong time, i.e., it was placed barely two months after the beginning of the global credit crisis in the US subprime market, which respectively caused high tension throughout the financial sector. As a result, after one year, in June 2008, the bank announced a new share issue and cut dividend payment to shareholders. These measures were taken to strengthen bank capital positions, which were severely damaged in writing off debts related to the US mortgage market. However, despite these efforts, the *Fortis* share prices fell sharply and reached their lowest level in 15 years. This has led to investor concerns about the liquidity level of the bank. In addition, many businesses and individuals withdrew their deposits, interbank loan market collapsed, and the Belgian government had to intervene and give additional capital to the bank in order to stabilise it. Joint intervention together with the Dutch and Luxembourg governments helped Belgium to save the bank from bankruptcy by means of public finances. A capital injection of EUR 11.2 billion was granted, which was used as the financial sustainability measure. Actions between governments were coordinated rather smoothly, but this did

619 *Ibid.* P. 70-71.

620 Hyun S.S. *Supra* note 610. P. 117-119.

621 Smits R. *Supra* note 81. P. 69-70.

622 Fonteyne W., Bossu W. *Supra* note 453. P. 55-86. Bruni. F., Congdon T. *The Failure of Northern Rock: A Multi-dimensional Case Study*. Vienna, SUERF, 2009.

not calm the markets and caused serious debates between the Belgian and Dutch supervisory authorities in deciding on the primary coordinator of resolution actions. The Bank's headquarters were in Belgium, but the Netherlands held the largest share of bank assets and its main business lines. Finally, the Belgian government decided to sell the entire banking group to the Dutch Government and the French bank BNP Paribas. The decision came under the pressure from the markets, and the stock price fell further, which forced the governments to provide immediate additional credit to *Fortis*. The bank's insolvency process was complicated by the fact that the Belgian and Dutch governments saw it differently. Belgium had the most interest in preserving the group as a functioning unit, while the Netherlands was mostly concerned with certain legal units of *Fortis* located in the Netherlands, which could in turn complicate the insolvency process of the bank. However, the buyer agreed to acquire 75% of the banking group, including 100% of the *Fortis* insurance group in Belgium. Nevertheless, *Fortis* shareholders objected to that transaction between the Belgian government and *BNP Paribas*. Brussels Court of Appeal suspended the execution of the transaction and ordered *Fortis* to obtain shareholders' approval. Another factor that made the judgment difficult was the adoption of a resolution and the performance of the transaction under Dutch law. After lengthy negotiations, *Fortis* shareholders finally agreed on the deal, under which *BNP Paribas* acquired 75% of *Fortis* Bank from the Belgian government, including 25% of Belgium's *Fortis* Insurance.

This bank insolvency case revealed that the competent authorities in Belgium and the Netherlands did not have sufficient powers to respond to the bank's financial difficulties in a timely and efficient manner. The competent regulatory authorities could not ignore and block shareholders' rights, even in urgent emergency situations, when banks needed to be stabilised quickly. Implementation of the restructuring was not possible without the court decision. Finally, the Belgian financial resources also proved inadequate in the banking crisis, highlighting better need for cooperation between supervisors, –and the absence of harmonisation of bank insolvency law in the EU.

In summary, it should be noted that before the recent financial crisis, 'too big to fail' doctrine was generally understood and related to the size of the bank and prevention of bank liquidation. Thus, various experts testifying that the traditional bankruptcy law is not enough for large financial institutions failures and referring to *Lehman Brothers* bankruptcy case. The main problem is that the judiciary system in *Lehman's* insolvency trial was too restrictive in a sense of procedural rights and lacked of accurate knowledge, court hearings were very complicated, since the very complex problems of financial structure were considered. The case clearly demonstrated that if the government decides to bail-out the ailing bank by using financial public support, it's unavoidable that the "moral hazard." issue arise. Moral hazard destroys rational evaluation of the banking risks, distorts competition and creates a fiscal burden on the government and, ultimately, taxpayers cover these costs.

1.8. Reflection on the Triggering Events and Criteria for Initiating Bank Insolvency Procedures

In a market economy, the social function of insolvency is to 'remove' ineffective and inefficient entities from circulation, to minimise losses of stakeholders and to balance the

competing interests⁶²³. As already discussed and proved above, banks are very specific business entities and their business activities are inherently risky. A legitimate question arises, whether the circumstances and conditions for determining bank insolvency are specific as well? Which aspects of bank activity should be taken into consideration while determining bank insolvency? Under what threshold it can be allowed or even required to take legal actions against the failing or likely to fail bank? There is no universal approach in the legal doctrine with regard to the bank insolvency criteria and conditions to be regulated and how. In accordance with international standards, the laws of the relevant jurisdictions have already given priority to bank rehabilitation and resolution, in particular aiming for the objectives pursued by resolution of insolvent banks, and bankruptcy proceedings are instituted only in cases where there is no doubt that bank resolution (by restructuring) is more consistent with the public interest and less severely affects the real economy. In addition, liquidation of a bank may jeopardise financial stability, interrupt the critical functions, and harm the protection of depositors' rights⁶⁷⁹. According to the second scenario, bankruptcy proceedings are initiated against the bank along with bank resolution tools. This section analyses general conditions for determining bank insolvency one of the bank insolvency procedures described above.

The bank may become insolvent at short notice, because, among other things, this relates to maintaining creditors' and particularly depositors' confidence. For example, mass withdrawal of deposits over the weekend in the twenty-first-century may affect the bank's ability to meet its obligations⁶²⁴. The determination of bank insolvency event and conditions is a collective work of both economists and lawyers. This section will focus on and examine the methods for determining bank insolvency and reveal the main qualifying criteria for bank insolvency. Bank insolvency triggers are relevant in all aspects, as it inevitably affects the subsequent bank insolvency procedure as a whole. In addition, from the very inception of the bank insolvency procedure, once officially published, it can cause systemic effects (systemic risk). Structuring the conditions for determining bank insolvency in the doctrine from a comparative viewpoint could encourage countries to create a more predictable legal environment and more efficient banks crisis management measures. In addition, consistent and detailed rules would assist in ensuring a true level playing field for banks, in harmonising competition rules between different jurisdictions and contribute to the sustainable coordination of the banking crisis management actions, particularly in cross-border bank insolvency cases, and would ensure greater transparency and legal certainty. The main goal of this section is not to find the 'golden solution', but to highlight the existing particularities of different legal systems, and classify the most important bank insolvency criteria found in the doctrine. It is also assumed that clearer classification of triggering criteria can contribute to greater legal certainty in the context of protection of shareholder, creditor, investor and depositor rights (stability of financial markets).

The identification of bank insolvency conditions places critical role on the legal acts adopted by legislators. After determining isolated statutory conditions for bank insolvency

623 United Nations Commission on International Trade. *Legislative Guide On Insolvency Law*. New York, United Nations, 2005. P. 9.

624 Fonteyne W., Bossu W. *Supra* note 453. P. 10.

or their entirety, we can identify *bank insolvency and/or failing or likely to fail*⁶²⁵ status of the bank, and start a particular bank insolvency procedure. The scientific literature also describes bank insolvency determination as the *triggering event*. In the countries with a developed system of DGS, bank insolvency is defined as a situation where the state is bound to pay compensations to depositors in accordance with the procedures defined in the laws (e.g., intervention, insolvency administrator's appointment, or bank license withdrawal)⁶²⁵. FSB has proposed an important legal definition of bank insolvency determination, highlighting that determination of bank insolvency involves '*qualitative and quantitative criteria to identify the insured event or fact used for determining when such situations arise which require the highest state-level managers or supervisory authority intervention. Such bank insolvency rules are created for determining designed to help prevent delays in solving the banking recovery, reorganization or liquidation situations*'⁶²⁶. It is important to note that the rules and indicators for determining bank insolvency are dissociated from the early warning interventions in the bank⁶²⁷. *Early intervention* often takes place when the supervisory authority needs to check the financial activity of the bank leading to suspicion or violation of the law. In addition, early intervention criteria, in particular, legally defined as *ex ante* criteria and only determined in view of the approaching negative and adverse financial circumstances that can substantially affect bank (in)solvency. The earlier the investigation of the bank's financial problems and decision-making, the lower bank resolution costs and the more successful bank resolution itself, compared to the situations where solutions are postponed to a moment in time when the bank has already become *de facto* insolvent⁶²⁸.

Pursuant to the new paradigm of bank insolvency law, the triggering conditions and criteria for determining bank insolvency designed to solve bank insolvency problems can in principle lead to three solutions for addressing the financial problems faced by the bank and three hypotheses for managing banking crises: either *bank recovery or bank resolution or forced liquidation of the bank*⁶²⁹. Thus, the events triggering bank insolvency should all together be understood as *a backup preventive bank insolvency crisis management measure, comprising a range of possible scenarios for managing the banking crisis and ensuring timely bank resolution and implementation of recovery plans in conjunction with a set of other legal instruments*. This legislative package is diverse and in some cases overlaps, depending on the legal regulation prevailing in a particular jurisdiction.

One of the key features distinguishing the banks from the normal business and crucial in assessing whether a bank is insolvent is bank liquidity. It is commonly known that banks act as liquidity suppliers in a given financial market. For example, banks in a particular country provide liquidity (by providing access to liquidity, readily available cash and capital) to creditors by collecting and distributing bank deposits demanded by the market, and by issuing loans to various borrowers from the accumulated deposits and

625 Parker D.C., IMF. *Supra* note 86. P. 3.

626 FSB. Recovery and Resolution Planning: Making the Key Attributes Requirements Operational, Basel, 2012. P. 3. *Ibid.* P. 6.

627 *Ibid.* P. 6.

628 Marinč M., Vasja R. A Cross-Country Analysis of Bank Bankruptcy Regimes. *Journal of Financial Stability*, No. 13, 2014. P. 139.

629 Peter H., Pnevmonidis I. *Supra* note 454. P. 4.

equity capital. In addition, banks are the primary financial market players, resulting in borrowers' obligations to the bank itself. Therefore, the determination of bank insolvency situation primarily requires the assessment of the liquidity position of the bank and the evaluation of supply of liquidity to the market, in order to determine the scale of solvency problems faced by the bank. This entertains several reasons. Banks have a duty to review and take account of deposits held by them not only in the form of obligations, but also in the form of bank assets creating added value⁶⁸⁸. Furthermore, the start of bank insolvency proceedings cannot automatically 'suspend' the bank's liabilities to depositors, in case of no liquidity problems and if the liquidity supply function is maintained. It is equally important that the banks, through a series of lending relationships, are closely related to each other. Therefore, even temporary suspension of the bank's liabilities can lead to a systemic risk situation, where liquidity problems faced by one bank trigger financial problems also for other banks operating in the market. For those reasons, the states and competent authorities provide guarantees for deposits, operating through deposit or bank guarantee schemes in the face of financial problems, giving priority to bank resolution, e.g. by selling bank deposits at their accounting (book) value. Thus, in banking activities, the illiquidity (lack of liquidity funds means liquid assets deficiency) and insolvency (inability to adequately and timely meet one's financial obligations) ratio is not always clear and that limit is particularly difficult to determine, as in economic terms a bank facing financial difficulties is not always legally insolvent. This position in jurisprudence is firstly based on the fact that, to determine a particular case of bank insolvency, this primarily requires a decision by the competent supervisory authority and/or a court, establishing the insolvency of a specific bank⁶⁸⁹. The bank is recognized insolvent if the competent authority has taken a decision to suspend the activities of the bank and terminate all of its operations. The restructuring actions of the bank can otherwise be often carried out by making a formal ruling on bank insolvency or, in other words, prior to the insolvency of the bank under its balance sheet. Capital adequacy and liquidity requirements are a particular precondition for allowing the competent authorities to take action against the bank, which is technically not yet insolvent according to the balance sheet test (e.g., its property still exceeds its liabilities). As noted by the IMF and the WB, the legislator should specify the legal regulation related to bank insolvency procedures, especially by legally determining the actual conditions specifically required and allowing crossing the threshold, qualified as the start of bank insolvency procedures and enabling the start of a certain bank insolvency procedure. Insolvency conditions can be determined when public authorities take over the control of the bank, whenever banks face financial difficulties, and formal administrative procedures are initiated⁶⁹⁰. It is thought that this concept is controversial, as it suggests opening of bank insolvency procedures when the institution is still technically solvent (according to the balance sheet test). This could lead to national constitutional problems, in particular with regard to the protection of shareholders' property rights and expropriation issues. Illiquidity and insolvency ratio is crucial also in view of bank and asset valuation problems, and by reason of the contagion effect that could spread over other banks facing financial difficulties, although still solvent.

630 IMF, WB. *Supra* note 86. P. 5.

Another essential difference from general insolvency law relates to the fact that banks are actively linked with coordination problems, e.g. when depositors start massively withdrawing their deposits from the bank. According to general company insolvency law, whereby one of the interested parties (creditors) initiates bankruptcy proceedings for the company, the coordination problem is addressed by suspending the debtor's contractual relations and liabilities (obligations), until the time when the decision is taken on whether to institute or not to institute insolvency proceedings for the company. In opposition to corporate insolvency law, in the case of bank insolvency procedures liabilities may be automatically suspended only in view of significant potential bank insolvency-related costs; otherwise it could destroy one of the major functions of the bank as the specific legal person, i.e. liquidity, and the bank may lose its going concern assumption. If the legal system lacks efficient and predictable bank insolvency procedures, this can be very costly for taxpayers. In particular, keeping in mind the fact that *ad hoc* solutions may not be swift and robust and require appropriate political support. Secondly, the competent authorities also need time to prepare, evaluate and adjust to the changes in the bank's financial situation. Therefore, at the time of massive withdrawal of deposits from banks⁶³¹, supervisory authorities play their crucial role in terms of accurate and timely intervention. Delayed intervention may cause enormous future costs.

The EU, the US and Swiss legislation governing bank insolvency procedures not necessarily regulate and distinguishes the same methods and criteria for determining bank insolvency. Some jurisdictions are more focused on the traditional concepts of 'overindebtedness' found in general insolvency law, while other jurisdictions give priority to independent or discretionary bank insolvency evaluation methods, i.e. leave the matter of determination of bank insolvency conditions to the discretion of the competent authorities⁶³². Such insolvency determination approach, based on the assessment of individual circumstances, relies on the complex identification of the financial situation of the bank. After a systematic analysis of both doctrine and legal regulation in the relevant jurisdictions, three methods and the related criteria for determining bank insolvency could be established for determining whether a bank is failing or likely to fail: (i) quantitative criteria; (ii) qualitative criteria; (iii) discretionary criteria. There is no consensus in the international insolvency law on this matter, thus more detailed analysis and interpretation of the legal rules of a particular country plays a significant role.

1.8.1. Quantitative Criteria

Bank balance sheet or 'overindebtedness' test. This method for checking the bank's insolvency threshold assesses whether the bank's balance sheet net asset value is neto, i.e.

631 The balance sheet situation of the bank is not that relevant, if the bank faces massive withdrawal of deposits. If depositors begin to withdraw their funds, it is very likely that the bank can only obtain low prices for fire-sale of its property, thus even a large part of the capital may disappear overnight. The Financial Crisis Inquiry Report. *Supra* note 28. Mr. 324th.

632 For example, some jurisdictions, while determining insolvency conditions of the bank, are more focused on the regulation of qualitative pre-insolvency criteria, by applying them together with the discretionary criteria set by the competent authorities. Meanwhile, some other jurisdictions use quantitative prudential criteria. BCBS. *Supra* note 15. P. 13-14.

whether the value of bank's liabilities exceeds (or not) the value of its assets. In theory, this may not bring forth any adverse legal consequences, unless the bank's payments have become due and it no longer fulfills its obligations⁶³³. In practice this may result in an ambiguous situation, whereby the bank may be solvent in terms of its cash flows, but insolvent on its balance sheet. The balance sheet or excessive indebtedness detection method has always been and is among the two classic ways for assessing bank insolvency⁶³⁴. This test verifies the particular financial situation of a bank, whereby the bank's liabilities exceed its assets, and for this reason its capital is inadequate or even exhausted, and the bank is therefore insolvent⁶³⁵. The test is open to criticism, because the balance test used as the only method for determining bank insolvency must be considered inefficient. This method can prove inaccurate and misleading for inadequately conveying the correct financial situation of the bank. This is because banks are using different international accounting standards and various techniques for the valuation of assets, which leads to different interpretations of the property value and the distortion of the respective facts and results, legal uncertainty and a very likely probability of litigation. In addition, it should be noted that such evaluation of financial situation is based on information that could not be easily evaluated by the supervisory authority, since such an approach would presuppose retrospective assessment. In addition, the regulator's intervention normally occurs at an advanced stage of insolvency and restrains the resolution of solvency problems and the effectiveness of the related actions. The valuation of bank assets and its financial capacity shall be assessed retrospectively, rather than based on the actual situation existing at the time of intervention. Different jurisdictions interpret that aspect in various directions. For example, in Switzerland the balance test is inevitable, and one of the mandatory elements for determining bank insolvency⁶³⁶. The EU Banking Recovery and Resolution Directive treats this test as an optional method in the form of an overall insolvency test, among other things, establishing possible conditions for resolution, in the case of overall non-viability of the banking group, and if there are no possible alternative solutions from the private sector or supervisory action and the protection of public interest⁶³⁷. Non-viability and likely insolvency of the bank should be examined by applying additional criteria that better reflect a realistic picture of the bank's balance sheet and facilitate better analysis⁶³⁸. In the US, this test is similarly used as a binding method for determining bank insolvency. The financial institution is considered failing or likely to fail if bank assets are either is or is likely to be less than its liabilities to creditors or other interested parties⁶³⁹.

Cash flow or liquidity test. The level of liabilities of the bank's contractors and interconnectedness of banks and financial markets, as well as bank liquidity crisis are the primary and perhaps the most essential reasons and sources of the banking crisis, especially

633 *Supra* note 329. P. 20.

634 *Ibid.* P. 21.

635 UNCITRAL. Legislative Guide on Insolvency Law. United Nations, New York, 2005. P. 46.

636 Swiss Banking law. Art. 25 (1).

637 BRRD. Art. 27 (1), Art. 32 (4).

638 BRRD. Art. 27 (2) (b).

639 Dodd Frank, 203(c) (4) chapter. FDIC Act. 11, (5) (A) chapter. Codified 12 U.S.C. 5383.

for international banks with extremely complex corporate structures⁶⁴⁰. However, no matter how ironic, prior to the 2008 financial crisis, at the time of assessing financial viability and financial sustainability of banks, liquidity factors were often ignored or simply disregarded. Since then, regulators of bank conduct started paying more attention to bank liquidity and its effect for determining bank insolvency. At present, it is recognized that this is an important element for determining the conditions and criteria of bank insolvency, reflecting the true financial situation of the bank. It could be argued that the regulatory approach to this matter evolved gradually and materialised in the implementation process of the Basel III package requirements, thereby improving the legal regulation⁶⁴¹. The cash flows test means an insolvency test applied to assess the (in)ability of the bank to repay the debts at the date of maturity or on creditors' demand. In such circumstances, insolvency law permits the competent authorities to initiate insolvency proceedings against the debtor (the bank). Therefore, this test allows verifying the bank's insolvency, in determining whether the debtor is and will be able to carry out the commitments to creditors in the future, when the payment term has expired, but the liabilities are not significantly overdue, and the creditor has therefore brought a claim against the debtor according to the applicable national legal procedures. Accordingly, the cash flows test describes situations where a bank fails to meet its obligations when they fall due⁶⁴². This bank insolvency evaluation method is more efficient, given that it is more likely that the bank's business may become unviable in the face of liquidity problems, and not as a result of insufficient capital⁶⁴³. It is assumed that the financial flow test is an important criterion, which may be used in the early stage of bank insolvency, as a warning for potential bank liquidity problems. This method is still based on the expected financial performance scenarios and future projections of the bank, rather than the analysis of facts explaining what may happen in the light of certain factors⁶⁴⁴. In any case, this method should be regarded as a desirable test for determining bank insolvency. The position of international organisations setting international financial standards is that this insolvency test method should apply in all cases to the bank suffering financial difficulties, even in ordinary economic circumstances, when the bank operates smoothly, and not only at the time of systemic financial crisis or after

640 See more 1 chapter 4 sec. 2 sub-sec.

641 The BCBS formulated and developed two minimum standards that were to finance bank liquidity. The first bank liquidity coverage ratio or liquidity buffer aims to ensure that the bank complies with adequate, high-quality liquid asset level. Maintaining this capital standard, bank capital can be easily converted into cash in order to ensure appropriate bank liquidity indicators. These parameters are guaranteed within 30 calendar days, after significant decrease in liquidity tensions and financial difficulty scenarios for financial markets. The second standard relates to the net stable funding ratio. It is part of the types and amounts of capital and finance commitments to ensure the stability and funding for one year under the most adverse market conditions. BCBS. Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring, Basel, 2010. P. 3.

642 UNCITRAL. *Supra* note 337. P. 45-46.

643 Peter H. Bankruptcy and Reorganisation Trigger Criteria: From a Retrospective (Balance Sheet) to a Prospective (Cash flow) Test. (in) Peter H., Jeandin N., Kilborn J. etc. *The Challenges of Insolvency Law Reform in the 21 st Century*, Schulthess, Zurich/Basel/Geneva. 2006. P. 35.

644 Jury T. *Cash flow analysis and forecasting: the definitive guide to understanding and using published cash flow data*, Wiley United Kingdom 2012. P. 257.

the bank has faced serious financial difficulties⁶⁴⁵. In accordance with the current Swiss banking law, the liquidity test applies even before the FINMA decides to implement compulsory bank liquidation procedures⁶⁴⁶. Under the EU legal system, the liquidity test is also used in order to correctly understand and figure out the rapidly deteriorating financial condition of the bank, including its liquidity position, the increasing leverage ratio and the number of non-performing loans or concentration of exposure, including own funds requirements. The bank's compliance with capital and liquidity requirements is verified. This method can be used either individually or collectively with the balance sheet test⁶⁴⁷. In the US, in order to determine whether a bank is failing or likely to fail in the nearest future, the fact whether a financial institution is or will be unable to fulfill its obligations (excluding *bona fide* disputes) in normal bank business times must be taken into account⁶⁴⁸.

Bank capital requirements test. In addition to the typical, standard tests of insolvency discussed above, bank insolvency is also determined by verifying the bank's capital adequacy ratios and their compliance with legislation. It should be noted that after the financial crisis of 2008, stricter capital rules entered into force for banks based on the Basel III rules. Banks are required to operate more and better quality capital⁶⁴⁹. Capital performs

645 WB. Principles and Guidelines for Effective Insolvency and Creditors' Rights Systems, 2001. P. 30.

646 Swiss Banking law. Art. 25 (1).

647 BRRD. Art 27 (1).

648 Dodd Frank. 203(c) (4) Section. FDIC 11, (5) (F) chapter. Codified 12 U.S.C. §5383.

649 A more detailed implementation of the Basel III package is illustrated by means of amendments of the EU legal framework. The primary objective of the legislative proposal package is to strengthen capital requirements for banks (capital quality and size), other underlying prudential guidelines and thus to reduce the pro-cyclical nature of the financial system, strengthen financial stability and improve the competitiveness of the EU banking. In addition, harmonise the requirements to the maximum possible extent, under the EU-wide uniform prudential requirements, implement the Basel Committee agreements (Basel III) agreed at the G-20 level. The implementation of the new requirements began on 1 January 2013 and should be completed by 2019. The Capital Requirements Directive and the Regulation came into force on 1 January 2013. The Regulation establishes new requirements for bank capital: Common Equity Tier 1 shall amount to 4.5% of risk-weighted exposure amounts collected; total Tier 1 capital shall constitute 6% of risk-weighted exposure amounts collected; the capital adequacy ratio should amount to 8% of total risk-weighted exposure amounts. Besides, it sets out the requirements for better quality equity. The EU Member States are allowed to determine more rigorous capital requirements for financial stability purposes. The following macro-prudential instruments are set: (1) Capital Reserve, Capital Conservation Buffer, which would amount of 2.5% of risk-weighted exposure amounts of property values. Banks will have to continuously meet the capital reserve requirement. (2) The counter-cyclical capital buffer in the range of 0% to 2.5% of risk-weighted exposure amounts of property values. Member States will be free to set a countercyclical capital buffer size of a particular institution or group of institutions so as to reduce the risk of pro-cyclicality and protect the banking sector and the economy from the lending boom. Given the experience of the financial crisis, new requirements for bank liquidity are introduced from 2015, which will consist of a liquidity coverage ratio, according to which the authorities will need to have high-quality liquid asset reserve that would cover the liquidity outflow loss within 30 days. In order to properly address the institutional financing problems caused by the discrepancies between the duration of assets and liabilities, the net stable funding ratio will be set from 2018, according to which institutions exposed to solvency or profitability decrease will have to follow proper financing structure for one year and have stable funding sources. The exact size and composition of the indicators will be determined after the observation and review period. BCBS. Basel III: a Global Regulatory Framework for More Resilient Banks and Banking Systems, Basel, 2010. P. 12. Dübel H.J. The Capital Structure of Banks and Practice of

a protective function and acts in the form of a buffer. In addition, capital is extremely important for banks because of the unique nature of its commercial assets, when bank liabilities are deducted to determine the changes in the bank's net asset value. It should be born in mind that the bank assets mostly consist of loans (mortgage, business loans) and other credits (e.g., credit cards), thus the value of this asset is rather unpredictable. At the international level, a common presumption has been agreed, according to which better-capitalised financial institutions are automatically better protected against both the collapse of financial markets and the particular bank insolvency cases 713. Eventually, a common practice has evolved to determine bank insolvency also based on the level of bank capital indicators. In the countries where bank insolvency procedures are governed by special law, in addition to the methods described above, another bank insolvency method applies, and is referred to as the regulatory threshold test. The essence of this formal analysis is that a bank may be declared insolvent if the supervisory authority finds that the bank no longer meets the statutory minimum capital requirements. In this situation, it is important to determine whether, under ordinary circumstances of the market, the bank can fulfill its obligations and make payments on the first creditors' demand. As a general rule, the bank needs to manage its financial resources in a manner that would allow maintaining the capital 'limit' legally required in all cases of particularly adverse situations. In addition, while maintaining adequate capital ratios, the bank ensures appropriate bank liquidity and better protects the interests of all creditors. On the one hand, this means that the bank is still solvent, but facing financial difficulties. In such a scenario, the bank may overcome temporary insolvency problems by borrowing on the market (unless the market has already confronted with adverse reactions on the financial situation of the bank, in which case the rescue actions and intervention of the surveillance authorities would be overdue). On the other hand, based on the equity method, in all cases, the insolvency of the bank needs to be determined by a competent supervisory authority. This basically means that the law needs to provide the right for the supervisory authority to initiate early intervention and perform the related interventions in order to reduce or avoid additional losses to creditors and the bank deposit insurance agency. It should be noted that, in contrast to general insolvency law, the bank could face a financial situation where, although encountered with significant financial losses, it still continues the performance of its obligations to creditors, since the bank still holds working capital and receives cash from current obligations, such as bank loan payment, new deposits, and similar. Therefore, it must be considered that supervisor's intervention must be timely and ensure avoiding greater losses in the future. This method of bank insolvency determination is based on the complex insolvency determination method: assessment of capital and bank business risk, i.e. formal breaches of banking laws. First of all, in view of the legal requirements, the legal basis for supervisory intervention is determined, if any. Then bank insolvency is determined on the basis of the financial reports addressed to the financial supervisory authority, other documents obtained from the bank or other parties and/or by means of bank inspection, where necessary.

Bank Restructuring. No. 2013/04. CFS Working Paper.. Berlin, 2013. This study presents an empirical analysis of capital and liability management in eight cases of bank restructurings and resolutions from eight different European countries.

For example, in the US legal system, the FDIC has deeply rooted traditions for applying quantitative equity parameters to manage banking crises. In this jurisdiction, capital adequacy ratio of the bank remains the most relevant and critical financial viability criterion, with certain rigorous restrictions applied gradually to: undercapitalised, significantly not capitalised, critically not capitalised banks and financial institutions⁶⁵⁰. The bank is undercapitalized, therefore, insolvent when has no reasonable prospect of becoming adequately capitalized, fails to become adequately capitalized when required to do so, fails to submit a capital restoration plan acceptable to that agency within the time, materially fails to implement a capital restoration plan submitted and accepted⁶⁵¹. Before FDIC requires to change the capital positions in accordance with restoration plan.⁶⁵² One of the direct legal actions and a way to mitigate bank insolvency issues relates to various convertible capital instruments. These tools principally focus on bank recapitalisation rather than liquidity needs⁶⁵³ and are directly related to the determination of bank insolvency, as they condition the convertibility of bank debt into capital and capital is immediately used to protect specific capital adequacy requirements⁶⁵⁴. As already mentioned above, Switzerland is dominated by high concentration of banks and systemically important banks. Therefore, the most recent bank insolvency legislation amendments introduced changes to improve and encourage bank recovery and transformation planning processes, by adding additional capital reserves for systemically important banks, the violation of which results in automatic rehabilitation and restructuring procedures for the bank: (a) the capital conservation buffer, which corresponds with bank recovery objectives and would apply in writing off debts and converting them into capital immediately upon bank's capital required by the regulator dropping to less than 7% of the total risk-weighted assets of the bank⁶⁵⁵; (b) capital gain, which can be used immediately for the purposes of bank restructuring and lead to the conversion of debt into capital when the bank capital set by the regulator falls below 5% of the total risk-weighted assets of the bank⁶⁵⁶. The EU legal framework provides that, before the bank's insolvency period, its capital may need to be raised urgently, when the credit institution does not or cannot comply with the requirements of Regulation (EU) 575/2013 and Directive 2013/36/EU and it is likely that the financial situation will be restored after such capital increase, by avoiding a situation where it would be subject to the conditions governing initiation of resolution⁶⁵⁷. Bank insolvency losses in the EU legal framework should, in particular, be covered by regulatory capital measures and losses should be distributed to shareholders by eliminating or transferring shares, or significantly reducing the earnings per share. If such measures are insufficient, the subordinated debt should be

650 FDIA. 11, (5) (K) chapter. Dewatripont M., Freixas X. Bank Resolution: Lessons from the Crisis. (in) *Supra* note 292. P. 118.

651 FDIA. 38 (b), 11 (5) (K).

652 FDIA. 38 (f)(2)(A), 38 (e)(2)(D), 38 (e)(2), 11 (5)(K).

653 Pazarbacioglu C., Jainping Z., Leslé V. etc. Contingent Capital: Economic Rationale and Design Features, IMF Staff Discussion, Note 25/01/2011. P. 8.

654 *See more* 2 chapter 5 sec. 4 sub-sec.

655 Swiss Federal Ordinance of 1 June 2012 on Capital Adequacy and Risk Diversification for Banks and Securities Dealers. Art. 129.

656 *Ibid.* Art. 130.

657 BRRD. Recital (124).

converted or written off. Privileged liabilities should be converted or written off, if all the subordinated classes have already been converted or fully written down⁶⁵⁸. The minimum amount allocated to cover losses or to carry out recapitalisation, amounting to at least 8% of the total commitments, including own funds or, where applicable, 20% of risk-weighted assets, is calculated on the basis of property assessments. Earlier losses already covered by the shareholders, thus reducing their own funds before such an assessment, should not be included in such percentages⁶⁵⁹. Besides, the EU Members States must ensure that if the issuing credit institution is no longer viable, the loss would be completely covered by means of Additional Tier 1 and Tier 2 capital instruments⁶⁶⁰. Therefore, the competent authorities should write off all of those instruments or convert them to Common Equity Tier 1 capital instruments from the moment when a credit institution becomes no longer viable, and before any adjustment measures are taken. The precise moment when a credit institution is no longer viable occurs when the relevant authority determines that the bank satisfies the conditions for the conversion, or when the authority decides that the bank would no longer be viable if those capital instruments were not written down or converted⁶⁶¹.

Therefore, the existing financial market is dominated by an apparent trend of hybrid (mixed) options of convertible debt, based, in particular, on capital adequacy ratio. The capital adequacy ratio test is considered to be a 'technical insolvency' test, but an objective one, as it requires the intervention of the competent supervisory authorities in bank control at an early stage of insolvency, before performing the balance sheet or financial flow tests.

1.8.2. Qualitative Criteria

Unlike the quantitative criteria for determining bank insolvency triggers, the qualitative insolvency criteria are not directly related to the particular bank capital or liquidity indicators. On the basis of qualitative criteria, financial performance indicators of a bank are the most important indicators, but some discretion of their application remains. When viability prospects of a bank are determined under qualitative criteria by a supervisory or other competent authority, it has some room for manoeuvre. As noted by the FSB, the qualitative criteria for determining bank insolvency consist, in particular, of the following criteria: the top-level management experience and losses it caused to the bank, adverse court rulings against the bank, significant sudden reputational risks and damage to the bank or claims arising out of the early discharge of obligations by the contracting parties⁶⁶². For example, based on MIFID II⁶⁶³ and CRD IV⁶⁶⁴ directives, a number of specific

658 BRRD. Recital (77).

659 BRRD. Recital (75).

660 Additional Tier 1 instruments – capital instruments in line with the conditions set out in Article 52(1) of Regulation (EU) No 575/2013; Tier 2 instruments – capital instruments or subordinated loans, satisfying the requirements of Article 63 of Regulation (EU) No 575/2013.

661 BRRD. Recital (81).

662 Financial Stability Board, *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational*, Basel, 2012. P. 5.

663 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

664 Regulation (EU) No. 575/2013.

qualitative requirements for the managing bodies, directors and their competence and suitability can be highlighted. The main criteria pertain to good reputation and the duty of care, to act reasonably and reliably. Under the EBA guidelines⁶⁶⁵ and implementing technical standards account must be taken of their unlawful behavior (both criminal, civil and administrative violations), pending investigations launched against the bank, non-transparent, non-cooperating behavior in addressing the current issues of the bank with the competent authorities and even declined memberships or registrations. In addition, various other criteria related to competencies (knowledge, skills, expertise), the operating structure, and the business model are applied⁶⁶⁶.

For example, in the US, FDIC may employ various highly qualitative bank insolvency criteria for determining bank insolvency in order to duly define the necessity (if any) for the competent authority to carry out intervention or to determine the fact of bank insolvency. The variety of criteria differs depending on the level of breach of legal requirements, considering whether such events and formal violations of the law may give rise to an insured event, the existence of unsafe and harmful conditions for continuing the bank's business, concealment of financial documents, accounting records of the bank, and any irregularities with regard to bank property and anti-money laundering prevention requirements⁶⁶⁷. Such qualitative damage should not necessarily be considered as a whole, as a single qualitative criterion and the respective violation is enough for the FDIC to initiate bank intervention and start one of the insolvency procedures. The factors that are required by the FDIC Board of Directors in connection with any determination of insolvency a) The financial history and condition of the bank; b) The adequacy of the bank's capital structure; c) The future earnings prospects of the bank.; d) The general character and fitness of the management of the depository institution; e) The risk presented by such bank to the Deposit Insurance Fund; f) The convenience and needs of the community to be served by such bank; g) Whether the depository institution's corporate powers are consistent with the purposes of FDIA⁶⁶⁸.

Swiss banking law was designed to primarily facilitate bank recovery and restructuring process planning. For example, systemically important banks must *ex ante* comply with the qualitative conditions for bank insolvency associated with risk diversification; their activities must comply with the principles of sustainable corporate governance, by also providing certain safeguards to protect financial services⁶⁶⁹. The general rule is that if the bank fails to demonstrate its ability to achieve qualitative requirements under the threat of insolvency, then FINMA will intervene against the bank's will and will apply appropriate sanctions to improve the solution of bank solvency problems⁶⁷⁰.

665 EBA. Guidelines on the assessment of the suitability of members of the management body and key function holders. EBS/GL/2012/06, 2012. EBA. Consultation Paper on draft Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution. EBA/CP/2013/03, 2012.

666 See more Bishof E. *Supra* note 513. P. 321-328.

667 FDIA. 11(5) (C), (E), (H), (J), (M).

668 FDIA. 6 Section. Codified 12 U.S.C. 1816.

669 Swiss Banking law. Art. 9 (2).

670 *Ibid.* Art. 10 (2).

1.8.3. Discretionary Criteria

Qualitative and/or discretionary criteria are set at the discretion of competent authorities and are sometimes called 'soft' bank insolvency criteria. They are less focused on the rules and are more dependent on individual decisions, personal judgments and reasonableness. If the actual financial situation of the bank is in line with these criteria, the competent authorities refuse automatic intervention in the bank in the case of statutory violations (capital, liquidity, or any other related business activity parameters). On the contrary, these criteria provide the competent authority with extensive powers to assess where and what legal measures must be applied and used to address the financial difficulties faced by the bank. It is assumed that such discretionary criteria are the most appropriate and optimal method of determining bank insolvency. In particular, all modern bank insolvency regimes have introduced at least some of the discretionary criteria and certain powers for resolution authorities in the legislation governing bank insolvency triggering event, namely the precise moment for public authorities to intervene⁶⁷¹.

On the basis of the EU Banking Recovery and Resolution Directive (Member States should harmonise national law in accordance with the Directive), a bank is failing or likely to fail (according to the EU law, the concepts of failing or likely to fail are used synonymously) if the competent authority establishes one or more circumstances set in the Directive. Firstly, it must be determined whether the bank infringes or, based on objective elements to support such a determination, or is likely to infringe the requirements for maintaining the authorisation in a way that would justify the withdrawal of the authorisation by the competent authority, including but not limited to the bank incurring or likely to incur losses that will deplete all or a significant amount of its own funds⁶⁷². Secondly, the bank's assets are negative or there are objective elements to support a determination that the bank will, in the near future, be unable to repay its debts or other liabilities as they fall due⁶⁷³. Thirdly, it is determined that the bank will need emergency public financial support, except for the situations when emergency public financial support is supplied to avoid serious economic disruption in the country or to remove such a disruption and preserve financial stability, in any of the following forms: (i) state guarantee to support liquidity measures supplied by central banks in accordance with the conditions of Central Banks; (ii) State guarantee to newly issued obligations; (iii) injection of own funds or purchase of capital at prices and conditions conferring no advantage for the institution⁶⁷⁴. Guarantees and equivalent measures are applied to solvent banks only, and solely if finally approved under the EU state aid system. The fact that urgent support of the central bank is required to raise liquidity should not *per se* be sufficient to demonstrate that the entity is unable or could be unable in the near future to pay its obligations when they fall due⁶⁷⁵. In addition, it should be noted that the assessment of whether a bank is failing or likely to fail, when there is no ground to believe that any alternative private sector or supervisory action taken within a reason-

671 Henke Ch., Kaal W. Contingent Capital in EU Bank Restructuring. *Northwestern Journal of International Law and Business* Vol. 32, 2012. P. 252.

672 BRRD. Art. 32 (4). (a).

673 BRRD. Art. 32 (4) (b).

674 BRRD. Art. 32 (4) (c).

675 SRM. Recital (57).

able period could prevent the collapse, is performed by the ECB and the Single Resolution Board⁶⁷⁶. A systematic analysis the EU legal system leads to a conclusion that the assessment of bank insolvency triggers and their adequacy, in particular the preparation of bank recovery and resolution plans, and at the same time the determination of financial condition of the bank must take into account additional, secondary considerations: the nature of the bank's business, shareholder structure, legal form, risk model, size and legal status, as well as the interconnectedness with other financial institutions or the financial system in general, its scope of activities and complexity, whether it is the member of an institutional protection scheme or other cooperative mutual solidarity scheme, and whether it provides investment services or is engaged in investment activities and whether its collapse and subsequent liquidation by means of ordinary bankruptcy proceedings could have significant adverse consequences for the financial markets, other institutions, financing conditions or the economy as a whole⁶⁷⁷. In the EU, the bank is considered to be failing or likely to fail, where: (i) private sector solutions and supervisory actions are unlikely to protect the bank from insolvency within a reasonable period of time, and when ordinary insolvency rules and procedures may pose threat to the public interest⁶⁷⁸; (ii) the competent authority or (under certain conditions) the resolution authority has determined that the bank is failing or likely to fail; (iii) with respect to time and other relevant circumstances, there is no reason to expect that by any alternative private sector solutions or supervisory action applied to the bank, including early intervention measures and write-off or conversion of appropriate capital measures, bank failure would be avoided within a reasonable timeframe; (iii) resolution and/or liquidation action is necessary for the sake of the public interest⁶⁷⁹. However, the determination that a bank is failing or likely to fail remains the discretionary assessment of the relevant authorities and does not prevent the relevant authorities from taking into account other considerations signaling bank is failing or likely to fail.

Discretionary bank insolvency criteria were further developed in the US, by the Dodd-Frank Act. In 2010, the Dodd-Frank Act provided for much more extensive legal regulation of bank insolvency triggering events, supporting the interpretation of a potential bank default risk as potential insolvency risk, while associating insolvency conditions with the necessary protection of the financial stability of the United States⁶⁸⁰. Despite the fact that the proposed criteria allow the use of wider institutional discretion in determining the appropriate time for intervention⁶⁸¹, the bank insolvency criteria must be assessed as a whole, before institutional intervention occurs. In the US legal system, a bank is failing or likely to fail is described by means of 'in default or in danger of default' doctrine. The

676 SRM. Recital (26).

677 BRRD. Recital (14).

678 EBA. Consultation Paper. Draft Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32 (6) of Directive 2014/59/EU. EBA/CP/2014/22. P. 6.

679 BRRD. Art. 32 (1).

680 Authorities may intervene in the following cases: (a) the financial institution is in danger of default; (b) bank failure would have serious negative consequences for the entire US financial stability; (c) no viable private sector means is available in order to avoid and prevent default; (d) no resolution actions would serve to prevent or mitigate such adverse effects; Dodd-Frank. Title II, 203 (b) (1) - (7) Unit.

681 Ibid. 203 (c) (4) chapter.

bank is considered as failing or likely to fail if the following conditions are present: (a) the insolvency proceedings have been commenced or are likely to be initiated soon, in view of the financial position of the bank, as provided for and regulated in the United States Bankruptcy Code; (b) the bank has suffered or is likely to suffer losses in the near future that will require all or a significant part of the bank's capital and there is no reasonable prospect of avoiding capital loss; (c) the bank's assets are or are likely to be lower than its liabilities to creditors and other persons or (d) the bank is incapable or is unlikely to be capable to fulfill its obligations (except for *bona fide* disputes) in the ordinary course of business⁶⁸². In essence, the requirements are very similar to general conditions for initiating involuntary insolvency procedures in general bankruptcy law. In addition, these provisions of the Act require that the US Treasury must determine whether insolvency proceedings may be commenced under the provisions of the Bankruptcy Code, governing the enforcement of insolvency (bankruptcy) procedures. The primary criterion is that the company has suffered or is likely to suffer losses that will minimise its assets, and the company's activities will no longer be protected from such losses, the assets are less than liabilities to creditors, or the company is unable, or is likely to be unable to fulfill its obligation under normal business conditions⁶⁸³. Another very important insolvency criterion is that before starting the administrative actions, the Secretariat of the Treasury has to come to the conclusion that there is no other alternative financial solution to the problems, and that this would cause serious adverse consequences for the entire US financial stability. The Secretariat also has to determine that there are no other viable alternatives from the private sector to assist protection against bank defaults. Additional criterion to be taken into account in determining bank insolvency is that the Secretariat must assess the competing interests of the state, creditors, stakeholders, shareholders and ensure their proper balance. The Secretariat only needs to determine whether the effect on the financial interests and creditor claims is 'appropriate', given the potential risks and threat to the US financial stability⁶⁸⁴. Among other things, in deciding on a particular bank's insolvency, we need to assess how the collapse of the bank will 'potentially increase the excess risk to creditors, parties and shareholders'⁶⁸⁵. Another important criterion relates to significant barriers and restrictions caused by general insolvency procedures. Before the Secretariat of the Treasury adopts its decision, it is necessary to obtain a recommendation both from the Federal Reserve Board and the FDIC. Two-thirds of the votes by the Federal Reserve Board members individually and two-thirds of the votes by the FDIC Board of Directors are required, and the FDIC must issue a recommendation on the start of the proposed bank insolvency procedures. This provision is open to criticism, because even three approvals are required to support the insolvency event. Two of the three permits depend on the will of public institutions, therefore, it must be assumed that determination of the grounds for bank insolvency also depends on the political will and their daily political pressures. Besides, considering bank insolvency, relevant provisions of US Bankruptcy Code should be taken into account⁶⁸⁶.

682 Dodd-Frank. 203 (b).

683 Ibid. 203 (b) (4).

684 Ibid. 203 (b) (4).

685 Ibid. 203 (b) (5).

686 US Bankruptcy Code. Title 11. Chapter 1. Sec. 101. (32).

The new *Swiss* capital adequacy ordinance act was subjected to certain amendments. It established certain bank non-viability ‘thresholds’ guaranteeing both broad discretionary powers of intervention on the part of FINMA for assessing creditworthiness of the bank⁶⁸⁷. The conditions of bank insolvency in the *Swiss legal system* are governed by the Banking Law, which should be read systemically, in conjunction with the ordinance of the Swiss Financial Market Supervisory Authority on the insolvency of banks and securities dealers. It can be concluded that there is no divide between the concepts of bank failing and likely to fail. When a bank is failing or likely to fail, the competent authority may intervene in the bank, where the actual situation meets the following conditions of bank insolvency: (i) insufficient level of capital and capital adequacy ratios, after FINMA gives time to correct these indicators; (ii) reasonable grounds to believe that the bank is overindebted; (iii) severe liquidity problems⁶⁸⁸. If one or all of the following conditions are met, the supervisory authority may adopt a resolution on the use of individual protection measures⁶⁸⁹ alone or altogether, by starting bank restructuring⁶⁹⁰ or liquidation procedures⁶⁹¹. According to the Banking Law, a bank is considered overindebted after it has been determined that the bank’s asset evaluation raises doubts about the bank’s viability, particularly in discharging creditors’ commitments. No formal evidence of overindebtedness is required. If special circumstances showing current or impending debt come into light, they are sufficient⁶⁹². Finally, the bank experiencing serious liquidity problems is no longer considered to be able to fulfill its obligations. Bank liquidity ratios must be adequate to cover the bank’s liabilities that are already due or will become due in the near future, and the bank is no longer able to obtain more liquid cash in the market. In addition, by imposing prompt corrective actions, the competent authority may initiate bank restructuring, by adopting the appropriate resolution⁶⁹³. In adopting this resolution, FINMA shall also approve the restructuring plan, by, inter alia, identifying the insolvency triggering conditions.

This chapter analysed the fundamental criteria for bank insolvency in different jurisdictions. Attention should be paid to the fact that the preparation of technical, secondary acts is still in progress, the list of such criteria is expanding, by developing their more detailed regulation. By optionally applying the micro - comparative method, we will examine the *EU legal system* in more detail.

1.8.4. Peculiarities of Bank Insolvency Triggering Events and Criteria in the EU Legal System

On 22 September 2014 the EBA published a document (in the form of regulatory guidelines), which discusses different criteria leading to a situation when a bank is failing

687 Swiss Federal Ordinance of 1 June 2012 on Capital Adequacy and Risk Diversification for Banks and Securities Dealers. Art. 29.

688 Swiss Banking law. Art. 25 (1).

689 Ibid. Art. 26.

690 Ibid. Art. 28-32.

691 Ibid. Art. 25 (2) d., Art. 33-37.

692 Swiss Federal Banking Commission decree published in SFBC, No. 48/2006, 2005. P. 271.

693 Swiss Banking law. Art. 41 (1).

or likely to fail⁶⁹⁴. While in the EU legal framework determination of a bank's failure or likelihood of failure depends on the discretion of the related competent authority in assessing the insolvency status of the individual bank, the guidance nevertheless provides important technical criteria and requirements that must be relied on for assessing bank insolvency. The important aspect revealed is that even after identifying certain objective criteria bank insolvency procedures are not automatic. The discretionary determination of bank insolvency is followed. In each case, the competent authorities must decide on the basis of detailed facts and criteria (assessment of quantitative and qualitative criteria), taking into account all relevant circumstances and information of the particular bank⁶⁹⁵. In determining insolvency of a particular bank, the competent authorities primarily rely on the supervisor's inspection results and the evaluation of assets and other insolvency indicators⁶⁹⁶, corrective actions applied by the supervisory authorities or early intervention measures applied to a particular bank. In addition, the competent authorities shall take into account bank recovery options, depending on the bank assessment results and in accordance with the obligations laid down in Article 36 of Directive 2014/59/EU. The competent authorities have the power enshrined in their national law to determine whether a bank is failing or is likely to fail, after consulting the appropriate authorities with regard to the determination of insolvency. They also need to perform autonomous insolvency assessment based on objective factors and criteria, primarily set out in those guidelines⁶⁹⁷. In view of the results obtained at the time of supervisory review and evaluation process⁶⁹⁸, and the duty placed under the Directive that conventional procedures and methodology, including assessment of the organisation and risk treatment, shall be governed by the EBA guidelines, the competent authority shall determine the requirements and evaluate whether the bank still meets the performance requirements for banks so that they are able to implement and continue their activities.

There following general criteria are applied for determining bank insolvency: *capital adequacy, liquidity, requirements providing the basis for operation (license) or its extension* (including the agreements of managing bodies, and administrative and operational capacity of the banks). The competent authority shall justify its decision with regard to the bank insolvency or imminent insolvency on the basis of the results of the supervisory review and, where possible, consider the following additional sources of information: (a) results arising from the application of surveillance measures and early intervention measures, if applied; (b) results arising from the bank's assets and liabilities⁶⁹⁹; (c) reports received from the bank, where the bank considers and treats itself as failing or likely to fail⁷⁰⁰. The capital position is seen as bad when the bank violates the statutory requirements for own funds, and disposes of the assets whose value is less than its liabilities⁷⁰¹. In assessing the bank's

694 EBA. Consultation Paper. *Supra* note 678.

695 *Ibid.* P. 4.

696 Directive 2013/36/EU. Art. 97, 107.

697 Dodd-Frank. Section 3, Title II.

698 Directive 2013/36/ES. *Supra* note 107. Art. 97., Art. 107.

699 Directive 2014/59/EU. Art. 36.

700 EBA. Consultation Paper. *Supra* note 678. P. 14-15.

701 Directive 2013/36/EU. Art. 104 (1) (a).

assets and liabilities, the competent authority, *inter alia*, takes into account the risks and indicators arising from the supervisory inspection, activation (perspective) of the bank's recovery plan, asset quality requirements set by national laws or the SSM, showing important signals that the bank assets have declined⁷⁰².

In determining the fact of bank insolvency, the competent authority may use *an extra set of insolvency criteria*: (a) the threat to the recovery of the bank's viability, given the significant increase in the financing costs to the level unbearable for the bank; very likely or important reduction in bank balance sheet; (b) decrease in the net fair value of the bank's assets, liabilities, contingent liabilities and reserves; (c) significant adverse changes in the macroeconomic environment, which may affect the financial situation of the bank and its viability, including the related changes in the interest market, real estate prices and value changes or economic growth. These changes have a potentially important adverse effect on the business model, the results of bank revenue, its future viability and long-term growth; (d) indicators reflecting financial market confidence, i.e. that the bank's solvency requirements were severely damaged and caused adverse effects for market interests or the financial situation and viability of the bank can be upset or put at risk, including, but not limited to, reduced bank accounting value or sudden drop in economic activity (leverage change); (e) significant and long-term (not temporary) deterioration of the bank's financial situation or violation of prudential requirements, by assessing the relevant market indicators, including, where possible, capital-based indicators (e.g. share price) or indicators based on debt (e.g. credit default swap or subordinated debt differences). These parameters shall indicate that the bank may suffer losses that could potentially jeopardise its solvency and operational continuity⁷⁰³.

Liquidity situation in the bank. It is presumed that the competent authority is aware of the risks inherent in banking activities and sustainable bank performance indicators to be measured and the related information to be collected through supervisory intervention. Activation of the bank recovery plan and the subsequent collapse, by implementing the selected bank recovery options serves as one of the liquidation criteria. For example, in cases where the implementation of the bank recovery plan by the competent authority was used as an early intervention instrument in accordance with Article 27(1) of Directive 2014/59/EU. Another criterion related to bank liquidity concerns significant adverse developments, affecting bank liquidity developments and funding profile in one way or another. Failure to comply with minimum liquidity requirements under EU Regulation No. 575/2013 (Art. 105) can be a key factor in determining bank insolvency. This can concern any national minimum liquidity requirements for banks. Among other things, it is important to determine whether liquidity problems are not temporary in nature, and the negative change of bank liquidity protection (stocks) and liquidity counterbalancing capacity⁷⁰⁴ is essential. In assessing the liquidity position of the bank, the following factors could be taken into account: (a) reliable liquidity inflows, including under various lines of credit and liquidity, i.e. any prospective contractual receipts and payments; (b) the ability

702 Directive 2013/36/EU Art. 104-105. Directive 2014/59/EU Art. 27 (1) (a). Directive 2014/59/EU. Art 36.

703 EBA. *Supra* note 678. P. 16-17.

704 Liquidity leverage counter weight capacity means the amount of cash that the bank can obtain for liquidity needs. The liquidity reserve is defined as the counterbalancing capacity of short-term stress situation scenario.

to renew funding; the ability to access long-term financing sources; (c) the state of emergency severely reducing or even suppressing liquidity, liquidity (loan-funded) line from partners or other counterparties; (d) increased non-temporary financing costs to an unstable level, particularly caused by increased costs (such as loan yields and differences) for unprotected assets and limitations of refinancing options; (e) significant negative development of current and future obligations of the bank. *The assessment of the bank's obligations* must take into account: (i) the expected bank liabilities (liquidity) flows, including claims by bank counterparties for the right to demand redemption of shares or obligations and other emerging factors which could lead to potential massive deposit withdrawal from banks; (ii) expected collateral requirements and lack of adequate collateral; (iii) any other foreseeable liabilities, including those arising from guaranteed credit lines or other liquidity lines (loans); (iv) the situation of bank payments, the changes in the existing clearing and settlement systems, or any other indicators implying that the bank is experiencing difficulties in meeting the commitments or in making payments in the clearing or settlement systems; (v) the progress that is likely to adversely affect the bank's reputation and importantly reduce the bank's credit rating set by one or several rating agencies, if this can influence important bank revenue, restrict funding options or activation of contractual conditions based on external ratings.

The essential requirements for banking authorisation. A competent authority may revoke the bank's license, *inter alia*, when the bank: (i) no longer meets the prudential requirements set out in the third, fourth or sixth parts of EU Regulation No. 575/2013 or under the provisions of Articles 104 (1) and 105 of Directive 2013/36/EU; (ii) there is no evidence that the bank will continue to carry out its obligations to creditors, and will no longer protect the property entrusted by creditors, or (iii) will violate one of the requirements laid down in points a to p of Article 67 (1) of Directive 2013/36/EU⁷⁰⁵. The resolution authority shall consider, *inter alia*, the existence and the level of importance of the shortcomings identified by the bank's managing bodies, for example, board arrangements, and whether operational capacity of the bank will materially affect the economic credibility of the bank and its ability to provide banking/investment services.

Bank management system. Bank insolvency evaluation criteria serve to determine whether a bank experiences serious financial problems and defects in its governance system, which can in many cases together with other objective elements be related to capital and liquidity ratios and lead to license revocation. The following criteria can be distinguished: (a) significant, inaccurate reports and financial statements addressed to the supervisory authorities, in particular decisions on the refusal of qualified external audits; (b) unduly protracted negotiations within the bank's internal managing bodies, which accordingly leads to the inability to timely make fundamental decisions; (c) the differences and non-compliance with the primary bank management procedures and systems, which may altogether lead to serious violations of prudential requirements. For instance, differences in assets. In essence, these are cases of violation of substantial law, regulated by the primary bank governance arrangements, which could cause severe negative impact on the bank and lead to the reasons for revoking the banking license. Some *examples* are worth mentioning: (a) inadequate strategic planning, low risk and acceptable risk level; (b) lack

⁷⁰⁵ Directive 2013/36/EU. Art. 18.

of risk control by the managing bodies, material weaknesses leading to the inability of the bank to identify, manage and report on existing bank risks experienced at the moment or in the near future; (c) ignoring significant weaknesses, disparities, irregularities and problems not reported to senior management in a proper and timely fashion; (d) inadequate internal control system and mechanisms; (e) significant reputational losses (“fit and proper” criteria) arising from the fact that the competence and eligibility of the persons appointed fails to comply with the legislative requirements; (f) operational risk of individual bank employees performing important functions in the bank, and significant reputation damage resulting from such risk (lack of transparency in business and operations or incomplete/inaccurate/incorrect information disclosure to the competent authorities; (g) major litigation or disputes risk, especially with regard to the actions of the appointed and employed persons in performing the key functions of the bank; (h) major non-compliance with remuneration⁷⁰⁶.

Operational capacity to provide services. These are certain objective elements that may adversely affect the operational capability (both financial and administrative) and functioning of the bank to provide banking and investment services, even without violating own funds and liquidity requirements. These are legally undefined circumstances and events that cannot be removed at the right time and in an efficient manner, but that must be taken into consideration when assessing bank insolvency. The following negative indicators can be distinguished: (i) the bank is unable to continue to implement its obligations to creditors successfully and, in particular, it can no longer ensure the protection of assets entrusted by depositors; (ii) the bank is unable to make or receive payments and, therefore, cannot properly pursue banking activities; (iii) by reason of operational risks, the bank loses market and depositor confidence, which leads to a situation in which the bank is no longer able to carry out its business and activities successfully (for example, the reluctance of other banks or third parties concerned to conclude a transaction providing capital to the bank and if the existing bank counterparties seek to terminate their contracts, including massive withdrawal of deposits)⁷⁰⁷.

As bank financing and liquidity is highly dependent on market confidence, it must be assumed that the determination of bank insolvency guided only by quantitative criteria is not possible. If the required quantitative criteria are poorly developed in legislation, there is a risk that a viable and healthy bank(s) may be inaccurately placed under the bank insolvency procedure or fall within the scope of special bank resolution regime. This raises the question of the degree of discretionary criteria to be adduced to the competent authorities. The wider the discretion given to public institutions, the higher the risk of excessive control by the regulatory authorities. However, it must be considered that certain flexibility is necessary for the public authorities in order to appropriately respond to a broad range of banking crisis scenarios. From a practical perspective, it is impossible to determine and legally define in advance the precise criteria and circumstances under which the bank will need to start insolvency proceedings. In any case, the criteria discussed above are an appropriate sign to the shareholders and the bank to assess the effects of the deteriorated

706 EBA. *Supra* note 678. P. 21.

707 *Ibid.*

financial position of the bank and to provide the bank with last chance to recover the situation before the intervention of public authorities.

1.9. Concluding Remarks

It is undeniably easier to define a banking crisis rather than to identify and assess its extent *ex ante*. Banks, described in the doctrine as inherently risky business entities and naturally unstable financial institutions, in particular, in view of their specific liquidity provisions (and other insolvency risk-related differences, as compared to the ordinary course of business entities), which, although add a particular added value to bank customers, nevertheless fail to protect against bank runs. Excessively frequent cases of deposit withdrawals can encourage the banks to promptly liquidate its assets, by incurring significant asset sales costs (such as execution costs for bailiffs or auction costs), which could affect the bank's ability to successfully discharge the remaining obligations to its depositors. Such cases of massive deposit withdrawal can induce public concern with regard to the financial solvency of the bank and lead to panic and moral hazards in the market. In all cases, banking crisis is indissociable from one or more bank insolvency cases and the ensuing government intervention for solving the problems faced by the distressed bank, as they relate to the public interest. While the debate on the narrowing of banking activities as a preventive measure for bank insolvency is still ongoing, it must be considered that the reduction of banking activities in the future might potentially help minimising the risks related to banking activities (it is necessary to make a detailed economic cost-benefit analysis before choosing a particular regulatory model) and would produce a preventive effect, but would not assist to fully avoid bank insolvencies. At the same time, the need to find regulatory solutions for banking concentration problems was endorsed by the G30, by suggesting that large, systemically significant financial institutions should be restricted in their activities that can lead to potentially very significant risks or serious conflicts of interest⁷⁰⁸. Although banking activities are particularly affected by the public interest, but bank insolvency is an inevitable consequence of the economic cycle. In order to mitigate the economic consequences of bank failures as much as possible, general insolvency law is not enough. Therefore, in view of the effects of the recent banking crisis, the aim for more effective resolution of bank insolvency problems according to international financial standards the paradigm of bank insolvency law has shifted. Special laws came into being. This led to a particular bank resolution regime and changes and/or significant modifications of the types of bank insolvency procedures. The central role in the general conception of bank insolvency law is placed on clear identification and determination of bank insolvency triggers and the qualitative, quantitative, and discretionary criteria. This is particularly important, first of all, due to the fact that, as demonstrated in practice, the *ad hoc* solutions are unsuitable (ineffective, related to political risk, etc.), as in the situations of bank run predictable, precise, timely intervention by the competent authorities in the activities of the bank plays a crucial role.

708 Group of Thirty, Financial Reform A Framework for Financial Stability. 2009.

II. REGULATION AND IMPLEMENTATION OF BANK RESOLUTION

Until the latest banking crisis, bank resolution or restructuring⁷⁰⁹ had been normally interpreted as the process of resolution of a failing or likely to fail bank, bank liquidation, sale of bank business, or various forms of recapitalisation, including ad hoc public financing. A number of bank asset recovery and resolution procedures, such as equity recapitalisation or government financial stabilisation tools, were considered to be a bank resolution⁷¹⁰. Bank resolution strategies were divided into two key solutions: i) private sector assisted solutions⁷¹¹; ii) public sector assisted solutions⁷¹².

In the first case, bank shareholders should have the responsibility to transform a bank facing financial difficulties by means of recapitalisation, i.e., by attracting additional capital in order to prevent its liquidation. If shareholders were unable to recapitalise a failing or likely to fail bank to a legal limit but they were fit and proper, the bank was still deemed viable and so a going concern. Such an undercapitalised and likely to fail bank, though, not meeting the criteria of insolvency laid down in the law, was allowed to remain in the system under more strict conditions of conduct or subject to any other prudent regulation. For example, the bank's recapitalisation could be phased and involve tighter monitoring and supervision of its activities and impose special additional requirements, prudent regulation measures such as suspension of dividend distributions until the required level of capital was restored. If the major shareholders, however, failed to recapitalise the bank adequately, the next usual step was to seek the assistance of other minority shareholders or additional support in financial markets. Eventually, if the above mentioned measures did not work, the financial difficulties of a bank would be addressed through the classic methods of bank resolution: a bank might be put into was liquidation, its assets and liabilities

709 Regarding the terminology, it should be highlighted that the legal doctrine found uses, for example, both the bank restructuring and bank resolution terms and concepts. Occasionally, it is referred that these terms are used in parallel. For example, see. Hoelscher D.S. *Supra* note 2. However, the author of the dissertation operates the concept of bank resolution, arguing that this theory is more modern in the doctrine, prevailing after the change of bank insolvency law paradigm, moreover, it is enshrined in the EU legal framework, and in the Banking Union legislation. On the other hand at the same time, it should be noted that the content of these terms according to their content is virtually identical. Resolution concept anchored in the The related legislation in the EU and the US related legislation, use the term 'resolution', meanwhile in Switzerland the term 'restructuring' term is used.

710 Hoelscher D.S. *Supra* note 2. P. 12.

711 When a bank facing financial difficulties approaches a point requiring formal intervention by public authorities, the supervisory authority first takes prompt corrective actions in order to strengthen the bank's activities. Such actions could amount to any restructuring efforts, such as planning sale of business. These efforts are generally described as 'private sector solutions' and do not necessarily cause extra costs to the insured. However, governments might incur costs, e.g. while writing-off assets or reducing tax-related liabilities of the bank. (in) *Supra* note 27. Financial Crises management and Bank resolutions. Protecting creditors of Insolvent Banks: How should the rights of different types of creditors be best managed? Chapter 13. P. 220.

712 *Ibid*.

might be sold (if permitted by law), the bank might be sold in part or in full (franchise), or the bank might be nationalised⁷¹³.

In the second case, failure of the private sector solutions and further distress of a bank would not necessarily result in the initiation of bankruptcy proceedings or bank liquidation. For example, financial and operational circumstances might force a bank to seek public support and take appropriate decisions on state aid⁷¹⁴. Public sector assistance would be based on a variety of financial sustainability measures, the most popular of which were joint recapitalisation schemes⁷¹⁵ (recapitalisation of both shareholders and the state), bank resolution through purchase-and-assumption transactions, or other method of sale where public funds are used to back transferred liabilities or guarantee asset values, or bank nationalisation (with a view to future re-privatisation)⁷¹⁶.

The recent banking crisis has demonstrated a lack of insolvency laws, limitations in national legal regulations, and that international bank resolution procedures were neither harmonised nor unified, and there was no single conceptual approach to a bank resolution regime⁷¹⁷. Bank resolution results, accordingly, were not appropriate enough. As discussed above, G20 states adopted new international financial standards for bank resolutions⁷¹⁸. Such international standards assisted in reforming national bank resolution regimes by pursuing a practical and consistent approach toward legal regulation. Analysis of the doctrine shows that, before the new paradigm of bank resolution regime, the following major factors limited the effectiveness of bank resolution procedures:

1. The law did not grant sufficient powers to competent authorities to write off debt instruments of bank shareholders and convert them into capital. Thus, a need emerged to form legal tools to enable bank supervisory authorities to reduce shareholders' equity, by converting debt to capital, in order to facilitate the bank resolution process and maintain the bank as a going concern. In addition, bank management bodies and shareholders facing financial difficulties often retained legal rights⁷¹⁹. Public authorities had to use the powers granted by shareholders and management bodies of the bank in resolution proceedings to sell the bank's assets and property under the right circumstances.
2. The law restricted the powers of competent resolution authorities to effectively restructure a failing or likely to fail bank. Many supervisory authorities faced re-

713 IMF, WB. *Supra* note 86. Marinč M., Vlahu R. *Supra* note 76. P. 42-43.

714 The aim of public financial assistance aims – is to reduce and limit the insolvent bank's costs to the real economy, if in a particular jurisdiction finds itself at the threshold of a bank or many banks or a bank performing systemically important functions find themselves at the threshold of insolvency or bank is engaged in systemically important functions.

715 IMF, WB. *Supra* note 86. Criteria and Incentives in the Recapitalization Scheme. P. 69-70.

716 The restructuring measures were generally selected on *ad hoc* basis, and bank resolution, in particular, resulted from the choice of certain restructuring strategies selected in accordance with bank's financial performance assessment procedure.

717 FSB. Thematic review on resolution regimes, 2013.

718 Key Attributes. *Supra* note 90.

719 In some cases, shareholders maintained broad control rights even after the declaration of the bank's insolvency, while taking part in the ordinary bankruptcy proceedings with a significant part of their claims.

restrictions on the sale or transfer of assets of a failing bank or part thereof. For example, the law required the approval of shareholders (the requirement associated with corporate law provisions). Under such regulation, the public authorities were not able to prevent a negative impact on the economy or take cost-reducing bank resolution actions⁷²⁰.

3. The legislation granted quite a weak mandate to supervisory, deposit insurance, and other resolution authorities involved in the bank resolution process. Therefore, over time, there emerged the need to review the legal regulation of the public authorities and to set a clear organizational framework, organizational arrangements, structure, and decision-making mechanisms, which, respectively, allowed the authorities to be adequately funded and to have competent management bodies, such as a board consisting of reputable professionals.
4. The law did not always prescribe adequate and comprehensively regulated bank resolution tools⁷²¹, which would empower early and prompt actions to be taken by public authorities within a weekend during a banking crisis, while the bank was still solvent⁷²². The bank resolution regulation was fundamentally inadequate, i.e. legally defective⁷²³. Thus, legislation that regulated legal relations in bank insolvency had to be supplemented with clear and detailed legal measures for bank resolution.
5. With some exceptions⁷²⁴, judges' knowledge of banking matters proved insufficient. Judges had only limited knowledge of the banking sector, which, in some cases, impeded the resolution of banks under a general insolvency law.
6. It was obvious that a bank resolution carried significant political risk in almost all cases (the promptness and quality of decision-making partly depended on political will)⁷²⁵.
7. A lack of legal protection for creditors, depositors and shareholders in bank resolution procedures was highlighted. For effective application of bank resolution tools, resolution authorities must be legally enabled to suspend creditors' or

720 For example, a comparison was made for bank resolution and bankruptcy costs were compared in the case of bank Lehman Brothers insolvency. The FDIC came into the conclusion that at the special bank resolution regime, if the special laws scope would be covered by investment firms came within the scope of operation of special laws, this type of solution for a distressed bank's solutions would cause losses by the extent of extending to 3 cents for 1 dollar, while in the case of bankruptcy cases, the loss would be amount to 79 cents to for \$ USD 1. FDIC. Press Release describing the Lehman OLA report. FDIC. The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act. Vol. 5, No. 2, 2011. Fleming M., Sarkar A. The Failure Resolution of Lehman Brothers. Fed. Res. Bank, NY, Economic Policy Review, Vol. 20, 2014.

721 BCBS. *Supra* note 15.

722 Hüpkes E. Resolving Crises in Global Financial Institutions: The Functional Approach Revisited. Shortcomings of Existing Resolution Regimes. (in) *Supra* note 27. Chapter 18. P. 294.

723 Therefore, many legal and practical issues and additional risks arose in practice due to potential breaches of creditor or shareholder rights by applying bank resolution tools.

724 US Bankruptcy Court. Case No. 08-13555. Opinion on Motions Seeking Modification of the Sale Order Pursuant to Rule 60 (B), The Trust EE'S Motion For Relief Under The SIPA Sale Order, Barclays' Cro SS-Motion to Enforce the Sale Orders and Adjudication of Related Adversary Proceedings, 2011. *See more* The Sale Motion of Lehman Brothers Holdings Inc. Docket No. 60. P. 4.

725 Hoelscher D.S. *Supra* note 2. P. 14-15.

counterparties' rights to run enforcement activities; in addition, contracts with a failing bank must be completed, accelerated, or otherwise terminated. The competent authorities need time to identify and evaluate the contracts to be handed over to a solvent third party without the risk of any change in value or scope of financial contracts upon exercise of the contract cancellation rights by the counterparties.

8. In pursuance of financial stability, restrictions for termination of creditor contracts or the right to terminate the contract was not properly taken into account. Counterparties' legal safeguards were underestimated as well. A need arose to protect the right of shareholders and creditors to a part of a claim not lower than that which they would receive in a case of ordinary insolvency procedures. Moreover, a judicial review of the decisions on bank resolution was not sufficiently regulated in cases of restricted legal proceedings.
9. Some banks were systemically important to the national economy and there were issues in applying general insolvency laws to them. Up until the financial crisis of 2007, creditors, regulators and investors underestimated serious problems in the financial stability of large, multinational banks, as well as the consequences that might arise from insufficiently regulated bank insolvency procedures⁷²⁶. During that era highly complex international financial systems were created consisting of a variety of credit institutions operating in different financial markets. Insolvency hit systemically large financial institutions such as Northern Rock, Bear Stearns, Lehman Brothers, Fortis, etc. Another major problem lay within the scope of the application of bank insolvency procedures that did not cover a vast variety of banks: investment firms, government-supported mortgage lenders, and other significant entities, e.g., hedge funds or specialized private equity firms⁷²⁷. There were prevailing presumptions in the market that some banks were too big to be subject to liquidations procedures, as economic hazard would automatically be caused. For example, there was no regulation to establish, which banking operations were considered critical to the stability of the overall financial system, and no resolution mechanism available to safeguard debtors or creditors against financial difficulties but also to protect public finances when addressing bank solvency concerns⁷²⁸.
10. Physical assets of a distressed bank are often valued too highly, and the bank continues to operate as a going concern, even though facing financial difficulties. A need arose to provide additional rights to parties concerned. Currently, for example, both private and public entities may reach a compromise through the comprehensive regulation of bank resolution tools that might foster or, at least, maintain a bank's value and the going concern presumption⁷²⁹.

726 Kkkoris I. Failing Firm Defence in Failing Markets. (in) *Supra* note 27, 2009. P. 258.

727 Knight D.M. Mitigating Moral Hazard in Dealing With Problem Financial Institutions: Too Big To Fail? Too Complex To Fail? Too interconnected to Fail? Banking Law Symposium. (in) *Supra* note 27. Chapter 16.

728 Rolef W. *Supra* note 593. P. 207. Hüpkes E. *Supra* note 737. P. 296-301.

729 Kkkoris I. *Supra* note 726. The Case For Bank Mergers. P. 260-261.

2.1. Concept of the Bank Resolution Regime

Different experiences of the banking crisis in a number of countries has proven that general insolvency legislation is not always appropriate for effective resolution of a failing bank, as it fails to acknowledge the necessity to avoid compromising financial stability, and to continue to provide essential services and protect depositors⁷³⁰. Bank bankruptcy proceedings are time-consuming⁷³¹, while their reorganisation requires complicated negotiations and arrangements with creditors, with the duration, costs, and outcomes causing losses to both debtors and creditors. Following the implementation of international financial standards and the agreement reached by the G20 leaders, member states were obliged to incorporate special legal regimes for bank resolution into their national law.

Clarification of which legislative measures and what, in general, should be considered as “bank resolution” requires a more comprehensive analysis. The use of this term in banking and in the overall jurisprudence is not consistent. The terms of bank restructuring and/or resolution had been used in legal doctrine prior to the financial crisis, however, it is worth noting that an attempt was made to define and standardize bank resolution process after the last financial crisis in order to comply with international financial standards. In addition, national positive law was substantially modified.

Bank resolution is defined in jurisprudence as the application of bank resolution tools. Certain bank resolution tools are provided to competent authorities by law. They are aimed at bank restructuring and/or at triggering a normal liquidation of a failing or likely to fail bank. These objectives of bank resolution can only be achieved where the regime allows for early, quick, and broad actions to be taken by a resolution authority as soon as a bank appears to be in financial risk⁷³².

The bank resolution definition is considered to have been first used by several experts who acted in the legal framework of bank insolvency– *Eva Hüpkes*⁷³³, *Tobias Asser*⁷³⁴ and *David S. Hoelscher*⁷³⁵. They were among the pioneering experts who used the term of bank

730 See more 1 chapter 4 sec. 2 sub-sec.

731 For example, the Swiss bank *Spar und Leihkasee Thun* bankruptcy case was very chaotic and liquidation proceedings lasted for 14 years. *Supra* note 42. P. 6.

732 Bliss R, Kaufman G., *Supra* note 75. P. 3.

733 Bank resolution is implemented in two fundamental ways: (i) through bank reorganisation procedure; (ii) through bank liquidation procedure (liquidation of assets). In her later publications, the author uses the term of bank resolution to describe all forms of public actions, including or excluding the involvement of the private sector, seeking to address solvency problems of the distressed financial institution threatening its viability. Hüpkes E., Devos D. Cross-border Bank Resolution: A reform agenda. (in) Giovanoli M., Devos D. International monetary and financial law, Oxford, Oxford University Press, 2010, P. 36. Hüpkes E. *Supra* note 71. P. 83.

734 Asser T.M.C. Legal Aspects of Regulatory Treatment of Banks in Distress. Washington DC, International Monetary Fund, 2001. Chapter XI. P. 141. Bank resolution procedures are utilized to transform the bank having financial difficulties and solve the bank's financial difficulties. Therefore, in general, the bank resolution procedures can be performed only when the bank starts the formal administration procedures or insolvency proceedings.

735 The author uses both concepts of bank restructuring and bank resolution. Bank resolution is described as a bank resolution tool, which, according to the relevant national legal regulation, available for resolving the financial problems of particular banks. They are all alternative legal bank resolution measures that are likely to be less dangerous to the economy, including the sale of the bank or transfer

resolution to describe the legislative techniques that could be applied to the resolution, disposal and/or liquidation of banks in the context of bank insolvency procedures, regardless of their legal basis (general insolvency law or special insolvency or administrative provisions)⁷³⁶. Later, the understanding of bank resolution was developed more widely by other reputable scholars, such as *R.M. Lastra*, *R.Bliss* and *G.Kaufman*⁷³⁷. Further, international regulators of financial systems have unified the bank resolution concept: i) FSB thematic review on resolution regimes and subsequent peer review reports define bank resolution as “any action taken by a public authority in respect of a [bank] that meets the conditions for entry into resolution, including in particular the exercise of a resolution power with or without private sector involvement, with the aim of achieving one or more of the statutory objectives of resolution. Resolution may include the application of procedures under insolvency law ...in conjunction with the exercise of resolution powers”⁷³⁸; ii) IMF describes the bank resolution as “the bank’s financial situation...diagnosed in the context of official administration [intervention, seeking] to restructure the [failing or likely to fail] bank’s business with a view to securing its continuation...as rapidly as possible, in a manner that minimizes disruptions to the financial system and limits costs to depositors, other creditors, and taxpayers.”⁷³⁹

Bank resolution *in its narrow definition* can be described as special bank insolvency procedures and/or legal regime of bank restructuring designed solely to regulate and deal with bank distress in order to ensure the continuity of essential functions of a bank, to preserve financial stability, and to restore the viability of all or part of that bank⁷⁴⁰. In light of peculiarities of the banking activities, the bank resolution regime offers tools to address financial difficulties of banks outside the general bankruptcy laws, to suspend direct formal bankruptcy procedures against the insolvent bank, but first of all, to prevent potential adverse effects or additional risks that may arise immediately after closing the bank’s activities, revocation of banking license, declaration of bank insolvency, and commencement of liquidation procedures.

In an economic sense, bank resolution is a situation where an operating part of a business entity facing financial difficulties or all activities (business) of it are subject to restructuring on a going concern basis, and/or, if the continuation of the bank’s activities is

of bank assets, rights and liabilities. The author defines bank resolution as a long-term process, often requiring to create new laws concerning the establishment or revision of old, and as certain restructuring strategies for development, such as liquidation of the bank, the bank’s business sales or bank recapitalization, restructuring or in order to recover the bank’s assets, activities and procedures. The restructuring strategy in the broad sense is divided into private and public sector solutions. Hoelscher D.S. *Supra* note 2. Introduction. P. 12-13.

736 Insolvency problems can also be addressed by using early intervention measures. They serve to preserve the value of the bank’s assets, to protect depositors and to limit moral hazards. Kkkoris I. *Supra* note 726. P. 259.

737 Scientists explains the definition of bank resolution in a very broad sense. Bliss R., Kaufman G. *Supra* note 75. P. 3.

738 FSB. Thematic review on resolution regimes. Peer review Report. Principle No. 3, 2013. P. 6.

739 IMF, WB. *Supra* note 86. P. 35.

740 Schillig M. *Supra* note 47. P. 67. Among other things, the concept of bank resolution well-established in the publications of international organizations, explaining the bank’s insolvency legal relations.

impossible, the failing bank gradually and duly terminates its operation in a normal way by liquidating its business in whole or in part⁷⁴¹.

From a legal perspective, bank resolution may result in either the bank continuation as a legal entity or the dissolution of its legal personality⁷⁴². Therefore, bank resolution is in essence associated with any kind of intervention by a public authority to a bank's activities. Official competent authorities conduct intervention in order to mitigate financial trouble suffered by a bank and potential negative consequences of its failure, to enhance or restore the bank's viability, not to avoid the bank's collapse in negative consequences in full, but, at least, to minimise their impact.

In the broad sense, bank resolution covers all legal banking crisis management tools to preserve a positive financial stability and, where necessary, to encourage an ordinary procedure for liquidating all or part of the financial institution⁷⁴³. Similarly, bank resolution denotes the set of legal arrangements establishing insolvency and quasi-insolvency procedures for restructuring and/or liquidation of a bank facing financial difficulties⁷⁴⁴. In case of financial system crises, bank resolution is associated with ad hoc state intervention solutions outside the legal framework of bank resolution, in order to support the banking sector, through extreme state-level stabilisation measures. "Resolution" could also be understood as the use of certain intervention tools in the doctrine, known *as government stabilisation tools*. Such governmental actions encompass every conceivable response of authorities when facing the bank's actual or imminent failure⁷⁴⁵. Thus, in a broad sense, bank resolution is a diverse set of administrative and legal measures to deal with the failing corporate governance system of a bank. That is - formal bank insolvency proceedings aimed at restructuring or liquidating banks, which have crossed the relevant legal bank resolution threshold and meet bank resolution objectives. Moreover, bank resolution is understood as private sector arrangements, decisions or transactions that the competent authorities initiate, such as sale of business or asset separation transactions leading to the transfer of the failed bank's operations, in whole or in part, to a viable financial institution, and serves continuation on a going-concern basis⁷⁴⁶. In other words, it is a large variety of legal measures to prevent ordinary insolvency proceedings⁷⁴⁷.

How is bank resolution regulated and construed in the legislative systems of the relevant jurisdictions? *Within the EU legal framework*, bank resolution is understood as the application of a resolution tool (business sale, asset separation, bridge bank, bail-in) in order to achieve one or more of the resolution objectives⁷⁴⁸. *In Switzerland*, bank resolu-

741 IMF, WB. *Supra* note 86. P. 15.

742 Ibid.

743 Hadjiemmanil C. *Supra* note 79. P. 12.

744 Ibid. P. 12-13.

745 Dewatripont M., Freixas X. Bank Resolution: Lessons from the Crisis. (in) *Supra* note 292. P. 106. Bank resolution is linked to the restoration of normal business conditions.

746 Dewatripont M., Freixas X. *Bank resolution: a framework for the assesment of regulatory intervention*. Oxford Review of Economic Policy, Vol. 27, No. 3, 2011. P. 415-420.

747 Hadjiemmanil C. *Supra* note 79. P. 12.

748 BRRD. Art. 2 (1) (1).

tion is associated with a statutory concept of bank restructuring⁷⁴⁹. The Swiss Banking Act describes bank restructuring as one of the main bank insolvency procedures⁷⁵⁰. Bank restructuring is explicitly interpreted as the application of a bank restructuring plan, serving as an optimal protection of creditors' and shareholders' interests against insolvency. The prospect of restructuring the bank or continuing individual banking services is justified if, at the time of the decision, there is sufficient evidence that creditors are likely to fare better from the restructuring than from the bankruptcy⁷⁵¹. *The US legal framework* widely applies a bank resolution concept. Bank resolution is associated with private measures of bank restructuring, which allows for bank viability through the management of financial trouble in both large and complex financial institutions and ordinary banks as well as through avoiding adverse effects and costs to taxpayers⁷⁵². Under this research, a bank's resolution is interpreted in accordance with the EU regulatory framework. Bank resolution applies to any type of bank – both those that are “too big to fail” and other banks.

In summary, it should be concluded that the bank resolution in its broad sense means the whole of bank restructuring efforts. The term is correlated with the bank insolvency jurisdiction, which defines bank resolution in more detail. Bank resolution is also directly linked to bank resolution objectives⁷⁵³. In the narrow meaning, it is bank restructuring intended to ensure the continuity of essential functions of a bank, to preserve financial stability, and to restore the viability of all or part of that bank. Bank resolution should be understood as restructuring of activities of a separate bank, which faces financial difficulties. A bank is restructured by means of a certain bank resolution tool. Scientific literature usually interprets bank resolution as all bank resolution methods that assure the speedy availability of funds for depositors and other creditors⁷⁵⁴. The general rule is that, if there is no threat to financial stability or taxpayers in the opinion of the supervisory authorities, a bank (or its individual parts) may fail in the normal way, therefore, a bank's resolution is an alternative to ordinary bankruptcy proceedings. The goal of bank resolution is to remove an insolvent bank from the financial system whilst ensuring that investors' and public confidence in the banking sector is maintained, to minimize negative consequences for taxpayers and the public, to restructure a bank facing financial trouble, and to duly control legal and economic risks. Given the fact that the failure of the banking system would prejudice interests of virtually all members of society, as well as their rights of ownership, the stability and reliability of the banking system should be considered to be of public interest to be defended by the State in carrying out its constitutional functions (e.g., p. 1 of Art. 23, p. 3, 4 of Art. 46 of the Constitution of the Republic of Lithuania).

749 FINMA. New Banking Insolvency Ordinance. A key element in the effective restructuring and orderly market exit of banks, 2012 [interactive]. P. 2. [accessed on 2014-12-05] <<http://www.finma.ch/e/regulierung/anhoerungen/Documents/fb-biv-finma-e.pdf>>. Swiss banking law. Art. 28.

750 Swiss Banking law. Art. 28-33.

751 Swiss Ordinance. 3 Section, Art. 40.

752 Dodd Frank. Title II. Section 203. FDIA Section 10(b)(3).

753 See *more* 2 chapter, 3 sec.

754 Hoelscher D.S. *Supra* note 2. Preface.

2.2. Significance of the Bank Resolution Regime

The bank resolution regime procedure is a central element in effective bank insolvency regulation⁷⁵⁵. Without calling into question the significance of the bank resolution regime for the bank's functions, the analysis of why the bank resolution regime is so important to public interest is required.

First and foremost, the bank resolution regime is an alternative to ordinary bankruptcy proceedings and the means for dealing with failing or likely to fail banks, the liquidation which would impact the public interest (threaten financial stability, the critical functions of a bank, and and/or the safety of deposits, clients' assets, and public funds), to restructure and /or liquidate banks⁷⁵⁶. The doctrine is consistently applied to the position that the bank resolution regime ensures a failing bank is able to exit the market without causing disruption to the financial system, it is consistent with the public interest since it avoids adverse effects on financial stability, ensures the continuity of critical functions of a bank, and protects covered depositors⁷⁵⁷. The bank resolution regime is also important for dissolving the legal personality of weak banks, whilst banks in financial trouble, continue to perform a critical function for the wider economy, and survive in the market. Given the cyclical nature of the economy and that banks' financial trouble is an inevitable part of a market economy, the bank resolution regime is the key to efficient running of the economy.

Second, a carefully designed legal framework for bank resolution is a central element for mitigating financial difficulties of not only a failing bank, but also other credit institutions, in particular, during a banking crisis. Until the recent banking crisis, the bank resolution regime was inadequate, and brought with it a whole set of negative consequences which resulted in huge cost to taxpayer⁷⁵⁸. Effective bank resolution tools are, therefore, indispensable for managing the banking crisis, and for sustaining or rebuilding market confidence. Confidence rebuilding is explicitly related to bank insolvency regulations, particularly the loss allocation mechanism, i.e., who, and on what legal basis, bears the losses of an insolvent bank. The absence of any bank resolution regime has led to the need to rescue banks by means of public funds and taxpayers' money whereby governments were uncertain about the scale of impact on the financial system that might arise due to the failure of a bank. Thus, the bank resolution regime functions as a banking crisis management tool, which diminishes financial risk and, accordingly, helps to prevent banks' financial crises in the future. Bank resolution is an integral component of the financial crisis prevention and limitation of the risk of bank default. Apart from it, the legal framework of resolution has a positive effect on lending decisions and reduces the degree of risk to the financial market⁷⁵⁹. In other words, the legal framework of bank resolution provides the

755 G-20 Report, 2010.

756 If, in the opinion of public authorities, there is no threat to financial stability and taxpayers, a bank (or the respective parts of it) may be allowed to fail in the ordinary way, by means of bankruptcy procedure

757 BRRD. Recital (45).

758 Attinger J.B. *Supra* note 49. P. 4.

759 Hüpkes E. Resolving Crises in Global Financial Institutions: The Functional Approach Revisited. Shortcomings of Existing Resolution Regimes. (in) *Supra* note 27. Chapter 5. P. 106.

basis for fundamental assumptions, which determine creditors' decisions, i.e., how likely a bank will be able to restore solvency, to revive and recover its activities, and how soon the bank will recover the value of its assets, etc.

Third, the doctrine argues that it is impossible to handle the failure of both large, operationally complex and systemically important banks and other banking institutions without an effective and reliable legal framework for bank resolution. Bank resolution tools are intended to reduce and mitigate adverse effects resulting from bank insolvency (liquidation) rather than to prevent bank liquidation (bankruptcy procedures)⁷⁶⁰. The primary objective of bank resolution is to furnish society with tools to deal with insolvency (bankruptcy procedures) of banks, especially those systemically important, as well as to manage the consequences without taxpayer support. Besides, effective and sound bank resolution regimes, operating across national borders, are compulsory for a "healthy" international monetary and financial system⁷⁶¹. It is equally important that prudential supervision of banks and short-term measures, as well as operational independence of banks go hand in hand with the sound and efficient legal regulation of bank resolution. Otherwise, it would inevitably demand more taxpayers' money, more issues of government securities, and considerably larger international commitments to a particular member state. Under the effective legal framework of bank resolution, public funds are subject to less pressure⁷⁶².

In order to make the bank resolution regime effective and important to national economies, it must meet two key requirements: i) resolution rules must be predictable, i.e., the end result, conditions laying down the resolution process, and selection of specific legal tools for resolution; ii) the rules must be sound (minimised risk of litigation).

2.3. Objectives of the Bank Resolution Regime and its Distinctive Features

It should be noted that all the general objectives of bank insolvency procedures, discussed in section 8 of Chapter 1 of the Thesis, are also applicable to the bank resolution regime. This section is dedicated to specific objectives of bank resolution, laid down in both the doctrine and positive law of separate jurisdictions, as well as to significance of the said legal regulation. The doctrine acknowledges that the bank resolution regime is pursuing specific objectives associated with the public interest: i) at the time of banking crisis, to provide sufficient legal tools for dealing with failed banks while preserving systemic stability, in the sense of securing the continuous provision of the key functions of the bank and maintaining as a going-concern; ii) *ex ante*, to create an effective and appropriate set of incentives for banks facing financial difficulties, so as to preserve market discipline and avoid financial hazard⁷⁶³.

Some researchers argue that in order to guarantee the efficiency of bank resolution tools to manage banking crises, the bank resolution regime must aim to establish appropriate legal and financial structures to control a failing bank, and to deal with the financial hazard arising

760 Hadjiemmanuil C. *Supra* note 79. P. 13-16.

761 *Ibid.*

762 Tucker P. (in) EUROFI. *Supra* note 92. P. 10-16, 56-68.

763 Hadjiemmanuil C. *Supra* note 79. P. 10.

from commencement of ordinary bank insolvency procedures⁷⁶⁴. This position is implausible as provisions of the bank resolution regime are designed to regulate ex ante a bank's loss allocation to both shareholders and holders (owners) of debt instruments, in case the bank becomes insolvent. First of all, it is obvious that such a preventive regulation raises the responsibility of private stakeholders in normal bank operation. It also restricts the negotiating freedom of private individuals dealing with competent authorities in a period of crisis. Secondly, under the bank resolution rules and explicit regulations, competent authorities are empowered to take prompt and legally undisputable actions upon taking control of the bank facing severe financial difficulties. When applying resolution tools and exercising resolution powers, relevant authorities should consider resolution objectives and choose legal tools and powers to achieve the best possible outcome under special circumstances.

Another objective of the bank resolution regime worthy of attention is to *offer appropriate solutions for specific technical failures of a bank which are unfeasible in general insolvency law, in particular, with a view to maximising the value of shares and the bank's assets, maintaining ongoing transactions in the markets and/or payment and settlement systems*. Once the insolvency procedures are initiated, it is no longer possible to rapidly suspend or completely terminate such transactions⁷⁶⁵.

All the stakeholders involved in bank insolvency procedures seek protection of an insolvent debtor's assets, therefore, we can identify *maximisation of the bank assets' value* (whether it is allocation of total assets of the bank in liquidation or resolution of an insolvent legal entity) as one of objectives of the bank resolution regime. Upon resolution of a bank, creditors' interest is retained to maximise the bank's assets with regard to the priority of their specific claims, as well as to allocate the losses due to the bank's insolvency in accordance with pre-defined and clear legal principles and in a predictable manner. The basic idea is to prevent destructive asset "racing" among certain creditors, which take place in all cases a business operator becomes insolvent because the uncoordinated actions of creditors may be focused solely on individual interests, and disregard common collective interests. Otherwise, debtor's assets might be disposed of in whole or part, so, stakeholders expect the bank to continue as a going concern and give added value to its creditors. The main objective of insolvency procedures within the general insolvency law is to increase the total mass of assets in a way that considers and meets all creditors' interests (e.g., individual recovery actions, collective procedures, the *pari passu* treatment of creditors and the statutory ranking of financial claims, etc.). However, bank resolution procedures are different from the ones of other business entities. Bank resolution procedures are specially designed to provide efficient solutions and related legal tools to handle highly specific bank solvency problems, while best meeting both creditors' needs and public interests of the state⁷⁶⁶.

764 Hüpkes E. Allocating Costs of Failure Resolution. Shaping Incentives and Reducing Moral Hazard. (in) *Supra* note 74. Lastra M.R. Cross-border bank insolvency. P. 104-107.

765 Hüpkes E. *Supra* note 71. The legal aspects of bank insolvency. P. 88.

766 In particular, the differences between the nature of financial assets and liabilities in the balance sheet can justify derogations from general, corporate insolvency law rules in order to increase stock taking and asset capture opportunities and avoid unwanted secondary, adverse effects of the insolvency proceedings. Another important factor - the transactions carried out on financial markets and/or payment and settlement systems. Since the commencement of insolvency procedures, it may materially affect the speed of such operations.

Bank resolution is associated *with payment of compensation to depositors* that is not among common objectives of corporate insolvency procedures, since deposit settlement typically takes place apart from bank insolvency procedures. The key effect of such payments is that they bring a certain class of bank liabilities over the entire insolvency procedure or, otherwise, determine the subrogation of a deposit insurer against original creditors (the right is transferred to the deposit insurer, who continues to take part in the insolvency procedure). Accordingly, one more noteworthy objective of the bank resolution regime is *to assure administrative consistency and continuity by means of banking supervision, deposit insurance, and resolution procedure*. It is of high importance to ensure the *integrity of administrative actions*, their consistency, smooth communication, and follow-up in the processes of supervision of banks, deposit guarantee scheme, and bank resolution.

EU legal framework lays down the following *main objectives for the bank resolution regime*: a) to ensure the continuity of critical functions; b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; c) to protect public funds by minimising reliance on extraordinary public financial support; d) to protect depositors and investors; e) to protect client funds and client assets⁷⁶⁷. When pursuing the above objectives, the resolution authority seeks to minimise the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives. The resolution objectives are of equal significance, and resolution authorities balance them as appropriate to the nature and circumstances of each case⁷⁶⁸. When choosing resolution tools within the EU legal framework, resolution objectives need to be taken into account, whereas resolution tools are selected and resolution powers are exercised so as to achieve the major objectives of resolution: i) assurance of continuity of a bank's critical functions; ii) avoidance of a significant adverse effect on the financial system for the EU and its Member States⁷⁶⁹.

During the recent banking crisis, a significant lack of adequate tools forced Member States to save banks using taxpayers' money. Thus, one of the key objectives of the bank resolution framework is *to obviate the need for such public support to the greatest extent possible*⁷⁷⁰. Another equally important objective of the bank resolution framework is that the resolution regime, particularly in view of the fact that EU banks are highly integrated and interconnected, should enable Member States *to seize control of a failing bank* using legal tools and to resolve it in a way that effectively *prevents broader systemic damage* and not to undermine Member States' mutual *trust* and the *credibility* of the internal financial services market⁷⁷¹. The onset of the financial crisis affected the access to funding of a large proportion of banks; the resolution regime would secure access to funding for banks that are otherwise solvent in order to avoid failures which would have consequences for the overall economy (for example, liquidity support from Central Banks and guarantees from Member States for securities issued by solvent credit institutions)⁷⁷².

767 BRRD. Art. 31.

768 BRRD. Art. 31 (2).

769 BRRD. Art. 32 (5).

770 BRRD. Recital (1).

771 BRRD. Recital (3).

772 BRRD. Recital (2).

A resolution action shall be treated *only as in the public interest*⁷⁷³, and this objective may disrupt the rights of shareholders and creditors. First and foremost, the power of the authorities to transfer the shares or all or part of the assets of an institution to a private purchaser without the consent of shareholders affects the property rights of shareholders. Secondly, the power to decide which liabilities to transfer out of a failing institution based upon the objectives of ensuring the continuity of services and avoiding adverse effects on financial stability may affect the equal treatment of creditors (priority of creditors' claims). Thirdly, resolution action should be taken only where necessary in the public interest and any interference with rights of shareholders and creditors which results from resolution action should be compatible with the Charter of Fundamental Rights of the European Union. Fourthly, where creditors within the same class are treated differently in the context of resolution action, such distinctions should be justified in the public interest and be proportionate to the risks being addressed and should be neither directly nor indirectly discriminatory on the grounds of nationality⁷⁷⁴.

Among other things, resolution should also aim to *preserve financial stability and minimise economic and social effects* in the Member States where the bank or group operates. To achieve these goals, authorities should have the power to impose preparatory and preventative measures⁷⁷⁵. When applying resolution tools, objectives should always be to ensure the continuity of critical functions, to avoid adverse effects on financial stability, to protect public funds by minimising reliance on extraordinary public financial support to failing institutions and to protect covered depositors, investors, client funds and client assets⁷⁷⁶. In all cases before applying resolution tools, the option to liquidate a failing bank through ordinary bankruptcy proceedings should be considered. A bank shall be deemed to be resolvable if it is feasible and credible for the resolution authority to either liquidate it under normal insolvency proceedings or to resolve it by applying the different resolution tools while avoiding to the greatest possible extent any significant adverse effect on the financial system of the Member State or all the Member States or the Union and with a view to ensuring the continuity of critical functions carried out by the bank⁷⁷⁷. A failing bank should be maintained through resolution tools as a going concern with the use, as far as possible, of private funds. That may be achieved either through sale to or merger with a private sector purchaser, or after having written down liabilities of the bank, or after having converted its debt to equity, in order to effect a recapitalisation⁷⁷⁸. When applying resolutions tools, resolution authorities should take all appropriate measures to ensure that shareholders and creditors bear an appropriate share of the losses, that the bank's management should in principle be replaced, that the costs of resolution of the bank are minimised, and that creditors of the same class are treated in an equitable manner. Use of the resolution tools may involve the granting of State aid; where resolution funds or deposit guarantee funds intervene to assist in the resolution of a failing bank.

773 BRRD. Art. 32 (1)(c) (5).

774 BRRD. Recital (13).

775 BRRD. Recital (18), (19).

776 BRRD. Recital (45).

777 BRRD. Art. 15 (1).

778 BRRD. Recital (46).

The question arises how should public authorities act when conducting the bank resolution so as to ensure the best possible balance between private and public interests? In particular, a rapid and coordinated resolution action is necessary to sustain market confidence and minimise contagion. The circumstances under which the failure of a bank may occur, and in particular taking account the possible urgency of the situation, should allow resolution authorities to take resolution actions without imposing an obligation to first use early intervention powers⁷⁷⁹. Secondly, when taking resolution actions, resolution authorities should take into account and follow the measures provided for in resolution plans unless resolution authorities assess, taking into account circumstances of the case, that resolution objectives will be achieved more effectively by taking actions which are not provided for in the resolution plans⁷⁸⁰. Third, with certain exceptions, resolution tools should be applied before any public sector injection of capital or equivalent *extraordinary public financial support* to a bank⁷⁸¹. This, however, does not impede the use of funds from the deposit guarantee schemes or resolution funds in order to absorb losses that would have otherwise been suffered by covered depositors or discretionarily excluded creditors. The Banking Union's legislation provides for explicit and duly regulated resolution tools (as discussed in other chapters of the dissertation - aut.note). Where a particular resolution tool have been used to transfer systemically important services or viable business (e.g, mortgage loans) of a bank to a sound entity such as a private sector purchaser or a bridge bank, the residual part of the bank should be liquidated within an appropriate time frame having regard to any need for the failing bank to provide services or support to enable the purchaser or the bridge bank to carry out the activities or services acquired by virtue of that transfer. Eventually, according to legislation of the Banking Union, it should be the financial industry, as a whole, that finances the stabilisation of the financial system. This idea, first of all, is based on the fact that there may be circumstances when the effectiveness of the resolution tools applied may depend on the availability of short-term funding for a bank or a bridge bank, the provision of guarantees to potential purchasers, or the provision of capital to the bridge bank. Notwithstanding the role of Central Banks in providing liquidity to the financial system even in times of stress, it is important that Member States set up financing arrangements so as to avoid such funds required coming from national budgets⁷⁸². It obliges Member States to establish their national financing arrangements through funds controlled by resolution authorities to be used for the resolution purposes. They should be allowed to collect mandatory contributions from banks which are authorised in their territories and which, in some cases, are not held through funds controlled by their resolution authorities. The contributions should be collected prior to and independently of any operation of resolution *ex-ante* or *ex-post*. It is compulsory that available financial means of the national financing arrangements amount at least to a certain minimum target level.

779 BRRD. Recital (53).

780 BRRD. Recital (54).

781 Extraordinary public financial support means- state aid within the meaning of Article 107(1) paragraph 1 TFEU, or any other supranational level of public financial support assistance at supra-national level, which, if provided for at national level, to would constitute State aid, and that a that is provided in order to preserve or restore the bank or banking group's viability, liquidity or preserve or restore the solvency of a bank or a banking group.

782 BRRD. Recital (103).

In the legal framework of the US, FDIC can decide to resolve a failing bank by a *receivership*⁷⁸³ or to act as a body empowered to take measures on resolving the solvency by a *conservatorship*⁷⁸⁴. The objective set out in the law requires the FDIC, as the receiver, to resolve a bank in accordance with principle of a *least cost* resolution in terms of a deposit insurance fund⁷⁸⁵. The FDIC may appoint itself as a receiver in order to reduce i) the risk that the deposit insurance fund would incur a loss with respect to the insured depository institution; ii) any loss that the deposit insurance fund is expected to incur; iii) on the grounds of the bank insolvency⁷⁸⁶. However, the exception provides that the FDIC may deviate from the principle of least cost resolution, if such a manner of bank resolution poses a potential threat to financial stability or the overall economy. As receiver, the FDIC may i) liquidate the bank in an orderly manner; ii) make any other disposition of any matter concerning the bank, as the FDIC determines is in the best interests of the bank and its depositors⁷⁸⁷. A similar legal regulation is laid down in the Dodd-Frank Act aimed at insolvency of SIFI, which, however, stipulates that the FDIC may be appointed as a receiver of any financial company operating within the US where it is in default or in danger of default and a resolution of which is likely to cause systemic instability according to provisions of the US Bankruptcy Code⁷⁸⁸. Under the act, the FDIC is entitled to seize bank assets, separate bank assets, or sell a bank whose default would have an effect on the financial stability of the United States. If the FDIC is appointed as the bank receiver, the Secretary of the US Treasury, based on the recommendation made by vote of no fewer than 2/3 of the members of the FED (Federal Reserve) Board of Governors and 3/3 of the members of the Board of Directors of the FDIC, determines that the bank is to be restructured using a particular resolution tool if the failure of the financial company and its resolution, under the US Bankruptcy Code (general insolvency law) i) would have serious adverse effects on the financial stability of the United States; ii) no viable private sector alternative is available to prevent the default of the bank; iii) bank resolution best meets interests of creditors, shareholders and counterparties, as well as other market participants; iv) resolution ac-

783 The FDIC concentration of powers is traditionally explained by the fact that: (a) there is a large need to take over control of the bank's assets in a timely manner and thus increase confidence in the banking system; (b) the FDIC acts as the largest creditor and provides better opportunities to maximise the value of the bank assets. Hynes M.R., Walt. D.S. *Supra* note 11. P. 1

784 The FDIC may also be appointed as a trustee of the bank, but this option is rarely used. The FDIC can recover or rehabilitate a failing bank without withdrawing the banking license. In this case, the FDIC takes over the management of the bank, but the bank will continue to operate as its obligations are not automatically suspended. On the contrary, when the FDIC is appointed as the insolvency administrator, the bank is closed and the senior officials and the governing bodies are relieved of the bank's management and this action does not require a court order. Then, the FDIC takes over all the bank's insolvency process management, including the sale of assets and settlement with creditors. *Ibid.* P. 2.

785 The principle of 'least cost' is used by the FDIC in the context of an economically optimal solution to address the problems of a failing bank. The selection of the bank's resolution measures should be in compliance with the total FDIC costs and obligations that would cause the least amount of costs to the deposit insurance fund, taking all possible measures of bank resolution into account. FDIC. Overview of the resolution process. 2014. Chapter 2. Least Cost Analysis. P. 60. [interactive]. [accessed on 2014-12-10]. < <https://www.fdic.gov/bank/historical/managing/history1-02.pdf>>.

786 FDIA. 11 (5), (9) (A) (B) Section.

787 *Ibid.* 11, (13) (B) Section. Codified 12 U.S.C. 1821(c).

788 Dodd-Frank. Title II, Sec. 203 (a).

tions mitigate adverse effects on the economy and the financial system and the cost to the general fund of the Treasury; v) the potential to increase excessive risk taken on the part of creditors, counterparties, and shareholders in the bank; vi) it is assessed and determined that the bank liquidation cannot be initiated for any other reason⁷⁸⁹.

In the Swiss legal framework, systematic analysis of the banking act and secondary legislation allows that the main objectives of bank resolution are the *protection of stability of the financial system* - including settlement systems⁷⁹⁰, protection of depositors and investors⁷⁹¹, protection of client funds and client assets⁷⁹² under bank insolvency procedures, which best meets the interests of creditors, shareholders and stakeholders of the bank on the brink of insolvency⁷⁹³. The aim of bank restructuring proceedings is to provide a financially stricken bank with the opportunity to continue its business operations to the best possible satisfaction of its creditors, with the support of measures from the authorities⁷⁹⁴. Creditors are likely to fare better than within the insolvency procedure⁷⁹⁵. The continuation of individual banking services is another objective of the resolution regime in Switzerland⁷⁹⁶. FINMA also aims to protect the payment system and financial market infrastructure⁷⁹⁷.

In summary, it can be stated that objectives of the bank resolution regime are achievable only if the existing legal regulation allows for early, quick, broad and decisive resolution actions to be taken by a resolution authority as soon as a bank appears to be at financial risk. Following the analysis of legal frameworks within relevant individual jurisdictions, it must be concluded that main objectives of the bank resolution regime are to reduce the cost to society and taxpayers to the maximum extent possible, to maintain the stability of the financial system and critical functions of banks. Further, a secondary objective of bank resolution – to maintain market discipline, which obliges not to pass the adverse effects of bank insolvency and costs from stakeholders of the bank onto taxpayers. In all cases, bank resolution is assumed to be based on the cost-benefit analysis which should be carried out prior to making decision on resolution. The bank resolution requires legal certainty, transparency, and predictability, while the above principles of law inevitably presume a certain attitude toward shareholders and creditors of a bank. Bank resolution is aimed at preservation of the value of bank assets, which otherwise would likely be affected by the bank insolvency procedure. One of the key positive characteristics of bank resolution is the opportunity given to creditors to get a clearer picture of the investment-related risks upon repealing the provision implying that banks are rescued by public funds. Eventually, financial arrangements of resolution under the State aid rules will ensure a much greater chance to achieve objectives of the resolution regime.

789 Dodd-Frank. 203 (2) (b) Section.

790 Swiss Banking act. Art. 27.

791 Ibid. Art. 29.

792 Swiss Ordinance. Art. 51.

793 Ibid. Art. 40 (1) (a).

794 FINMA. *Supra* note 42.

795 Swiss Ordinance. Art. 40 (1) (d) (a).

796 Ibid. Art. 40 (1).

797 Ibid. Art. 53.

2.4. Fundamental Conditions and Principles of the Bank Resolution Regime

EU legal framework of bank resolution provides for timely entry into resolution before a financial institution is balance-sheet insolvent and before all equity has been fully wiped out. Resolution actions shall be treated as in the public interest if it is necessary for the achievement of and is proportionate to resolution objectives, and winding up of the bank under normal insolvency proceedings would not meet those resolution objectives to the same extent⁷⁹⁸. The adoption of an early intervention measure is not a condition for taking resolution action⁷⁹⁹. The fact that a bank does not meet the requirements for authorisation should not justify *per-se* the entry into resolution, especially if a bank is still or likely to still be viable. The need for emergency liquidity assistance from a Central Bank should not, *per se*, be a condition that sufficiently demonstrates that a bank is or will be, in the near future, unable to pay its liabilities as they fall due⁸⁰⁰. The resolution action is taken in accordance with the following principles: a) original shareholders of the bank under resolution bear first losses; b) creditors of the bank under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings; c) management body and senior management of the bank under resolution are replaced, except in those cases when the retention of the management body and senior management, in whole or in part, as appropriate to the circumstances, is considered to be necessary for the achievement of resolution objectives; d) management body and senior management of the bank under resolution provide all necessary assistance for the achievement of resolution objectives; e) natural and legal persons are made liable, subject to Member State's law, under civil or criminal law for their responsibility for the failure of the bank; f) creditors of the same class are treated in an equitable manner; g) no creditor shall incur greater losses than would have been incurred if the bank had been wound up under normal insolvency proceedings in accordance with safeguards of asset separation; h) covered deposits are fully protected; and (i) resolution action is taken in accordance with the safeguards applicable to creditors and shareholders⁸⁰¹.

*The Swiss bank resolution regime*⁸⁰² is based on two key principles of bank resolution: i) bank restructuring (approval of the restructuring plan) must protect the interests of bank creditors and shareholders in the best possible manner. In the case of a viable prospect for bank restructuring or continuation of functions, by extension a public authority is obliged to commence the restructuring procedure⁸⁰³. The restructuring plan is submitted to FINMA for approval; it does not require the consent of shareholders of the bank⁸⁰⁴. Execution of the restructuring plan cannot be launched without the approval of FINMA⁸⁰⁵ in accordance with the following principles: ii) bank restructuring assists in maintaining continuity of the bank's functions; iii) the bank's assets have been valued on the basis of asset valua-

798 BRRD. Art. (32) (1) (5).

799 BRRD. Art. 32 (3).

800 BRRD. Art. 32 (4).

801 BRRD. 34.

802 Swiss law impose the bank restructuring definition rather than resolution.

803 Swiss Banking law. Art. 28.

804 Ibid. Art. 29.

805 Swiss Ordinance. Art. 40.

tion standards; iv) creditors find themselves in a better position upon the restructuring of the bank than liquidating it under normal insolvency procedures; v) creditors of the bank under restructuring bear losses after the shareholders in accordance with the order of priority of their claims; shareholders bear losses first⁸⁰⁶; vi) the restructuring plan adequately takes into account legal and economic links of the bank's assets, liabilities, contractual obligations; vii) other bank insolvency procedures are not capable of adequately addressing the bank's distress while the restructuring plan allows for new bank capital by converting bank debt into capital⁸⁰⁷; viii) FINMA discloses the restructuring plan to the public; ix) the liabilities and contractual relationships and the change of debtor involved do not infringe upon the rights of the creditors⁸⁰⁸; x) any property rights held may jeopardize the restructuring plan, as denied; xi) the majority of creditors may reject the restructuring plan unless the bank has SIFI status - in which case, the creditors' rejection is inadmissible⁸⁰⁹. It should also be noted that bank restructuring within the Swiss legal framework is based on corporate governance principles⁸¹⁰. Restructuring activity must ensure that creditors take precedence over owners of the bank while at the same time generating sufficient new capital that, following restructuring, the bank meets the capital adequacy requirements. Therefore, equity capital and debt instruments that the bank has issued for such cases (additional Tier 1 or Tier 2 capital) have to be completely reduced before debt capital is converted into equity capital⁸¹¹.

In the US legal framework, the narrative section of Title II of the Dodd-Frank Act expands the scope of application of the resolution model under the Law of Federal Insurance Institution from deposit accepting (commercial) banks to systemically important financial institutions in default or in danger of default⁸¹². Under the new legal regime, bank resolution should be carried out consistently in compliance with the following three basic principles: a) creditors and shareholders bear losses of the financial company in default; b) management held responsible for the condition of the financial company are not retained; c) the FDIC and the other public authorities take all steps necessary and appropriate to assure that all parties having responsibility for the condition of the financial company bear resulting losses, consistent with their responsibility, restitution or compensation⁸¹³. A further provision lays down that taxpayers shall bear no losses from the exercise of any authority by the FDIC under the title of receiver⁸¹⁴. Authorities must address financial troubles of conventional banks being empowered by the special resolution body – FDIC. The main principle of bank resolution is so called the least-cost insured deposit method. The least cost procedures require the FDIC to choose the resolution method in which the

806 Ibid. Art. 47 (1) (a), Art. 46, 45.

807 Swiss Banking law. 31, 31(a), 31 (b).

808 Swiss Ordinance. Art. 46 (2).

809 Ibid. Art. 46.

810 Ibid. Section 3.

811 FINMA. New FINMA Banking Insolvency Ordinance. A Key element in the effective restructuring and orderly market exit of banks, 2012. P. 2-3.

812 Dodd-Frank. Section 203 (a).

813 Dodd-Frank. Section 204 (a).

814 Dodd-Frank. Section 214.

total amount of expenditure and obligation incurred by the FDIC⁸¹⁵ (including any immediate and long-term obligation and any direct or contingent liability) has the least cost to the deposit insurance fund, regardless of other factors⁸¹⁶. When taking resolution actions, the FDIC has two main options. First, to close the bank a) through the purchase and assumption transaction and bank liquidation by paying off deposits and, in both cases, winding up the legal entity; b) using the *open bank assistance*⁸¹⁷ where the State grants loans, guarantees, or capital injections to the bank⁸¹⁸. The powers granted to the FDIC as receiver under Title II of the Dodd-Frank Act are analogous to those the FDIC uses to resolve failed insured depository institutions under the FDI Act. Such powers are also considered the core bank resolution principles: (i) bank resolution is given priority over the ordinary bank liquidation procedure - which allows continuation of essential functions and maintains asset values of the bank; (ii) the ability to make advance dividends on creditor claims and prompt distributions to creditors based upon expected FDIC's recoveries in the future; (iii) the ability to continue key, systemically important operations, including through the formation of one or more bridge banks; and (iv) the ability to transfer all qualified financial contracts with a given counterparty to another entity and, thus, avoid their immediate termination and liquidation to preserve value and promote stability⁸¹⁹. Furthermore, the FDIC must always take into account its potential operational cost to the deposit insurance fund, resolution costs and the deposit insurance fund's earnings, as well as the impact on operation of the payment system, and other risk factors⁸²⁰.

2.5. Bank Resolution Tools. Analysis of the EU and the US legal frameworks

Early intervention potentially involving liquidity support, internal recapitalisation or intra-group asset transfers, withdrawal of the management body, appointment of a temporary administrator, etc. might prove insufficient to address the difficulties of a failing bank and may fail to restore a bank's solvency. Where, despite the failure of early intervention, a bank retains some franchise value, the quickest, most cost effective solution causing least threat to financial stability may be a form of special bank resolution or, as a positive law defines, bank resolution tools⁸²¹. For example, the bank is transferred to a private sector

815 The law provides one exception, in the case it is concluded that systemic problems may arise that also affect other financial market participants. Such findings require the approval of 2/3 of the FDIC Board of Directors, members of the Federal Reserve Board and the Treasury Secretariat, after consultation with the President of the United States. FDIA Act. 13 (c) (4) (A) A Section. Codified 12 U.S.C. 1823 (c) (4) (A).

816 The difference in the accounting of the bank's assets and liabilities, the level of guaranteed and unsecured deposits, the contributions paid by the buyer, losses on creditors' claims, property value, if the assets are liquidated through the ordinary bankruptcy procedure, and the guarantees provided by the bank. Sale of business tool enables depositors to maintain access to their funds. FDIC. Overview of the resolution Process. Chapter 2. Least Cost Analysis. P. 60.[interactive] [accessed on 13-12-2014]. <<https://www.fdic.gov/bank/historical/managing/history1-02.pdf>>.

817 FDIA. Section 13 (c).

818 FDIA. Section 9.

819 FSB. Thematic review on resolution regimes. Peer review Report. 2013. P. 46.

820 FDIA. Sec. 7 (2). Codified 12 U.S.C. 1816.

821 Fonteyne W., Bossu W., Cortavarrial-Checkley L. *Supra* note 453. P. 44.

purchaser by means of a purchase and assumption transaction or a bridge bank tool. Such private sector solutions allow competent authorities to isolate and preserve those more valuable assets and protect liabilities of the bank which are to be saved or mandatorily saved, leaving behind impaired assets and unsecured creditors in the bank to be placed into ordinary insolvency procedures. Bank resolution tools should be applied to achieve resolution in line with the objectives and principles set for the national framework. In addition, before taking a decision on resolution or approving the resolution scheme, a competent authority shall take into account other factors that might affect the entire bank resolution procedure, in particular, assets and liabilities of the bank under resolution, as assessed by the valuation of property. Second, liquidity of the bank under resolution. Third, market value of the bank's franchise, with regard to competitive and economic conditions in a given market. Fourth, the time factor. Bank resolution tools can be applied individually or in a combination, with the exception of the asset separation tool, to be used in conjunction with other resolution tool only. Where a bank business is sold or a bridge bank is established, the resolution is aimed at a partial purchase and assumption, while the remaining part of the bank, in which the purchase and assumption transaction was conducted, is liquidated by initiating ordinary bankruptcy proceedings.

Bank resolution is a complicated legal procedure. It requires a financial and legal infrastructure. For example, a bank's functions and some of its contractual relations, facilities, and human resources (employment contracts) are subject to separation and transfer, irrespective of their belonging to a legal entity of a bank or a banking pool. Further, a situation may force regulators to ex post legally and functionally separate some critical business lines (e.g., loans). To properly carry out such actions, competent authorities should assume responsibility for review and assessment of business models in banks operating within their jurisdiction, a structure of the banks or the banking pool, as well as the resistance of resolution tools to the banking crisis. In order to minimize rescue of the failing bank by using public finances, costs and alternative exposure to the financial contagion are to be diminished.

2.5.1. The Sale of Bank Business

In the normal merger-acquisition market environment, a healthy, private-sector financial institution having no financial trouble and with regard to the nature of the sale of business tool purchases all or part of assets and/or part of the business of a failing bank, as well as the rights and, thus, assumes all or part of the liabilities of the failing bank, in particular, its insured deposits. Otherwise, the transfer of the bank's assets may assume the transfer of both shares and other equities to another solvent financial institution. The essence of this resolution tool is a merger of a failing bank with a purchasing bank, in parts or as a whole. One of the key requirements herein is that the transaction should not give rise to competition law infringement⁸²². Through the business sale transaction, competent resolutions authorities are able to isolate and preserve more valuable assets and protect liabilities of the bank; as shareholders, unsecured creditors are uninsured depositors and retain their rights in the part of the bank to be sold. The transferred part of the

822 Ibid. P. 61.

failing bank continues as a going concern but thenceforth is owned by another legal entity. A purchaser may demand any rights of the insolvent bank, including rights of membership and access to payment, clearing and settlement systems, stock exchanges, and deposit guarantee schemes. It is also important that the competent authorities have the power to force the sale of a distressed bank, otherwise the bank's shareholders could oppose such a transaction. This is a key difference from ordinary insolvency procedures, under which shareholders can still influence the manner of resolution of a firm⁸²³. When exercising the sale of business tools, a purchasing bank accepts not only all the assets and liabilities of a failing bank, but also becomes the owner of the legal entity.

2.5.1.1. The EU Regulatory Framework

Perhaps the most important feature under the EU legal framework is that the sale of business tool can be applied without obtaining the consent of shareholders of a failing bank or any third party other than a purchaser, and without complying with any procedural requirements under company or securities law, with the exception of the requirements laid down below⁸²⁴. Meanwhile, a failing bank's assets that have no market demand are liquidated under normal insolvency procedures, unless it jeopardises financial stability. Under this legal tool, instruments of ownership, issued by a bank under resolution or all of a part of assets, rights and liabilities of a bank under resolution are transferred (sold) to a purchaser that is not a bridge bank⁸²⁵. When applying the sale of business tool, the resolution authority may exercise the transfer power more than once in order to make supplemental transfers of shares or other instruments of ownership issued by a bank under resolution or, as the case may be, assets, rights or liabilities of the bank under resolution⁸²⁶. When the above tool is applied, the decision on resolution sets out the assets, rights, liabilities or shares or other instruments of ownership to be transferred, as well as commercial terms having regard to the circumstances and the costs and expenses incurred in the resolution process, pursuant to which the national resolution authority shall make the transfer. As well, following an application of the sale of business tool, resolution authorities may, with the consent of the purchaser, exercise the transfer powers in respect of assets, rights or liabilities transferred to the purchaser in order to transfer the assets, rights or liabilities back to the bank under resolution, or the shares or other instruments of ownership back to their original owners, and the bank under resolution or original owners shall be obliged to take back any such assets, rights or liabilities, or shares or other instruments of ownership⁸²⁷. Any consideration paid by the purchaser shall benefit i) owners of shares or other instruments of ownership, where the sale of business has been effected by transferring shares or instruments of ownership issued by the bank under resolution from holders of those shares or instruments to the purchaser; ii) the bank under resolution, where the sale of business has been effected

823 Marinč M., Vlahu R. *Supra* note 76. P. 44.

824 BRRD. Art. 38 (1) (b).

825 SRM. Art. 24 (1) (a) (b).

826 BRRD. Art. 38 (5).

827 BRRD. Art. 38 (6).

by transferring some or all of assets or liabilities of the bank under resolution to the purchaser⁸²⁸.

Thus, the sale of business tool means a transfer by a resolution authority of instruments of ownership issued by an institution under resolution, or its assets, rights or liabilities to a purchaser. In all cases, the transaction must comply with the procedure of resolution, banks, marketing of assets, rights, and liabilities established by EU Member States' national resolution authorities. In addition, the sale of business shall be carried out in accordance with the following procedural requirements. Primarily, it shall be as transparent as possible and shall not materially misrepresent the assets, rights, liabilities, shares or other instruments of ownership of that bank that the authority intends to transfer, having regard to the circumstances and in particular the need to maintain financial stability. Second, it shall not unduly favor or discriminate between potential purchasers⁸²⁹. The resolution authority shall not be prevented from soliciting particular potential purchasers. However, the exception provides that in order to preserve the stability of the financial system, an issuer that is a credit institution or a financial institution, may, on its own responsibility, delay the public disclosure of inside information, including information which is related to a temporary liquidity problem and, in particular, the need to receive temporary liquidity assistance from a central bank or lender of last resort, provided that all of the following conditions are met : a) immediate disclosure is likely to prejudice the legitimate interests of the issuer and of the financial system; b) the public interest requires to delay the disclosure of inside information provided; c) the confidentiality of that information can be ensured . d) the competent authority has consented to the delay⁸³⁰. An issuer or an emission allowance market participant, may, on its own responsibility, delay disclosure to the public if a) immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant; b) delay of disclosure is not likely to mislead the public; c) the issuer or emission allowance market participant is able to ensure the confidentiality of that information⁸³¹.

It should be emphasized that the EU legal framework provides for an exception where the public authority – the resolution board – may apply the sale of business tool without complying with the marketing requirements when it determines that compliance with those requirements would be likely to undermine one or more of the resolution objectives and in particular where the following conditions are met: i) The Board considers that there is a material threat to financial stability arising from or aggravated by the failure or likely failure of the bank under resolution; ii) The Board considers that compliance with those marketing requirements would be likely to undermine the effectiveness of the sale of business tool in addressing that threat or to avoid significant adverse effects on financial stability of the entire EU or relevant Member States, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline⁸³². Third, conflicts of interest must be avoided in all cases. Fourth, it shall not confer any

828 Ibid. Art. 38 (4).

829 Ibid. Art. 39 (2) (f).

830 Regulation (EU) No. 596/2014. Art. 17 (4) (5).

831 Ibid. Art 17(1), (4) (5).

832 SRM. Art. 24 (3).

unfair advantage on a potential purchaser. Fifth, when applying the sale of business tool, the need for resolution actions to the greatest extent possible must be considered⁸³³. Sixth, the sale of bank business tool is aimed to maximise, as far as possible, the sale price of the shares or other instruments of ownership, assets, rights, and liabilities. Eventually, it must be established whether the compliance with the marketing requirements by the national resolution authority is likely to undermine one or more resolution objectives⁸³⁴.

In summary, it is important to note that the major advantage of the sale of business tool according to the EU regulation is that it enables public authorities to effect a sale of a bank or parts of its business to one or more purchasers without the consent of shareholders. When applying the sale of business tool, authorities should make arrangements for the marketing of that bank or part of its business in an open, transparent and non-discriminatory process, while aiming to maximise, as far as possible, the sale price, and not to confer any advantage on a potential purchaser, and avoid any conflict of interest. If possible, a transfer must be made on commercial terms, based on fair and realistic valuation of the assets carried out by an independent third party. If the assets do not cover all transferable obligations, the purchasing bank acquires the compensation to the extent of the price shortage. Compensation consists of DGS payments to the extent that the transfer comprises insured deposits⁸³⁵. Financing is compensated from the resolution fund which is sufficient to complement DGS payments to the extent that other rights of creditors are transferred by insufficiently covered assets. Moreover, a situation may arise, depending on pre-financing, where such payments may cause a deficit in DGS and resolution funds, such a lack, therefore, should be temporarily offset by using public finances. This case may require borrowing from the money market for compensation payments. One of the points of criticism is that the legal framework does not strictly require an auction to be held for potential purchasers – on the contrary, the resolution authorities may propose a potential purchaser of their choice⁸³⁶. On the other hand, shareholders' and creditors' rights are protected based on the 'no creditor disadvantaged' principle. Shareholders and

833 Kkkoris I. *Supra* note 726. P. 259.

834 SRM. Art. 24 (e).

835 Sale of business tool enables depositors to maintain access to their funds.

836 In the US, the FDIC creates a virtual data room for each failing bank, dedicated to the market and potential buyers. This allows access to the distressed bank's financial data, legal documents, information on the legal verification procedures, possible bidding procedures, descriptions of potential resolution transactions that are offered by the competent authorities. After creating a virtual data room, the FDIC sends an e-mail invitation to potential buyers interested in the failing bank, together with the electronic system access data. Before that, the potential buyers sign confidentiality agreements with the FDIC. Access is granted 24 hours a day, seven days a week, thereby providing an opportunity for potential buyers to make a proper assessment of the financial situation of a failing bank before supplying the commercial proposal. Proposals shall be submitted to the FDIC by the appointed deadline, usually in one or two weeks. Proposals will be evaluated by comparing them with the potential liquidation costs. The price usually consists of two terms: the amount of the franchise value (e.g., the price is proposed only for insured deposits, or for all deposits), and the price for failing bank assets, estimated at current market conditions. In addition, by offering their price, purchasers can also take advantage of the value increase tool, which basically means that this tool can guarantee to the FDIC that particular interests will be secured by the buyer's shares at a specific price and at a specific time. FDIC. Resolution Handbook. Chapter 3. Resolution Process. 2014. P.12. [interactive]. [accessed on 2014-12-15] <https://www.fdic.gov/about/freedom/drr_handbook.pdf#page=13>.

creditors whose interests are not transferred (written down or converted) should receive at least the same treatment they would have received if the bank had been wound up under normal insolvency proceedings immediately prior to the transfer (or write down and conversion)⁸³⁷. If it is determined that shareholders and creditors have received inferior treatment, they should be entitled to compensation of that difference to be paid by the resolution authority⁸³⁸. In order to determine the amount of compensation to which the shareholders and creditors are entitled, a secondary independent valuation of the assets must be carried out⁸³⁹.

2.5.1.2. The US Regulatory Framework

The sale of business tool has been particularly helpful and effective in handling bank failures in the US⁸⁴⁰. When the FDIC is appointed as the receiver of a failing bank, an institution may use the purchase and assumption transaction to transfer part or all of the assets of the failing bank to a healthy financial institution, at the same time, selecting all or part of the bank's liabilities. In light of the fact that insured and uninsured depositors have priority over unsecured creditors, the FDIC usually switches places with insured depositors (subrogation) to become the largest creditor of the bank, while unsecured creditors assume greater losses⁸⁴¹. This legal regulation allows for a situation where deposits and current account holders are transferred to the purchaser. The main difference is that secured depositors and DGS share uninsured deposits on a *pari passu* basis. According to the 'no creditor disadvantaged' principle, which is mandatory for the FDIC, general unsecured creditors may demand substantial compensation from resolution authorities, which, consequently, could significantly increase the cost of the bank resolution. Besides, the required additional valuation inevitably slows down the resolution process. Partial transfers of mostly small and medium sized banks' assets to a private sector purchaser (or a bridge bank) were conducted effectively in United States⁸⁴². In contrast, large and complex banks found it difficult to apply the resolution tool due to the constraints of legal and operational structures. Core bank functions, such as risk management, IT, treasury and cash management could be centralised or arranged through different business functions, in view of the possibility of taxation and arbitration. Separation of the above functions, as well as preservation of their effectiveness, is legally complicated and time-consuming. This problem is believed to be solvable, first of all, through ex ante proper planning of bank recovery and resolution. It should be noted that the US legal framework requires the written approval of a competent authority (Comptroller of the Currency, Board of Governors of the Federal Reserve System, or FDIC) to apply the sale of bank business tool⁸⁴³. Notice

837 BRRD. Art. 65.

838 Ibid. Art. 67.

839 Ibid. Art. 95.

840 Zwet A. Crisis Management Tools in the EU: What Do We Really Need? DNB Occasional Studies. Vol. 9, No. 2, 12-18, 2011. P. 10-11. FDIC. Merger Transactions. Decisions on Bank Application [interactive]. [accessed on 2014-12-15] <<https://www.fdic.gov/regulations/laws/bankdecisions/Merger/>>.

841 Hynes R., Walt S. Why Banks are Not Allowed in Bankruptcy. *Supra* note 11.

842 Zwet A. *Supra* note 856. P. 2.

843 FDIC. 18 Section (F) (c) (2).

of the application of the sale of business tool must be published prior to the granting of official approval⁸⁴⁴. The FDIC shall not approve the sale of bank business tool, if i) any proposed bank merger transaction would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or ii) may substantially reduce competition, or tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of meeting the convenience and needs of the community; iii) in every case, the responsible authority shall take into consideration financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and risk to the stability of the US banking or financial system⁸⁴⁵.

The importance of the sale of bank business tool to the bank restructuring procedure within the US legal framework has been accurately identified in the U.S. Supreme Court's case: '*United States v General Dynamics Corp*'⁸⁴⁶. The court ruled there that management, shareholders, and creditors were benefiting from the applying the sale of business tool in respect of the bank which was facing financial difficulties. As the Court has stated, it is unlikely that shareholders might lose their investment as a result of applying this bank resolution tool, on the contrary, they are more likely to gain in case the sale of the bank is commercially profitable. Creditors would also benefit without losing their rights to the debtor (the bank) in case of sale, and it is more likely that they will be rewarded and repaid their portion of the loan granted to the bank. By contrast, creditors' claims are unlikely to be fully satisfied in the case of liquidation.

2.5.1.3. Criteria and Principles of the Sale of Business Tool in the EU and US Case-Law

It is important to identify criteria for effective bank resolution. Legal frameworks in both U.S. and the EU have highly developed criteria for assessing the potential of the tool by a failing bank⁸⁴⁷.

First of all, it is necessary to consider *the general criteria*. Competent public authorities play a crucial role in bank sales. They are responsible for identifying and establishing whether a bank merger will negatively impact competition. In such cases, the authorities must prohibit such transitions, which effectively means failure of the bank resolution⁸⁴⁸. National market economies with a competitive banking sector must follow the key business sale criteria, and when applying the resolution tool should take into account any co-benefit resulting in increased effectiveness of the bank's operational capacities, focus-

844 FDIC. 18 Section (F) (c) (3).

845 Ibid.

846 *United States v. General Dynamics Corp* 415 U.S.486. 1974.

847 See more Olivares C. *Expedited Corporate Debt Restructuring: An International Comparative Analysis*. The Hague. Kluwer Law. 2007. Chapter Implications of Merger Legislation for corporate Restructuring Procedures.

848 Kkkoris I. *Failing Firm Defence: a Success or Failure for Corporate Restructuring?* International Corporate Rescue, 2007. P. 149.

ing the business capabilities on business entities with a socially higher added value, preservation of jobs, and sale of the distressed bank's loan commitments to a healthy bank. *Economic criteria* are also no less important: - greater economies of scope and scale and positive social consequences⁸⁴⁹. Furthermore, it should also be assessed whether the failing bank should be sold in the near future, or forced out of the market because of financial difficulties if not taken over by another financial enterprise. In the absence of a merger and sale of business tool, the bank, along with its assets, would inevitably exit the market. Another criteria is that the failing bank should be *de facto* insolvent or become insolvent in the near future, rather than just have temporary financial difficulties⁸⁵⁰. Economic and social effects must also be considered prior to the transaction. The extent of social costs and benefits of the bank failure are difficult to identify, however, it is important to assess the potential burden in the context of higher prices (for example, reduced fixed costs of the bank) or lost benefits of consumers, as well as potential losses to employees, the community, which encompasses the bank's assets⁸⁵¹.

In the EU legal framework, the criteria for the sale of bank business has been revised in three manners: through issuing interpretative guidelines⁸⁵², by case law⁸⁵³ and by developing Banking Union legislation⁸⁵⁴. In scientific literature, a comprehensive description of the EU model of sale of a banking business is found in the work by *Fiordes F*⁸⁵⁵. The author believes that the most important criteria is to determine whether a causal link between a bank merger and any potential impact on competition structure can be established. It is of high importance to ensure the procedural rights and the right of defence of a failing bank. Thus, in all cases, the comparative analysis of the opposite situation is necessary to look at the failing bank's right of defence in the competitive environment and the conditions that may become a reason for prohibiting bank mergers⁸⁵⁶. European guidelines consider the following three criteria to be relevant for the application of sale of a business tool: i) the allegedly failing bank would in the near future be forced out of the market because of financial difficulties if not taken over by another financial undertaking; ii) there is no alternative purchase which would have a lesser impact on competition than the sale of the business tool. For example, there may be a situation where the purchaser is interested in purchasing failing bank's assets only after the bank exits the market (under the insolvency procedure). The bank's withdrawal from the market may also provide new opportunities for a new legal entity to enter the market. Or a competitive environment may benefit more if several purchasers acquire the bank's assets rather than a single purchaser acquires all

849 Ibid.

850 Kkkoris I. *Supra* note 726. P. 239.

851 Ibid.

852 Guidelines on the assesment of horizontal mergers under the Council regulation on the control of concentrations between undertakings. Official Journal C31, 2004. P. 5-18. EC. Directorate General for Competition. OECD Competition Committee Meeting. Roundtable on Failing Firm Defence Note by the services of the European Commission Directorate-General for Competition, 2009.

853 *Kali v. Salz/MdK/Treuhand Case IV/M308* [1994]. *France v. Commission, Societe Commerciale es Potasses et de l'Azore (SCPA) v Commision Cases No. C-68/94 and No. C-30/95* [1998] ECR- I-1375.

854 See more 1 chapter 5 sec. 2 subsec.

855 *Fiordes F. Mergers and Acquisitions in European Banking*. Palgrave Macmillan. Great Britain, 2009.

856 Ibid.

assets of the bank; iii) what would happen in the absence of the purchase and assumption merger and if the assets of the failing bank inevitably exit the market. Where a failing bank's right of defence is assured, the merger is believed not to entail major legal barriers to the effective competitive environment⁸⁵⁷.

EU case law demonstrates the development of criteria in detail. In particular, it should be noted that the burden of proof with regard to the transaction's suitability lies with the parties concerned. For example, in the case *Kali & Salz/MdK/Treuhand*⁸⁵⁸, the Court has noted that a failing bank's right to a fair hearing through the sale of business tool is an exceptional situation. The most important thing that must be considered is whether the sale of the bank business might lead to a strengthening of a dominant position. The tool can be regarded as creating a dominant position in the market even in the event of the merger being prohibited, if the purchaser will inevitably create or strengthen a dominant position. Existence of a causal link between the concentration and the deterioration of competition is excluded if i) the acquired bank will in the near future be forced out of the market or purchased by another firm; ii) the acquiring bank would gain the market share of the acquired bank if it was forced out of the market; iii) there are no better -competitive alternatives to the sale of business.

In another case, *BASF, Eurodil v. Pantochim*⁸⁵⁹, the Court set out the following criteria. According to the Court of Justice, existence of a causal link between the concentration and the deterioration of the competitive structure of the market can be excluded if a bank merger could be regarded as a rescue measure and only if the competitive structure resulting from the concentration is expected to deteriorate similarly⁸⁶⁰. The condition under this case that there is no anti-competitive alternative purchase is interpreted as the requirement not to gain a larger market share. It should be established whether assets of the acquired bank are likely to be forced to inevitably exit the market upon liquidation under the normal bankruptcy procedure. Furthermore, a basic rule sets out that, in view of a merger, where one of the parties is a failing bank, the sale of business tool should not be regarded as an ordinary acquisition-merger, which excluded the failing bank. Another point is that if competent authorities reject a bank merger as a potential bank resolution method, it should be evaluated whether the liquidation of the bank would not cause significant harm to competition compared with the potential outcome of applying the sale of bank business tool⁸⁶¹. When determining whether there are alternative purchasers, good faith efforts in searching for other purchasers should be taken into account. It imposes an obligation to the failing bank to elicit alternative offers in the market. This would help to keep the failing bank in the market by causing the least possible harm to the competitive environment. The Bank is still forced to look for alternatives and bona fide commercial offers. This is a kind of protection against further losses in the competitive environment. However, it is too early to make assumptions that the offer of one of the potential purchasers is better for

857 Ibid. 90 para.

858 *Kali v. Salz/MdK/Treuhand*. Case No. IV/M308, OJ L186/30 [1994].

859 *BASF v. Eurodiol/Pantochim*. Case No. M.2314, [2001].

860 *Newscorp v. Telepiu*. Case No. COMP/M. 2876, OJ L110/73 [2004], 207 para.

861 Ibid. 212 para.

being based on the future price premiums (payments for the expected benefits or gains) arising from the transaction or on the market power after effecting the transaction.

US case law puts much emphasis on *interpretation of terms and content of alternative purchase of bank business or part of it*. One of the key cases is *Citizen Publishing Co v. United States*.⁸⁶² According to the Court, in view of the benefits of the sale of bank business tool without prejudice to the principle of effective judicial protection, it is obvious that the right to a fair hearing should have priority over the interests' of other market participants. For example, market participants may simply seek a higher income stream, and sources of revenue, with no intention to act as potential competitors in banking activities in the implementation of long-term investment plans. Further, the court points out that during a financial crisis, with the lack of available capital in the market, it may be difficult enough to find an alternative purchaser – as a result, the lack of capital might hamper the entry of new “market players”. In this case, it is likely that the purchasers will fail to raise the adequate level of capital to purchase a failing bank. Thus, in the long-standing practice of the US it has been established that competent authorities should not expect a large number of potential alternative purchasers. Priority should be given to a less anti-competitive purchaser with lower liquidity shortage. A failing bank's rights of defence should be regarded in conjunction with other relevant criteria, such as social and public policy (related to the protection of private parties, e.g., in assessing whether creditors would benefit from reserving their rights against the debtor and commitments satisfied, the shareholders would retain their investment, which is likely if the merger is profitable) and labour relations (potential job losses). These aspects may influence the assessment of the sale of bank transaction as a whole, therefore, competent authorities must take into account the above aspects., when applying this resolution tool.

Another distinctive feature are the concepts “failing”, “quasi-failing” and “weak competitor”, which have been formed in US case law⁸⁶³. The Court has identified that the bank merger causes fewer problems than the overall market share of the acquiring bank. The term “weak competitor” derives from the fact that the entity wishing to acquire the bank finds it difficult to borrow capital. In this case, the Court has supported the sale of the bank business, even though the acquiring company lacked the sufficient reserves necessary to compete effectively in the industry. The US Supreme Court rejected the argument of the affected banking industry and stressed the importance of considering all the relevant factors, particularly, in cases where the relevant markets or industries had a fluctuating and dynamic nature. It was noted that the US Competition Authority might also consider and assess the banking industry upon effecting the transaction, as one of the likely arguments for supporting or rejecting the sale of a bank business. The challenging financial status of the industry may result in increased restrictions on market entry and, thus, make it much harder to obtain approval for the transaction. Nevertheless, Competition Authorities are obliged to consider the impact of economic conditions and purchasers' ability to raise capital and make investments that are necessary to become an efficient competitor. Government is willing to support transactions on the sale of bank business, especially, during a banking crisis. For example, in US, the Bank of America acquired the investment bank

862 *Citizen Publishing Co v. United States*. Case No. 243, 394 U.S. 131, [1969]

863 *United States v General Dynamics Corp*. Case No. 85-1385, 481 U.S. 239, [1974]

Merrill Lynch – a leader in national retail banking. This transaction entered into force on 15 September 2008, soon after the commencement of Lehman Brothers bankruptcy procedure under Section 11 of the Bankruptcy Code (ordinary bankruptcy procedure). The transaction value – USD 50 billion. The bank's business was sold primarily due to the fact that *Merril Lynch's* had bad assets worth several billion USD. The purchase was approved by the Treasury Department and the Federal Reserve of the US, which did not allow for due diligence in full by reason of effects of the financial crisis, and the transaction was immediate. The size of bad assets was unknown upon effecting the transaction. At the end of the first quarter of 2009, the US government injected capital amounting to USD 45 billion, alongside granting a loan to the Bank of America, which was purchasing additional capital. In this case, the sale of business tool was aimed at mitigating effects of some bad asset write-offs resulting from the decline of stock market value. Moreover, as the purchasing bank still had to prove that it could retain its solvency following the transaction, the immediate execution of the transaction could interfere with the financial strategy of the Bank of America for many years. This transaction has set out the following criteria to be taken into account: the size of the industry and the scope of the transaction and which is best evidenced through price-earnings ratio, accounting, cash flow, cost-income ratio, and a maximum selling price analysis⁸⁶⁴.

2.5.2. The Bridge Bank

In the absence of private sector purchasers, competent authorities may apply the bridge bank resolution tool in respect of a failing bank. It is important to note that the bridge bank is an auxiliary interim solution for banks, which is operated in a conservative manner, where a market shows neither interest nor demand for a bank's assets or business. This tool postpones the immediate liquidation of the bank for a period of time. If it is not possible to sell the bridge bank through the bank acquisition-merger transaction, i.e., the banking consolidation (within a reasonable period of time) or to apply any other bank resolution tool more suitable for particular circumstances, competent authorities must terminate the bank's operations, revoke its operating license, and liquidate the bank business⁸⁶⁵. When applying the bridge bank tool, competent authorities should transfer all or part of the bank's assets, rights and liabilities on temporary grounds to a newly founded bank. In essence, a bridge bank is a legal entity owned by one or more of the public authorities and founded to take over all or some of assets, rights and liabilities of a bank under resolution, as well as to provide all or some of services of the bank under resolution and carry out all or some of its activities. The main goal of the bridge bank is to purchase the failing bank's rights, assets and liabilities and preserve its going concern value until it is sold to a private sector purchaser or is liquidated. This tool may be attractive in particular to large and complex banking organisations, especially in cases where it is difficult to find a private purchaser within a short period of time⁸⁶⁶.

864 DePamphilis D.M. *Mergers, Acquisitions, and other Restructuring Activities*. Sixth Edition. Elsevier, United States, 2012. P. 169-171.

865 Haentjens M., Wessels B. *Supra* note 92. P. 62.

866 Čihak M., Nier E. *Supra* note 15. P. 16.

2.5.2.1. The EU Regulatory Framework

A systematic analysis of EU regulation⁸⁶⁷, first of all draws attention to the fact that a bridge bank is a legal entity that meets basic requirements for bank establishment and operation. The requirements state that a legal entity is one that is wholly or partially owned by one or more of the public authorities, which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority. Such tool is needed, in particular, when the purchase-acquisition market is not functioning or a bank is too large to be merged with another bank, and, therefore, it is not possible to sell the failing bank within a short timeframe. The EU legal framework specifies, that it is created for the primary purpose of receiving and holding some or all of the shares or other instruments of ownership issued by a bank under resolution or some or all of the assets, rights and liabilities of one or more banks under resolution. Therefore, legislation of the Banking Union shall ensure that resolution authorities have the power to transfer to a bridge bank shares or other instruments of ownership issued by one or more banks under resolution, all or any assets, rights or liabilities of one or more banks under resolution. The transfer referred may take place without obtaining the consent of shareholders of the banks under resolution or any third party, and without complying with any procedural requirements under company or securities law⁸⁶⁸. The core principle is that when applying the bridge bank tool, the resolution authority should ensure that the total value of liabilities transferred to the bridge bank does not exceed the total value of the rights and assets transferred from the bank under resolution or provided by other sources⁸⁶⁹.

The question arises: how does the bridge bank tool work? Following an application of this tool, the resolution authority may transfer rights, assets or liabilities back from the bridge bank to the bank under resolution, or the shares or other instruments of ownership back to their original owners, and the bank under resolution or its original owners shall be obliged to take back any such assets, rights or liabilities, or shares or other instruments of ownership. Resolution authorities may take such actions if the possibility that the specific shares or other instruments of ownership, assets, rights or liabilities might be transferred back is stated expressly in the instrument by which the transfer was made and the specific shares or other instruments of ownership, assets, rights or liabilities do not in fact fall within the classes of, or meet the conditions for, transfer of shares or other instruments of ownership, assets, rights or liabilities specified in the instrument by which the transfer was made⁸⁷⁰. The bridge bank may continue to exercise the rights of membership and access to payment, clearing and settlement systems, stock exchanges, investor compensation schemes and deposit guarantee schemes of the bank under resolution, provided that it meets the membership and participation criteria for participation in such systems⁸⁷¹. In cases when the resolution authority seeks to sell the bridge bank or its assets, rights or liabilities, it shall be ensured that the bridge bank or the relevant assets or liabilities are marketed openly and transparently, and that the sale does not materially misrepresent

867 Bridge bank provisions found in both the BRRD and the SRM.

868 BRRD. Art. 40 (1).

869 Ibid. Art. 40 (3).

870 Ibid. Art. 40 (7) (a), (b).

871 Ibid. Art. 40 (10).

them or unduly favor or discriminate between potential purchasers⁸⁷². Any such sale is made on commercial terms⁸⁷³.

It should be ensured that the operation of the bridge bank meets the following requirements. The contents of the bridge bank's constitutional documents are approved by the resolution authority which appoints the bridge bank's management body, the remuneration of the members of the management body and determines their appropriate responsibilities. Further, the resolution authority approves the strategy and risk profile of the bridge bank. The bridge bank must be authorised (obtain a license) to carry out the activities or services. Accordingly, the bridge bank should comply with the requirements of and is subject to supervision in accordance with the EU State aid framework⁸⁷⁴. Notwithstanding the above provisions and where necessary to meet the resolution objectives, the bridge bank may be established and authorised without complying with Directive 2013/36/EU or Directive 2014/65/EU for a short period of time at the beginning of its operation. To that end, the resolution authority shall submit a request in that sense to the competent authority. If the competent authority decides to grant such an authorisation, it shall indicate the period for which the bridge bank is waived from complying with the requirements. Subject to any restrictions, the management of the bridge bank shall operate the bridge bank with a view to maintaining access to critical functions and to selling the bank, its assets, rights or liabilities, to one or more of the private sector purchasers when conditions are appropriate and within the set period.

The bridge bank terminates its activities in the following cases: i) the bridge bank merges with another entity; ii) the bridge institution ceases to meet the requirements of a legal entity; iii) the sale of all or substantially all of the bridge bank's assets, rights or liabilities to a third party; iv) the expiry of a period of two years after the date on which the last transfer from a bank under resolution pursuant to the bridge bank tool was made⁸⁷⁵. The resolution authority may extend this period for up to one year. Where the operations of a bridge bank are terminated, the bridge bank is wound up under normal insolvency proceedings. Any proceeds generated as a result of the termination of the operation of the bridge bank shall benefit the shareholders of the bridge bank.

In summary, the EU legal framework shall ensure that a bridge bank exercises all the rights transferred to it from a failing bank, including the rights of membership and access to payment, clearing and settlement systems, stock exchanges, and deposit guarantee schemes. The transfer of such assets may take place without obtaining the consent of the shareholders of the bank under resolution or any third party and without complying with any procedural requirements under company or securities law that would otherwise be applicable. The bridge institution's assets are completely wound down and its liabilities are completely discharged. Shareholders and creditors, whose claims are not transferred, have no right to the residual value of the bank's assets resulting from the disposal of the sold assets of the bridge bank. Furthermore, it should be noted that the setting up of a bridge bank and the capitalisation may impose additional administrative costs to the resolution

872 Ibid. Art. 41(4).

873 Ibid. Art. 35 (4).

874 Ibid. Art. 41 (1).

875 Ibid. Art. 41 (3).

institution, including wages to senior management and other staff. Public authorities may incur ex post losses in two cases: 1) if a bridge bank can be sold to a private sector purchaser only at a price lower than original cost of capitalisation; 2) if liquidation procedures do not cover the cost of capitalisation in full. When applying the bridge bank tool, the resolution authorities shall transfer all or part of the bank's business to a state-controlled entity. The bridge bank must be authorised, meet capital needs, and operate on commercial terms, subject to restrictions imposed in accordance with the state aid framework. Activities of a bridge institution are of a temporary nature, and the main purpose is to sell the business to the private sector under appropriate market conditions. Meaning, the efficient implementation of the mechanism is highly dependent on the capacity of the bridge bank to operate profitably within a reasonable time period. Otherwise, a valid question arises whether a purchaser would ever enter the market willing to purchase a bridge bank.

2.5.2.2. The US Regulatory Framework

In the U.S. legal framework, two temporary and correlated bank resolution tools exist: establishment of a de novo depository national bank and a bridge bank.

As soon as possible after the default of a bank, the FDIC should, if it finds that it is appropriate and in the interest of the insured depositors, organise a new national bank in the same community as the bank in default was located. The purpose of such a bank resolution process is to assume the insured deposits of such bank in default to perform temporarily the functions hereinafter provided⁸⁷⁶. The law prescribes that no capital stock need be paid in by the FDIC to the new bank, however, the FDIC is the only source of funding, and basic requirements for the authorisation (license) to carry out activities are set out at the FDIC's discretion. Further, the new bank should not have a board of directors, but should be managed by an executive officer appointed by the Board of Directors of the FDIC, who should be subject to its directions. In all other respects the new bank should be organised in accordance with the current existing provisions of law relating to the organisation of national banking associations⁸⁷⁷. It is important to note that the new bank shall be exempt from all taxation imposed now or hereafter. The FDIC should make available to the new bank an amount equal to the estimated insured deposits of such insured bank in default plus the estimated amount of the operating expenses of the new bank relating to the transfer of deposits⁸⁷⁸. All the earnings of the new bank should be transferred over or credited to the FDIC. If the new bank, during the period it continues its status as such, sustains any losses which may lead to insolvency, the FDIC should furnish to it additional funds in the amount of such losses⁸⁷⁹. Besides, the FDIC should assure funding for payment of the insured deposits. Another important aspect is the issue and redemption of the new bank's stock. Whenever by the judgment of the Board of Directors it is desirable to do so, the FDIC should cause capital stock of the new bank to be offered for sale on such terms and conditions as the Board of Directors shall deem advisable in an amount sufficient, in the

876 FDIA. Sec. 11 (m) (1).

877 Ibid. Sec 11 (m) (3) (4) (5).

878 Ibid Sec 11 (m) (11).

879 Ibid Sec 11 (m) (12) (13).

opinion of the Board of Directors, to make possible the conduct of the business of the new depository institution on a sound basis⁸⁸⁰. The stockholders of the bank should be given the first opportunity to purchase any shares of common stock so offered⁸⁸¹. At the next stage of the legislative procedure, upon proof that an adequate amount of capital stock in the new bank has been acquired, the *U.S. Comptroller of the Currency* may require the organization certificate to be obtained by the bank to conform to the requirements for the organisation of national banks. Thereupon the bank should cease to have the status of a new bank, and should be managed by directors elected by its own shareholders, and should be subject to all provisions of law relating to national banks⁸⁸². If the capital stock of the new bank is not offered for sale, or if an adequate amount of capital is not subscribed and paid for by the shareholders, the Board of Directors of the FDIC might offer to transfer its business to any depository institution in the same community. Such financial institution would take over assets of the new bank, assume its liabilities, and pay to the FDIC for such business such amount as the Board of Directors of the FDIC may deem adequate. Eventually, unless the capital stock of the new bank is sold or its assets are taken over and its liabilities are assumed by another insured bank within 2 years after the date of its organisation, the FDIC shall wind up such a new bank. Thereafter, the FDIC should be liable for the obligations of such a new bank and should be the owner of its assets⁸⁸³.

One of the legal means to mitigate default of a bank is a bridge bank⁸⁸⁴. The FDIC has been applying this legal tool since 1991⁸⁸⁵. The main purpose of a bridge bank is to take over and maintain banking services to the customers of a failed bank⁸⁸⁶. Its legal regulation and procedure are designed to “bridge” the temporary gap between the failure of a bank and the time when the FDIC can implement a satisfactory and effective purchase and assumption by a third party. An important aspect of the bridge bank tool applied by the FDIC is that the creation of the bridge bank allows the FDIC to take control of the failing bank and stabilize it in the market, to monitor the bank’s franchise value, and to evaluate alternate forms of bank resolution⁸⁸⁷. Additional time also allows for due diligence of the failing bank by potential purchasers. Furthermore, after a bridge bank is established, assurance is provided to depositors that their money is safe, and potential purchasers are given time for a thorough assessment of the failing bank’s condition in a more stable environment. In the case of multiple bank failures, a bridge bank can facilitate the handling of multiple failures in a short time⁸⁸⁸.

880 Ibid Sec 11 (m) (15).

881 Ibid. Sec 11 (m) (15) (b).

882 Ibid. Sec 11 (m) (16).

883 Ibid. Sec 11 (m) (17) (18).

884 Ibid. Sec. 11 (n).

885 FDIC. Chapter 6. Bridge Banks. P.171-175. [interactive]. [accessed on 2014-12-15] <<https://www.fdic.gov/bank/historical/managing/history1-06.pdf>>.

886 FDIA. Sec.11 (n). Managing the Crisis. FDIC History. Chapter 6. [interactive]. [accessed on 2014-12-15] <<https://www.fdic.gov/bank/historical/managing/>>.

887 Ibid. 175.

888 FDIC. *Supra* note 855. P.175. [interactive]. [accessed on 2014-12-15] <<https://www.fdic.gov/bank/historical/managing/history1-06.pdf>>.

When 1 or more depository banks are in default or might default in the near future, the FDIC might, at its discretion, organise a bridge bank. A bridge bank shall have the following rights: i) to assume insured deposits of a bank that is in default or in danger of default as the FDIC may, at its discretion, determine to be appropriate; ii) to assume other liabilities (including liabilities associated with any trust businesses) of the bank; iii) to purchase assets (including assets associated with any trust businesses) of the bank; iv) to perform any other temporary functions⁸⁸⁹. A bridge bank shall have an interim board of directors consisting of not fewer than 5 and not more than 10 members appointed by the FDIC. Additionally, a chief executive officer (CEO) is selected. This might be the private sector representative or FDIC senior staff member tasked to conduct day-to-day bank operations. The interim board of the bank, along with the CEO, is responsible for developing a strategic plan for the bank to address any operational issues confronting the bank. In any case, the FDIC board retains authority to effect a final resolution of the bank and approve the sale of bank assets⁸⁹⁰. The bridge bank staff must complete an inventory to identify, evaluate, and work out troubled assets. Besides, it develops realistic market values for assets and assigns appropriate loss reserves. The bridge bank may sell transferred assets of the failing bank. For a period of up to 90 days after the bridge bank begins operations, assets that could benefit from the powers of receivership or assets that would be difficult to sell to a franchise acquirer can be transferred by the bridge bank management to the receivership. The assets transferred from the bridge bank to the receivership would be those with the most problems and the least potential for improvement, including non-performing loans⁸⁹¹. Like any other bank that has assumed deposits from the FDIC, the bridge bank must notify depositors that their accounts have been transferred to the bridge bank. In turn, depositors must contact the bank within 18 months to claim their deposits. Bridge bank management also decides whether to maintain or change the interest rates paid on deposits by the failing bank. The FDIC requires that rates remain the same for the first 14 days and that the bank provide depositors 7 days notice of any rate change. Bank customers can withdraw their funds without penalty until they enter into new contracts with the bridge bank. Among other things, the FDIC is obliged to review the failing bank's liquidity during the preparation phase, and to monitor liquidity levels in the bank, to determine if the bridge bank can meet its own funding needs and re-establish lines of credit and correspondent banking relationships that were maintained by the failing bank.

The law sets out three key conditions for the establishment of a bridge bank. First, the requirement that the amount which is reasonably necessary to operate a bridge bank should not exceed the amount which is reasonably necessary for liquidating, including paying the insured deposit accounts. Second, the continued operation of such a bank in default or in danger of default with respect to which the bridge bank is chartered is essential to provide adequate banking services in the community where such bank is located. For example, the bank may accept deposits and issue low-risk loans to regular bank customers. Third, the bridge bank resolution tool should be applied, and the continued

889 FDIA. Sec 11 (n) (B).

890 FDIC. *Supra* note 855. P. 176.

891 *Ibid*.

operation of the business should be carried out “in the best interest of the depositors”⁸⁹². The transfer of any assets of a bank in default shall be effective without any approval of stakeholders, such as shareholders and creditors, under Federal or State law⁸⁹³. No capital stock is required to be issued to a bridge bank⁸⁹⁴. The FDIC shall make available funds for the operation of the bridge bank. Apart from the asset transfer, the bridge bank tool may be applied in conjunction with the sale of business tool⁸⁹⁵.

The status of a bridge bank as such shall terminate at the end of the 2-year period following the date it was granted a charter. The Board of Directors might, at its discretion, extend the status of the bridge bank for an additional 1-year period⁸⁹⁶. The bridge bank shall be terminated upon the earliest of i) the merger or consolidation of the bridge bank with a depository institution that is not a bridge bank; ii) at the decision of the FDIC, the sale of a majority of the capital stock to an entity other than the FDIC or another bridge bank; iii) the sale of 80 percent, or more, of the capital stock of the bridge bank to an entity other than the FDIC; iv) at the decision of the FDIC, either the assumption of all or substantially all of the deposits and other liabilities of the bridge bank by a bank holding company or a bank that is not a bridge bank, or the acquisition of all or substantially all of the assets of the bridge bank by a bank holding company, a depository institution that is not a bridge bank, or other legal entity; v) the expiration of the period subsequent to the charter being granted or the earlier dissolution of the bridge bank on other grounds (for example, at the decision of the board of directors at any time or the FDIC acting as receiver of the bank in default to liquidate a bridge bank)⁸⁹⁷. It is important to note that the FDIC might organise multiple bridge banks, i.e., 2 or more bridge banks to assume any deposits of, assume any other liabilities of, and purchase any assets of a single bank in default⁸⁹⁸. The law also prescribes regulations prohibiting the sale of certain assets of a bridge bank. For example, to persons who engaged in improper conduct with a failing bank, who cause losses to the bank and contributed to the failure to perform the bank’s obligations or defaults or to the weakening of the bank’s collateral positions, or persons found to have engaged in fraudulent activity, which respectively resulted in the failure to perform the bank’s obligations on time in the past, etc⁸⁹⁹. To prompt the purchase and assumption transaction by the FDIC, all or part of assets and liabilities of the failed banks may be transferred to the bridge bank. This gives potential bidders sufficient time for a due diligence process and allows the FDIC to clean up the failed bank, to achieve greater transparency, and sell assets for a higher price⁹⁰⁰.

Following the U.S. legal framework, a bridge bank tool has several major advantages. First of all, the establishment of a bridge bank allows a concurrent going concern. A bridge

892 FDIA, Sec 11 (n) (2) (A).

893 Ibid. Sec 11 (3) (4).

894 Ibid. Sec 11 (5) (A), (B).

895 Ibid. Sec 11 (8) (A), (B).

896 Ibid. Sec 11 (B) (9).

897 Ibid. Sec 11, (10) (A)-(E).

898 Ibid. Sec 11, (13).

899 Ibid. Sec 11, (p) (1) (2).

900 Marinč M., Vlahu R. *Supra* note 76. P. 115.

bank allows customers to maintain due relations with the bank, at the same time, minimising disruption to the financial system. Second, when applying the bridge bank resolution tool, the FDIC is able to plan sufficient time to the market to assess the financial condition of the failing bank, while the bank continues as a going concern. Third, the bridge bank allows a failing bank to be liquidated under the ordinary procedure, in case market attempts are unsuccessful⁹⁰¹. The legal regulation of the bridge bank and practical application of this legal tool in the United States has several drawbacks. The prompt corrective action provision limits regulatory discretion and requires that institutions be closed by their chartering authority within 90 days of their becoming critically undercapitalized (capital is less than or equal to 2 percent). In particular, in the case where a bank is a publicly traded institution, enforcement of such measures becomes public information and can lead to deposit withdrawals and liquidity crises for the failing bank. Second, FDIA also restricts the authority of a Federal Reserve Bank to make advances to banks that are undercapitalized or critically undercapitalized. For example, by limiting a failing bank's ability to borrow from the Federal Reserve Bank, FDIA makes it more likely that failing bank could face liquidity shortages in the future. Third, when the FDIC creates a bridge bank from a failing bank and maintains control of it until it is sold or resolved, the bridge bank is in effect a nationalised bank. Critics have expressed concern that the government is running a bank and is effectively competing against other non-government owned banks. That concern can be mitigated by the short-term nature of the bridge bank as the bank is meant to be sold as quickly as possible⁹⁰².

To summarise the EU and U.S. legal frameworks and their doctrinal approaches; the following general and specific advantages of the bridge bank tool can be identified i) the need for a bridge bank arises if there is a risk that, despite an attractive bank franchise, it may, nevertheless, become insolvent before it finds a purchaser; ii) the creation of a bridge bank allows day-to-day operations of the bank to continue; iii) market circumstances imply that it is unreasonable to commence formal liquidation procedures, for example, in case where reluctance is expressed to carry out formal liquidation procedures upon the failure of multiple banks at the same time⁹⁰³. One of the most criticised aspects of the bridge bank tool is at the moment when a bank or a group of banks is facing financial trouble. In this case, this tool seems more difficult to put into practice, a decision to apply the bridge bank tool is taken only after assessing longer-term perspectives. This is an important issue in dealing with bank solvency problems, as there is a potential threat of adverse effects. Therefore, the need for additional time is a very significant aspect, in particular, when resolving banks which might carry a systemic risk. Second, after a bridge bank is set up, the costs and potential liabilities and financial assets of the failing bank, as well as interim safeguard measures applied to the bank, to be purchased by other market participants in the future, are unknown. Third, the bridge bank tool might be not suitable enough for addressing financial problems and operations of complex multinational banks⁹⁰⁴. The

901 FDIC. Failed Bank Information. Questions and Answers Guide for Silverston Bank. [interactive] [accessed on 2014-10-21] <https://www.fdic.gov/bank/individual/failed/silverston_q_and_a.html>.

902 FDIC. *Supra* note 855. P. 184.

903 General Guidance for the Resolution of Bank failures. (in) Cambell, LaBrosse, Mayes etc. Deposit Insurance. Basingstole. Palgrave Macmillan, 2007. P. 252.

904 Mayes. D.G. Resolution Methods for cross-border Banks in the Present Crisis. (in) *Supra* note 27. P. 303.

main purpose of a bridge bank isto find a purchaser as soon as possible. If banks are allowed to operate for a longer period of time, they are exposed to additional risks, e.g., what forms of capital should be allowed for their operation and what capital adequacy ratios should be applied – particularly in view of the fact that a bridge bank would come into direct competition with other commercial banks during the “transitional” period. It is highly important to determine debt repayment terms in case of granting public support to the bridge bank. The bridge bank should also be governed by professional management bodies. When setting up a bridge bank, government guarantees should also be considered for thepurpose of bank viability⁹⁰⁵. Furthermore, it must be always ensured that the bridge bank is operating subject to the same prudential regulations and capital standards. That is the only way to prevent political risk and intervention⁹⁰⁶.

2.5.3. The Bank Asset Separation Tool and/or Purchase and Assumption Transactions

Purchase and assumption agreement is basically the most widely used and one of the most effective methods of restructuring in the global bank resolution practice⁹⁰⁷. The asset separation tool is a bank resolution tool that allows for the transfer of a troubled bank’s operations, assets, rights, transactions, and liabilities to another, healthy bank. The resolution process usually involves the withdrawal or revocation of the license of the troubled bank, the termination of the shareholders’ rights, the assumption of the troubled bank’s deposits and good assets, and the take-over of the bank’s problem assets by the resolution authority⁹⁰⁸. Alternatively, the competent authority can apply this transaction to transfer only parts of the assets of a failing bank to a bridge bank and subsequently sell the bridge bank to a private acquirer and liquidate the remaining parts of the bank’s assets⁹⁰⁹. Thus, one of the forms of the asset separation tools is a bridge bank. A purchase and assumption agreement is, in general, considered a kind of bank asset separation tool, which is primarily aimed at enabling the resolution authorities to dispose of impaired or bad assets to another credit institution to manage and, eventually, process the assets, and to avoid the adverse effects of immediate liquidation⁹¹⁰. Assets should be transferred at their market or long-term economic value in order to recognise the transaction losses during the transaction, i.e., the asset transfer process. In order to minimize deterioration of competition and moral hazards, this tool is mainly practiced in conjunction with other forms of resolution tools. First of all, doctrinal aspects of this resolution tool will be analysed, then, special features will be outlined and introduced into the regulatory framework of individual case law. A bank purchase and assumption transaction tool is applied in the U.S. legal framework. Swiss and the EU legislations apply a type of bank asset separation tool. The purposes of

905 LaBrosse R.J. International Experience and Policy Issues in the Growing Use of Bridge Banks. (in) *Supra* note 27. Chapter 14. P. 234. McGuire C.L. Simple Tools to Assist in the Resolution of Troubled Banks. WB, Washington, DC, 2012. P. 7. Marinč M., Vlahu R. *Supra* note 76. P. 45.

906 Hoelscher D.S, *Supra* note 2. P. 116.

907 Marinč M., Vlahu R. *Supra* note 76. P. 45.

908 McGuire C.L. *Supra* note 905. P. 3.

909 Marinč M., Vlahu R. *Supra* note 76. P. 45.

910 Hoelscher D. S. *Supra* note 2. P. 106-110.

these legal tools are correlating. In both cases, the competent authority is seeking to sell a failing bank as a whole (the business) or in parts to a sustained, healthy purchaser. The key difference from the sale of business tool is that in the purchase and acquisition agreement, the purchasing bank only buys assets and obligations, but not the bank license or any other potential obligation⁹¹¹.

An analysis of scientific literature shows that the legal doctrine⁹¹² distinguishes the following key types of asset separation (hereinafter referred to as the P&A) transactions:

- i) *P&A with Asset Pools*. A P&A can also be offered to potential purchasers with a failed bank's asset pools and, later, with loans from the failed bank's portfolio divided into separate pools of like loans, such as loans within the same geographic location or with the same payment terms. The other method of using this resolution tool is to divide loans into performing and non-performing. Such pool can be marketed separately from the deposit base. Bidders are thus able to bid on the parts of a failed bank's business that fit best with their own business model. The key advantage of this type of transaction is that this arrangement allows for marketing to a greater number of potential acquirers, which can lead to a greater number of assets being transferred from the failed bank. A potential disadvantage is that assets may be understated, i.e., be heavily discounted to sell (undervalued) if nonperforming assets are included in the asset pools. Additionally performing loans that are directly related to the bank's customers - who generally hold current accounts with the bank, assist in the retention and continuation of the bank's functions;
- ii) *Loan Purchase P&A/Modified P&A*. In these transactions, the purchasing bank acquires the performing loan portfolio of the failed bank (the performing loan portfolio along with timely fulfilled liabilities or the mortgage loan portfolio) by paying for it in cash or cash equivalents. Key advantage - installment loans and mortgages usually provide the acquirer with a base of performing loans in the future.
- iii) *Loss Share P&A*. The acquirer and the resolution authority enter into an agreement to share any future losses on a defined set of assets. By limiting the risk for the acquirer, the resolution authority might be able to attract more bidders for the purchase of the failed bank's assets. The acquirer is reimbursed for a percentage of the expenses associated with managing the assets transferred. The acquirer also assumes a percentage of the losses, which is designed to incentivise the acquirer to engage in good credit management. The main advantage: limiting the risk to the acquirer to a fixed amount may attract more bidders for assets. Disadvantage: the acquirer must work closely with the resolution authority throughout the term of the loss share agreement and take on administrative duties, which may not be attractive to potential acquirers⁹¹³.

911 Marinč M., Vlahu R. *Supra* note 76. P. 45.

912 McGuire C.L. *Supra* note 905. P. 7-8. Hoelscher S.D. *Supra* note 2. P. 106-117. Hüpkes E. *Supra* note 71. P. 90-93. IMF, WB. *Supra* note 86. P. 39-41. Parker D., IMF. *Supra* note 86. P. 196-199, 200-204.

913 McGuire C.L. *Supra* note 905. P. 7-8. Hoelscher S.D. *Supra* note 2. P. 106-117.

2.5.3.1. The EU Regulatory Framework

EU lawmakers apply an asset separation tool, which enables authorities to transfer assets, rights, or liabilities of a bank under resolution to a separate vehicle. Asset separation tool means the mechanism for effecting a transfer by a resolution authority of assets, rights or liabilities of a bank under resolution to an asset management vehicle⁹¹⁴. That tool should be used only in conjunction with other tools to prevent any undue competitive advantage for the failing bank⁹¹⁵. In particular, the new resolution regime ensures that Member States have the power to transfer assets, rights or liabilities of a bank under resolution or a bridge bank to one or more asset management vehicles. The transfer may take place without obtaining the consent of shareholders of the banks under resolution or any third party other than the bridge bank, and without complying with any procedural requirements under company or securities law⁹¹⁶. Second, for the purposes of the asset separation tool, an asset management vehicle is a legal entity, wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority, created for the purpose of receiving some or all of the assets, rights and liabilities of one or more banks under resolution or a bridge bank⁹¹⁷. Third, the objective is set out and it is presumed that an asset management vehicle shall manage the assets transferred to it with a view to maximising their value. Eventually, the assets are sold or wound up in an orderly manner. The operation of an asset management vehicle respects the following provisions and principles: a) the contents of the asset management vehicle's constitutional documents are approved by the resolution authority; b) subject to the asset management vehicle's ownership structure, the resolution authority either appoints or approves the vehicle's management body; c) the resolution authority approves the remuneration of the members of the management body and determines their appropriate responsibilities; d) the resolution authority approves the strategy and risk profile of the asset management vehicle⁹¹⁸.

Resolution authorities may exercise the power granted to transfer assets, rights or liabilities in compliance with applicable principles. This type of transaction is allowed only if a) the situation of the particular market for those assets is of such a nature that the liquidation of those assets under normal insolvency proceedings could have an adverse effect on one or more financial markets; b) such transfer is necessary to ensure the proper functioning of the bank under resolution or bridge bank; or c) such transfer is necessary to maximise liquidation proceeds⁹¹⁹. Any consideration paid by the asset management vehicle in respect of the assets, rights or liabilities acquired directly from the bank under resolution shall benefit the bank under resolution. Such a consideration is not prevented from having nominal or negative value⁹²⁰. Resolution authorities might transfer assets, rights or liabilities from the bank under resolution to one or more asset management vehicles on more

914 BRRD. Art. 2 (55).

915 Ibid. Recital (66).

916 Ibid. Art. 42 (1).

917 Ibid. Art. 42 (2).

918 Ibid. Art. 42 (4).

919 Ibid. Art. 42 (5).

920 Ibid. Art. 42 (6), (7). SRM Art. 26 (2) (b).

than one occasion and transfer assets, rights or liabilities back from one or more asset management vehicles to the bank under resolution if the possibility exists that the specific rights, assets or liabilities might be transferred back, and is stated expressly in the instrument by which the transfer was made and/or the specific rights, assets or liabilities do not in fact fall within the classes of, or meet the conditions for the transfer of rights, assets or liabilities specified in the instrument by which the transfer was made⁹²¹. Shareholders or creditors of the bank under resolution and other third parties whose assets, rights or liabilities are not transferred to the asset management vehicle shall not have any rights over or in relation to the assets, rights or liabilities transferred to the asset management vehicle or its management body or senior management. The objectives of an asset management vehicle shall not imply any duty or responsibility to shareholders or creditors of the bank under resolution, and the management body or senior management shall have no liability to such shareholders or creditors for acts and omissions in the discharge of their duties unless the act or omission implies gross negligence or serious misconduct in accordance with national law which directly affects rights of such shareholders or creditors⁹²².

2.5.3.2. The US Regulatory Framework

FDIC, as a receiver of a failing or failed bank, might use two basic resolution tools: a deposit pay-off (liquidation) or a purchase and assumption agreement⁹²³. The third option is as open bank assistance⁹²⁴. The P&A is the most common method used by the FDIC to resolve a failing bank and is considered the least disruptive to local communities⁹²⁵. This transaction can vary based on factors such as the amount of time available to arrange the transaction, the location and size of the bank, the nature of its deposits, and the assets available for transfer⁹²⁶. In essence, the purchase and assumption is designed in the U.S. legal framework to provide flexibility since each potential acquirer has different interests and market conditions change over time. For example, some acquirers may believe it is essential to acquire a substantial portion of the bank's assets with the deposit franchise; other acquirers may prefer to only purchase assets or deposits. Generally, the FDIC attempts to

921 Ibid. Art. 42 (10).

922 Ibid. Art. 42 (12) (13).

923 FDIA. Sec. 11 (d) (10) (11). Compensation is paid to insured depositors, whereas uninsured depositors and other general creditors must submit their financial claims, which, after their determination, would allow pay dividends on proved claims received from liquidation of the insolvent bank's assets.

924 Ibid. Governmental financial aid is granted in order for the bank facing financial difficulties to remain as a going-concern. State aid can take several forms. In a general sense, by providing open bank assistance, the FDIC requires new managing bodies of the bank in order to ensure that the bank's share of property is distributed and be equal to the nominal value of the bank and that attempts are undertaken to obtain funding from the private sector. The main objectives and benefits of this specific measure is to maintain public confidence in the banking system and the continuity of banking services in a local community. This measure is mainly criticized for a reason that the shareholders and other creditors of a failing bank benefit at taxpayers' expense when receiving public assistance. FDIC. Overview of the Resolution Process. Resolutions Handbook. Chapter 5.

925 FDIC. Overview of the Resolution Process. Resolutions Handbook. Chapter 4. 2014. P. 16.

926 Ibid. P. 16.

dispose of as many of the failing bank's assets as possible at the time of its closing; however, the offer prices must meet the requirements of the "least cost" principle.

To begin with, the P&A agreement is a closed bank transaction. Therein, a healthy financial institution purchases some or all of the assets of a failed bank and assumes some or all of the liabilities, including insured deposits. The FDIC is looking for an acquiring bank which would purchase all or part of the failed bank's assets and liabilities. The acquirer generally bids separately for assets and deposits⁹²⁷. Due to the fact that the deposit gathering function of the failed bank is transferred to the acquirer, the acquirer's bid for the liabilities may reflect the franchise value of the failed bank. In most cases, the acquirer receives most or all of a failed bank's assets and deposits in return for a one-time payment. The acquirer's bid reflects the value of the deposit franchise less expected loss in the book value of the assets⁹²⁸. The FDIC may transfer any asset or liability of the bank in default (including assets and liabilities associated with any trust businesses) without any approval, assignment, or consent with respect to such transfer⁹²⁹.

From 2008 to September 2013⁹³⁰, the FDIC as receiver has used this bank resolution tool within the U.S. legal framework to 452 of 502 financial institutions. There are several variations of P&A transactions:

- i) *Basic P&A*. In this transaction, the assuming bank or acquirer generally takes on only limited assets of a failing bank. Usually, the transaction is settled in cash or cash equivalents. Bank premises, including furniture and fixtures, can be offered to other acquirers on an optional basis. In this case, a purchase price is agreed upon by the acquirer and the resolution authority. Liabilities of the failing bank are then matched to the assets taken and consist of either all or some of the deposits. To the extent that the resolution authority wants the acquirer to take on more liabilities than there are assets to be acquired, it needs to prove that the resolution authority will offset the difference and make a cash payment to the acquirer or provide an official note that will equalize the asset and liability sides of the balance sheet. It should be noted that the amendment of the FDIA Act in 1991 had a significant impact on this resolution practice. Previously, the FDIC had structured most of its transactions to transfer both insured and uninsured deposits along with certain assets of a failed bank. After the introduction the "least cost" method to the legislation, the FDIC began entering into P&A transactions that included only the insured deposits⁹³¹. The key advantages of this type of transaction are that consumers with insured deposits suffer no loss in service, they may have new accounts with the new institution, but old cheques can still be used. It should also be noted that consumers do not lose interest on deposits

927 FDIC. Overview of the Resolution Process. Resolutions Handbook. Chapter 2. 2014. P. 56.

928 Bennett R.L. *The Effects of Resolution-Method Choice on Resolution Costs in Bank Failures*. FDIC Division of Insurance and Research. Haluk Unal Smith School of Business, University of Maryland, FDIC CFR, 2009. P. 6. [interactive] [accessed on 2014-12-15] <https://fdic.gov/bank/analytical/cfr/2009/july/CFR_2009_bennett.pdf>.

929 FDIA. Sec. 11 (d) (G) (ii).

930 FDIC. Industry Analysis. Failed Banks. Loss-Share Questions and Answers [interactive]. [accessed on 2014-12-15] <<http://www.fdic.gov/bank/individual/failed/lossshare/>> .

931 FDIC. Overview of the Resolution Process. Resolutions Handbook. Chapter 4. 2014. P. 17.

held in the accounts (insurance up to USD 250,000). The acquiring financial institution has an opportunity to gain new customers. Besides, the FDIC can use this method when there is not enough time to complete due diligence. Finally, the FDIC transaction costs are less than a deposit pay-off or bank liquidation. Among the disadvantages of such a transaction, should be mentioned that the receivership must liquidate the majority of the failed bank's assets; as a result, unsecured depositors may suffer losses in the event of the bank liquidation. In addition, the FDIC financial costs related to the bank resolution increase.

- ii) *Whole Bank P&A*. In this type of transaction, the acquirer purchases the entire portfolio of the failed bank on an "as-is" basis, i.e., the maximum amount of assets of the failed bank, with no guarantees to the competent authority. The main advantage of this type of transaction is that it minimizes the one-time FDIC cash outlay by having the acquiring institution purchase all assets, with the FDIC having no further financial obligation to the acquiring institution. Furthermore, the transaction reduces the amount of the failed bank's assets held by the FDIC for its future liquidation under the normal insolvency procedure. In addition, loan customers continue to be served by the acquiring financial institution (mainly operating in the same community). However, it should be considered that the transaction may not prove to be the least costly method compared to other types of resolution. For example, in case of a systemic crisis, negative bidders may enter the industry.
- iii) *Option shared loss P&A*. Essentially, the FDIC, as receiver, agrees in resolution transaction to share losses on certain types of a failed bank's assets with the proposed acquirer. To create a greater incentive for acquirers to bid on a failed bank's assets, the competent authority can provide a "put" option on some of the transferred assets. This agreement is similar to the whole bank P&A except for the sharing provision on the assets purchased. For example, during the recent financial crisis, the FDIC offered loss share where the acquirers accept 20 percent of the losses, or more, depending on the bid⁹³². The assets are typically distressed assets of the failing bank that otherwise might not appeal to potential acquirers without some sort of public incentive by authorities or protection from losses. Therefore, under this option, the FDIC splits pre-defined losses and expenses on certain assets with the acquirer. The assets have typically been single-family residential loans, commercial loans, commercial real estate loans. Among advantages, it should be noted that this type of deal reduces the FDIC's immediate funding needs through the liquidation procedure. In operating terms, it is an easier solution – the option moves assets quickly into the private sector. In addition, this type of transaction allows the purchaser to have additional time, for example, 60 or 90 days, before the resolution authority determines the asset volume, size and value more precisely. The key disadvantages of the transaction, are giving the acquirer, e.g., 90 days to look over assets while it decides what assets to assume. Assets which are not chosen can deteriorate. Additionally asset quality may deteriorate from lack of attention (requiring additional administrative supervision

932 Ibid. P. 18.

from both the acquiring institution and the FDIC), thereby making it harder for the resolution authority to market such bank assets or collect on them later. Such agreements can be administratively impractical in certain cases, as they generally last for 8 to 10 years⁹³³. The FDIC does not control the assets, thus, retains a large risk of potential loss.

- iv) *Bridge bank P&A*. In the transaction, the FDIC acts temporarily as the acquiring institution. The failed bank is closed by appointing a public authority to act as a receiver. A new, temporary bank is created. The deal provides a purchaser with the time necessary to assess the bank's assets condition in order to submit their offers. Before establishing a bridge bank, a cost analysis must show that the franchise value of the bank is greater than the marginal costs of operating the bridge bank, thus being less costly than a deposit pay-off. The sale and closure of a bridge bank is similar to the sale and closure of other failed banks. The FDIC requires at least 16 to 24 weeks to properly prepare for the sale, which includes gathering information, soliciting interest from potential acquirers, arranging for due diligence by potential acquirers, and receiving and analysing bids. The transaction has several key advantages: first, it provides the FDIC time to arrange a permanent transaction; second, prospective purchasers are given time to assess the bank's condition in order to submit reasonable bids; thirdly, the transaction provides continuity of service to bank customers. Among disadvantages, there should be noted duplicating elements of the resolution process. The FDIC must complete two closures, one for the original bank and one for the bridge bank. In addition, it is difficult to retain key employees during the transition period. Economic conditions may continue to deteriorate leading to lower premiums. Premium customers may leave the failing bank for a more stable environment, thereby reducing its franchise value.

2.5.3.3. Lithuanian Bank 'Ūkio Bankas' case study

Pursuant to the regulatory framework of Lithuania, existing upon the failure of 'Ūkio Bankas' bank, on activities of which a moratorium was announced and to which a temporary administrator was appointed, assets, rights, transactions and liabilities may be transferred to another bank if: 1) there is a real threat that the net value of assets of the bank subject to administration will fall below the bank's liabilities or that the bank will meet other conditions established by legal acts adopted by the supervisory institution for recognising the bank as insolvent, or it is established that the bank already meets the conditions for recognising the bank as insolvent, and 2) the transfer of assets, rights, transactions and liabilities of the bank subject to administration to another bank would retain the confidence of depositors in the stability and soundness of the banking system and otherwise protect public interest, while liquidation of the bank subject to administration due to bankruptcy would not protect such interests to the same extent⁹³⁴.

933 Ibid.

934 Republic of Lithuania Law on the Bank of Lithuania. Official Publication *Valstybės žinios*. 2004, No. 54-1832. Art. 7.

The assets, rights, transactions and liabilities of a bank subject to administration may be transferred only after the performance of their assessment by an audit firm and/or property appraisal company engaged by the temporary administrator. When transferring the assets, rights, transactions and liabilities of a bank subject to administration to another bank, the assets, rights, transactions and liabilities of the bank subject to administration may be transferred in their entirety, or in part. Furthermore, the already transferred assets, rights, transactions and liabilities may be returned to the bank subject to administration under the terms and conditions provided for in the documents on the transfer of assets, rights, transactions and liabilities, where necessary by appropriately adjusting the amount covering the difference in values paid, where such a possibility is explicitly specified in such documents or the circumstances indicate that the transferred assets, rights, transactions and liabilities had not been intended for transfer. It should be emphasized that when applying the asset separation tool, the provisions of the Civil Code of the Republic of Lithuania, other laws and legal acts or transactions concluded by the bank stipulating the requirement to notify in advance creditors, borrowers or other persons about the actions performed for the purposes of the transfer of assets, rights, transactions and liabilities, the requirement to obtain permits or consents of other persons for the performance of such actions, including the consent of the creditor to transfer the debt to another person, or otherwise limiting the performance of the transfer of assets, rights, transactions and liabilities shall not apply. In addition, the transfer of assets, rights, transactions and liabilities shall not be considered as a violation of the transaction and/or a valid ground for creditors, borrowers or other persons to terminate a transaction concluded with the bank subject to administration. If the creditors, borrowers or other persons terminate a transaction disregarding this provision, such a transaction may be returned to the bank subject to administration⁹³⁵.

At the beginning of the recent banking crisis, the Bank of Lithuania announced 'Ūkio Bankas' was insolvent and revoked its license⁹³⁶. The transfer of assets, rights, transactions and liabilities of a bank subject to administration upon approval of the supervisory institution and in observance of its instructions are organised and performed by the temporary administrator⁹³⁷, therefore, the Bank of Lithuania authorised the temporary administrator to begin negotiations with other banks regarding the transfer of assets and liabilities of 'Ūkio Bankas' to another bank. The publicly available information in the media shows that the temporary administrator had to consider for basic options of bank resolution: bank recapitalisation, creation of a bridge bank, declaring a bank bankrupt, or the transfer of part of assets, rights, transactions, and liabilities of the bank. In view of the fact that the transfer of assets, rights, transactions and liabilities of the bank to another bank would maintain the trust of depositors in the stability and soundness of the banking system and otherwise protect public interest compared to liquidation of 'Ūkio Bankas' due to bankruptcy, the Bank of Lithuania proposed to the State Deposit and Investment Insurance to take part in financing the transfer of assets, rights, transactions and liabilities of 'Ūkio Bankas' to another bank, which, under the Art. 46 of the Republic of Lithuania Law on the Bank of

935 Ibid. Art. 76 (1).

936 2013, February 18th, Decree of the Bank of Lithuania No.03-31 on the insolvency of 'Ūkio bankas'.

937 *Supra* note 934, Art. 76 (4).

Lithuania, took over the assets, rights and obligations of 'Ūkio bankas' in order to cover the difference in values of the liabilities transferred and assets, rights and transactions, which, according to estimates of the temporary administrator of 'Ūkio bankas', was equal to LTL 800 million⁹³⁸. It should be noted that in accordance with Law on the Insurance of Deposits and Liabilities to Investors of the Republic of Lithuania, the insured event is considered to have occurred where the bank is not able to settle with creditors, i.e., becomes insolvent⁹³⁹. Thus, the decision was justified by the consideration that the bank division would assure the continuity of payment and part of the other financial services rendered to customers of the failing bank to a greater extent than the sale of all assets of 'Ūkio Bankas' under the bankruptcy procedure, and would preserve the value of the failing bank.

In summary, there are arguments highlighting advantages of this resolution tool, however, there also are reasons why this legal tool should not be applied.

On the one hand, it should be emphasized that the application of this measure alone helps to lower administrative costs incurred. This method is particularly advantageous when the bank is funded mainly by depositors' contributions. Operational issues are among the difficulties in undertaking bank resolutions⁹⁴⁰. One of the benefits of this type of transaction is that it can be executed quickly (e.g., in the United States, these transactions are typically accomplished over a weekend⁹⁴¹, in Lithuania, the transaction was entered into 11 days after the announcement of a moratorium of 'Ūkio Bankas'). Speed is important since it is a critical factor in maintaining public confidence in the financial system. Moreover, it is a relatively easy transaction to explain to the public and depositors, since, as far as they are concerned, there are no other changes rather than their accounts being transferred to a new bank. If there are several potential purchasers, the transaction enables a government and/or a deposit insurer to seek to satisfy the creditors' and the state's interests through maximising a cost of such a transaction and reaching a maximum value for the assets managed by the bank. This helps to reduce high fiscal costs, usually arising from the immediate execution of the bank bankruptcy. Among other things, the transfer of the bank's assets, rights, transactions, and liabilities prevents the contagion effects of systemic risk (which is more likely under immediate liquidation), and the inefficient bank is removed from the financial system. Current bank debtors maintain the loan relationship with the purchasing bank, thus minimising damage to the settlement system. The purchasing bank takes over the failing bank's liabilities and its position in the settlement and payment system. The transfer and assumption agreement is also attractive for the mechanisms of safeguarding the creditors' rights prescribed therein and consisting of preliminary and final stages of the disposed asset valuation, e.g., a purchasing bank's obligation to repay the difference in value of part of the bank's assets acquired in case of an increase in it, and the transferring bank's option right to purchase a part of the disposed assets.

938 Public information provided by the temporary administrator of bank 'Ūkio bankas' [interactive]. [accessed on 2013-03-13]. <<http://www.ub.lt/>>.

939 Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors. Official Publication Valstybės žinios. 2002, No. 65-2635. Art. 2.

940 Hoelscher D.S. *Supra* note 2. P. 109.

941 *Ibid.*

On the other hand, there also can be identified adverse legal effects of applying the purchase and assumption tool. One of the major drawbacks of this type of transactions is that they are more difficult to accomplish technically and operationally. Another possible disadvantage is that assets, rights, transactions and liabilities of 'Ūkio bankas' in insolvency have been transferred under the contract to another bank based on a preliminary asset valuation of questionable legal effect⁹⁴². Following the revised, comprehensive, and secondary asset valuation, the difference is transferred either to the insurance or in the other contractual manner, however, this may entail a number of related legal issues and increase the likelihood of litigation. Furthermore, bank 'Ūkio bankas' insolvency procedure gave rise to the situation where 'Šiaulių bankas', which acquired the portfolio, tried to regain the money transferred to the savings deposit accounts after finding out that depositors would open cumulative or universal deposit accounts with the former insolvent bank (to assure the possibility to fill them at anytime and, thus, benefit from compound interest effect) and deposited? after the restriction of the bank's activities. It is therefore natural that the bank which acquired the assets and liabilities, would be reluctant to pay the interest promised by the insolvent bank, since such deposits may be in conflict with market conditions. After having purchased and taken over the failing bank's liabilities, the purchaser may choose to unilaterally amend terms of the contract on deposits taken over from the insolvent bank and transfer all of this type of deposit to the "bad" assets of the insolvent bank, or impose a new tax of such deposits. This leads to a high probability of bringing actions by some of the former depositors of the insolvent bank against the portfolio acquirer to defend their rights. Besides, these transactions are aimed, in some degree, at meeting public interest objectives (maintaining the trust of depositors in the stability of the banking system and otherwise protecting public interest), however, the involvement of the supervisory authority in such transactions alone does not assure a balance between a public and private interest and no infringement of the bank creditors' rights.

2.5.4. The Bail-in

At the international level, the bail-in tool (hereinafter – bail-in) and the corresponding approach to regulation of this bank resolution tool are deemed as the fundamental measure of bank resolution within the overall new paradigm of legal regulation governing bank insolvency⁹⁴³. Nationally, jurisdictions in relation with this research have already implemented such a legal tool⁹⁴⁴ and have accordingly granted legal powers to compe-

942 Under the Lithuanian Framework Law for Asset and Business Valuation, the estate market price shall be determined in the asset valuation report prepared in accordance with the law, while the law fails to define the legal status of the preliminary property assessment (Framework Law on Property and Business Evaluation, Art. 23. The supplied preliminary assessment statements often fail to comply with the above-mentioned law and the requirements set therein for the final asset valuation report, and therefore there is no reason to follow the asset value set in this document (Article 24(1) of the Framework Law on Property and Business Assessment).

943 In 2011, the FSB established a set of rules governing bank resolution. *Inter alia*, it made recommendations for the states to create a bank regime comprising bail-in tool as part of bank resolution tools, and bank stabilisation measures undertaken by the competent authorities. *See more* chapter 1 sec. 5 subsec. 1.

944 FSB. Thematic review on resolution regimes. *Supra* note 11.

tent authorities to ensure that investors, not taxpayers (bail-out), bear the cost of bank failure, thus, reducing the necessity of external capital injection into the failing bank⁹⁴⁵. The primary objective of bail-in is to enable the relevant institution to avoid a sudden and disorderly liquidation by enabling it to continue in business as a going concern (presumption of the going concern) until the bank can be restructured or the decision is made to liquidate it along with its assets⁹⁴⁶. Thus, the bail-in is aimed at avoiding formal insolvency procedures by allowing the bank to be returned to balance sheet stability and ensuring it as a going concern and without the destructive consequences of such a procedures. In other words, the aim of the bail-in tool is to create an alternative legal tool to taxpayer-funded rescues of banks or, at least, initially, to force its subordinated creditors and some senior creditors to take losses and to contribute to the bank resolution before taxpayer's funds are put at insolvency related-risk. In some sense, it is a system of sanctions against individuals that basically means that bank insolvency costs are imposed on its shareholders and creditors. The doctrine supports the view that this bank resolution approach avoids the significant destruction of the bank value, reduces financial contagion, and potentially preserves critical banking functions⁹⁴⁷. A detailed critical analysis of this legal tool is a separate topic of thesis or scientific publication (for example, a special regulation of this tool is applied to banking groups, important financial institutions, multinational banks with G-SIFI status, etc.). There are plenty of scientific articles on this relevant topic⁹⁴⁸. But despite all the research – relevant jurisdictions apply this bank resolution tool as a part of positive law – it has never been put into practice. For example, the EU legal framework is planning to introduce this tool at the latest by 1 January 2016, and most Member States have not yet incorporated the directive into their national law. This subsection is intended to discuss only a few key potential advantages and disadvantages of this tool, legal aspects, and particularities of positive law in separate jurisdictions.

In legal concept, the bail-in tool is straightforward. In general terms of the legal framework of bail-in, some of the bank's debts (creditors' claims) are compulsorily converted into equity. The supervisory authority establishes the resolution procedure at its own discretion, while the bank is still a going concern. In other words, these are the means of bank resolution, applied as one of the main tools to restore viability of the failing bank. This increases the immediate loss-bearing capacity of the bank and enables the competent authorities to conduct an orderly wind-down of the bank⁹⁴⁹. The only difference is that the resolution authority would decide how and when to wind down the bank as a going concern: whether to wind down one or more business lines of the bank, to sell all or part of the bank to a third party, to create a bridge bank, or to transfer the bank's deposits to

945 Gleeson S. *Supra* note 15. P. 2.

946 Huertas F.T. The case for Bail-ins. International Institute of Finance, 2012. P. 1.

947 Gleeson S. *Supra* note 15. P. 2.

948 Coffee C.J. Bail-ins versus Bail-outs: Using Contingent Capital to Mitigate Systemic Risk. Columbia University School of Law, New York. Working Paper No. 380, 2010. Avgouleas E., Goodhart Ch. A Critical Evaluation of Bail-in as a Bank Recapitalisation mechanism. International Macroeconomics, Centre for Economic Policy Research, No. 10065, London, 2014. Smits R. Is my money safe at European banks? Reflections on the bail-in provisions in recent EU legal texts. Capital Markets Law Journal, Vol. 9, No. 2, 2014. Schillig M. *Supra* note 47. P. 88-98.

949 Huertas F.T. *Supra* note 25. P. 2.

a third party. What is the bail-in composed of? The first is a special resolution regime for banks, the jurisdiction must have one, and it must give the resolution authority statutory power to impose this resolution tool. A special resolution regime must empower the resolution authority to initiate resolution and to direct the affairs of the failed bank in much the same manner as an insolvency practitioner would be able to direct the affairs of a company in administration. The second precondition – there must be an amount outstanding of instruments subject to bail-in that is sufficient to write off or convert in order to recapitalise the bank. Write-off may be applicable to the bank's equity as well. The doctrine suggests that the minimum amount of debt instruments subject to bail-in should be from 7% to 10% of the bank's risk weighted assets. That is considered to be enough to restore the bank's common equity (Tier 1 capital) to its minimum level⁹⁵⁰. Instruments subject to bail-in should include any instrument that counts as capital for the bank, in particular, it would include non-core Tier 1 capital instruments such as preferred stock as well as Tier 2 capital instruments such as subordinated debt. A third precondition is the provision of liquidity to the bank in resolution⁹⁵¹. The bank in resolution is likely to require liquidity, in order to remain in operation and continue to meet customer obligations. For the framework to be practical, measures must be taken to assure that the bank in resolution will actually have unencumbered assets (assets without guarantee) that might serve as collateral for such a liquidity facility. Therefore, priority should be given to write-off and conversion of investors' capital, which will assist in assuring the continuity of customer obligations and critical functions. Fourthly, measures will have to be taken to ensure that the bank in resolution does not disrupt financial market infrastructures. Fifth, and perhaps most fundamentally – banks and the authorities have to establish reliable parameters with respect to how investors will be treated in bank resolution⁹⁵². Investors need to have some idea of the process that the resolution authority will treat each element of the bank's equity structure. Finally, all of the above needs to be accomplished at great speed. If the supervisor places the bank into resolution at the close of the business day, bail-in and the arrangements to assure continuity of customer obligations have to be in place by the start of the next business day. That generally leaves the competent authorities with at most 36 to 48 hours (elapsed time between close of business on Friday and opening of business on Monday) to complete all the tasks required to make resolution successful⁹⁵³. These actions require considerable advance planning and preparation, therefore, resolution plans are an important step in this direction.

How does the bail-in tool work? Bail-in, by definition, is a legal process which applies to some but not all of the senior creditors of a bank. Chief amongst those to be protected

950 Ibid. P. 5.

951 Zhou J., Rutledge V., Wouter B. etc. From Bail-Out to Bail-In: Mandatory Debt Restructuring of Systemic Financial institutions. Retrieved from IMF Staff Discussion Note, IMF, 2012. International Institute of Finance. Making Resolution Robust-Completing the Legal and Institutional Frameworks for Effective Cross-Border Resolution of Financial Institutions, 2012. P. 38-41.

952 Huertas F.T. *Supra* note 25. P. 55-59.

953 For this reason, bank resolution regime imposes no obligation on the resolution authorities to obtain court approval before deciding on bank resolution. The bank resolution regime applies other requirements that may preclude the resolution authorities from intervening and performing resolution activities within 36-48 hours.

are depositors. The failing bank is to be preserved as a going concern where its “trade creditors” – payment services customers, short term creditors, securities and trading exposures – are preserved intact, and the bail-in process is applied to the long-term investment creditors of the bank – loosely, bondholders and holders of subordinated debt. The essence of this resolution tool is the idea that some senior creditors of a bank should, in certain circumstances, have part of their claim against the bank written down in whole or in part, after the write down of lower ranking subordinated claims and equity. In turn, senior creditors may receive new shares in the bank, but subordinated creditors may have their claims simply extinguished⁹⁵⁴. As demonstrated in the brief example below, a full spectrum bank might have total assets of EUR 1 billion financed by inter alia EUR 50 billion of shareholder equity, EUR 20 billion of subordinated debt and EUR 200 billion of senior debt securities. Thus applying a write-off of 40% to the senior debt securities would be more than sufficient to restore the bank’s equity capital and to replace its subordinated debt with equity, assuming that the bank’s losses burn through these layers of protection.

2.5.4.1. The EU Regulatory Framework

EU legal framework defines “bail-in tool” as the mechanism for effecting the exercise by a resolution authority of the write-down and conversion powers in relation to liabilities of a bank under resolution⁹⁵⁵. Resolution authorities apply the bail-in tool to meet the resolution objectives in accordance with the resolution principles for any of the major purposes: i) to recapitalise a bank that meets the conditions for resolution to the extent sufficient to restore its ability to comply with the conditions for authorisation (to the extent that those conditions apply to the entity), to continue to carry out the activities, and to sustain sufficient market confidence in the bank or banking group; ii) to convert to equity or reduce the principal amount of claims or debt instruments that are transferred a) a bridge bank with a view to providing capital for it; b) under the sale of business tool or the asset separation tool⁹⁵⁶. Competent authorities may apply the bail-in tool only when relevant resolution objectives are achieved and the bank is restored in question to its financial soundness and long-term viability⁹⁵⁷. In exceptional circumstances, the bail-in tool may be applied, by excluding certain liabilities from the application of the write-down or conversion powers where i) covered deposits; ii) secured liabilities including covered bonds and liabilities; iii) any liability that arises by virtue of the holding by a bank of client assets or client money, provided that such clients are protected under the applicable insolvency law; iv) any liability that arises by virtue of a fiduciary relationship between the bank (as fiduciary) and another person (as beneficiary) provided that such a beneficiary is protected under the applicable insolvency or civil law; v) liabilities to banks, excluding entities that are part of the same group, with an original maturity of less than 7 days; vi) liabilities with a remaining maturity of less than 7 days, owed to systems or operators of systems or their participants and arising from the participation in such a system; vii) liability to employees,

954 Gleeson S. *Supra* note 15. 2012. P. Zhou J., Rutledge V, etc. *Supra* note 965.

955 BRRD. Art. 2 (53).

956 *Ibid.* Art. 43 (2).

957 *Ibid.* Art. 43 (3).

i.e., liability in relation to accrued salary, pension benefits or other fixed remuneration, except for the variable component of remuneration; viii) a commercial or trade creditor arising from the provision to the bank of goods or services that are critical to the daily functioning of its operations, including IT services, utilities and the rental, servicing and upkeep of premises; ix) tax and social security authorities; x) deposit guarantee schemes arising from mandatory contributions. In exceptional circumstances, where the bail-in tool is applied, the resolution authority may exclude or partially exclude certain liabilities from the application of the write-down or conversion powers of the parties concerned where: a) it is not possible to do this within a reasonable time notwithstanding the good faith efforts of the resolution authority; b) the exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines in a manner that maintains the ability to continue key operations, services and transactions; c) the exclusion is strictly necessary to avoid giving rise to widespread contagion, in particular as regards eligible deposits held by natural persons and micro, small and medium sized enterprises, which would severely disrupt the functioning of financial markets in a manner that could cause serious disturbance to the economy of a Member State; d) the application of the bail-in tool to those liabilities would cause a destruction in value such that the losses borne by other creditors would be higher than if those liabilities were excluded from bail-in⁹⁵⁸.

Thus, when applying the bail-in tool within the EU's legal framework, the resolution authorities are empowered to write off claims of a failing bank's unsecured creditors and to convert debt claims to equity. The tool may be used to recapitalise a failing or likely to fail credit institution since it enables the authorities to restructure during the resolution process and, after having restructured it, to restore its viability. In order to apply the bail-in tool, resolution institutions must that the bank has on its balance sheet a sufficient amount of liabilities eligible for a bail-in tool. This is the key requirement of this bank resolution tool. Before the Member State is allowed to use the ESM funds for recapitalisation of a failing bank, national resolution funds and the bail-in tool must be applied first. The minimum amount of liabilities is calculated on a proportion and adjusted to each bank based on their risks (liabilities) and a percentage of own funds. This amounts to no less than 8 percent of shareholders' and creditors' liabilities before the competent authorities may use national resolution funds, loss absorption, or new capital injection into the bank, and only then write off 5 percent of the bank's liabilities⁹⁵⁹. The resolution authority may seek funding from alternative financing sources provided that i) contribution to loss absorption and recapitalisation equal to an amount not less than 8 % of total liabilities including own funds of the bank under resolution, measured at the time of resolution and in accordance with the valuation, has been made by shareholders and holders of other instruments of ownership, and holders of relevant capital instruments and other eligible liabilities through write down, conversion or otherwise; ii) the contribution of the resolution financing arrangement does not exceed 5 % of total liabilities including own funds⁹⁶⁰. In extraordinary circumstances, the resolution authority may seek further funding from alternative financing sources after

958 Ibid. Art. 44 (3).

959 BRRD. Art. 44 (5), (7), Art. 37 (10) (a), Recital (73).

960 Ibid. Art. 44 (5) (a) (b).

the 5 % limit has been reached; and all unsecured, non-preferred liabilities, other than eligible deposits have been written down or converted in full⁹⁶¹. In any case, resolution authorities shall give due consideration to the principle that losses should be borne first by shareholders and then, in general, by creditors of the bank under resolution in preference order. Consideration should also be given to the level of loss absorbing capacity that would remain in the bank under resolution if the liability or class of liabilities were excluded and to the need to maintain adequate resources for resolution financing⁹⁶². Historical losses which have already been absorbed by shareholders through a reduction in their own funds prior to such valuation should not be included in those percentages⁹⁶³. Furthermore, a systematic analysis of the Directive BRRD shows that there is apparently no prohibition for the bank's losses to exceed 13 percent of liabilities of the bank under resolution, on carrying out another stage of this resolution tool in order to cover remaining losses by creditors and unsecured, non-preferred depositors before using public or ESM funds. On the other hand, the use of public funds is permitted (including temporary public ownership, nationalisation according to Art. 58 of BRRD) in the very extraordinary situation of a systemic crisis⁹⁶⁴, on approval under the EU State aid framework⁹⁶⁵. In any case, the requirements for the use of public funds are very strict, they are used as a last resort⁹⁶⁶.

Within the EU legal framework, we can identify a number of problematic aspects of the bail-in tool regulation. If the insolvency concerns a banking group, operating outside the Member State, resolution authorities may carry out smooth coordination, however the decision on the use of bail-in has an effect of loss allocation to obvious losers. In some cases, this may cause a crisis of confidence in the banking system of the certain Member State and provoke major disagreements on (in the case of a banking group's insolvency) the bank branch which is subject to this tool and that which is not. When a bank branch operates outside the Member State, such disagreements may seriously affect inter-state relations, especially in cases of uneven loss allocation. Possible solution – to follow the banking group's resolution approach and to allocate all the losses to a particular legal entity of the banking group on behalf of the entire banking group, which operates within the EU. However, in that case, the bail-in and the amount of debt written off or converted at the group level shall be carried out in a holding company for the banking group operating in the EU; otherwise, the competent authorities will be forced to subsidise the bank. Another challenge concerns the liquidity support from resolution funds and Central Banks. The support can be provided either through each legal entity of the banking group with regard to the available collateral in each bank, or directly through assistance to the parent undertaking. In both cases, it would take place in the Euro area, where all liquidity support from the Central Bank ultimately needs to be reserved in the ECB's balance sheet, at least, until the bank resolution is successfully carried out. In addition, in case of the lack of backstop⁹⁶⁷ to

961 Ibid . Art. 44 (7).

962 Ibid. Art.44 (9).

963 Ibid. Recital (75).

964 Ibid. Art. 37 (10).

965 TFEU Art.107. BRRD. Art. 56, 58, 37 (10).

966 BRRD Art. 37 (10), 56, 58.

967 Ambrasas T. Supra note 444. P. 20-24.

other parts of the financial system, creditors may start to change banks, which may alter the financial system, even if banks manage to retain sufficient amounts of liabilities eligible for bail-in. There are opinions expressed that the main impact of this tool will be the incurring of higher debt servicing costs by banks. Bail-in and changes in the hierarchy of creditors' and depositors' claims will substantially increase bank borrowing costs⁹⁶⁸.

2.5.4.2. The US Regulatory Framework

U.S. legal framework provides that creditors and shareholders are the first to bear the losses of the financial company, whereby the *Orderly Liquidation Authority*⁹⁶⁹ acts as a receiver and takes control of the company. The bail-in concept should be interpreted and associated with the primary goal of the Dodd-Frank Act stated in the Preamble "to protect an American taxpayer by ending bailouts upon the bail out." It should be emphasized that the narrative section of Title II of the Dodd-Frank Act provides the FDIC with new rights and powers designed to address the default of solely SIFI banks. The FDIC can be assigned as a receiver of any U.S. financial institution which meets the specific criteria laid down in the Dodd-Frank Act and where the bank resolution under the US Bankruptcy Code (ordinary insolvency procedure) is likely to cause systemic instability in the country. In order to enhance the effectiveness of a bank or banking group resolution and minimize systemic disruptions, the FDIC has opted for the *single point of entry*⁹⁷⁰ model as a last resort of the effective bank resolution regime⁹⁷¹. This means that the FDIC, acting as receiver in accordance with the Dodd-Frank Act, is given all rights, powers and privileges to act and intervene in creditors' rights and claims relating to counterparties and lenders of the bank under resolution, which, consequently, may affect the bank's assets. Provisions of Section 210 of the Dodd-Frank Act provide for the right to compensation after termination of contractual rights or revocation of counterparties' or creditors' claims. With the purpose of intervention into counterparties' or creditors' rights, the FDIC organises a bridge bank and transfers ownership rights of the failing bank or banking group to the healthy legal entity through the separation of the banking group's or bank's shareholders and creditors from the failing bank's assets⁹⁷². Furthermore, the FDIC holds and implements the procedure of satisfying creditors' claims and establishes the priority for satisfying claims of the creditors of the bank under resolution without taxpayers' money⁹⁷³. Eventually, the bail-in institution provides that the receiver shall satisfy creditors' claims in accordance with and subject to the debt securitisation requirements, taking into account the priority of creditors under Section 210 and allowing the bank to raise debt and equity. Before converting creditors' claims to securities, the FDIC shall determine the value of the bridge bank, based on independent asset valuation. It was also noted that the FDIC presumes that the counterparties'

968 HM Treasury. The EU Bank Recovery and Resolution Directive Impact Assessment. Opinion, 2014. P. 2.

969 Dodd-Frank. Section 204 (a) (1).

970 FDIC. Resolution of Systemically Important Financial Institutions: the Single Point of entry Strategy. 78 Fed. Reg. 243, 2013.

971 Dodd-Frank. Section 619 (d).

972 Ibid. Section 210 (a), 210 (h). Title II, Sec. 201 (3).

973 Ibid. Section 210.

capital, subordinated debt and a large part of unsecured liabilities, with the exception of a seller's claims, are treated as residual claims to be recovered by the receiver⁹⁷⁴. This is the essence of the bail-in procedure. The tool allows the bridge institution to have clean commitments and healthy bank, instead of converting unsecured creditors of the insolvent bank into the bridge bank's shareholders⁹⁷⁵. Upon the establishment of a bridge bank that holds a significant part of assets and a much smaller amount of liabilities of the parent holding company, it is assumed that the bridge bank has a more stable balance sheet and, consequently, is in a better position to borrow money from conventional markets under normal conditions. If this tool is insufficient and there is still a capital deficit, the FDIC may apply to the *Orderly Liquidation Fund*⁹⁷⁶. All other expenses incurred in the bank resolution by the FDIC as a receiver in case of the failure of the above methods shall be borne by the industry as ex-post contributions. In addition, provisions of Dodd-Frank expand the powers of the FDIC, including the power to select assets and liabilities that might be transferred to a third party. Further, the FDIC can treat the same class of creditors in different ways, for example, to give priority to short-term creditors over long-term creditors or to provide creditors with more favorable conditions over bondholders or lenders. The FDIC, in such discretion, prescribes that a creditor shall in no event receive less than the amount that the creditor is entitled to receive in case of liquidation of the bank⁹⁷⁷.

According to researchers, the primary weakness of the U.S. legal framework is in the case of breakdown of a parent bank within a banking group, with respect to providing required funding for recapitalisation, operating bank branches, that may impose a reputational risk on the entire banking group, including operating branches. As the potential contagion of reputational risk shows, it may lead to severe consequences⁹⁷⁸. If such a risk occurred, CB or deposit / resolution fund would inject a large amount of capital into banks to increase bank liquidity. Secondly, there is the issue of speed – how quickly a bridge bank's capital structure can be restored. This question becomes very relevant after the bankruptcy procedure against the parent holding company is commenced. While the bail-in tool is applied, the bank is not isolated. The use of the tool is a part of the bank resolution process, involving the replacement of senior management and restructuring of business of the banking group. However, it takes quite some time to restore a new bridge bank's capital structure, therefore, public authorities in the end have an undercapitalized structure of an operating bank and incur large liabilities on the public sector. The government would not force private sector purchasers to acquire a new bridge bank's capital or (subordinated) debt. This may also involve rumours. Thus, despite the enforcement measures such as the suspension of dividends or redemption constraints, in particular, during the financial crisis, it is not easy to collect non-distributed profits or restore capital. The third potential problem is related to the application of the measure and associated costs incurred by the banking sector. If the bank is rescued through the write-off or conversion

974 FDIA. Art. 17.

975 Dodd-Frank. II Section of the Preamble.

976 FDIA. Sec. 11 A.

977 Dodd-Frank. Sec. 210 (a) (7) (B).

978 Kanas A. Pure Contagion Effects in International Banking: The Case of BCCI's Failure. Vol. 8, Journal of Applied Economics, 2005. P. 101-123.

of private debt instruments, the transfer of liabilities is very likely to affect the banking industry's prices.

To summarise the doctrinal concept of the tool and peculiarities of positive law in various jurisdictions, we can distinguish the following key advantages of the bail-in tool: the bank, which is not able to deal with its financial trouble independently, is usually seeking additional funding in the capital market either by issuing new equity instruments to market investors or by seeking private solvent acquirers. These methods, however, are not suitable for all banks and only in certain situations. Application of this tool presumes a time issue; besides, privately funded recapitalisation makes it more or less impossible to identify every significant creditor, in particular, of a SIFI, in any reasonable timescale⁹⁷⁹. At this point, public intervention is still required, while the bail-out helps in resolving a bank, by requiring at least some creditors to contribute to privately funded recapitalisation. Primarily, this tool allows public subsidies to replace private sanctions or particular private insurance, causing the banks to assume the costs of internal operating risks within the course of their business⁹⁸⁰. In general, apart from the bearing of bank insolvency losses by shareholders under the new paradigm of bank resolution, bank insolvency losses are also covered by ex ante (or ex post) resolution funds financed with industry contributions and specific classes of the bank's creditors, and the fixed amount of their debt claims to a bank are converted to capital. This allows for the restoration of the bank's equity capital (capital conservation buffer) as required for normal banking operations. Second, a change of unsecured debt to bail-in should encourage creditors to pay more attention to monitoring, thereby, restoring market discipline. For example, potential bank insolvency costs would be allocated not only to creditors, but also to shareholders. It is assumed that creditors will become more careful with bank leverage in this case, by limiting the most likely bank solvency and management costs associated with excessive leverage effects⁹⁸¹. Shareholders are interested in having the greatest possible leverage level in order to maximise their return on capital⁹⁸². Third, it is likely that the bail-in will ensure a greater legal certainty on a sufficient amount of funds to cover bank losses and induce early recapitalisation of banks in view of pre-planned agreements between creditors and the bank. Finally the tool helps to maintain activities of the bank acting as a business entity and to avoid the adverse effects of liquidation.

Apart from distinctive disadvantages of individual jurisdictions, the bail-in tool also has a number of problematic aspects. One of the primary weaknesses of a bail-in as a bank resolution tool is that although it renders the bank creditworthy, it provides no new cash. Thus in order to survive, the bank must not only be creditworthy, but credibly creditworthy to at least its Central Bank, and preferably to the market as a whole. There are also issues around the objectives of resolution. It has been noted that the objectives of bail-in differ in various jurisdictions. For example, the bail-in procedure in U.S., whereby credi-

979 Gleeson S. *Supra* note 15. P. 13.

980 KPMG. Bail-in liabilities: replacing public subsidy with private insurance. 2012.

981 Admati A.R., DeMarzo P.M., Hellwig M.F. etc. *The Leverage Ratchet Effect*. Working Paper Series of the Max Planck Institute for Research on Collective Goods. Vol. 13, 2013.

982 Admati A.R., DeMarzo P.M., Hellwig M.F. etc. *Debt Overhang and Capital Regulation*. Rocke Center for Corporate Governance at Stanford University Working Paper No. 114, MPI Collective Goods Preprint, No. 2012/5, 2012.

tors' claims are written off or converted, is designed for SIFI banks only and is organised through the Orderly Liquidation Authority and in accordance with regulatory provisions. Under the narrative section of Title II of the Dodd-Frank Act, the bail-in tool aims to provide sufficient capital to the bank. Thereafter, the resolution is normally carried out by liquidating a non-viable part of the bank. The tool is intended rather for parent banks operating within banking groups. The EU system explicitly distinguishes between eurozone and non-eurozone Member States. BRRD Directive and the European Stability Mechanism Act require bank creditors to bear bank resolution costs. This means that either the bank is kept operational, and the bail-in tool and bank recapitalisation procedure restore the bank's viability (the bank continues as a going concern), or, by applying the tool in conjunction with other resolution powers, it is considered that the bank has lost the going concern presumption (the bank is closed). Among the disadvantages can be mentioned that this resolution measure requires swift actions, and has to be accomplished over a weekend (within as short as possible a time period after the market closes). There may emerge some challenges around the fact that the tool can be applied without the consent of shareholders or creditors, without public hearings or consultations being held, and where hardly any conditions are provided for the judicial follow-up of administrative decisions, mainly, in the context of expropriation of ownership rights. It is also believed that this tool will not produce a zero-failure environment for banks. Recapitalisation only works for good businesses with bad balance sheets. Businesses which are fundamentally bad will not and should not be bailed in, but will be left to a resolution regime in the ordinary way. It is also possible for a bail-in to fail – if the initial assessment of the extent of the losses of a bank is sufficiently adrift, or the amount of new capital created by the bail-in is insufficient to support the business. Possibly more importantly, a bailed-in bank will only survive if counterparties, creditors and customers believe that the bank is now robust. Besides, market confidence in the bailed-in bank requires to be quickly restored in order to maintain the franchise value of the bank or to cover the official liquidity support.

2.6. Peculiarities of Swiss Bank Resolution Tools

The Swiss legal framework provides that the FINMA opens the restructuring proceedings after it issues a ruling and approves the restructuring plan. In its opening ruling, FINMA may specify whether existing protective measures are to be maintained or altered, or replaced by new ones, including the application of bank resolution tools⁹⁸³. The law provides for mandatory elements to be covered by the restructuring plan, including, but not limited to the bank's assets and liabilities, the bank's future organisation and management, whether and how the restructuring plan affects the rights of the bank's creditors, transactions which require an entry in the Commercial Register or in the Land Register, and provisions of resolution tools, if any⁹⁸⁴. The Law gives priority to the continuation of services of a failing bank⁹⁸⁵. Special priority is given to the bank's asset separation tool. The restructuring plan may provide for the transfer of the bank's assets or parts thereof,

983 Swiss Ordinance. Art. 41.

984 Ibid. Art. 44 (2).

985 Swiss Banking law. Art. 30.

including assets and liabilities as well as contractual relationships, to other entities or to a temporary bridge bank⁹⁸⁶. If contractual relationships or the bank's assets or parts thereof are transferred, the transferee will take the place of the bank, provided the restructuring plan foresees this, therefore, the Mergers Act of 3 October 2003 is not applicable⁹⁸⁷. If assets are transferred, the FINMA will order an independent valuation of these⁹⁸⁸.

The Swiss legal framework sets out three key bank resolution tools: asset separation, bridge bank⁹⁸⁹, and bail-in⁹⁹⁰. The transfer of bank assets, contractual relationships, and liabilities to another bank might take place by applying the asset separation tool or a bridge bank. The restructuring plan shall describe in detail the above bank resolution tools which are subject to the following key requirements: a.) name the legal entity or entities to which such banking services and assets are to be transferred; b.) describe the assets, liabilities and contractual relationships to be transferred and the compensation to be provided for them; c.) describe the banking services that are to be continued and transferred; d.) list the corporate actions undertaken and, where banking services are to be transferred to a bridge bank, describe how assets and liabilities will be shared between the bank and the bridge bank; e.) stipulate an obligation on the bank's part to take any action necessary to ensure that all of the assets and objects to be transferred, including in particular those located abroad or subject to foreign law, can be transferred to the other legal entity; f.) explain whether compensation is to be paid, how such compensation is to be calculated and whether a maximum compensation amount is to be imposed; g.) explain whether systems and applications will be used jointly by the bank and the other legal entity and, if banking services are to be continued by a bridge bank, how the latter will be guaranteed access to payment transactions and financial market infrastructure and how it will be able to use this; h.) describe how to preserve the legal and economic connections between assets, liabilities and contractual relationships, thereby ensuring that only the following can be transferred: i) all claims and liabilities on the bank's part vis-à-vis a counterparty or several counterparties that can be offset, in particular those that are subject to a netting agreement; ii) secured claims and liabilities together with their collateral; and iii) structured financing arrangements or comparable capital market agreements to which the bank is a party, together with all rights and obligations pertaining to them⁹⁹¹.

As soon as the approved restructuring plan is enforceable, all transferred assets or contractual relationships, together with all rights and obligations pertaining to them at the time of the approval of the restructuring plan, pass to the new legal entity or entities⁹⁹². The bridge bank mainly serves to ensure the temporary continuation of individual banking services transferred to it. FINMA shall grant the bridge bank a license with a fixed term

986 Ibid. Art. 30 (2).

987 Ibid. Art. 30 (3).

988 Ibid. Art. 30 (b).

989 Swiss Ordinance. 51 str.

990 Ibid. Art. 48, 49.

991 Ibid. Art. 51 (1).

992 Ibid. Art. 51(2).

of two years. It may deviate from the licensing requirements when granting it. The license may be extended in necessary⁹⁹³.

The Swiss legal framework has established the bail-in tool. The essence of this tool, as in other jurisdictions relevant for the purposes of the research, is that all bank claims, with a few clearly defined exceptions, are subject to compulsory conversion of debt into equity or compulsory waiving of claims. The resolution tools prescribed by the legal regulation can be combined and applied together or individually at the same time. When FINMA instructs creditors to waive their claims, it is not obliged – in contrast to the procedure for converting debt into equity – to completely wipe out the junior creditors before calling on the next senior category of creditors to share in the loss, thus, establishing a new creditor hierarchy. This means that FINMA can distribute a loss across a range of creditor groups. From a quantitative perspective many Swiss banks are likely to have adequate “bail-in” debt. However, it remains to be seen whether this debt is in the ‘right’ legal entity and in the right form (e.g. as a subordinated bond)⁹⁹⁴. Furthermore, Swiss law defines the key principles for converting debt capital into equity capital. If the restructuring plan provides for this tool, then a) sufficient debt capital must be converted into equity capital to ensure that the bank holds the required capital to continue its business activities after the restructuring is completed; b) share capital must be completely written down before converting debt capital into equity capital; c) debt capital may be converted into equity capital only if the debt instruments issued by the bank as part of additional core capital or supplementary capital have already been converted into equity capital, in particular contingent convertible bonds; d) the following order of rank shall be observed when converting debt capital into equity capital where claims of the next rank are only converted if the conversion of claims of the previous rank does not suffice to meet the capital adequacy requirements in accordance with letter a: i) subordinated claims without capital adequacy eligibility, ii) other claims not excluded from the conversion, with the exception of deposits, and iii) deposits, in so far as they are not privileged⁹⁹⁵. All debt capital can be converted into equity capital, with the exception of privileged claims in classes: employees’ and public authorities’ claims and insured depositors for up to CHF 100,000, pension funds’ claims⁹⁹⁶; as well as secured claims to the extent that they are secured and offsettable claims to the extent that they are offsettable, if the creditor can credibly demonstrate the existence, amount and the fact that the claim is the object of a relevant agreement, or this is evident from the bank’s books⁹⁹⁷. When converting debt capital into equity capital, FINMA may order a partial or full reduction in claims⁹⁹⁸.

FINMA shall give public notice that the bankruptcy proceedings or the restructuring proceedings have been completed⁹⁹⁹. Meanwhile, the restructuring agent shall report to FINMA, summarising the progress of the restructuring proceedings¹⁰⁰⁰.

993 Ibid. Art. 52.

994 FINMA. New FINMA Banking Insolvency Ordinance. A Key element in the effective restructuring and orderly market exit of banks. Bern, 2012. P. 4.

995 Swiss Ordinance. Art. 48.

996 Swiss Banking law. 37 (a)(1)-(5). DEBA Art. 219 (4).

997 Swiss Ordinance. Art. 49.

998 Ibid. Art. 49.

999 Ibid. Art. 58 (3).

1000 Ibid. Art. 58 (1).

2.7. Financial Stabilisation Tools – the Way of Dealing with Bank in Distress?

Legislation of relevant jurisdictions establishes an alternative to bank resolution as a last resort – application of government stabilisation measures (government guarantee, redemption of bank assets, public equity support tool, and taking bank shares for public needs). They are, in essence, government financial stabilisation tools, intended for the banking system. The doctrine¹⁰⁰¹ and research-related jurisdictions do not treat this measure for dealing with financial trouble as a bank resolution tool due to the difference of its legal nature from other legal means of bank resolution, therefore it is analysed in more detail outside this study¹⁰⁰². This presumption, among other things, is made because the financial stabilisation tools consist of public equity support and temporary public ownership tools¹⁰⁰³. For example, in the EU, financial stabilisation tools are construed as extraordinary public financial support, direct intervention in the bank's activities in order to avoid its winding up¹⁰⁰⁴. It should be noted that in the absence of alternatives to bank resolution tools and/or an effective legal regime of bank resolution, this measure had been used quite often in the latest banking crisis, particularly, in view of the fact that jurisdiction provided for the only other solution for bank insolvency – immediate liquidation of the bank¹⁰⁰⁵. Yet, in practice there were instances where one of the financial stabilisation tools – nationalisation – had been used even under the legal framework of resolution tools. Nationalisation is a stabilisation mechanism, when a bank's shares are taken for state needs and duly compensated¹⁰⁰⁶. However, this tool requires wider discussion in relation to the nationalisation and later liquidation of the Lithuanian bank 'Snoras' during the recent banking crisis. This tool was typically applied in the event of large failing banks such as *Continental Illinois National Bank*¹⁰⁰⁷ and *intensively practiced in Sweden*. The Swiss nationalisation scheme was as follows: firstly, the state nationalises bank property, then public authorities use the asset separation tool in respect of the bank owned and establish a "bad" bank for shifting "bad" assets and loans into. The remaining "good" bank is recapitalised by the government. The Government receives performing loans, while the bank can normally operate as a going concern. Meanwhile, it is gradually allowed to sell troubled assets to the "bad" bank which accepted its non-performing assets, and, thus, to prevent the scale of losses that would inevitably result from immediate sale of the assets. In essence, the "bad" bank serves as an asset management company. Crisis Management Authority was responsible for undertaking the tasks under administration of the "bad

1001 Frydl E.J., Quintyn M. The Benefits and Costs of Intervening in Banking Crises. (in) Bank Restructuring and Resolution. IMF, Washington, 2006. P. 32-33.

1002 In the doctrine, they are understood as pre-insolvency bank resolution tools, applied after the paradigm shift prior to public sector capital injection in the bank, or before providing public financial support, or treated as a measure of last resort.

1003 BRRD. Art. 56 (5).

1004 BRRD. Art. 56 (1).

1005 Hoelsher D.S. *Supra* note 2. P. 105.

1006 Ibid. Marinč M., Vlahu R. *Supra* note 47. P. 46.

1007 FDIC. Continental Illinois and „Too Big to Fail“. Chapter 7. An Examination of the Banking Crises of the 1980s and Early 1990s. Vol. 1. History.

bank” insolvency¹⁰⁰⁸. Through the micro-comparative method, this tool is demonstrated in the insolvency case of the Lithuanian bank ‘Snoras’, where the tool’s strengths and weaknesses have been analysed. Second, it should be considered specifically how the tool is interpreted within the new bank insolvency procedure of the EU legal framework.

The reason why this measure cannot deal with bank distress and be considered a bank resolution tool is explained through the EU regulatory framework. In particular, the EU legal framework establishes the principle that resolution of a bank should maintain it as a going concern and, solely as a last resort, involve government financial stabilisation tools, including temporary public ownership¹⁰⁰⁹. The public ownership and assumption of risk should be accompanied by reward. Therefore, the financial stabilisation measure does not constitute bank resolution tools. Second, the government financial stabilisation tools are used as a last resort after having assessed and exploited any other resolution tools to the maximum extent practicable whilst maintaining financial stability. The competent ministry or the government makes the decision after consulting the resolution authority¹⁰¹⁰. Third, when applying for government financial stabilisation tools, there shall be conventional resolution tools applied as a priority only if all the following compulsory conditions are met: a) the competent ministry or government and the resolution authority, after consulting the Central Bank and the competent authority, determine that the application of the resolution tools would not suffice to avoid a significant adverse effect on the financial system; b) the competent ministry or government and the resolution authority determine that the application of the resolution tools would not suffice to protect the public interest, where extraordinary liquidity assistance from the Central Bank has previously been given to the bank; c) in respect of the temporary public ownership tool, the competent ministry or government, after consulting the competent authority and the resolution authority, determines that the application of the resolution tools would not suffice to protect the public interest, where public equity support through the equity support tool has previously been given to the bank¹⁰¹¹. Fourth, the financial stabilisation tools consist of the public equity support tool and temporary public ownership tool (in doctrine, also known as nationalisation). The regulation of the public equity support tool provides that a Member State may participate in the recapitalisation of a bank, by providing capital to the latter in exchange for Common Equity Tier 1 instruments and Additional Tier 1 instruments or Tier 2 instruments¹⁰¹². Where a Member State provides the public equity support tool, it shall ensure that its holding in the bank is transferred to the private sector as soon as commercial and financial circumstances allow¹⁰¹³. Meanwhile, a temporary state ownership stipulates that a nominee of the Member State or a company fully owned by the Member State as a transferee may make one or more share transfer orders¹⁰¹⁴.

1008 Marinč M., Vlahu R. *Supra* note 76. P. 101-102.

1009 BRRD. Recital. (8).

1010 BRRD. Art. 56 (3).

1011 *Ibid.* Art. 56 (4).

1012 *Ibid.* Art. 57 (1).

1013 *Ibid.* Art. 57 (3).

1014 *Ibid.* Art. 58 (2).

2.8. Lithuanian Bank ‘Snoras’ case study

Bank nationalisation is a legal tool whereby shareholder management is replaced by the government (or rather the deposit insurer) management. The Government of Lithuania shall take bank shares for public needs¹⁰¹⁵ in exceptional cases only where the public ownership of bank shares is deemed necessary to allow the State to take immediate action aimed at stabilising the banking system if other available measures are not suitable or the measures that have been applied are insufficient to achieve this objective. The bank's shares are taken by decree of the Government by granting fair compensation¹⁰¹⁶. The right of ownership of the shares taken is transferred to the State once the decree of the Government to take bank shares for public needs enters into force. Nationalisation requires large fiscal costs (especially if the majority of creditors of the bank are insured) and is practiced worldwide only in extreme cases¹⁰¹⁷. When shares are taken for public needs according to the Law on Financial Sustainability of the Republic of Lithuania, shareholders may appeal the decision, but only in part for a fair price (since the law provides an exception to the general regulation that shares shall be transferred to state ownership upon the adoption of the decree by the Government of RL rather than the settlement). It should be noted that other legislation also provides for taking shares for public need¹⁰¹⁸. Pursuant to the Lithuania Law on Insurance of Deposits and Liabilities to Investors, the Board of the State Deposit and Liabilities Insurance shall make a decision to take bank shares from shareholders after having been informed by the supervisory authority that the bank operation is not safe or sound and that the bank may become insolvent and if it may have sufficient grounds to believe that the possible insured event of the bank could endanger liquidity of the insurance company and adequate payment of insurance claims. The key distinctive feature of the mechanism of taking bank shares for public needs in this case is the right of appealing the transfer of ownership. The bank nationalisation consists of several stages. First, the bank shall be announced as insolvent by decision of the supervisory authority¹⁰¹⁹,

1015 Article 8(6) of the Republic of Lithuania Law on Financial Sustainability states that the Government shall approve the price of shares, taking into account the proposals of the audit company and/or property evaluator, and the costs of identifying the share price shall be covered by public funds. In determining the bank's share price, the measures to strengthen financial stability already applied or planned to apply to the bank in accordance with this Law cannot be taken into account. When share price is paid to the former shareholders, interest shall also be paid in accordance with Article 6.210 (1) of the Civil Code as of the intended share price. In addition, fixed rate of interest paid for the shares shall be paid for the period from the date of entry into force of the resolution to take over the shares until the date of settlement with the former shareholders.

1016 Republic of Lithuania Law on Financial Sustainability. *Valstybės žinios*. 2009, No. 93-3985. Art. 8.

1017 Marinč M., Vlahu R. *Supra* note 76. P. 46.

1018 Expropriation of shares for public demands is provided for in the Law on Insurance of Deposits and Liabilities to Investors and the Law on Banks.

1019 According to the Decree No. 132 of the Bank of Lithuania of 7 September 2012 on the insolvency of credit institutions, insolvency of a credit institution shall be determined in accordance with credit institutions' financial and supervisory reports, information received from other credit institutions or other persons, documents and/or, where appropriate, the credit institution's inspection (review). The board of the Bank of Lithuania may decide to declare insolvency of a credit institution if at least one of the following conditions are met: 1. The credit institution's net asset value is less than the credit institution's liabilities; 2. For six months in a row, the credit institution fails to fulfill the

and the existing legislation shall allow the supervisory authority to apply certain enforcement measures. Second, the state shall be able to recapitalise the bank under the current legal framework, that is, to fill the resulting financial gap. This involves the cleaning of negative capital and depositing additional capital by the state or the Central Bank, acting as a lender of last resort. The essence is that the bank shall have capital adequacy ratios set out by the supervisory authority.

The State of Lithuania nationalised bank ‘Snoras’ during the recent banking crisis¹⁰²⁰. This decision was taken in accordance with provisions of the Law on Banks and the Law on Financial Sustainability, conferring the right to apply appropriate enforcement measures in exceptional cases where a bank is likely to fail, and if they are insufficient - to take bank shares for public needs¹⁰²¹. Such a decision hinders the bank in meeting its commitments. The bank cannot assume new obligations, principally, the bank’s activities are suspended, which has a negative impact on its customers (execution of framework agreements entered into with this bank prior to nationalisation is suspended, restrictions on the provision of banking services causes inconvenience to customers, etc.)¹⁰²².

On one hand, if activities are arranged in an adequate and timely manner, the decision on bank nationalisation can be taken quickly enough (while planning and negotiations on other resolution tools to be applied may take several months) and allows the preservation of “healthy” lending relations in the state, protects creditors against further losses, maintains public confidence in the financial system, and reduces the systemic hazard to the financial system. Timely application of the nationalisation tool, therefore, assists in avoiding major delays, relating to the immediate liquidation of a large bank and severely affecting creditors and financial stability in the further bank insolvency procedure. The tool helps to manage systemic risks in case of fragile public confidence in the banking system. Once the bank decides to continue as a going concern, solvent clients can maintain their legal credit-loan relations with the bank. This is particularly beneficial in situations where there are no alternative sources of credit in the state, or they are limited¹⁰²³. Similarly, upon the effective application of this tool, there is no disruption to the banking settlement and payment system. In addition, the timely use of this tool does not increase state “fiscal outlay”.

capital adequacy (solvency) ratio set by the Bank of Lithuania; 3. The credit institution cannot satisfy any reasonable creditor’s claim within 5 working days (by reason of lack of funds in its accounts it is unable to fulfill the customer’s order, return deposits and other borrowed funds or perform other financial obligations).

1020 Lithuanian bank ‘Snoras’ report of bankruptcy process. [interactive]. [accessed on 2013-02-10]. <http://www.lb.lt/seimo_posedyje_ab_banko_snoras_bankroto_proceso_apzvalga_1>.

1021 Republic of Lithuania Law on the Bank of Lithuania. Official Publication Valstybės žinios. 2004, No. 54-1832. Art. 90.

1022 It is a common international practice as well. For example, the insolvency of the Continental Illinois National Bank in the US. At that time, the country’s eighth-largest bank was declared insolvent. Instead of direct liquidation of the bank, a ruling was adopted, under which the Federal Deposit Insurance company took over USD 3 billion of liabilities and a billion dollars of bad loans from the insolvent bank. The state-owned company also invested a significant amount of cash in order to restore capital adequacy requirements. Shareholders gave up and rejected their property rights with regard to the bank’s residual value, and refused their claims to the assets obtained after winding-up the ‘bad’ assets.

1023 Hoelscher D.S., *Supra* note 2. P. 109.

With nationalisation, the fiscal outlay is limited to the amount of funds needed to bring the capital level up to supervisory norms (the size of the hole plus additional capital)¹⁰²⁴.

On the other hand, nationalisation may have adverse effects. Bank nationalisation in any case erodes the discipline of the financial market, distorts the market (as the government gives an explicit guarantee, besides, less strict prudential regulatory requirements are imposed). Bank shares, that have been taken over by the government are almost impossible to sell, moreover, it usually causes additional indirect costs. For example, borrowing funds on international markets (subject to political will) is, respectively, directly related to the slowdown in the state's financial development and financial output or, to further litigation on the value of shares. Another related legal issue is evidenced in the Lithuanian legal framework – the legislation does not prescribe any deadline for settlement with shareholders for the shares disposed of. One other major disadvantage of this tool is that if other creditors of the bank believe that the government will step in and protect them anytime a bank fails, they will have no reason to monitor the bank's operations and fiscal security i.e., they fail to impose discipline. Legal literature describes this term as a risk of moral hazard. Among other things, in case of nationalisation, the government or the supervisory authority is not a competent, experienced bank owner, it does not have necessary knowledge or resources (e.g., human), which suggests that it would not be capable of managing the bank in a proper and effective manner, moreover, political risk arises, decision-making is not efficient enough¹⁰²⁵, and there are doubts around methods and grounds of information transmission to third parties; the speed and quality of decision-making are to some extent dependent on a political will. Furthermore, if the bank, as a going concern, does not apply the bank resolution tools to its troubled assets, the bank may continue to incur losses even, after being takenover by the state. For example, a state-owned bank may also be under-capitalised. It should also be noted that pursuant to the Law on Insurance of Deposits and Liabilities to Investors of the Republic of Lithuania, deposits by natural and legal persons of up to EUR 100 thousand are insured. This means that upon the suspension of the bank's activities or failure of the bank to meet its obligations, all persons holding deposits of up to EUR 100 thousand within the bank would recover them. However, the deposit amount exceeding EUR 100 thousand is not insured and there is a risk that the assets held by the bank will not be sufficient to repay these deposits. Moreover, it should be borne in mind that the litigation to protect against unfair actions of shareholders (especially when managers' and owners' actions are not only unsuccessful but also blatantly criminal, or, depositors' funds are pledged for loans or transferred to other schemes potentially associated with shareholders in offshore jurisdictions, etc.) and to "pump" assets to the bank or

1024 Ibid.

1025 The Government adopts the decision on the financial stability measure. The Ministry of Finance examines and analyses the information received, identifies the problem, selects accurate particular measure, determines the availability of resources, and prepares the draft government resolution. In 2008, the government of the Republic of Lithuania approved the financial crisis prevention and management plan and set up a permanent Financial Crisis Prevention and Management Commission. In all cases, the information can be reviewed both by the Ministry of Finance and the Financial Crisis Prevention and Management Commission, it therefore implies that the group of people involved is too large.

to declare certain transactions void may become time-consuming, meanwhile, the bank's assets may be devalued or become illiquid.

It is important to note that there are instances in practice where bank stabilisation measures are confused with temporary administration (early intervention and/or official administration tool). It should be noted that the temporary administration of the bank is just the initial phase of bank insolvency procedures taking place before recognition of the bank's insolvency, where the supervisory authority, as a part of exercising its rights, takes over control of the bank's operations and decides what further actions to take in respect of the failing bank. The purpose of such actions is twofold: i) provides legal protection to the Bank (solvency diagnosis) ii) at the same time, allows for the consideration of methods to deal with the bank's financial trouble, including a possible application of financial sustainability measures, bank resolution alternatives, and immediate liquidation of the bank. The "temporary administration" procedures should be equated with bank insolvency procedures as they are applied in the pre-insolvency stage, whereupon the bank's activities are temporarily suspended. Further, pursuant to the law, the official administrative procedures involve an official authority (in EU – a *temporary administrator* and/or a special manager¹⁰²⁶; in Switzerland – a *special investigating agent*¹⁰²⁷, who takes control of the bank in order to protect the bank's assets, to assess the current condition of the bank, and to restore the solvency of the bank to the greatest extent possible. The powers of the official administrator cease after the bank has been restored as a going concern, or it is decided to apply a certain bank resolution mechanism, and/or to liquidate the bank. Official administration has a temporary nature and, thus, must be performed as quickly as possible¹⁰²⁸. A more comprehensive analysis is not a part of this thesis.

1026 Temporary administrator either replaces the managing body of the bank on a temporary basis, or temporarily works in conjunction with the senior management of the bank. The competent authority in each case defines the powers of the temporary administrator. The key functions are: to secure the financial situation of the bank, to administer bank business (or a part thereof) administration to preserve or restore the financial condition of the bank and application of measures in order to restore the sound and prudent management of the institution's activities. The special administrator replaces the managing body of the bank and can implement reforms towards the implementation of the resolution objectives, under the control of the conversion authority.

1027 Federal Act on the Swiss Financial Market Supervisory Authority of 22 June 2007 (Status as of 1 January 2015). Art. 36.

1028 IMF, WB. *Supra* note 86. P. 26-31.

III. PUBLIC AUTHORITIES AND RESOLUTION DECISION CONTROL

3.1. Key Public Authorities Involved in Bank Insolvency Procedures, their Role

The doctrine names the following critical *functions* of public institutions directly related to bank insolvency procedures: prudential regulation, supervision, lender of last resort, deposit insurer, and insolvency administrator. The *infrastructure* of public authorities, which play a significant role in the bank insolvency procedures, consists of the following main institutions: banking supervision authority, deposit insurance authority, and courts. Initially, the role and significance of public authorities have emerged in the general insolvency law and differences in the bank resolution legislation. For example, there are significant differences in bank insolvency and/or resolution provisions, as well as criteria for commencing bank insolvency procedures. The right of initiative in the insolvency procedures, in particular, belongs to the following counterparties: the company, creditors, who are seeking to satisfy their financial claims against the borrower, and shareholders. The *banking supervisory authority* commences bank insolvency procedures at its own initiative. It plays a central role and exercises exclusive rights in maintaining stability of the banking (financial) system, managing information on banking activities, thus, it can assess the real situation and the extent of financial problems faced by the bank in the most objective manner. This common regulation and its essence is based on the assumption that after the official commencement of bank insolvency procedures, the information may have a systemic effect on the society and banking supervisory authorities should therefore be responsible for the consequences thereof. The importance of the supervisory authority is best demonstrated by the example to the contrary, as to what would happen if banking supervision procedures were decentralised. Creditors could take unreasoned or even lightminded actions against the bank to satisfy their claims, start “assets races”, and so on. The role and powers of the *deposit insurance authority* depend on the jurisdiction in which it operates. On the one hand, the primary purpose of the *deposit insurance authority* is to compensate bank depositors for losses resulting from bank failure and to protect depositors against systemic risk and, at the same time, to protect the bank against massive deposit outflows. On the other hand, in some cases a deposit insurer may acquire more extensive rights. For example, if a bank faces financial trouble, the DIA can take over the bank and act as an administrator of the insolvent bank, thus controlling the entire bank insolvency procedure (in the case of the U.S.). Eventually, bank insolvency procedures are inseparable from *courts*, acting in certain states as competitive priority enforcement authorities. First, national courts enforce justice; second, the courts have powers to administer bank bankruptcy procedures; third, they act as a verifying authority that reviews administrative decisions, enabling the parties concerned to defend their rights and interests and to expect an independent judgment on decisions taken by the banking supervisory authorities (legality and validity review). It is important to note that the banking crisis and its management may *inter alia* involve public funds and cause additional related costs, therefore, the government (*national ministries of finance*) may also play its role in the bank insolvency procedures.

The recent banking crisis has demonstrated that a failing or likely to fail bank needs public intervention, not only in the form of bank resolution and/or liquidation procedures, but also by providing the means, even if short-term, to finance bank resolution¹⁰²⁹. This assumption is based on the fact that, once insolvency procedures start, the banks are likely to lose access to private funding markets, and the state therefore often remains the only source of liquidity and capital for the distressed bank. Another important aspect is related to the need for simultaneous intervention of several public authorities with different roles in the bank insolvency procedures. *Why is it so important to delimit public authorities and the functions implemented by them in the bank insolvency procedures?* First of all, the detailed discussion on the role of public authorities in different jurisdictions is important both nationally and internationally, in particular, if banks are operating across several countries where the role of the relevant public authorities may vary. *Second*, public authorities, such as the Central Bank, IDI, play their vital role both at the bank pre-insolvency phase and after the recognition of bank insolvency. *Third*, banking crises and the corresponding bank defaults are inseparable from political risk. In case of a serious banking crisis, it is very likely that some governments will be forced to engage in bank insolvency procedures¹⁰³⁰, for example, request information that is usually subject to strict confidentiality provisions, or even make attempt to manage the banking crisis, in search for the ways to resolve the financial difficulties faced by a bank. Moreover, the recent banking crisis echoed numerous prominent political statements and attempts to influence (even including uncontrolled interference or attempts to promptly amend the existing legal regulation of bank insolvency procedures) in many states. Such government intervention in resolving solvency problems is based on the logic that politicians often seek to be in the public eye and attempt to manage and find certain solutions for the banking crisis. Once a bank faces financial trouble in any State, it will be unlikely to avoid political elements and political influence, unless the bank is very small and is considered to be systemically irrelevant. With regard to this aspect, it is very important to identify the role of public authorities and their key functions. *Fourth*, it should be noted that the laws governing legal bank insolvency relations are, to some extent, convergent, depending on the legal framework of a particular jurisdiction, which consequently leads to diverse roles and powers of the relevant authorities in both bank resolution and liquidation processes. Insolvency procedures of multinational failing banks are even more complicated. Since the complexity of bank insolvency procedures determines the responsibility of public authorities, it is extremely important to understand the rules applicable to the *ex ante* bank insolvency procedures and designed to resolve failing banks. The banking crisis, bank resolution and/or liquidation mechanisms are inseparable from the banking crisis prevention, particularly, from adequate and sufficient banking supervision and effective legal regulation of insolvency procedures to be enforced by the relevant competent authorities. Eventually, single authority of a certain jurisdiction can perform more than one function.

1029 Pauly L.W. The Old and the New Politics of International Financial Stability. *Journal of Common Market Studies*, Vol. 47, No.5, 2009. P. 958-959.

1030 This phenomenon could be observed throughout many banking crises. A good example is the situation in the UK, where the Prime Minister Gordon Brown has firmly taken the lead in search of solutions to the crisis and was keen to be seen in the society as the solver of the difficulties faced by the distressed bank. Lastra R.M. *Cross-border bank insolvency*. *Supra* note 74. P. 75-80.

3.1.1. Supervisory Authority and/or Central Bank

The Central Bank (the CB) is a public entity¹⁰³¹. One of the most common characteristics of the CB legal framework is the multifunctionality of CB objectives in exercising its powers¹⁰³². For example, the Central Bank is responsible for formulation and implementation of the national monetary policy, supervision of the payment system, keeping and managing national external reserves, supervision of commercial banks, etc. It implements the above functions by virtue of particular rights and powers granted under the law and in accordance with particular responsibilities¹⁰³³. According to the doctrine, the CB has three main objectives and roles: (i) to maintain price stability in consistence with the national monetary policy; (ii) to maintain financial stability and foster financial development; (iii) to meet the financing needs of the state during the crisis, and to restrict the state's abuse of financial powers in normal economic conditions¹⁰³⁴. The analysis of the specific principles and objectives of the CB related to the implementation of the financial stability policy is provided below.

The banking supervisory authority is in charge of banking licensing, approval of a bank as a legal entity, its compliance with licensing (operational) requirements, it also implements and enforces prudential regulations, as well as monitors and supervises banking activities¹⁰³⁵. Besides, one of the primary duties of the supervisory authority is to monitor banks, to take appropriate legal measures aimed at the protection of interests of bank depositors, to determine cases of bank insolvency, to take corrective actions, i.e., to impose sanctions that would assist in maintaining market discipline, including revocation of the banking license, initiation of bank insolvency proceedings, and/or bank takeover, to adopt other decisions on bank resolution and/or liquidation.

In the relevant jurisdictions, the banking supervisory authority has the power to commence bank insolvency procedures. In essence, this situation is opposite to corporate insolvency procedures in which both creditors and managing bodies are entitled to com-

1031 Gianviti F. The Objectives of Central Banks. (in) Cottier T., Lastra R.M., Tietje Ch, Satragno L. The Rule of Law in Monetary Affairs. Cambridge University Press, 2014. P. 449.

1032 Ibid.

1033 The powers (*imperium*) allow their holders to take binding decisions (e.g., the power to collect taxes, adopt secondary legislation or a decision to close the bank). A right (*jus*) is understood as a legally protected interest (such as the right to collect fees associated with the provision of services, the right to ensure the fulfillment of contractual obligations, the right to property, the right to compensation, the right to sell the product, etc.).

1034 Goodhart C.A.E. *The Changing Role of Central Banks*. Financial Markets Group. London School of Economics, 2010. P. 1. Parker D., IMF. *Supra* note 86. P. 7-12.

1035 The doctrine distinguishes the following essential powers of the supervisory authority: (a) to give orders and to oblige the bank to comply with restrictions with regard to the payment of dividends or salaries and bonuses to the managing bodies, to restrict lending and investment transactions and/or limit the collection of deposits or otherwise limit the indebtedness; (b) to order the bank to change the system of its managing bodies or to undergo other organisational changes, to adjust its internal control systems (e. g., the Prevention Department) or the methodology applied by its managing bodies; (c) to give instructions to avoid certain unreasonable business operations and the associated restrictions; (d) to order the bank to introduce additional security conditions for certain loans already issued, to prepare for capital increase, close bank branches, etc.; (e) to limit deposit-taking/ collection; (f) to restrict the bank's license. Hüpkens E. *Supra* note 71. P. 32-36.

mence insolvency procedures themselves. The powers of banking supervisory authorities with regard to bank licensing and supervision allow assuming that the banking supervisory authority is in a good position to determine when and to what extent a bank is facing severe financial trouble, which requires further intervention by the supervisory authority or application of other sanctions. This position can be considered fair, because, first of all, unlike the banking supervisory authority, creditors do not have access to all financial information in order to adequately assess the financial situation of the bank, moreover, they may lack specific knowledge on the complicated legal and economic nature of banking. Second, if creditors had the right of initiative to commence bank insolvency procedures, it would imply a risk of delay of insolvency procedures in order to prevent any personal loss, which, consequently, would aggravate financial trouble of the bank or even encourage more intense outflow of deposits from banks, and also disrupt the restoration of solvency of the bank under resolution. Third, apart from deposit collection and lending, many banks, as mentioned above, are involved in additional financial activities, such as placement of securities, management of investment funds, asset management and insurance businesses. These issues are subjected to different and highly specific regulation that may be misunderstood by creditors.

Among other duties, the CB acts as a supervisory authority, as a *financial stability enforcer*, which is one of its primary objectives. In essence, the CB formulates and implements the state monetary policy, supervises the payment system, controls and manages national external reserves, etc. The CB implements these functions under certain rights (powers) and obligations. *Financial stability* is widely recognised as one of the main objectives pursued by the CB¹⁰³⁶ and established by law. In other cases, legal regulation obliges the CB to perform this specific function under implementing provisions, such as the provisions regulating the CB emergency financial assistance to banks, the lender of last resort¹⁰³⁷ function, or maintenance of the payment system. Supervision of banks (or other financial institutions) reflects the common endeavour to seek for financial stability. However, the legislation does not usually define common objectives of financial stability¹⁰³⁸ or their impact on the Central Bank's activities, powers, and monetary policy objectives. Thus, one of the objectives of the CB is to contribute to overall stability of the financial system¹⁰³⁹.

For example, *in the U.S. legal framework*, the Federal Reserve performs multiple functions with no specific priority, and generally describes all the functions as monetary policy instruments and objectives. Section 2A of the Federal Reserve Act of 1933¹⁰⁴⁰ (the Act was supplemented in 1977) provides that the CB seeks “monetary policy objectives,” “*The Board of Governors of the Federal Reserve System and the Federal Open Market Committee*

1036 Gianviti F. *Supra* note 1031. P. 474.

1037 Winkler A. *The ECB as Lender of Last Resort: Banks versus Governments*. LSE Financial Markets Group Special Paper Series, 2014.

1038 Other definitions of financial stability can also be found: financial stability is defined as a condition under which the financial system is able to cope with economic shocks and financial imbalances and it is unlikely that financial intermediaries will suffer enough various negative disorders significantly affecting the profitable investment opportunities. Shinasi G. *Financial Stability-Theory and Practises*. IMF, Washington DC, US, 2006. P. 80.

1039 Gianviti F. *Supra* note 1031. P. 485.

1040 12 USC 225 (a).

shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Implementation of the monetary policy is not the only and primary function of the Federal Reserve. The primary objective of the CB is to address financial difficulties of banks, and deposit panic issues, thereby, the Federal Reserve implements maintenance tasks, functions, regulates activities of banks acting as a lender of last resort, which is directly related to financial stability¹⁰⁴¹.

Within the Swiss legal framework, in accordance with Swiss Ordinance to the Federal Act on the Swiss National Bank of 18 March 2004. (January 1st, 2015), the CB seeks monetary policy objectives that serve the interests and welfare of the entire country. The CB must ensure price stability, and, for this purpose, properly monitor economic development, in other words, achieve financial stability objectives¹⁰⁴². One of the regulatory objectives is contribution to the stability of the financial system¹⁰⁴³. In determining whether a financial market infrastructure is important for the stability of the financial system, the CB shall, in particular, take the following factors into account: (i) the transactions that are cleared or settled through the financial market infrastructure, and in particular whether they are related to foreign exchange, money market, capital market or derivatives transactions, or transactions that serve to implement monetary policy; (ii) the transaction volume and amount cleared or settled through the financial market infrastructure; (iii) the currencies in which transactions are cleared or settled through the financial market infrastructure; (iv) the number, nominal value and currency of issue of the financial instruments held in central bank; (v) participants; (vi) links with other financial market infrastructures; (vii) the possibility of participants to switching to another financial market infrastructure or to an alternative clearing and settlement arrangement at short notice in order to clear and settle transactions, and to avoid the associated risks; (viii) credit and liquidity risks associated with the operation of the financial market infrastructure¹⁰⁴⁴. In addition, the CB shall prepare a plan to ensure the recovery of the SIFI in the event of impending insolvency or other scenarios jeopardising its viability as a going concern¹⁰⁴⁵.

In the EU legal framework, the primary objective of a supervisory authority shall be to maintain price stability. Without prejudice to the objective of price stability, the European

1041 Federal Reserve Act. Preamble.

1042 Ordinance to the Federal Act on the Swiss National Bank of 18 March 2004. (Status as of 1 January 2015). Art. 3.

1043 *Ibid.* Art. 19. Financial stability is defined over the stability of the financial market infrastructure, which respectively relates to the entire Swiss financial system: (i) if there is no access to the financial market infrastructure, especially because of the technical and operational problems or financial difficulties, when any entity operating in the market can lead to severe losses, liquidity weaknesses or financial or operational problems for intermediaries or other financial market infrastructures, or result in serious adverse financial market shocks; (ii) payment or compliance problems of one market participant could spread to other market participants or influence the financial market infrastructure, incurring serious losses, the lack of liquidity or operating problems, or cause serious financial market shocks.

1044 *Ibid.* Art. 20 (2).

1045 *Ibid.* Art. 26.

System of Central Banks shall support general economic policies¹⁰⁴⁶. Second, the ESCB shall act in accordance with the principle of open market economy with free competition, favoring an efficient allocation of resources¹⁰⁴⁷.

The Central Bank may also act as a *supervisory authority*. The reasons why banks must be supervised different from normal businesses, were clearly identified and codified by the BCBS. In 1997, it issued the Core Principles for Effective Banking Supervision, that were later regularly revised and updated¹⁰⁴⁸. They define 25 principles for effective supervision. It was decided that in view of the fact that bank insolvency is inevitable in any system, their financial difficulties should be supervised by the public sector, since the effects on the society might be severe in the case of bank failure. Thus, governments must provide the necessary legal, administrative and judicial powers to supervisory authorities for a timely and effective intervention in banks when needed. The legal doctrine presumes that government intervention must be *prompt* (with no long, disturbing periods between intervention announcement and *de facto* intervention), *transparent* (creditors and other counterparties must be aware of how the intervention will affect their property exposures) *correspond to market practices* (without prejudice clearing, settlement systems, payment completeness, set-off and netting arrangements, collateral enforcement systems and procedures)¹⁰⁴⁹. Supervisory authorities are also responsible for bank licensing and monitoring of banking activities: whether operators meet the licensing requirements and prudential regulation. In addition, supervisory authorities are responsible for the supervision of banks, enforcement of prudential legal regulation, taking adequate measures in order to protect the interests of bank depositors, determine whether a bank is insolvent, imposition of sanctions, including revocation of banking license, and initiation of potential administration, resolution and liquidation procedures. Actions of a banking supervisory authority during the banking crisis must best serve the public interest, as well as the entire economy, by moving away from private economic and political interests. In the case of successful national monetary policy-making and effective banking supervision, independence is one of the key characteristics and criteria. Independence, decisive and clear actions, and uniform application of the law to all market players (level playing field) make the legal banking supervision system more reliable.

The role of a supervisory authority is demonstrated in the example of the EU. The recent banking crisis has revealed major weaknesses in the supervision of financial institutions *within the EU legal framework*, both in terms of individual cases and the entire financial system. It was found that the pre-existing banking supervisory measures were insufficient to avoid, manage and overcome the crisis. It became evident that national supervisory models were far behind the reality - integrated and interconnected European financial markets, in which many financial institutions operate across borders. The finan-

1046 TFEU. Art.127.

1047 Ibid. Art. 119.

1048 BIS. BCBS. Core Principles for Effective Banking Supervision, 2012 [interactive]. [accessed on 2014-12-05] <<http://www.bis.org/publ/bcbs230.htm>>.

1049 Gleeson S. International Regulation of Banking: Capital and Risk Requirements (2nd Edition), Oxford University Press, 2012. Why Banks are supervised? Chapter 2. Part I: The Elements of Bank Financial Supervision. P. 29.

cial crisis has revealed major issues of cooperation among national supervisory authorities, coordination of their activities, consistency and confidence.

It is extremely important to mention the Single Supervisory Mechanism (SSM)¹⁰⁵⁰ that has been established and is now operating within the EU legal framework. It comprises a regulation conferring tasks on the European Central Bank (ECB) and amending Regulation on establishing the European Banking Authority (EBA). The SSM system will include the ECB and national supervisory authorities. Currently, the ECB is responsible for the efficient functionality of the entire SSM.

The amended EBA regulation provides for the ECB's involvement in the activities of the EBA, changes EBA's voting and decision-making procedures, in view of the fact that the EBA will involve Group 2 countries – participating SSM and non-participating SSM. The Regulation, *inter alia*, confers supervisory tasks on the ECB. The SSM comprises the ECB and national supervisory authorities. The ECB will be responsible for efficient operation of the SSM. In cooperation with national supervisory authorities, the ECB will *directly* supervise large, systemically important banks in the SSM participating Member States (at least 3 largest banks in each state). Smaller banks will be *directly* supervised by the national supervisory authorities in accordance with the ECB guidelines and recommendations. In addition, national supervisory authorities will be accountable to the ECB for their decisions.

All the eurozone Member States have joined the SSM, while the states outside the eurozone will be able to choose whether to participate in the SSM (sign the “close cooperation” agreement with the ECB, stating that competent authorities shall follow all regulations of the ECB). Distribution of supervisory functions between the ECB and the national supervisory authorities will depend on the degree of relevance of banks¹⁰⁵¹. Bank relevance will be viewed based on their size, importance for both the economy of a certain SSM participating Member State and in terms of cross-border operations. Among other things, the Regulation *confers the following basic supervisory tasks on the ECB*: (i) to authorise credit institutions and to withdraw authorisations of credit institutions; (ii) to assess notifications of the acquisition and disposal of qualified majority shares; (iii) to ensure compliance with the prudential requirements in the areas of own funds, securitisation, large exposure limits, liquidity, and leverage; (iv) to ensure compliance with regard to reliable governance arrangements (including risk management processes, internal control mechanisms, remuneration policies and practices); (v) carry out supervisory checks, including stress testing; (vi) to carry out supervisory tasks in relation to recovery plans, and early intervention, where a credit institution is in breach of prudential requirements. Within the scope of its supervisory tasks, the ECB will exercise the rights granted by the EU legislation regulating banking activities (including national legislation of the participating Member States

1050 See more 1 chapter sec. 5 subsec. 2.

1051 The credit institution is considered as important, if at least one of the following conditions are met: (i) the total value of its assets exceeds EUR 30 billion; (ii) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below EUR 5 billion; (iii) the national competent authority has determined that the credit institution is systemically important for the local economy; (iv) the ECB considers the credit institution as relevant, as it has subsidiaries engaged in banking activities in more than one participating Member State and its cross-border assets and liabilities represent a significant portion of the total assets or liabilities; (v) financial assistance was requested or directly supplied to it from the European Financial Stability Facility (EFSF) or the European Stability Mechanism. SSM. Art. 50.

transposing the Directive), e.g., to set the requirements for additional capital, liquidity or reporting, to restrict activities, etc.), it will be empowered to impose pecuniary sanctions, and to conduct investigations and inspections.

In the U.S. legal framework, the banking supervision system is unique for its high complexity and consists of five federal regulators – the Board of Governors of the FED¹⁰⁵², twelve Federal Reserve Banks¹⁰⁵³, the Federal Open Market Committee¹⁰⁵⁴, Member-banks, and advisory committees¹⁰⁵⁵. The Board of Governors of the Federal Reserve System consists of 7 members, it supervises 12 Federal Reserve Banks and is responsible for the U.S. national monetary policy. The Twelve Federal Reserve Banks operate regionally and act as the Federal Reserve’s “hand.” The Banks assume a number of responsibilities and functions, such as to keep cash reserves in depository banks of the United States, provide loans to these institutions, supervise member banks, and develop and implement the U.S. monetary policy. The Federal Open Market Committee is directly responsible for regulation and management of open-market operations. Under the law, all U.S. banks are members of the Federal Reserve System, including the Federal Reserve and over 50 U.S. banks and Offices of Thrift Supervision. The U.S. Federal Reserve System implements its functions in cooperation with the Federal Deposit Insurance Institution (FDIC), which was founded upon the adoption of the Banking Law in 1933, during the Great Depression. The main objective of the FDIC is to address the issue of massive withdrawal of deposits (bank runs), to create an effective banking supervision scheme, to effectively deal with financial difficulties of insolvent banks, to establish a supervision system for national banks, to provide guarantees and insurance¹⁰⁵⁶. Therefore, the U.S. banking supervisory system is unique for its complexity, as it consists of four federal governors, including the Federal Reserve, and more than 50 national bank supervising authorities. The Federal Reserve System pursues the following primary monetary policy objectives: to maintain long-term monetary, credit market, economic growth, to increase banking production, in order to effectively promote the goals of maximum employment, stable prices, and moderate long-term interest rates¹⁰⁵⁷. In *Switzerland*, the tasks related to bank insolvency procedures are conferred on different public authorities (the CB and FINMA). Therefore, both the CB and the supervisory authority collaborate and share relevant information¹⁰⁵⁸. For example, it may be required to assess whether a bank has crossed the regulatory limits with regard to insolvency and to encourage a number of specific actions to be taken by the regulated authorities. Financial market supervision pursues the objectives of protecting creditors, investors, and insured depositors as well as ensuring the proper functioning of the fi-

1052 Federal Reserve. Board of Governors of the Federal Reserve System. Mission [interactive]. [accessed on 2014-1-05] <<http://www.federalreserve.gov/aboutthefed/mission.htm>>.

1053 Federal Reserve Act. Section 4. Federal Reserve Banks.

1054 Federal Reserve Act. Section 12 A. Federal Open Market Committee. Codified 12 USC 263(a).

1055 Federal Reserve Act. Section 2. Partially codified 12 USC 222, 223.

1056 FDIA. 12 USC Sec 1811 (f).

1057 Federal Reserve Act. Section 2 A. Codified 12 USC 225a.

1058 Swiss Federal Constitution. Art. 98. Federal Act of 22 June 2007 on the Swiss Financial Market Supervisory Authority. FINMA. Ordinance of the Swiss Financial Market Supervisory Authority FINMA of 15 October 2008 on the levying of supervisory fees and duties.

ncial market. It thus contributes to sustaining the reputation and competitiveness of Switzerland as a financial centre¹⁰⁵⁹.

Finally, the CB may act as a *lender of last resort*. In some cases, in addition to conventional macro-prudential measures, the CB may apply systemic financial stabilisation (sustainability) mechanisms, i.e., take the opportunity to lend to distressed banks and thus provide liquidity to them, for example, to a certain bank that faces difficulties, but having the ‘too big that fail’ status. In this case, if the CB cannot allow liquidation of the bank because of the adverse legal effects, and the market fails to provide more capital, the only means of financing is taxpayers’ money. The doctrine of the CB as a lender of last resort is based on four key elements. *First*, the CB, acting as a lender of last resort, should prevent the collapse of a still solvent bank with temporary liquidity issues. The CB provides loans on a short-term basis. *Second*, the CB should ensure free lending, but charge interest rates for its loans. *Third*, the CB shall provide loans to all banks that have good collaterals valued before panic emergence. *Fourth*, the CB shall be prepared to implement this task by determining borrowing terms in advance. In addition, the doctrine explicitly states that a lender of last resort should act in a discretionary but not mandatory manner. The CB must not only evaluate whether the situation allows identifying bank illiquidity or insolvency, but also whether bank insolvency could result in financial “contagion”. The aim of this task is not to protect a single bank, but to protect the entire market or the financial system¹⁰⁶⁰. For example, the functions of the U.S. CB, the Federal Reserve System, as a lender of last resort, were established in 1914. However, the main amendments took place in 1991.¹⁰⁶¹ The fundamental difference was in easing loan collateral requirements for emergency lending by the CB¹⁰⁶². The main goal was to prevent financial “panic from spreading and to provide a mechanism for limiting any crises that did occur”¹⁰⁶³. This objective enabled creating an ‘asset-backed’ currency market and to establish reserve banks to hold the reserves of the banking system and provide additional currency for short-term borrowing¹⁰⁶⁴. During the recent financial crisis, the FDIC expanded the lending framework¹⁰⁶⁵. In 2007–2010, the Federal Reserve, acting as a lender of last resort, lent more than USD 16 billion¹⁰⁶⁶. Therefore, based on the latest approach U.S., a lender of last resort should generally provide liquidity to markets as a whole rather than focus on a certain bank, but rather to, as bank insolvency inevitably causes severe adverse effects on credit

1059 Federal Act on the Swiss Financial Market Supervisory Authority of 22 June 2007 (Status as of 1 January 2015). Art. 5.

1060 Lastra M.R. *Lender of Last Resort. An International Perspective*. International and Comparative Law Quarterly, Vol.48, 1999. P. 340-361.

1061 1991 Federal Deposit Insurance Corporation Improvement Act amended Section 13(3) of the Federal Reserve Act.

1062 Walker F. T. *FDICIA's Emergency Liquidity Provisions*. Cleveland Federal Reserve, Economic Review, No. Q III, 1993. P. 20.

1063 Carlson M.A., Wheelock D.C. *The Lender of Last Resort: Lessons from the Fed's First 100 Years*. Federal Reserve Bank of St. Louis. Working Paper 2012-056B, 2013. P. 2.

1064 Ibid.

1065 Michel J.N. *The Fed's Failure as a Lender of Last Resort: What to Do About It*. The Heritage Foundation, Washington DC. No. 2943, 2014. P. 8-9.

1066 Ibid. P. 9.

markets. According to the general rule, if a financially troubled bank can no longer fulfill its obligations, it must be allowed to fail, while investors must bear losses. However, if it is possible to identify justified risks of systemic bank collapse and systemic risk, the FED shall intervene and ensure adequate liquidity in the banking system in order to rebuild market confidence¹⁰⁶⁷.

3.1.2. Deposit Insurance Institution

Deposit Insurance Authority (DIA) implements two main aims in the context of bank insolvency procedures: protects against systemic risk and provides protection for individual depositors, while addressing social inequalities¹⁰⁶⁸. Another goal of the DGS– is to compensate depositor losses resulting from bank insolvency and protect depositors against systemic risk, while safeguarding the bank from massive withdrawal of deposits¹⁰⁶⁹. It also facilitates the operation of the single market in certain jurisdictions, such as the EU common market. The doctrine explains the legal nature of DIA through the existing information asymmetry in the banking business¹⁰⁷⁰. It is presumed that banks have more knowledge and information about their own products and the financial, legal and regulatory environment in which they operate, compared to consumers or even securities analysts¹⁰⁷¹. Therefore, DGS, among other things, seeks to resolve the information asymmetry problem. DIA guarantees that depositors will recover their cash if the bank becomes insolvent. In addition, it should be noted that, given the experience of the banking crisis, it is obvious that avoiding moral hazards in the absence of DGS is not possible¹⁰⁷². Were it not for the DGS and DIA, investors would fear losing their deposits in the case of bank insolvency. It is likely that in the absence of DGS, many depositors would withdraw their deposits from the bank at the same time, as they often behave irrationally. Such a situation would obviously destabilise the activities of the bank, which would fall short of funds and be forced to go bankrupt¹⁰⁷³. DGS is designed to cover and protect only certain depositors¹⁰⁷⁴ secured by the law and only to a certain extent, accordingly, it would not secure

1067 Wallison P.J. *The Future of Banking: The Structure and Role of Commercial Affiliations*. Federal Reserve Bank of Chicago's. Annual Conference on Bank Structure and Competition. American Enterprise Institute. May 5, 2000.

1068 Cartwright P. *Understanding, Awareness and Deposit Insurance*. (in) *Supra* note 27. Chapter 9. P. 139-140.

1069 Reiser N. *Supra* note 94. P. 3.

1070 Sabourin P.J. *Rethinking The Role of Deposit Insurance: Lessons From the Recent Financial Crisis*. (in) *Supra* note 27. Chapter 8.

1071 *Ibid*. P. 141.

1072 White E. *Deposit Insurance*. WB Policy Research Working Paper No. 1541, 1995. P.12. Diamond W.D. *Banks and Liquidity Creation: a Simple Exposition of the Diamond-Dybvig Model*. (in) *Fed. Res. Bank, Richmond Econ Q*, Vol. 93, No. 2, 2007. P. 189.

1073 Diamond W.D. *Banks and Liquidity Creation: a Simple Exposition of the Diamond-Dybvig Model*. (in) *Fed Res Bank, Richmond Econ Q*, Vol. 93, No. 2, 2007. P. 189.

1074 For example, in the EU legal framework, Member States shall ensure that the coverage level for the aggregate deposits of each depositor is EUR 100 000 in the event of deposits being unavailable. Deposit repayment excludes deposits held by other credit institutions on their behalf and for their own account, deposits of collective investment undertakings, deposits of public authorities and other deposits referred to in the Directive. DGS. Article 6(1), Art. 5 (1).

unprotected depositors¹⁰⁷⁵ or other creditors of the bank. For example, other banks or insurance companies may be excluded from the scope of deposit insurance, normally raising considerable amount of cash held in a particular bank. Such a restriction is aimed at avoiding moral hazard problems, maintaining market discipline and exerting certain economic pressure on banks. In addition, as mentioned above, banks have more knowledge about their activities, such as the quality of assets, size of liabilities, staff competences and their intentions and strategic plans for the future. For this reason, DGS is a solution to the information asymmetry problem. Decision of bank customers on where to deposit and keep their cash becomes a less significant problem when depositors are guaranteed that they will recover their (secured) deposits in the case of bank insolvency. In the EU, the US and Switzerland, DIA is responsible for proper administration of the DGS. DIA collects fees from banks, invests the accumulated funds and pays monetary compensations to bank depositors after the bank is declared insolvent. After depositor claims are compensated, IDI takes over all the rights, with the ensuing obligations for the debtor, and subrogation occurs¹⁰⁷⁶. Then the insured is involved in the liquidation procedures of the insolvent bank and often becomes the main creditor in the bank bankruptcy procedure. For the reasons mentioned above, IDI has a direct interest in preventing bank insolvency, and in most jurisdictions the deposit insurance agency, inter alia, disposes extensive inspection and audit powers and acquires the right to request all the relevant information and documents on the financial situation of the bank and impose sanctions. The jurisdictions relevant for the study are characterised by specific DIA features.

DGS is an important element in the EU financial supervision system. The main aim of the revised Deposit Guarantee Schemes Directive is to ensure the same level of legal protection for depositors throughout the EU, to protect them against the consequences of bank insolvency, which would accordingly eliminate internal market distortions and unfair competition¹⁰⁷⁷. However, at the same time, DGS performs incidental functions, as it should contribute to bank resolution financing¹⁰⁷⁸. Thus, in the EU Member States, where permitted according to their national law, that DGS is able to pursue compensation function, but also performs a preventive function, i.e. seeks to use the available resources

1075 Deposit insurance does not cover the repayment of deposits in excess of EUR 100 000. Social and other types of deposits may be protected during the relevant period above EUR 100 000. DGS. Article 6(2).

1076 After a creditor realises its claim, they becomes a new creditor instead of the old creditor and assume the same rights held by the former creditor, and shall not acquire rights not held by the former creditor. Whether it is useful to treat an Deposit Insurance Corporation as an average creditor, is a difficult and complex issue. This issue is analysed in more detail in a separate article written by the author. In the event of subrogation, the insurer takes over the rights and duties of the depositors, as the majority of liabilities pertain to depositors, and the Deposit Insurance Corporation becomes the largest creditor of the insolvent bank and continues to play a very significant role in the bank resolution process. If under the insolvency laws depositors are treated as preferred creditors, as in the case of Lithuania, in Switzerland and the United States, respectively, the deposit holder transforms into a preferred creditor shortly after the funds are paid to depositors. Ambrasas. T. *Supra* note 460.

1077 DGS. Recital (6).

1078 *Ibid.* Recital (15).

in order to avoid bank defaults¹⁰⁷⁹, compensation of costs to depositors and other adverse effects. To achieve these objectives, EU Member States shall designate the appropriate administrative authority¹⁰⁸⁰. The competent public authorities, the designated authorities, resolution authorities and the respective administrative authorities must cooperate with each other¹⁰⁸¹. In addition, each Member State must imperatively ensure that at least one or several DGS authorities is introduced and officially recognized on their territory. If these requirements of the Directive are not complied with, in essence, this means that the bank may not accept deposits in that Member State, and a threat of license revocation arises. Another obligation of the DIA in view of the size of the bank and interconnections between credit institutions is to determine *ex ante* whether bank liquidation under normal insolvency procedure will not jeopardise the financial stability of the bank and whether the bank is better suited for a resolution procedure. DGS is also entitled to perform inspection activities¹⁰⁸². The main objective of this right is to ensure that the costs of such measures undertaken to prevent credit institution default should not exceed the costs associated with the preservation of insured deposits in the credit institution or the protection of the institution itself. Thus, the deposit insurance agency must actively cooperate with the principal banking supervisory authority, e.g. the CB, in order to avoid liquidation of the bank. The role of DIA coincides with the role undertaken by the bank resolution authority. IDA should be able to offer assets for purchase to another bank in order to facilitate merger procedures with another bank or to reduce the total closure risk and damages that may result from the subsequent bank insolvency. Other relevant aspects of the EU DIA are discussed in point 2, Section 5, Chapter 1.

In the *U.S. legal framework* all deposit-taking financial institutions are subject to federal deposit insurance rules under the FDIC Act¹⁰⁸³ or under the Federal Credit Union Act. The DGS was revised in 2006¹⁰⁸⁴. The Federal Deposit Insurance Reform Act¹⁰⁸⁵ and the related legislative amendments provided for a common deposit insurance fund, while the bank insurance fund and the Savings Banks Association Insurance Fund have been

1079 The recital to the Directive notes that unavailable deposit' means a deposit that is due and payable but that has not been paid by a credit institution under the legal or contractual conditions applicable thereto, where either:(a) the relevant administrative authorities have determined that in their view the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and the institution has no current prospect of being able to do so; or (b) a judicial authority has made a ruling for reasons which are directly related to the credit institution's financial circumstances and which has the effect of suspending the rights of depositors to make claims against. DGS. Art 2(1) (8), (a) (b).

1080 DGS. Art. 3 (1).

1081 Ibid. Art. 3 (2).

1082 Ibid. Recital (16).

1083 FDIA. Section II. 12 U.S.C. 1813 (c) (1). 12 U.S.C. § 1821.

1084 The FDIC is vested with broad powers with regard to "deposit-taking institutions", "banks that are defined as banks and members of savings banks association". 12 U.S.C. 1813 (c) (1), the 1815th.

1085 The Federal Deposit Insurance Reform Act of 2005 The Federal Deposit Insurance Reform Conforming Amendments Act of 2005 Public Law No. 109-171, tit. II, 2101-2109, 120 Stat. 4, 9-21 (February 8, 2006) Public Law 109-173, 119 Stat. 3601 (February 15, 2006). *See more* FDIC. Highlights of the Reform Act [interactive]. [accessed on 2014-11-05]. <<https://www.fdic.gov/deposit/insurance/reform.html>>.

merged. In addition, in October 2008 the FDIC increased the deposit insurance amount from USD 100 000 to USD 250 000¹⁰⁸⁶. The increase of the temporary deposit insurance coverage came into effect in 2009 and operated until 2013. Eventually, a permanent legal act was adopted, by incorporating its provisions into the Dodd-Frank Act and consumer protection legislation. Under the existing DGS system, the US deposit insurance fund is financed *ex ante*, after considering the key bank risk profile-based criteria governing collection of fees. All the banks must pay the fee, in view of the bank's income and total assets held, and the concentration in the legal system of bank insolvency procedures. In contrast to the Swiss legal system, deposit insurance fees are based not only on the balance sheets of insured banks, but also on the risks posed by banks to the deposit insurance fund (risk-based approach). This legal regulation allows the FDIC to interpret individual risks faced by a specific bank in their broad sense¹⁰⁸⁷. Individual bank risk is assessed taking the four key risk elements into account. A system based on individual bank risk is understood as a potential of the bank to incur losses for the deposit insurance fund, in view of the bank's assets and liabilities, the amount of losses after the collapse of the bank and the revenue needed for the deposit insurance fund¹⁰⁸⁸. Where necessary, the FDIC is entitled to collect additional charges *ex post* to finance the fund after a certain bank becomes insolvent. The FDIC can borrow from the US Treasury, the Federal Financing Bank, the Federal Loans Bank and other insured deposit-taking financial institutions¹⁰⁸⁹. In addition, deposit insurance is guaranteed by the federal government¹⁰⁹⁰. Thus, the US deposit insurance system is based on a hybrid financing scheme funded both *ex ante* and *ex post*.

The FDIC operates under federal law, except where legal regulation expressly provides for other, more specific provisions. The FDIC holds extensive rights, powers and privileges¹⁰⁹¹. Although the main purpose of the FDIC is insure bank deposits¹⁰⁹², it should be noted that the outstanding feature of the U.S. legal framework that the FDIC, while operating as a DIA, is not only responsible for the federal administration of the DGS, but also can act as receiver of the insolvent bank¹⁰⁹³, if the deposit-taking financial institution, the bank, as an insured person, becomes insolvent¹⁰⁹⁴. The FDIC is in charge for the administration of the federal deposit insurance system¹⁰⁹⁵, but it also acts as the administrator of the insolvent bank, directed by the following key functions and powers: (i) to find an op-

1086 Federal Deposit Insurance reform Act. 2013 (c). Codified 12 U.S.C. 1821 (a) (3) (A).

1087 FDIRA. 2104-2106, 120 Stat. 4, 12-16. Codified 12 U.S.C 1817 note, 1817 (b) (1) (E)-(F), 1817 (b) (2) (A)-(B), (D), (b) 3, (b) (5), (g), 1828 (h).

1088 FDIC. Reform of Deposit Insurance. Risk Based Assessment System [interactive]. [accessed on 2014-11-05]. <<https://www.fdic.gov/deposit/insurance/reform.html#rbas>>.

1089 FDIC. Financial Statements and Notes. Deposit Insurance Fund. P. 67. FDIC Act. Sec. 11A. Codified 12 U.S.C. 1821.

1090 FDIA. Sec. 11 A (B) (c). Codified 12 U.S.C. 1821a(c)-(f).

1091 Supreme Court. *O'Melveny & Myers v FDIC*. No. 93-489, 512 U.S. 79 [1994].

1092 Williamson P.B. *Insolvency Issues And The FDIC*, New York: Nova Science Publishers, 2010. EBSCO-host.

1093 FDIA. Sec. 9 (a). Corporate powers. Codified 12 U.S.C. 1819(b).

1094 Ibid. Sec. 12. Codified 12 U.S.C. 1822.

1095 Regarding to the dual competences see more *Goodwin v. FSLI*, 806 F.2d 1290 [1987]. *Womble v. Dixon*, 752 F. 2d 80 [1984].

timal bank resolution solution (with respect to the deposit insurance fund); (ii) to strictly comply with the legally established hierarchy of bank creditor claims¹⁰⁹⁶. Thus, the US law provides for dual responsibility of the deposit insurer: responsibility for the insolvency procedure of the failing bank and responsibility for using the income accrued in the fund, i.e., for payoffs to approved creditors and the distribution of assets. However, this situation is rather extraordinary both for the EU and Switzerland, as the DIA is granted with fewer powers and rights, and it comes into play only after the insured event and the ensuing duty to cover depositor claims. However, as in other jurisdictions, in the United States, the FDIC seeks to maintain minimum own losses and to recover the maximum share of the insolvent bank assets. Thereby the DIA ensures that in the face of financial difficulties of the bank, public finances will be preserved to the maximum. It should be noted that the US law provides for an exception in the system under which the FDIC may depart from the least cost principle, if any bank resolution tool poses a threat to financial stability or the real economy.

The second package of DIA functions, rights and obligations relates to the fact that the FDIC may act as conservator of the insolvent bank¹⁰⁹⁷, but this is rarely used in practice. A bank may be subjected to conservatorship, by appointing the FDIC as a conservator, replacing senior management of the bank, or placing temporary restriction on their rights. The purpose of conservatorship is to reform the banking operations in order to strengthen the financial position of the bank or to prepare for bank purchase or merger with another financial institution rather than to close the bank on a temporary basis¹⁰⁹⁸. Acting as the bank supervisor, the FDIC may rescue and rehabilitate the bank without revoking its license. In this case, the FDIC takes over the management of the bank from its managing bodies, but the bank will continue to operate. If the FDIC is appointed as the insolvency administrator of the bank, the bank is finally closed in legal terms and removed from civil circulation. In this case, senior managing bodies and shareholders are excluded from bank management without court intervention. The third group of the FDIC functions and rights is related to the controlled liquidation process of the bank, if the FDIC decides to use immediate bank liquidation tool (depositors pay-off), including asset sale and cash distribution to creditors. In this context, it should be noted that the FDIC, acting as the administrator of the insolvent bank, can employ two basic bank resolution methods: (i) direct deposit pay-off and subsequent liquidation of the bank; (ii) transfer of the bank's assets, rights, transactions and liabilities, and the liquidation of the remaining "bad" assets. If the first option is selected, the insured depositors receive their part or the insolvent bank is sold to a sound bank. In the first case, the FDIC liquidates the "bad" assets of the bank and sells the bank assets (acting through the creditors' committee) and at least partly covers the losses incurred, by paying compensations to depositors. Deposit pay-off method is rarely used, because it is believed that the bank asset liquidation process is expensive and, furthermore, the FDIC must commission the fund in advance to make immediate payouts to insured depositors, and the process can protract. In the second case,

1096 FDIA. Sec 11, 2 (a).

1097 Ibid. Sec. 11, (c)-(e), (2) (A) (8). Codified 12 U.S.C. 1821(c).

1098 McGuire C.L. Simple Tools to Assist in the Resolution of Troubled Banks. World Bank, Washington, DC, 2012. P. 3.

the FDIC is looking for a purchaser, a financially capable bank, willing to buy all or a part of the bank's assets and liabilities. Finally, it is important to note that in August 2010 the FDIC Board of Directors established the Complex Financial Institutions Bureau, which became the focal point acting as a systemic bank resolution authority. Its main purpose is to coordinate bank insolvency procedure along with other FDIC departments and offices, by ensuring an adequate level of expertise and support for the implementation of the FDIC functions¹⁰⁹⁹: monitoring (systemically important, complex banking risk management), restructuring planning and implementation (responsible for the review of restructuring plans *ex ante*), coordination of international action (coordination of action with the competent authorities of foreign jurisdictions in the case of cross-border bank resolution)¹¹⁰⁰.

The Swiss banking law came into force in 1935.¹¹⁰¹ This legal act was governing the privileges granted to bank depositors in the case of insolvency, by restricting their scope, for example, by insuring depositors up to CHF 5000 CHF¹¹⁰². More stringent rules governing depositor protection were created only in 2004¹¹⁰³. Moreover, in view of the global financial crisis of 2008, the deposit insurance system was reviewed once again and the final version of the law came into force at the end of 2010¹¹⁰⁴. The last amendments were made in September 2011¹¹⁰⁵. Under the current wording of the law, if a Swiss bank fails, depositors are immediately compensated up to CHF 100 000 CHF¹¹⁰⁶. Before such payment, the FINMA needs to assess the liquid assets of the bank and the priority of the remaining creditor claims¹¹⁰⁷. Banks are under an obligation to participate in the deposit insurance system¹¹⁰⁸. Depositors must be paid within 20 business days from the date of application of resolution tools to the bank or opening of bankruptcy proceedings. According to the self-regulatory principles, the minimum regulatory standards approved by FINMA¹¹⁰⁹ provide that the compensation must be paid to depositors within 5 days from the date of official confirmation of the resolution tool¹¹¹⁰. The banking industry was subjected to a new maximum amount of the DGS, which can be collected from the banking industry, i.e., from CHF 4 billion up to CHF 6 billion. The insurance amount is still funded *ex post*. *Ex ante* DGS funding was rejected by the Parliament¹¹¹¹. Therefore, the money is collected from

1099 Office of Inspector General. The FDIC's Progress in Implementing Systemic Resolution Authorities under the Dodd-Frank Act. Office of Audits and Evaluations. Report No. AUD-14-00, 2013. P. 1.

1100 Ibid. P. 9.

1101 Bundesgesetz über die Banken und Sparkassen. (Bankengesetz, SR 952.0).

1102 FINMA. Chronologie. [interactive]. [accessed 2014-12-05]. <<https://www.admin.ch/opc/de/classified-compilation/19340083/history.htm>>.

1103 Emch/Renz/Arpagaus (Fn 18). N 1462.

1104 Botschaft des Bundesrates zur Änderung des Bundesgesetzes über die Banken und Sparkassen vom 5. November 2008, BB1 2008, 8841, 8853.

1105 Bericht des Eidgenössischen Finanzdepartements über die Vernehmlassungsergebnisse zu einem Bundesgesetz über die Sicherung der Bankeinlagen, Februar 210.

1106 Swiss Banking law. Art. 37 (b), 37 (a) (1).

1107 Ibid. 37 (b), (1), (2).

1108 Ibid. Art. 37 (h), 37(a).

1109 Ibid. Art. 37(h), para 1.

1110 Ibid. Art. 5, para 5.

1111 Reiser M. *Supra* note 94. P. 6.

operating Swiss banks only when a certain bank fails and triggers the obligation to pay compensation to depositors¹¹¹². At the same time, each bank is under a duty to keep the amount of liquid assets to cover at least half of total potential bank charges¹¹¹³. Moreover, Swiss banks have a duty to constantly maintain the level of local creditor claims or dispose other assets, which account for 125% of the protected deposit amount¹¹¹⁴, regardless of the bank risk profile.

3.1.3. Courts

Courts play different roles in the context of bank insolvency procedures. First, courts administer justice. Therefore, they assist the banking supervisory authority in implementing and executing its decisions and resolutions. Second, courts administer regular bank insolvency (liquidation) procedures. Third, courts act as a judicial review authority that secures the parties concerned with their right to an independent judgment, which is usually adopted by a supervisory authority¹¹¹⁵. Fourth, court rulings or certain enforcement actions may be initiated by banking supervisory authorities. For example, under the U.S. legal regulation, the FDIC may apply to the US state court for an injunction or application of interim protection measures against the bank, i.e. for suspending or terminating the operation of the bank¹¹¹⁶. Finally, legal proceedings are necessary in view of the disputed bank resolution tools in order to ensure fundamental rights of individuals and the rights of defence.

The role of courts varies in the context of administration of bank insolvency procedures, depending on a particular jurisdiction. However, the legal doctrine defines the following main judicial powers directly relating to bank insolvency procedures: interim protection measures (to prevent enforcement actions against a bank), appointment of an administrator or liquidator, and judicial review of administrative decisions¹¹¹⁷. It should also be noted that the powers of courts and supervisory authorities may intertwine or coincide to a certain extent. Bank insolvency procedures in the EU, the US, and Switzerland fall within the scope of administrative procedures that may be initiated without permission from the court.

3.1.4. Court Role and Key Bank Resolution Functions in the EU

The EU legal framework conceives a *judicial authority* in the broad sense as the authority competent in the field of winding-up tools, whereas the administrative authority is

1112 Ibid.

1113 Winzeler Ch. Basler Kommentar zum Bankengesetz, Basel 2013. Art. 37 (h), N29.

1114 Swiss Banking law. Art. 37 (a), (6).

1115 European Convention of Human Rights. Chapter II, III, IV.

1116 Codified 12 USC 1818 (d).

1117 In order to determine whether the competent authorities acted in accordance with the law, the general rule is that courts are not allowed to overestimate the decisions made by administrative authorities in exercising their discretion, unless there are clear evidence or factual insufficiencies, abuse or misuse of powers. The law must explicitly regulate the right to losses (compensation) and this issue could also be addressed in court. Hüpkes E. The legal aspects of bank insolvency. *Supra* note 71. P. 29. IMF, WB. *Supra* note 86. P. 5, 22-25.

competent in the field of reorganisation measures¹¹¹⁸. Perhaps the most important judicial function – to ensure the fundamental rights of individuals and the rights of defence – is analysed in Section 5 of this Chapter. This section briefly reviews other court functions prevailing in the context of the bank resolution regime.

The EU legal framework admits that crisis management measures undertaken by national resolution authorities may require complex economic assessments and a large margin of discretion. It is presumed that national competent administrative authorities are specifically equipped with the expertise needed for making such assessments and for determining the appropriate use of the margin of discretion¹¹¹⁹. Therefore, it is important to ensure that the complex economic assessments made by competent national authorities in the context of bank insolvency procedures form the basis for national courts when reviewing bank insolvency procedures. However, judicial procedures addressing disputable bank resolution solutions are still needed in order to guarantee fundamental rights and the rights of due defence. Therefore, the regulation contains a reservation to the effect that the complex nature of those assessments should not prevent national courts from examining whether the evidence relied on by the resolution authority is *factually accurate, reliable and consistent*, whether that *evidence contains all the relevant information* which should be taken into account in order to assess complex situations and whether this information is capable of substantiating the conclusions drawn therefrom. Given that crisis management measures may require urgent application due to serious financial stability risks in the Member State and at the EU level, national law must provide an extraordinary procedure relating to the application for *ex ante* judicial approval of a crisis management measure and the consideration of such an application in court. Given the requirement for urgent application of a crisis management measure, the *court shall rule on bank resolution* within 24 hours and the Member State shall accordingly ensure that the respective authority can decide immediately after obtaining the court's approval. This must be without prejudice to the potential right of the parties concerned to request the court to set aside the decision for a limited period of time, after the resolution authority initiates the respective crisis management measure¹¹²⁰.

The role of the court is reflected in *on-site inspections at the residential or business premises of the banks or related individuals*. For example, subject to prior notification to national resolution authorities and the relevant national competent authorities, the Board may conduct all the necessary on-site inspections, such as: inspecting the employees of the bank and third parties entrusted with certain functions or activities by the bank, inspecting premises of natural or legal persons. Where the proper conduct and efficiency of the inspection so requires, the Board may carry out on-site inspection without prior announcement to the respective legal persons¹¹²¹. On-site inspections shall be conducted on the basis of a decision of the Board. If an on-site inspection requires authorisation of a judicial authority in accordance with national rules, the Board shall request such au-

1118 BRRD. Art. 2.

1119 BRRD. Recital (89).

1120 Ibid. Recital (92).

1121 SRM. Art. 36 (1).

thorisation¹¹²². On-site inspections are conducted under the supervision of the relevant national authorities. In controlling the proportionality of the coercive measures, the national judicial authority may ask the Board to provide detailed explanations, in particular relating to the grounds relied on the Board for suspecting an infringement, the seriousness of the suspected infringement and the nature of the involvement of the person subject to coercive measures. However, the national judicial authority shall not review the necessity of the inspection itself and shall not require the provision of information contained in the Board's file. The Court of Justice of the EU is the only authority empowered to review the lawfulness of the Board's decision¹¹²³.

Another function of courts under the EU legal framework relates to *enforcement and allocation of fines and periodic penalty payments*. The fines may be imposed on banks, whenever they fail to supply information requested for resolution purposes or whenever banks do not submit to a general investigation in respect of natural or legal persons with regard to information, or an on-site inspection in accordance (where the Single Resolution Board conducts all the necessary on-site inspections at the business premises of natural or legal persons), or where they fail to comply with the obligation to cooperate and exchange information, or fail to comply with a decision addressed to them¹¹²⁴. Enforcement is governed by applicable procedural rules in force in the participating Member State where the penalties are to be paid. The order for its enforcement shall be appended to the decision without applying any other formality than verification of the authenticity of the decision by the authority designated by the government of each participating Member State for that particular purpose and notified to the Board and to the Court of Justice. When those formalities have been completed, the enforcement procedure may be initiated¹¹²⁵. Enforcement may be suspended only by a decision of the Court of Justice. However, the courts of the participating Member State concerned shall have jurisdiction over complaints on the legality of enforcement¹¹²⁶.

Another judicial function in the EU legal framework relates to the *pre-eminent role of the Court of Justice*. First of all, under to the SRM regulation, which comprises the Board, the Council, the Commission and resolution authorities of the Member States, *the Court of Justice has jurisdiction to review* the legality of decisions adopted by the Board, the Council and the Commission, in accordance with Article 263 TFEU, as well as to determine their non-contractual liability. Furthermore, under Article 267 TFEU, the Court of Justice is competent to give preliminary rulings upon request of national judicial authorities on the validity and interpretation of acts of the institutions, bodies or agencies of the EU. National judicial authorities, in accordance with their national law, shall be competent to review the legality of decisions adopted by the resolution authorities of the participating Member States in the exercise of the powers conferred on them by this Regulation, as well as to determine their non-contractual liability¹¹²⁷. Second, proceedings may be brought

1122 Ibid. Art. 37 (1).

1123 Ibid. Art. 37 (2).

1124 Ibid. Art. 34, 35, 36, 38.

1125 Ibid. Art. 41 (3).

1126 Ibid.

1127 SRM. Recital (120).

before the Court of Justice in accordance with Article 263 TFEU contesting a decision taken by the Appeal Panel or, where there is no right of appeal to the Appeal Panel, by the Board. Furthermore, the EU institutions, as well as any natural or legal person, may institute proceedings before the Court of Justice against decisions of the Board, in accordance with Article 263 TFEU. Another important aspect is that if the Board has an obligation to act and fails to take a decision, the proceedings for failure to act may be brought before the Court of Justice in accordance with Article 265 TFEU¹¹²⁸. The Court of Justice shall have jurisdiction to review any dispute relating to the liability of the Resolution Board. Proceedings in matters arising from non-contractual liability shall be barred after a period of five years from the occurrence of the event giving rise thereto¹¹²⁹.

In order to protect the rights of shareholders and creditors to receive no less than they would have recovered under normal insolvency proceedings, clear obligations are laid down concerning the *valuation of assets and liabilities*. The valuation shall form an integral part of the decision to apply a resolution tool or exercise a resolution power. The valuation itself is subject to a separate right of appeal, but it may be subject to an appeal together with the decision taken by the resolution authority. Sufficient time is allowed for valuation to assess the treatment that shareholders and creditors would have received if the bank had been wound up under normal insolvency proceedings. In addition, an *ex post* comparison between the treatment that shareholders and creditors have actually been afforded and the treatment they would have received under normal insolvency proceedings is obligatory and should be carried out after resolution tools have been applied. If it is determined that shareholders and creditors have received in payment the equivalent of less than the amount that they would have received under normal insolvency proceedings, they should be entitled to recover the difference. As opposed to the valuation prior to the resolution action, it should be possible to challenge the difference separately from the resolution decision. Member States should be free to decide on the procedure of payment of any difference identified to shareholders and creditors. The difference, if any, should be covered by using financial arrangements.

Eventually, the role of a court is to ensure the *compliance with requirements of professional secrecy*. Information subject to requirements of professional secrecy shall not be disclosed to any other public or private entity, unless such disclosure is required for the purpose of legal proceedings¹¹³⁰.

3.1.5. Government and/or the Ministry of Finance

It is likely that the Ministry of Finance will be involved in the bank insolvency procedures, subject to any chance of using public financial assistance to bail out the bank facing financial difficulties or several banks operating in certain jurisdictions. The CB provides temporary assistance in the form of liquidity (lender of last resort) and shall not be

1128 Ibid. Art. 86.

1129 Ibid. Art. 87 (5).

1130 BRRD. Art. 84. SRM. Art. 88.

involved in the bank recapitalisation process. This function is reserved for the Government and the Ministry of Finance in particular¹¹³¹.

3.2. Administrative or Judicial Resolution Procedures? Analysis of the Arguments

There is an established opinion in the doctrine and the positive law of the relevant jurisdictions (see Section 4 of this Chapter) that the effective solutions of bank resolution and the solutions for banks facing financial difficulties in general are hard to achieve through general commercial courts. It is stated that judicial proceedings are long-lasting, the appeals are time-consuming, and this can result in a variety of adverse legal consequences, such as license revocation, settlement with depositors, etc.

The doctrine notes that each system - both judicial and administrative - of decision-making in the field of bank resolution has both advantages and disadvantages¹¹³². First of all, the doctrine analyses arguments reflecting the court-based adoption of resolution decisions and the resulting benefits: (i) the court may be forced to intervene in the bank insolvency procedures, as they are often concerned with or even repealed by property rights (such as shareholders' rights). Thus, the relevant legislation in certain jurisdictions may provide for an obligation to entrust such actions to courts only; (ii) a society characterised by confidence in the judiciary may have an established attitude that possible infringement of individual rights is best remedied when the matter is adjudicated by the court; (iii) the judicial system is considered to be more transparent and more accountable; (iv) in the case of cross-border bank insolvency, it may be easier to strengthen cross-border cooperation, where as a result of bank insolvency, court orders are adopted in the place of administrative decisions of supervisory authorities; (v) the chance of complaints is less likely, if the first stage of decision-making on bank resolution takes place in court, and only then judicial review takes place at first instance and on appeal. The arguments that highlight the advantages of the bank resolution administrative decision-making system: (i) a specialised, public administrative body is presumed to have more experience in banking, in contrast to the judicial system. Courts lack specialised knowledge, furthermore, courts are rather slow in adopting judgments and this complicates the judicial procedures. This is particularly true in countries with no specialised courts and no specialised judges. It is still theoretically possible to imagine a legal situation when a judge hearing family and/or divorce disputes before a general court must examine bank insolvency proceedings; (ii) the courts generally act slower than the specialised administrative authorities and the judicial proceedings take longer than administrative procedures. In addition, specialised administrative authorities can urgently take certain actions related to bank resolution and/or winding-up and often give priority to such actions, depending on the jurisdiction and the legal regulation; (iii) in addition to that, administrative authorities have more capacity and human resources in determining whether a bank is insolvent. Agility in solving the financial problems of distressed banks is one of the essential conditions for success. General courts may not have enough judges because of the number of other important

1131 Lastra R.M. *Cross-border bank insolvency*. *Supra* note 74. P. 48.

1132 IMF, WB. *Supra* note 86. P. 18-20.

cases pending in parallel, or by reason of removal or challenge of judges engaged in bank insolvency proceedings; (iv) administrative processes can save more costs related to bank insolvency procedures¹¹³³.

In summary, it can be said that there is no bank insolvency decision-making and management system that is absolutely correct, as everything depends on the positive law of a particular jurisdiction and the performance of a judicial system in a given country. Most importantly, whatever model is established, the legal system must provide a clear opportunity for the public authority to commence bank insolvency procedures, in accordance with the bank insolvency threshold and criteria. Full accountability for decisions must be maintained. In any case, the right to judicial review of administrative decisions must be in place.

3.3. Is it Appropriate to Set up a Specialised Panel to Deal with Financial Institution Insolvency Proceedings? The US Study Case

Although in the EU Member States, specialised courts prevail in Germany, the UK, France, Spain, and Belgium¹¹³⁴, specialised courts dealing exceptionally with bankruptcy proceedings outside the system of general courts are a rare example. A similar situation is in Switzerland¹¹³⁵. However, some researchers are of an opinion that specialised courts are the future of the judicial system in many countries¹¹³⁶. The opposite situation is found in the U.S. legal framework, which is characterised by deeply rooted traditions of bankruptcy proceedings¹¹³⁷. For instance, the US bankruptcy law of 1898 provided for referee dealing with bankruptcy proceedings, appointed by the US state court judges in certain cases with the main function to administer judicial bankruptcy proceedings. In the long run, after the adoption of additional legislation, the statutory powers of bankruptcy judges were expanded, gradually taking over the powers from the state courts¹¹³⁸. The first federal rules governing bankruptcy procedures were adopted in 1973, which further expanded the limits of liability of the US bankruptcy judges¹¹³⁹. In 1978, the Bankruptcy Code was created and further revised after 1984. The federal courts were granted exclusive jurisdic-

1133 Lastra R.M. Cross-border bank insolvency. *Supra* note 74. P. 49.

1134 Zimmer M.B. Overview of Specialised Courts. *International Journal for Court Administration*, 2009. P. 14-15.

1135 Swiss Federal Supreme Court. The Paths to the Swiss Federal Supreme Court An Outline of Switzerland's Judiciary Structure. 2013 [interactive]. [accessed on 2014-12-05] <http://www.bger.ch/wege_zum_bundesgericht_e.pdf>. Swiss Civil Procedure Code of 19 December 2008 (Status as of 1 May 2013).

1136 The following key advantages should be mentioned: efficiency, consistency, expertise, knowledge, case management improvement, flexibility, better quality mechanisms to review administrative decisions, consistency with the administrative law. *Ibid.* P. 1-3.

1137 *See more* United States Courts. Bankruptcy Courts. [interactive]. [accessed on 2014-12-05] <<http://www.uscourts.gov/bankruptcycourts.htm>>.

1138 Chandler Act. Chapter 575, 52 Stat. 840 (1938) (repealed 1978).

1139 Delk P. *Special Masters in Bankruptcy. The Case against Bankruptcy Rule 9031*. *Mo. L. Rev.* Vol.67, No. 29, 2002.

tion to act as courts dealing with bankruptcy issues¹¹⁴⁰. The state courts were obliged to refer bankruptcy proceedings to the federal court. Moreover, it is important to note that the Dodd-Frank Act of 2010 contained a provision requiring a thorough analysis as to whether or not set up special courts dealing with insolvency cases of financial institutions, and special masters or panels of judges to supervise insolvency cases of financial institutions under the Bankruptcy Code to minimise the negative impact on the financial markets without moral hazard¹¹⁴¹.

Following the U.S. legal framework with deeply rooted legal tradition it is worth to analyze in more detail why it is appropriate to distinguish specialized judges and/or even special judicial panels dealing exclusively with insolvency proceedings of financial institutions. The doctrine holds different opinions on this issue.

Some academics find positive features of such regulatory direction and, moreover, the U.S. courts specialising in bankruptcy proceedings propose to establish a special judicial panel that can deal with insolvency proceedings of financial institutions holding at least USD 100 billion or more mixed financial assets or to leave the insolvency cases of financial institutions for consideration in separate chambers¹¹⁴². The proposal recommends to insert new provisions in Chapter 28 of the Bankruptcy Code, which would allow designation of specialised state court judges to deal with bankruptcy cases of large financial institutions in second and last instance, excluding such cases from the jurisdiction of general courts¹¹⁴³. The judges appointed to examine the insolvency cases of large financial institutions would be vested with exclusive rights and prevented from referring such cases to general courts. Moreover, judges could appoint special masters to the panel, which could hear cases and the entire civil proceedings to the same extent as a bankruptcy judge and together with the latter¹¹⁴⁴. Thus, according to this mixed regulatory scheme, the cases of financial institutions would be dealt with by special state judges in conjunction with special masters, appointed and selected from among such judges, in order to ensure full independence from the influence of any possible financial institution, government or creditor. Other proposals urge general appointment of special masters in all bankruptcy proceedings, making the appropriate amendments to Article 53 of the Federal Code of Civil Procedure¹¹⁴⁵. These arguments supporting and rejecting the reforms diverge.

Researchers, in particular, identify the positive impact of such regulation, finding that the management tool in the form of a special master will encourage and optimise the aims of the bankruptcy system to “protect the immediate and economically most advantageous administration of each bankruptcy proceedings under the Bankruptcy Code and more operational, inexpensive actions for determining and conducting insolvency

1140 28 U.S.C. Section 1334 (a).

1141 Dodd-Frank. Section 216 (a) (2) (B).

1142 Jackson H. T. *Bankruptcy Code Chapter 14. A proposal*. P. 29. Hoover Institution Resolution Task Force, 2011. Jackson H.T. Chapter 11 F: A proposal for the use of Bankruptcy to Resolve Financial Institutions. In *Ending Government Bailouts as we know Them*, 2010. P. 232.

1143 *Ibid.* Chapter 14. P. 6.

1144 *Ibid.* P. 6-7.

1145 Kesan J.P. Ball G.G. *A Study of the Role and Impact of Special Masters in Patent Cases*. Federal Judicial Center 2009.

procedures”¹¹⁴⁶ This idea is based on the fact that in federal cases, special masters would be appointed from among private lawyers, retired judges or academics selectively appointed to decide on matters of special, exceptional effects of such cases and complex problems resulting from them. Other suggestions argue that it would be useful to change the federal Bankruptcy Rules of Procedure, in particular, providing for the right of bankruptcy judges to appoint special masters only in certain exceptional cases, when the court is faced with complex and difficult application of the law and fact. In this case, a special master could contribute to solving complex, difficult problems, scientific discoveries and more effective initiation and conducting the negotiation with regard to the out-of-court agreement (the Lawsuit Agreement)¹¹⁴⁷. The essence of this process is that the special master would contribute ‘to the administration of justice’, maximise the effectiveness and management of the proceedings, provide expert knowledge in complex cases that cannot be handled by common judges¹¹⁴⁸. According to some opinions, such reforms would improve the effectiveness of the procedure designed to identify creditor claims, as the special master could ‘contribute to the security of oral civil procedure, save time and legal costs and speed up bankruptcy procedures for other borrowers who need the attention of bankruptcy judges’.¹¹⁴⁹ Among other things, some of the proposals encourage the appointment of a special master in certain cases only, when it can provide expert knowledge in cases where the judicial machine is not self-sufficient.¹¹⁵⁰ Given the caseload of general courts dealing with insolvency proceedings, judges lack the time in order to gain deeper understanding of large and complex bankruptcy procedures¹¹⁵¹. In addition, it is argued that special masters can contribute to multinational financial institution insolvency proceedings, particularly involving many countries and necessitating comprehensive collection, evaluation, and examination of evidence, thus inclusion of both foreign and national experts will also serve this objective.

However, the existing U.S. legal framework contains no harmonised rules with regard to the appointment of a special master. Consistent approach among stakeholders, researchers, practitioners as to the effectiveness of the US Bankruptcy Code in addressing the problems of insolvency of financial institutions is still lacking. The proponents use the Lehman Brothers bankruptcy model to justify their position, especially because the court procedure was too complicated and the courts lacked expertise with regard to banks holding complex financial structures¹¹⁵². Many new legislative proposals have been submitted in this regard¹¹⁵³. It is assumed that the arguments supporting the position of introducing

1146 Clift S. R. Should the Federal Rules of Bankruptcy Procedure be Amended to Expressly Authorize United States District and Bankruptcy Courts to Appoint a Special Master in an Appropriate and Rare bankruptcy Case or Proceeding. Vol. 31 U. Mem. L. Rev, 2001. P. 353, 399.

1147 Ibid. P. 355.

1148 Delk P. *Supra* note 1148. P. 50-52.

1149 Kaufman D. *Procedures for Estimating Contingent or Unliquidated Claims in Bankruptcy*. Stan. L. Rev., Vol. 35, 1982. P. 153, 173.

1150 Clift S.R. *Supra* note 1155. P. 373.

1151 Ibid. P. 376.

1152 Chann S., Appelbaum B. *They've Got It: Fixes for the Financial System*, N.Y. Times, 2010 [interactive]. [accessed on 2014-12-06] <<http://www.nytimes.com/2010/04/25/weekinreview/25chan.html>>.

1153 Ayotte K., Skeel D. Bankruptcy or Bailouts? *Journal of Corporation Law*, Vol. 35, 2010. P. 469.

special masters are rational. Appointment of specialised state courts or bankruptcy court judges to hear insolvency cases of financial institutions in any case requires changes to the Bankruptcy Code and conferral of additional powers.

3.4. Bank Resolution Decision-Making Mechanisms. Who Makes Decisions on Bank Resolution Decision-Makers: Administrative Authorities or Creditors?

3.4.1. Centralised Resolution Decision-Making in the EU

As already mentioned above, one of the primary elements of the Banking Union is the the Single Resolution Mechanism (SRM) Regulation, with the main objective to enable the EU to create a centralised mechanism to address bank resolution and insolvency issues and adopt decisions in a centralised manner by a central resolution body, i.e., the Single Resolution Board¹¹⁵⁴ (the Board), in order to ensure clear, uniform and consistent approach across the internal market. The BRRD Directive establishes minimum harmonisation rules, but does not provide for centralisation of decision-making in the field of bank resolution, which basically means that common bank resolution tools and resolution powers are conferred on the national authorities of each Member State, leaving the discretion to national authorities as to the methods of application of such tools and the use of national financing arrangements to support resolution procedures. In addition, the BRRD still leaves the possibility for the Member States to adopt different and potentially inconsistent decisions regarding the resolution of cross-border bank groups which may affect the overall costs of resolution. Moreover, as it provides for national financing arrangements, the Directive does not sufficiently reduce the dependence of banks on the support from national budgets and does not completely prevent different approaches by Member States as to the use of the financing arrangements; centralised resolution powers are established and entrusted to the Resolution Board established by the SRM Regulation and to the national resolution authorities¹¹⁵⁵. Within the SRM framework, it is possible to directly resolve any credit institution of a participating Member State¹¹⁵⁶. The Board is empowered to take decisions in relation to significant banks or banking groups, banks or banking groups directly supervised by the ECB, or cross-border banking groups¹¹⁵⁷.

1154 The Board is a special EU agency with a concrete structure in line with its specific tasks. Its model is different from that of all other EU agencies. The composition of the Board should ensure that due consideration is given to all the interests involved in resolution procedures. Taking into account the tasks of the Board, the President, the Vice-President and four other full-time members of the Board should be assigned according to their merits of banking and finance knowledge and understanding of financial supervision, and the experience relevant for regulation and restructuring. The President, the Vice-President and four other full-time members of the Board should be selected following an open selection procedure, of which the European Parliament and the Council should be adequately informed and which should respect the principle of gender balance, experience and qualifications. The Commission should present the final list of candidates for the chairman, the Vice-chairman and four other full-time members of the Board to the competent committee of the European Parliament

1155 SRM. Recital (11).

1156 Ibid. Recital (22).

1157 Ibid. Recital (28).

Until the latest banking crisis, the divergences between national bank resolution rules in different Member States and the corresponding different administrative practices and the lack of a unified decision-making process for resolution in the Banking Union have contributed to the reduced market confidence and increased market instability, as it was impossible to predict the possible outcome of bank failure, and persons responsible for strategic decision on the insolvency of a specific bank were not clear¹¹⁵⁸.

Under the SRM framework¹¹⁵⁹, the EU Member States have a *central decision-making mechanism* and a single resolution fund (consisting of Member States' national compartments during the transitional period), which supposedly allows ensuring coordinated and effective decision-making across participating Member States, minimising the negative impact on financial stability and reducing the dependence of bank creditworthiness on governments¹¹⁶⁰. The SRM could not work properly without a common financing source. If the funding of resolution were to remain at the national level in the longer term, the link between the public sector and the banking sector would not be fully broken, and investors would continue to establish borrowing conditions according to the place of establishment of the banks rather than their creditworthiness¹¹⁶¹.

Several key elements of the resolution decision-making mechanism should be distinguished. The Board is responsible for adopting a resolution scheme. Immediately after the adoption of the resolution scheme, the Board shall transmit it to the European Commission. Within 24 hours from the transmission of the resolution scheme by the Board, the European Commission shall either endorse the resolution scheme, or object to it with regard to its discretionary aspects. Within 12 hours from the transmission of the resolution scheme by the Board, the European Commission may propose to the Council (a) to reject the resolution scheme on the ground that the resolution scheme adopted by the Board does not fulfill the criterion of public interest (achievement of, and is proportionate to one or more of the resolution objectives and winding up of the entity under normal insolvency proceedings would not meet those resolution objectives to the same extent); (b) to approve or object to a material modification of the amount of the Fund provided for in the resolution scheme of the Board. For approving or objecting decisions on the resolution scheme, the Council shall act by simple majority¹¹⁶². The resolution scheme may enter into force only if no objection has been expressed by the Council or by the European Commission within a period of 24 hours after its transmission by the Board. The Council or the European Commission, as the case may be, shall provide reasons for the exercise of their power of objection. Where, within 24 hours from the transmission of the resolution scheme by the Board, the Council has approved the proposal of the European Commission for modification of the resolution scheme on the ground referred to or the European

1158 Ibid. Recital (2).

1159 SRM regulation is already published and came into force. Major provisions are applicable from 1st January 2015 with some exceptions that will apply from 1st January, 2016.

1160 CoE. Single Resolution Mechanism: Council confirms deal with EP. Brussels, Press release, 2014. [interactive]. [accessed on 2014-09-20] <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/142512.pdf>.

1161 SRM. Recital (19).

1162 SRM. Art. 18 (7).

Commission raises objections, the Board shall, within eight hours modify the resolution scheme in accordance with the stated reasons¹¹⁶³.

3.4.2. Is the Single Resolution Board Empowered to Take Legally Binding Decisions That Would Prevail Over Decisions of National Authorities?

The SRM – aims for the common resolution mechanism with centralised decision-making and centralised governing body and the single resolution fund, benefiting the Member States, taxpayers, banks and financial stability in the EU. However, like every piece of legislation, this Regulation may entail potential legal risks, which may be experienced in the practical application of the SRM Regulation.

First of all, it should be noted that the legal basis of the SRM Regulation plays a very important role within the context of this Chapter. The SRM is based on Article 114 of the Treaty on the Functioning of the European Union, authorising Member States to adopt measures for the approximation of the provisions laid down by law which have as their object the establishment and functioning of the internal market. This aspect deserves particular attention, because it is very likely that the bank resolution-related decisions will in all cases be addressed in court because of their highly political nature. The issue of the legal basis has been extensively discussed by legislative bodies and essentially relates to the fact whether the SRM will maintain the integrity of the internal market, improve the functioning of the internal market, remove barriers to the exercise of fundamental freedoms, and help avoiding excessive distortion of competition. The SRM provides for the rights and powers of the SRB¹¹⁶⁴ with a high degree of intervention into private rights (intervention of ownership rights in the contractual relationship) and can result in significant fiscal impact on both private parties (e.g. creditors) and the SRM participating Member States. The legislative process was surrounded by extensive discussions with regard to the legal basis. The main problematic issues relate to the following aspects: (1) the SRM legal framework (it is questionable whether the internal market of TFEU, Article 114 can be employed as a legal basis for the SRM proposal; 2) doubts were raised regarding the new institutional framework of the EU's development and appropriateness SRB compliance with the *Meroni*¹¹⁶⁵ principles; 3) the legal basis of financing arrangements and levies from the industry

It is questionable whether Article 114 TFEU provides a sound legal basis for the collection of contributions from the EU banking industry. It is assumed that these contributions could be established based on Articles 310, 311 TFEU (articles designated for the forma-

1163 Ibid. Art. 18.

1164 In order for all the participating Member States to have full confidence in the quality and impartiality of the banking resolution process, in particular as regards the impact on the local economy, resolution decisions will be prepared and centrally monitored by the Single Resolution Board. Such a resolution scheme will ensure consistency and uniform approach.

1165 In 1958, the ECJ in *Meroni vs. High Authority of the European Coal and Steel Community* established the fundamental principles that could be used in the context of delegation of powers to the new authorities. The ECJ stated in that case that the delegation of powers was compatible with the Treaty if the executive powers, the implementation of which may be rigorously supervised by the delegating entity, were clearly defined. According to the ECJ, discretionary powers could not be given to authorities not listed in the TFEU, as this may disrupt the institutional balance enshrined in the Treaty.

tion of the EU budget) or Article 352 TFEU (article designated for agreements on actions, if the EU Treaties fail to provide the appropriate powers, requiring unanimity in the EU Council, if contributions are not included in the general budget of the EU). Thus a question arises whether Article 114 provides for a reliable legal basis to collect contributions from the European banking industry? Article 352 could be the legal basis for the SRM, as it aims to safeguard financial stability in the SRM Member States by, among other things, including economic and monetary provisions set out in Article 119 TFEU. Therefore it can be assumed that Article 352 TFEU may be a more appropriate legal basis for ensuring that the SRB is vested with effective rights and powers, and the resolution procedures are implemented promptly. Legal risk also occurs when bank resolution decisions may actually impact the national budgets of the Member States, which suggests that the SRM Regulation still lacks stronger provisions for protecting the budget of the participating Member States to ensure compliance with the Member States' constitutions. A more serious legal problem may arise while implementing the Regulation in practice after analysing whether the powers of the Board comply with the EU treaties and the general principles of EU law, in accordance with the principles of the *Meroni* case-law.

SRM consists of uniform bank resolution rules and procedures to be applied by the SRB together with the European Commission, the EU Council and the resolution authorities of the participating Member States. The adopted and approved SRM Regulation is based on Article 114, which provides for and allows the adoption of certain measures for the approximation of Member State laws and other legal provisions designed for the creation and functioning of the internal market¹¹⁶⁶. It should also be noted that part 2 of the same article provides that the approximation shall not apply to fiscal provisions. So far, this legal basis worked well for harmonising the majority of financial services legislation, except for the cases established in the case-law to the effect that this legal framework limits the smooth functioning of the internal market, based on the principles of consistency (proportionality) and subsidiarity enshrined in Article 5 TEU¹¹⁶⁷. The question is

1166 According to the proposal, national laws on the recovery and resolution of credit institutions and investment firms are harmonised to the extent necessary to ensure that the Member States have the minimum level of tools and methods to eliminate systemic failures. Thus, a coherent system should promote the financial stability of the internal market, by ensuring a minimum requirement for resolution of credit institutions across Member States and by facilitating cooperation between national authorities in the case of failure of cross-border banking groups.

1167 Under the principle of subsidiarity enshrined in Article 5(3) of the Treaty on the European Union, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. Only EU action can ensure that the Member States use measures sufficiently compatible with each other to seize failing institutions. Although the EU banking sector is highly integrated, the banking crisis resolution systems are established on the national basis and vary widely. Currently, according to many national legal systems, the institutions are not given the powers necessary for the orderly winding up of financial institutions and thereby to sustain the services which are essential to safeguard the financial stability, minimising the losses sustained by taxpayers in the result of such support for insolvency. In order to properly cope with cross-border crises, such divergent national legislation is inappropriate and complicates the cooperation between the home Member State and the host Member State. Moreover, the essential differences between national resolution procedures could pose unacceptable risks to financial stability and threaten effective

whether *centralisation of executive competences and powers* complies with the Article 114 TFEU. The argument to the contrary is that the Commission, in part with the EU Council is granted wide powers and responsibility for the functioning of the bank resolution system, which Article 114 TFEU fails to provide. This article is intended for the creation of the internal market, therefore its suitability is open to doubt, whether it is appropriate to pursue exceptional objectives for strengthening financial stability only in some of the EU Member States (i.e., only in the participating MS, instead of all 28 MS). Therefore, it is questionable whether this article confers the right on the Commission to assume the powers of a resolution authority in one segment of the common market only, i.e. the eurozone, and whether such regulation could lead to the fragmentation of the single market, and whether this will assist in maintaining integrity and enhancing the functioning of the internal market.

Another potential problem with regard to the legal basis may arise from the degree of centralisation and a potential conflict between the EU primary law and principles (e.g., the EU Charter of Fundamental Rights) and secondary EU law. The problem may also arise due to the status and powers of the SRB conferred by regulatory analogy of the EU agencies (Article 114 TFEU). It must be assumed that, *first of all*, the SRM may in require future revision of primary EU law. As recently confirmed by the Advocate General of the CJEU in the proceedings for Short Selling Regulation¹¹⁶⁸, Article 114 TFEU restricts the powers of agencies that cannot replace national authorities from the moment when such powers held by agencies exceed harmonisation powers. *Secondly*, the operating limit of the SRM regulation remains unclear, especially in the transfer of competencies from Member States to the Commission and/or to the Council, and then the question arises whether this issue relates to the internal market principles. The principles established in *Meroni*¹¹⁶⁹ still

restructuring of cross-border groups, since for proper adjustment procedures to be laid down at the Union level, national law must be closely harmonised. According to the principle of proportionality, the content and form of the Union action should not exceed what is necessary to achieve the objectives of the Treaties. See more judgment of the ECJ in *Germany v. Parliament and Council C-376/98*, [2000] ECR- I 8419..

1168 See more Advocate General judgement *United Kingdom of Great Britain and Northern Ireland v. Council of the European Union and European Parliament*, Case No. C-270/12, 12 September 2013.

1169 In *Meroni vs. High Authority* the ECJ laid down the conditions under which it was possible to delegate powers to the new authorities. It stated that the delegation of powers was compatible with the Treaty if the executive powers, the implementation of which may be rigorously supervised by the delegating entity, were clearly defined. According to the ECJ, entities and structures not identified in the Treaty could not be given broad discretionary powers. Article 7 of the European Economic Community Treaty (The achievement of the tasks entrusted to the Community shall be ensured by: the European Parliament, a Council, a Commission, and a Court of Justice, the Court of Auditors) expresses the principle of institutional balance. According to the Court, this principle becomes ineffective when broad powers of discretion are transferred to administrative entities. Therefore, two main principles were formulated in that case: (i) the delegating authority cannot grant powers to another authority other than those granted to the delegating authority by the Treaty, and not to comply with those powers; (ii) it is not possible to transfer powers covering a broad discretion on many different objectives and tasks, thereby shifting the responsibility and avoiding political control. In *Meroni*, the ECJ has somewhat expanded the narrow limits of Article 7 of the European Economic Community Treaty, by allowing delegation of certain executive functions to the derivatives not listed in the Treaty, and setting strict conditions when such a structure can be established. ECJ. *Meroni vs. High Authority of the European Coal and Steel Community*. Case No. C-10/56, ECR 157. [1958].

serve as a precedent for establishing new institutions (agencies) of the EU through secondary EU law. This case still restricts the discretion and powers held by a particular agency, especially those described by the delegating authority (EC), and when delegating powers falling outside the scope of Commission's own competence. This may cause a conflict of interest in the primary legislation of the Member States, e.g. in the Constitution.

Despite the SRM's entry into force, the suitability of Article 114 TFEU as a legal basis for the establishment of the SRM and SRF may still be debated. It is very likely that the validity of this legal basis will subsequently be addressed in court. This statement is primarily based on the fact that the Board (the agency) has a very broad mandate to prepare bank resolution plans and schemes and to require their implementation. It is very important that the SRM decisions for bank resolution, their adoption and voting mechanisms ensure the effective and timely decision-making, especially at the time of a financial crisis. Finally, the Regulation must ensure that any bank resolution decision is taken by the Board, the Commission, and/or the EU Council as soon as the situation so requires. The SRM requires uniform application of the rules on bank resolution, it is therefore uncertain whether the same result cannot be accordingly achieved using other harmonisation methods. At the same time, in order to avoid legal risks in the future, amendments to the EU treaties may even be required. The amendment of the EU Treaties¹¹⁷⁰ is a complex and lengthy process, therefore, if implemented, this method would require national referendums to be held in certain countries, as the issue touches the transfer of significant competences from the national to the EU

3.4.3. US Resolution Decision-Making Mechanism

Unlike the Federal Bankruptcy Code, according to which decision-making procedures and supervision are court-based, bank resolution regime of the United States is characterised by administrative decision-making procedures. The law delegates broad administrative powers to FDIC in order to address the problems faced by failing banks, including the decision-making procedure¹¹⁷¹. When a bank meets the statutory bank insolvency triggers, before making a decision on bank resolution, the FDIC staff first makes a written recommendation to the FDIC Board of Directors¹¹⁷², asking for the approval of the bank resolution tool and of the relevant transaction. The recommendation contains, *inter alia*, the copy of the 'least cost' analysis and the information regarding the potential losses and their allocation, which would be born by bank customers through uninsured deposits held in the bank. The Recommendation also talks about the need to make advance payments to bank customers holding uninsured deposits, i.e., whether they may recover a part of creditor's claim as long as the FDIC bank is engaged in the resolution process and the transfer of the remaining assets of the bank. Finally, the FDIC Board of Directors is responsible for the choice of the bank resolution measures in line with the "least cost" principle and the execution of the transaction. The Board of Directors may delegate the selection of the best purchaser to the corresponding FDIC Section Director. After the FDIC Board

1170 The Treaty of Lisbon was created before the financial and economic crisis.

1171 FDIA, Sec. 11.

1172 Ibid. Sec. 10, (a).

adopts the resolution transaction, the FDIC staff shall notify the purchaser, all the other unsuccessful purchasers and licensing authority¹¹⁷³. Before closing the bank, the FDIC shall hold a meeting with the customer, and executes all the legal documentation in order to implement the transaction¹¹⁷⁴. Furthermore, the FDIC continues to co-ordinate bank closing procedures with the purchaser. The last step is the closing of the bank. After that, when the bank is closed, the bank's assets acquired by the purchaser and the transferred deposits are passed on the purchaser. The licensing authority closes the bank and appoints the FDIC to act as a bank receiver. Then, the FDIC becomes responsible for the current affairs of the bank, including swift balancing of accounts, transfer of specific assets and liabilities, identification of payment amounts specific for the customer (assumed bank liabilities, if less assets are purchased, and the setting of contributions). When acting as a receiver, the FDIC is legally and functionally separated from the FDIC as a deposit insurance authority. The FDIC, as a receiver, has different rights and duties, compared with the FDIC acting as a DIA. The courts have long recognised this dual functionality and individual capacities¹¹⁷⁵. The formal resolution procedure starts when the bank licensing body sends a 'failing bank letter' advising the FDIC to open insolvency proceedings. Once the FDIC receives the letter, its team contacts the bank and discusses the logistical and senior bank management roles in the resolution, and requests to supply loan and deposit data. After the FDIC receives the primary data, a team of 5–10 professionals goes to the bank to analyse the additional information related to its activities. Alongside, the information package is prepared, giving potential purchasers the opportunity to evaluate all the assets of the bank, by determining the amount of uninsured deposits, the resolution structure and plans, the date of bank closure and the date of opening insolvency proceedings¹¹⁷⁶.

According to Dodd-Frank Act, rather sophisticated bureaucratic procedures were developed, under which the bank insolvency process is administered and in particular the decision-making procedures for the resolution of large, complex and non-bank financial institutions¹¹⁷⁷. An exceptional public authority OLA deals with banks whose insolvency and resolution under the ordinary bankruptcy procedure (the Bankruptcy Code – aut.

1173 National banks – *Office of the Comptroller of the Currency*, federal saving banks – *Office of Thrift Supervision*.

1174 On the technical details of the resolution measures *see more* FDIC. *Supra* note 852. P. 8-14. Once the FDIC receives information that a bank fails, it not only prepares the restructuring plan for the procedure but also has a number of different tasks: to prepare a failing bank newsletter to stakeholders, to prepare the information package, to perform valuation of assets, to determine the best conversion tool and structure, to carry out individual analyses and checks in order to prepare for bank closure.

1175 FDIC. *Resolution Handbook*. Chapter 5. *Receivership Process – Post-closing Activities*. 2014. P. 25-26.

1176 FDIC. *Overview of the Resolution Process*. Chapter 2. P. 57.

1177 In the US, a new regulatory reform and the legislative review took place after the collapse and bankruptcy of the Lehman Brothers investment bank. The main problems arose from the fact that the bank could not be taken over by the competent authority (FDIC) as other banks, as according to its status it was an investment company, and investment companies fell outside the scope of conventional bank insolvency procedures. Therefore, the Dodd-Frank Act created a new public body - Orderly Liquidation Authority – the mandate of which apply not only to banks but also to other financial institutions, including investment firms whose insolvency in terms of the US Treasury Secretariat would cause serious adverse consequences for the financial stability of the US. This procedure gave unprecedented rights and discretion to the administrative authorities, leaving the scope of bankruptcy laws far behind. Dodd Frank Act, Title II.

note.) can cause systemic risks and severe problems¹¹⁷⁸. OLA is designed in a way that as soon as certain bank meets the default threshold or imminent default conditions, the FDIC is promptly appointed and starts to act as a receiver¹¹⁷⁹. In order to determine whether the financial difficulties faced by the bank can cause systemic risk, the FDIC and the Federal Reserve Board shall (on their own initiative or at the request of the State Treasury Secretariat – aut.note.) appoint the FDIC, which should act as a receiver of the eligible financial institution¹¹⁸⁰. First of all, the Federal Reserve and the FDIC adopt joint guidelines for the Secretariat of the Treasury, which are based on certain assumptions of facts, including the reasons why the bank should not be subject to bankruptcy proceedings under the Bankruptcy Code. Then Treasury Secretariat adopts conclusions within 7 days by determining whether the bank has serious financial default risks (due to lack of capital or inability to meet the obligations that have fallen due). It should be concluded that if the above-mentioned financial difficulties are to be dealt with according to the Bankruptcy Code, it would lead to severe negative consequences to the US financial stability¹¹⁸¹. Such decision of the Treasury Secretariat requires the support of 2/3 of the Federal Reserve and the FDIC votes¹¹⁸². The Treasury Secretariat has no right to object and must adopt a petition to appoint the FDIC in a federal court as a receiver, despite the agreement or disagreement of the Bank Board¹¹⁸³. The law requires to decide within 24 hours. If no majority is reached and consent is not given, the Treasury Secretariat must apply to the US Columbia State Court with a request to appoint the FDIC as a receiver¹¹⁸⁴. Title II of the Dodd-Frank Act restricts the scope of judicial review as to whether the determination by the Secretariat was ‘justified’ and ‘lawful’ considering the appointment of the FDIC as a receiver. If the court fails to respond within 24 hours, the FDIC automatically becomes the administrator¹¹⁸⁵. The appeal is limited to the extent referred above¹¹⁸⁶. An appeal to both the financial institution and the Secretariat may be filed within 30 days, and the complaint is examined as a matter of urgency¹¹⁸⁷. However, an appeal shall not interrupt the resolution procedure¹¹⁸⁸. Therefore, a practical opportunity to review the appointment of the receiver is very limited. When the FDIC is appointed as a receiver it has the authority to liquidate the financial institution falling within the scope of the Act, to transfer the assets to a bridge bank and etc.¹¹⁸⁹

1178 Dodd-Frank. Sec. 201(a)(11). Codified 12U.S.C. §5381 (a) (8), 5383 (b).

1179 Dodd Frank. Sec. 202(a)(1)(A)(i).

1180 Dodd Frank. Sec. 203(a)(1)(A).

1181 Dodd Frank. Sec. 203 (b).

1182 12 U.S.C.A. § 5383 (a) (1) (A).

1183 12 U.S.C.A. §5382 (a) (1) (A) (i).

1184 Ibid.

1185 12 U.S.C.A. §5382 (a) (1) (A) (iv) - (v). The action of the state court is limited to the extent that in setting or if the FDIC finds that the financial institution is failing or likely to fail and meets the definition of a financial institution, and whether the decision was justified and lawful.

1186 12 U.S.C.A. §5382 (a) (2).

1187 Dodd-Frank. Sec. 202(a)(2)(A).

1188 Dodd-Frank. Sec. 202(a)(1)(B).

1189 12 U.S.C.A. §5390 (h) (1) (B).

One of the problematic aspects of such decision-making is linked to the conduct of the court hearing dealing with the question whether to open a bank resolution procedure. First, the closed and secret court hearing is held in which the Secretariat presents all the relevant documents supporting the Authority's recommendation and its conclusions. Secondly, the bank may make defensive arguments and evidence relating to the assessment of the property portfolio and capital level or possibility to access the sources of liquidity. Third, the judge shall consider and assess all the contradictory facts and evidence. Fourth, the court shall adopt a ruling designating the receiver, or issue a written opinion, considering any reason that would justify a refusal to accept the petition. If the federal court fails to achieve these tasks within 24 hours, a resolution is guaranteed by law¹¹⁹⁰. An important aspect is that, in spite of the obvious limitation of effective supply of rebutting evidence and arguments on the part of the bank, the findings and conclusions are based on court judgment adopted within a shortened period of time¹¹⁹¹.

Another problematic aspect relates to the fact that, if the Treasury Secretariat decides to take a resolution action, it must first obtain the consent of the FDIC Board of Directors. The question then arises whether the government has exceeded its authority, if such consent is not obtained, which often is the case. It is very likely that the board members of the bank will try to deal with the Secretariat, the Federal Reserve and the FDIC simultaneously by all legal means, and challenge the resolution decision. For example, they can exercise the advantage conferred by the Dodd-Frank provisions of Section 207, which protect them from liability, without giving permission to start the resolution procedures in good faith or to appoint the receiver. If the Secretariat fails to obtain the consent, it shall be entitled to petition the US state court (Columbia District court) to appoint the FDIC as the administrator of the insolvent bank¹¹⁹². According to the existing US legal framework, the bank may address to court only with regard to this restrictive issue. However, even when submitting the petition to District court, its subject-determination is limited to the scope of whether a covered financial company satisfies the definition of financial company or is in default or in danger of default and is arbitrary and capricious under the Dodd-Frank provisions 201 (a) (11)¹¹⁹³. The next stage is the appointment of the FDIC. When the FDIC starts acting as a receiver, any procedural issues arising from the bankruptcy court or against the SPIC (Securities Investor Protection Corporation) are rejected¹¹⁹⁴. The FDIC may exercise its powers by acting as an administrator for a period of up to 5 years (administration may be extended for no longer than 2 years, if this is further necessary to ensure adequate representation in courts and litigation)¹¹⁹⁵. The limits of operation of the FDIC vary depending on the type of financial institution. For example, in case of insolvency of financial intermediaries and securities dealers, the FDIC must appoint SPIC to act as a trustee. If the assets held by any of those entities is not transferred by the FDIC to the bridge bank, the bank continues to be administered by the SPIC in accordance with

1190 Dodd-Frank. Sec. 202 (a) (1) (A) (v).

1191 Ibid. Sec. 202 (a) (1) (B), 202 (a) (1) (3).

1192 Ibid. Sec. 202 (a) (1) (A) (i).

1193 Ibid. Sec. 202 (a) (1) (A) (iii).

1194 Ibid. Sec. 208.

1195 Ibid. Sec. 202 (d) (4).

the normal rules applied to the liquidation of financial intermediaries and securities dealers¹¹⁹⁶.

Another problematic aspect that will be analysed in the section below in more detail—relates to expropriation. Like any other government act regarding the seizure of property, it allows the affected individuals to challenge such decisions in court. First of all, it is noted that the Dodd-Frank legislation repeatedly holds that limitation on judicial review is as follows “*no court shall have jurisdiction over any claim or action for payment from , or any action seeking a determination of rights with respect to , the assets of any covered financial company for which FDIC has been appointed receiver*”, *including assets which the Corporation may acquire from itself as such receiver*”¹¹⁹⁷ The Act allows complaining against decisions relating to the beginning of the receivers’ appointment, after crossing the statutory threshold of insolvency, but not against decisions concerning the details of the insolvency process. Therefore, in principle, while the FDIC acts as a receiver, the court only examines disputes concerning the amount of creditors’ claims and ensures adequate protection of depositors’ rights.

3.4.4. FINMA and Swiss Resolution Decision-Making Mechanism

The Ordinance of the Swiss Financial Market Supervisory Authority on the Insolvency of Banks and Securities Dealers provides that the FINMA shall start bank resolution procedure by adopting an individual ruling. The law does not provide for the possibility to open the restructuring procedure automatically¹¹⁹⁸. As a next step, FINMA must immediately give a public notice with regard to the opening of bank restructuring procedures, by specifying whether the existing protective measures are to be maintained¹¹⁹⁹. When FINMA opens the restructuring procedures, it may also approve the restructuring plan which is the cornerstone element of the entire restructuring procedure. In addition, FINMA must clarify in the decree regarding the bank restructuring commencement whether the application of prompt corrective actions and measures under Article 26 of the Banking law must be maintained or replaced with new ones.¹²⁰⁰ FINMA shall also issue a ruling on the appointment of the restructuring agent, unless it decides to act as a restructuring agent itself¹²⁰¹. When FINMA appoints a restructuring agent, it must ensure that the latter has sufficient time and knowledge to carry out the mandate in a diligent, efficient, and effective manner and that the agent is not related to any conflict of interests that may compromise its ability to perform the mandate. In its ruling, FINMA shall determine the restructuring agent’s powers and whether the latter is authorised to act in place of the bank’s managing

1196 Dodd-Frank Act. Sec. 205 (a), (b). In addition, SPIC must apply to the state court for protective measures, and the court is obliged to adopt a resolution automatically. 205 (a) (2) (A), 205 (c) To the extent that the parties involved do not agree to transfer assets to a bridge bank, they may bring an action for damages in a state court. 205 (e).

1197 Dodd-Frank. Sec. 210 (e), 210 (a) (9) (D).

1198 Swiss Ordinance. Art. 40 (1).

1199 Ibid. Art. 41 (2).

1200 Ibid. Art. 41 (3).

1201 Swiss Ordinance. Art. 42 (1).

bodies¹²⁰². No consent of the bank board is required to approve the restructuring plan¹²⁰³. The plan could be appealed against in 2 years from the date of its adoption¹²⁰⁴. In addition, FINMA must specify the details of the administrator's tasks, in particular the restructuring costs, covering administrative, accounting (reporting) and control costs¹²⁰⁵. The restructuring plan provides details of the restructuring plan, by setting out the basic elements of the restructuring, the bank's future capital structure and business model after the restructuring, and explaining how it fulfills the conditions for approval. After the approval of the restructuring plan, FINMA shall publish the basic features of the restructuring plan, stating how the affected creditors and owners can inspect and review the plan¹²⁰⁶. Strategic decisions, including the bank restructuring procedures, are taken by the FINMA Board of Directors (bank restructuring is treated as entailing public interest features, moreover, it can lead to significant consequences for financial markets if one of the supervised financial institutions is of systemic importance¹²⁰⁷) in accordance with the internal rules of FINMA¹²⁰⁸. Decisions are taken by a simple majority of votes present¹²⁰⁹. The Executive Board performs the role of the subsidiary managing¹²¹⁰. It is a collective managing body carrying out the functions falling outside the scope of the competences entrusted to the Board of Directors and assisting in preparing and implementing decisions.

In summary, it must be stated that both the BRRD, the FDIA, the Dodd-Frank Act, the Swiss banking law or secondary act governing bank insolvency¹²¹¹ and other relevant acts do not include bank insolvency or resolution mechanisms, which are legally similar to the ordinary insolvency procedures and general corporate restructuring mechanisms. Instead, bank resolution regime prefers all viable solutions while applying the specific resolution tools and powers. For instance, as far as the EU is concerned, such decisions are implemented by the resolution authorities of individual EU Member States, in cooperation with the supervisory authorities and in consultation with other competent authorities, such as the ministries of finance¹²¹². The decision-making model of the bank resolution system

1202 Ibid. Art. 42 (3).

1203 Swiss Banking law. Art. 31 (2).

1204 Ibid.. Art. 32 (3) (b), (d).

1205 Ibid.

1206 Ibid. Art 45 (2).

1207 Regulations on the organisation of the Swiss Financial Market Supervisory Authority FINMA.18 December 2008 (Status as of 1 March 2015). Art 2 (3).

1208 Ibid. Section 2.

1209 Ibid. Section 8.

1210 Ibid. Section 3.

1211 In addition, it should be noted that FINMA decision-making is an administrative procedure. Federal Act on the Swiss Financial Market Supervisory Authority of 22 June 2007 (Status as of 1 January 2015). Art. 53.

1212 BRRD. Art. 3. The resolution authority shall be a public administrative authority or authorities entrusted with public administrative powers. The staff performing the functions of a resolution authority shall be structurally separated from the staff performing maintenance tasks (in accordance with Regulation (EU) No 575/2013 and Directive 2013/36/EU), or from other staff performing the tasks of the relevant authorities, it is also subject to other reporting guidelines. Institutions performing maintenance and restructuring and persons performing those functions on behalf of such authorities shall closely cooperate in developing, planning and applying resolution solutions both in the

is based on an administrative rather than judicial decision-making concept and process. Judicial decision-making procedure is established in ordinary insolvency procedures. For example, in the EU, the reason for administrative decision-making procedure and the relevant legal regulation is given in one of the recitals of the Bank Recovery and Resolution Directive – ‘to ensure the required speed of action, to guarantee independence from economic actors and to avoid conflicts of interest’¹²¹³. It is assumed that the regulatory model of administrative decision-making for bank resolution purposes is more effective, taking into account the following key considerations:

1. In administrative procedures, decisions are taken by a group of people. General insolvency law requires voting on the proposed legal measures and qualified majority (of creditor votes) for certain decisions. This voting method is time-consuming, and time factor is crucial in bank resolution¹²¹⁴. The delays are directly related to the depreciation of assets. On the contrary, the decisions taken by a single person authorised by an administrative authority or generally by an administrative authority, in accordance with the strict internal decision-making procedures, duties and responsibilities, may be adopted in a few hours, which is why this model seems more suitable in the context of bank resolution regime.
2. Decision-making in specific public institutions excluding court involvement, when decisions are adopted by individual judges, should be viewed as a better choice, since such decisions are more accurate and require specific expertise knowledge. Bank resolution procedures are very complex, addressing socially sensitive issues and difficult legal issues, which often happens in the face of the banking crisis, highlighting further need for swift decision-making. It is assumed that a specific public authority has more knowledge, resources and operational skills in a very specific, most complex and dynamic area of financial industry. However, it should be noted that the courts are sometimes also able to effectively manage bank insolvency cases that involve significant legal and financial consequences and the impact on international policy or the economy. However, the analysis of the lessons learnt from the recent banking crisis in the field of bank insolvency law clearly shows that such cases were exceptional. The key reason to follow the administrative resolution decision-making model is the increasing need for cooperation with other state bodies (supervisory authorities, ministries, heads of state, government authorities of other Member States) during bank resolution.

case where resolution authority and the competent authority are separate entities, both in the case when the functions are performed by the same entity. Member States shall ensure that any resolution authority has special knowledge, resources, and practical capacity to apply the restructuring actions and to exercise its powers rapidly and flexibly, to the extent necessary to achieve the objectives of the restructuring. In addition, there is still the EBA, which cooperates with the competent authorities and resolution authorities, develops the necessary expertise, resources, and know-how capabilities.

1213 SRM. Recital (15).

1214 Empirical research shows that the link between the cost, complexity, and time required to perform resolution procedures is very clear. Scmieder C., Scmieder S.P.A. Impact of Legislation on Credit Risk-Comparative Evidence from the United States, the United Kingdom, and Germany. IMF Working Paper. WP/11/55, 2011.

3.5. Right of Judicial Review of Administrative Resolution Decisions and Restrictions

3.5.1. Right of Judicial Review and Restrictions in the EU

Article 47 of the EU's Charter of Fundamental Rights enshrines the right to due process of law and the rights of defence against the sanctions applied to any person. It follows that judicial review of bank resolution decisions taken by resolution authorities and the right of appeal is mandatory. In order to protect third parties that have purchased the assets, rights and liabilities of the bank under resolution and when public authorities apply resolution tools, also in order to ensure the stability of financial markets, the right of appeal should not affect administrative decisions and/or transactions entered on the basis of the annulled decision. In this case, the remedies with regard to the unfair decision are limited to a compensation for the damage suffered by affected persons. The question arises as to the legal consistency of this presumption and whether the balance of competing interests is secured. It is equally important that the suspension of the decision taken by resolution authorities may interfere further implementation of the key banking functions, so the question is whether the law provides for the impossibility to suspend the enforcement of resolution decisions in the result of an appeal or in regard to a temporary court decision.

The EU legal framework provides for *ex ante* court approval of decisions regarding preventive measures against the banking crisis or banking crisis management measures (including bank resolution tools), on a condition that the application for approval with regard to the decision shall also be submitted to court in accordance with national law, which shall consider it as a matter of urgency¹²¹⁵. Given the fact that the crisis management measures need to be applied expeditiously, the court should decide within 24 hours, and the EU Member States are therefore under the obligation to ensure that the relevant authority may adopt a decision as soon as the court approval is obtained. This is without prejudice to the potential right of the interested parties to request the court to postpone the decision for a limited period of time after the resolution authority has introduced a crisis management tool¹²¹⁶. National law of the EU Member States provides for *the right to appeal* against that decision to apply the crisis management measure or the decision to exercise any of the powers falling outside the scope of the crisis management measures. Member States shall ensure that the review is expeditious and that national courts use the complex economic assessments of the facts carried out by the resolution authority as a basis for their own assessment.

The following criteria should be applied with regard to judicial review: (a) the complaint lodged against the decision shall not entail any automatic suspension of the effects of the decision under appeal; (b) the authority's decision on bank resolution is immediately enforceable and is subject to a non-rebuttable presumption that the suspension of enforcement would be against the public interest. When it is necessary to protect the interests of third parties who have acquired shares in good faith, other instruments of ownership, assets, rights or liabilities of an institution under resolution by virtue of the use of resolution tools or exercise of resolution powers by a resolution authority, the annulment of a

1215 BRRD. Art. 85.

1216 Ibid. Recital (92).

decision adopted by a resolution authority shall not affect any subsequent administrative acts or transactions concluded by the respective resolution authority and based on the annulled decision. In this case, the remedies for a wrongful decision or action adopted by a resolution authority is limited to a compensation for the loss suffered by the applicant in the result of that decision or action¹²¹⁷.

Another important requirement is an obligation to ensure, if necessary for the effective application of the resolution tools and powers, that when the bank is under resolution, resolution authorities may request the court *to apply a stay for an appropriate period of time* in accordance with the resolution objective pursued, on any judicial action or proceeding in which the bank under resolution is or becomes a party¹²¹⁸. In addition, *no ordinary bankruptcy proceedings shall be opened*, except for the case where the decision opening bankruptcy proceedings is taken only with the consent of the resolution authority. The petition for bankruptcy may not be considered in court if the resolution authority fails to notify the authorities responsible for normal bankruptcy proceedings, that it intends to undertake resolution actions with regard to the bank in difficulty and a period of 7 days has not passed from the date of notification¹²¹⁹. In any case, the implementation of rights to security measures shall not be affected.

Thus, in the EU legal framework, a remedy against a wrong decision can only be limited to a compensation for the damage suffered by the affected persons. In addition opening of other legal actions are prevented with regard to the bank under resolution. Therefore, the existing regulatory framework provides that before opening any bankruptcy proceedings against any credit institution of the EU Member State, a national judge has a duty to notify to the resolution authority of such requests.

It is important to note that, before bank resolution actions are taken, an impartial, cautious and realistic valuation of bank assets and liabilities should be carried out¹²²⁰. Asset valuation for bank resolution purposes is an integral part of the decision to apply resolution tools, to exercise resolution powers or to apply capital write-down or conversion powers¹²²¹. The asset valuation itself shall not be subject to appeal, but can be appealed against together with the resolution decisions.

It also provides for the right of shareholders, creditors and third parties to appeal against the transfer of shares or other equity instruments, assets, rights and liabilities, as well as the creditors' right to appeal against bank bail-in tool and write-off or conversion of liabilities¹²²². Moreover, after applying the resolution tool, the bank shareholders and

1217 Ibid. Art. 85.

1218 Ibid. Art. 86 (3).

1219 Ibid. Art. 86 (2).

1220 SRM. Recital (63). Before any resolution action is taken, a fair, prudent and realistic valuation of the assets and liabilities of the entity should be carried out. Such valuations should be subject to fair, prudent and realistic valuation of the assets and liabilities of the entity should be carried out. The value of liabilities should not, however, be affected in the valuation of the entity's financial situation. It should be possible, for reasons of urgency, for the Board to make rapid valuation of the assets or the liabilities of a failing entity. That valuation should be provisional and should apply until an independent valuation is carried out.

1221 BRRD. Art. 36 (13).

1222 BRRD. Art. 66 (6), (a), (b).

creditors shall be supplied with an ex post comparison of the terms applied and the terms that they would have been subjected to under normal insolvency proceedings. If it is determined that shareholders and creditors have obtained a lower amount, compared to the one they would have obtained after the opening of normal insolvency proceedings, they should be entitled to compensation. The difference, if any, should be paid from the Single Resolution Fund.

Another important moment for the right to lodge a complaint relates to the centralised resolution decision-making mechanism in the EU according to the SRM regulation. The SRB sets up the Appeal Commission, which adopts decision on appeals and acts as the first instance for centralised administrative resolution decisions. The Appeal Commission consists of five persons of good repute from the EU Member States, with relevant knowledge and professional experience supported by documentary evidence (including experience in the field of bank resolution) acquired in the fields of banking or other financial services, excluding current board staff of the SRB and employees of resolution authorities or other national or EU banking institutions, bodies and agencies participating in the Board's affairs¹²²³. Any natural or legal person, including resolution authorities, may appeal against a resolution decision of the Board adopted with regard to that person, or against a decision that is directly and individually concerned with that person¹²²⁴. In addition, the resolution decisions adopted by the Board could be complained to the European Ombudsman or proceedings could be initiated before the Court of Justice. Prior to that, it is obligatory to lodge a complaint with the above-mentioned Appeal Commission¹²²⁵.

3.5.2. Right of Judicial Review and Restrictions in the US

In the US legal framework, expropriation of bank property (ownership), like any other property seizure performed by the government, allows persons affected by such decisions to initiate judicial review. However, in the bank resolution procedures the role of the judiciary is limited.

First, no court can take action that may affect the resolution or order taken by the FDIC Board of Directors or otherwise affect the exercise of the rights or functions held by the FDIC acting as a receiver or a conservator¹²²⁶. It should be noted that the Dodd-Frank legislation reiterates that “*no court may take such restrictive practices or does not otherwise affect the receiver’s powers and functions and the implementation of any legal protection against the FDIC, as an administrator, and should be limited only by the scope of damages in accordance with this article*”¹²²⁷. Such legal regulation allows appealing only against decisions relating to the start of appointment of a receiver, when the threshold of statutory regulation for insolvency conditions is overstepped. However, no appeal is possible against decisions regarding the details of insolvency administration process, including the choice of bank resolution tools. In principle, at the time of operation of the receiver, the court

1223 SRM. Art. 85 (2).

1224 Ibid. Art. 85 (3).

1225 Ibid. Art. 90 (3). TFEU Art. 228, 263.

1226 FDIC Sec. 11 (j). Codified 12 U.S.C. 1821(j).

1227 FDIC Sec. 11 (j). Codified 12 U.S.C. 1821(j).

may only review disputes arising out of the size of the creditors' claims, seeking to ensure adequate protection of the rights held by secured depositors.

Some US researchers argue that OLA lacks a comprehensive mechanism for judicial review and securing the rights of defence (for example, by requiring the court to approve or reject the FDIC receiver's candidacy within 24 hours, after the request of the Secretariat). For example, *Skeels* argues that if the public authority decides to take over the financial institution or put it under resolution, the administrative decision adopted by the FDIC, the State Treasury and the Federal Reserve by using their significant discretion makes it almost impossible to raise objections against the financial institution, filing a complaint against an administrative decision, on the grounds that no time and legal basis for objections is provided, thereby violating the fundamental rights of defence.¹²²⁸ A similar position is shared by other researchers, such as *Scott*¹²²⁹. It is noted that when the Secretariat decides to take a resolution action, it must first obtain the consent of the bank's board of directors. The question is whether, if no such consent is obtained (which is almost a common practice), the government exceeds its powers. It is very likely that at the same time, the bank's board members will try to fight with the Secretariat, the Federal Reserve and the FDIC by all legal means and to challenge their actions. For example, it is very likely that they will benefit from preferential Dodd-Frank provision provided in section 207, which protects the bank's board from liability against the receiver in the cases when the permit for bank resolution is not granted on a voluntary basis and in good faith. If the Secretariat fails to obtain the consent of the bank's board, it shall be entitled to petition to the US state court (Columbia District), in order to obtain a resolution decree in order to appoint the FDIC as a receiver of the bank¹²³⁰. According to the US law, the bank may only appeal against this narrow procedural bank resolution moment. However, the complaint is limited in the scope of "*the determination by Secretariat that the financial institution falling within the scope of the Act is in default or in danger of default and it satisfies the definition of financial institution under 201 (a) (11) is lawful and justified*"¹²³¹ The court must decide within 24 hours¹²³² The petition shall be granted by operation of law, which means that if the court fails to make an order, the petition is automatically granted.

The next stage concerns the appointment of the FDIC. When the FDIC starts acting as a receiver, any procedural disputes arising in the bankruptcy proceedings or before the Securities Investor Protection Corporation (SPIC)¹²³³ shall be rejected. In addition, the FDIC may exercise its powers and capacities as a receiver up to 5 years (administration may be further extended, if necessary to ensure proper representation in courts and litigation)¹²³⁴. FDIC operational scale varies depending on the type of financial institution. For example,

1228 Skeel D.A. The New Financial Deal: Understanding the Dodd-Frank Act and its (Unintended) Consequences. The New Financial Deal. U of Penn, Inst for Law & Economic Research Paper No. 10-21, 2011. P. 152.

1229 Scott K.E. Dodd-Frank: Resolution or Expropriation? (in) Resolution of Failed Financial Institutions: Orderly Liquidation Authority and A New Chapter 14. 2011. P. 199-203.

1230 Dodd-Frank. Sec. 202 (a) (1) (A) (i).

1231 Ibid. Sec. 202 (a) (1) (A) (iii).

1232 Ibid. Sec. 202 (a) (1) (A) (v).

1233 Dodd-Frank. Sec. 208.

1234 Dodd-Frank. Sec. 208.

in case of financial intermediaries and securities dealers insolvency, the FDIC shall appoint SPIC as a trustee. If any assets of such entities are not transferred by FDIC to a bridge bank, it should be further administered by the SPIC in accordance with the ordinary rules applicable to liquidation of financial intermediaries-securities dealers¹²³⁵.

Judicial review of administrative actions is the central safeguard both against possible errors, as well as abuse of powers. It should be noted that the state court ruling can be appealed against, but the appeal cannot be delayed, subject to shortened procedural time-limits, and it must be examined within 30 days, thus in any case the court of appeal shall urgently examine the appeal¹²³⁶. Among other things, the court's judgment cannot be delayed or otherwise procedurally suspended because of pending appeals¹²³⁷. At this point, the question of constitutionality arises with regard to the Fifth Amendment to the US Constitution, which provides that "no person shall be deprived of life, liberty or property other than that provided by law." The rule of law and that constitutional provision forms a key part of the U.S. legal framework. The statutory provisions enshrine the rights of defence and the right of due process. However, in different legal contexts, the right to an effective legal remedy (rights of defence and right to a fair hearing) is understood differently. Therefore, different interpretations of the principle of effective legal remedy in different legal contexts also creates a problem long dealt with by common law courts in England and the US before reaching a reasonable degree of clarity¹²³⁸. Typically, administrative law measures and actions in taking over ownership must be undertaken by notifying the persons concerned and by ensuring the rights of the defence before a national court¹²³⁹. If the court finds that the property was expropriated by reason of the actions which, taken as a whole, can be described as emergency circumstances (similar to the position adopted by the US Supreme Court in the case for appointment of the supervisory authority as a receiver or conservator of the bank¹²⁴⁰), in this case it is assumed that the rights of the persons concerned are guaranteed and the expropriation is justified. At a later stage, after the receiver or conservator is appointed and takes over the control of the bank, the latter may apply to the federal court disputing the legality of the expropriation. Also, the parties can apply the federal court with regard to the legality of expropriation and request an open hearing within the framework established by law. Thus, it can be debated whether the above-mentioned amendment to the US Constitution prohibits the government from expropriating private property in the name of public interest and without proper compensation. At this point, it should be noted that the FDIC, acting as a bank receiver, takes over private property for public interest objectives. In addition, the law confers very broad powers to the FDIA: "all rights, titles, powers, and privileges of

1235 Also SPIC must apply to the state court for protective measures, and the court is obliged to adopt a resolution automatically. To the extent that the parties involved do not agree to transfer assets to a bridge bank, they may bring a claim for damages in state court. *Ibid.* 205 (a), (b), 205 (a) (2) (A), 205 (c), 205 (e).

1236 *Ibid.* 202 (a) (1) (B), 202 (a) (2).

1237 *Ibid.* 202 (a) (1) (B).

1238 Scott K.E.P. *Supra* note 1229. P.199.

1239 *Ibid.*

1240 *Fashey v. Mallonee*, 332 U.S. 245, 253-5 [1947].

the covered financial company and its assets, and of any stockholder, member, officer, or director of such company”¹²⁴¹

The Dodd-Frank legislation expressly provides for the right to compensation to the affected parties. Any person has the right to bring a lawsuit against the FDIC, acting as a receiver, and obtain a compensation guaranteed by the amount that a particular person would have received if the FDIC had not been appointed to act as a receiver, and the bank had been liquidated under state or federal law¹²⁴². It is assumed that such a compensation scheme is valid only in the theoretical sense. In practice, the amount of compensation would be extremely low or equal to zero. This position is based on the fact that if bank insolvency endangers the overall state of the economy, it is hard to imagine the compensation that would be paid to creditors in a situation where the whole economy is collapsing and the government has not taken any steps to prevent this. In this case, the amount of compensation and the remedies of the parties concerned would be negligent. Among other things, the Dodd-Frank provides that “no court may take such action which may restrict or affect the receiver’s powers and the implementation of functions”. The U.S. legal framework recognizes the right of affected parties to claim for monetary damages under the Tucker Act¹²⁴³. Under the existing practice, it is sufficient to avoid complications caused by property takeover¹²⁴⁴.

The right to due process is even more problematic. Due process means a civil process in which a financial institution is given an early warning of expropriation and the possibility of hearing a dispute before a judiciary authority¹²⁴⁵. In general, the notice and the right to be heard are part of the right to due process¹²⁴⁶. In legal terms, difficulties arise from the right to be heard at the hearing, and the possible interpretation of the related legal rules. State courts are not allowed to review the Secretariat’s decision on the merits. Instead of that, the court is bound to focus on the analysis of two narrow issues: (i) whether a financial institution is in default or in danger of default (ii) whether a financial institution falls within the definition of financial institutions. Furthermore, the state courts must apply the principles of legality and reasonableness in conjunction with the principle of judicial review. On the one hand, the standard of legality and reasonableness itself is not problematic. It has been a while that US Supreme Court is of the opinion that such judicial review of administrative decisions meets the rule of law and the ensuing issues¹²⁴⁷. This standard is normally used in administrative law and considered suitable by the courts for assessing the decision appointing the receiver under the Financial Institutions Reform, Recovery and Enforcement Act¹²⁴⁸. On the other hand, a potential problem arises with regard to the restrictions on civil procedure, i.e., the scope of review. The Court has no authority to review other critical, crucial, bank resolution-related conclusions adopted by the Sec-

1241 *Fashey v. Mallonee*, 332 U.S. 245, 253-5 [1947].

1242 *Ibid.* Sec. 210 (d) (2).

1243 *Ibid.* Sec. 210 (e).

1244 *Blanchette v. Connecticut General Ins. Corp.*, 419 U.S. 102 [1974].

1245 Dodd-Frank. 202 (a) (1) (A) (iii).

1246 *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 [1950].

1247 *Yakus v. United States*, 321 U.S. 414 [1944].

1248 *Franklin Sav. Ass v. Directors, Office of Thrift Supervision*, 934 F.2d 1127 [1991].

retariat prior to the appointment of the receiver. These conclusions assess the impact of bank insolvency on the US as a whole, whether no “adverse consequences for the financial stability and viable and appropriate private sector alternatives” arise¹²⁴⁹. Most probably, such limits defined in positive law are based on the idea that determination of existence of a possibility of judicial review, even if the findings are legitimate and reasonable, and the related regulations prevent the court from taking action. However, the line of case-law on potential constitutional problems remains unclear¹²⁵⁰. Another potential problem relates to the authorisation of procedures within 24 hours, while ensuring full secrecy of such procedures¹²⁵¹. It is assumed that the court is unable to reflect on and to understand such complex and difficult legal issues in such a short period of time. Such time limits apparently reduce the right to be heard before executing the expropriation, which can cause potential problems in the field of possible violations of the right of due process¹²⁵². In other words, the owners of financial institutions may seek judicial review of the decision, but be unable to suspend the enforcement of decisions, while consideration of the appeal is pending. Therefore, it is likely that the dispute will be considered at a time when the appeal has already been decided. The third problem is related to *professional secrecy*. Once the petition is registered in court, the state court obliged to act without publicly revealing any information related to the process. In addition, any other third party is not allowed to disclose information about the ongoing judicial process. A person who has negligently disclosed such information shall be punishable under criminal law, and is a subject to criminal sanctions, including a 5-year imprisonment sentence¹²⁵³. Such protection of professional secrecy may be constitutionally questionable not only because of the enforcement of the right to due process, but also with regard to the Fifth Amendment of the Constitution. In some of its cases, the US Supreme Court has held that secret criminal proceedings are incompatible with the press rights provided in the Fifth Amendment¹²⁵⁴. At the same time, so far the Supreme Court has not addressed the right to public access in civil proceedings, but occasional cases have occurred in the lower courts, and the ensuing

1249 Dodd-Frank. Sec. 203 (b).

1250 The doctrine is very complex on this aspect. The case-law offers to give broad powers to the Congress by limiting judicial review of decisions Faloon H. Etc. Hart& Wechsler's the Federal Courts and the Federal System, Sixth edition, 2009. Chapter 4.

1251 Dodd-Frank. Sec. 202 (a). The state court judge during this certain period of time from the time of filing the petition must: (i) report to the bank and hold a closed hearing; (ii) review (under two of the required 7 findings of the administrative bodies); (iii) to authorize the insolvency administrator to determine whether the Secretariat actions were lawful and justified; (iv) in the latter case, to supply a written statement for each cause justifying the judge's opinion.

1252 The FDIC has emphasized that the Dodd Frank Act enables restrictions and decision review earlier than allowed by other federal laws for opening the receivership of the failing bank and then starting its administration. The immediately ongoing review of the decision according to the Dodd-Frank is prioritised under other legislation. FDIC. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street reform and Consumer Protection Act. 12 CFR Part 380. P. 4208 n. 1. January 25, 2011.

1253 Dodd-Frank. Sec. 202 (a) (1) (C).

1254 *Press-Enterprise Co. V. Superior Court*, 464 U.S. 501, 508 [1984]. It must be noted that open court hearings play a vital role in the administration of justice. This position is based on the fact that people not actually attending court hearings must have access to information in accordance with the standards of trust and fairness. The openness of court hearings makes it possible to monitor the process and to publish the deviations, if any.

negative consequences of disclosing such information are easy to imagine¹²⁵⁵. Although the lawmakers have adopted professional secrecy protection provisions, the US Supreme Court has noted that it requires individually to prove the rebut of presumption according to the specific features of the particular case and the circumstances involved¹²⁵⁶. It should also be born in mind that the possibilities to challenge this provision are limited by the long tradition of non-disclosure of information in the field of banking regulation to third parties¹²⁵⁷. In addition, it is easy to imagine the negative consequences of early disclosure. It should be noted that in this case, the only persons who can bring the complaint are the financial institution's directors as the only persons disposing the relevant information. Finally, the affected parties have the right to apply to court at a later time for the review of legality of their claims¹²⁵⁸.

In summary, it is difficult to conceive of an objective situation, when the government expropriates property overnight and the persons adversely affected can later apply to court only with regard to the well-foundedness of their claims. In any case, damages are more theoretical and minimal. In addition, it is difficult to rely on the effectiveness of such judicial review and believe that it provides adequate legal protection against abuse of public power. It is usual in banking, that the administrative authority adopts its decision at the end of the business day, for instance, in the case of the US, after the petition is filed in the US court and detailed documents-recommendations are submitted to the State Treasury, prepared by the Federal Reserve, the FDIC, and the SEC. The bank receives those documents the next morning, analyses them and prepares thousands of stock assessments and urgently presents them for the court hearing. At noon, the judge must review the complete documentation, come to reasonable conclusions, write an explanatory decree in a few hours or issue an order without going into much detail, against which the affected counterparties are practically unable to take full legal action. In the EU legal framework, the relevant situation is complicated as well, because national courts must approve the resolution decision within 24 hours. In addition, if the resolution decision is centralised, the resolution scheme is as follows: the Board of Directors confirms the resolution scheme at its meeting according to the ECB estimates. Within 24 hours, after the Board forwards the resolution decision to the EC and the Council, the latter authorities may raise objections. If any objections are raised against the resolution scheme, the EU Council has the casting vote and decides on amendments within 24 hours. It is hard to imagine an objective situation, in which the court must assess the data from four public institutions within 24 hours, especially when it is related to the resolution of large and complex banks.

1255 *Huminski v. Corsones*, 386 F.3d 116 [2004].

1256 *Supra* note 1250. *Press-Enterprise Co.*, 464 U.S. P. 510. It should noted that the presumption of openness could be resolved if the competing interests are protected by the judgment so the reason disclosing such information is designed to protect higher values, therefore the satisfaction of the public interest might be reduced.

1257 5 U.S.C. 552 (b) (8).

1258 Dodd-Frank. Sec. 2010 (a) (4).

IV. IMPACT OF BANK RESOLUTION PROCEDURES ON BANK SHAREHOLDERS AND CREDITORS

4.1. Implications and Limitations of Bank Resolution Regime on Shareholders Rights

Bank resolution procedures may to a certain extent impact not only on shareholders' property rights, but also their rights in connection with corporate governance¹²⁵⁹. The shareholders' meeting is usually convened to elect a director, to vote for a variety of corporate strategic issues, such as changes in the capital structure, or when dealing with the large asset transfer, asset acquisition or pre-emptive rights in regard to the acquisition of shares. Most of the national laws of the EU Member States also secure shareholders' right to draw up a shareholders' meeting agenda or to convene an extraordinary shareholders' meeting. However, under the new bank resolution regime, the competent authorities may temporarily suspend or even terminate some or all rights of the parties involved (shareholders of a failing bank) in the resolution procedures.

4.1.1. Impact on Shareholders' Rights in the EU Legal Framework

Article 1 of Protocol No 1 to the ECHR protects shareholders from both direct expropriation of their property rights and indirect forms of intervention by public authorities. For example, the Convention protects the rights of shareholders from the effect of their own corporate conduct¹²⁶⁰. The EU regulatory framework also contains relatively high minimum standards in the field of protection of shareholders' rights. This raises the question whether expropriation of shareholders' property rights, especially shareholder debt write-offs or reduction of related shareholders' rights or shares when converting debt into capital or recapitalising the bank can lead to the conflict of public and private interests, for instance, with regard to the provisions of Directive 2012/30/EU.

The Directive, *inter alia*, determines that the shareholders' meeting must approve any change, increase or decrease in the capital level of the company¹²⁶¹. Furthermore, in cases where capital increases in cash, the newly issued shares must be offered on a pre-emptive basis to shareholders in proportion to the size of their interest¹²⁶². Finally, the Shareholders' Rights Directive 2007/36/EC lays down minimum procedural requirements for shareholders' meetings, in particular with regard to the period prior to the shareholders' meeting and the form of convening the meetings¹²⁶³.

Bank resolution regime shall ensure that the legal consequences arising from bank resolution and/or subsequent liquidation are consistent with the degree of protection of the rights of the interested parties during resolution, i.e. the level of protection that may

1259 Hüpkens E. *Supra* note 78. P. 283-285.

1260 ECoHR. *Sovatransavto Holding v Ukraine, Judgement*. Case No. 485553/99, 25 July 2002. 91 para.

1261 Directive 2012/30/EU. Art. 29 (1), 34 (1).

1262 *Ibid.* Art.33 (1).

1263 Directive 2007/36/EC. Art. 5.

be expect by counterparties under the applicable legal framework in certain jurisdictions. As discussed above, one of the main features delimiting resolution of financial institutions from resolution of non-financial institutions is swiftness of the procedure and its importance for bank resolution actions. The competent authorities must intervene and act as fast as possible, as soon as it is established that the bank is failing or likely to fail and no longer viable. In addition, public authorities must act to protect the bank's core financial functions that are relevant to the society as a whole. In order to resolve the difficulties faced by a failing bank quickly and effectively and in order to achieve rather radical bank resolution tools (by applying them individually or in combination), ideally in one weekend, the authorities must have a broad range of legal, restrictive intervention tools and powers. Before the change of bank insolvency law paradigms, such measures most often consisted of recapitalisation of shareholders or creditors and change of the governing bodies, sale of all or part of business operations to another bank or financial institution, establishment of a bridge bank, which temporarily continues the provision of essential banking services, or the establishment of a separate asset management company with the help of the asset separation tool, whereby the bad assets of the bank are transferred to the asset management company¹²⁶⁴. After the shift of paradigm, a bank bail-in tool was created, and also other classic bank resolution tools were significantly developed. In order to successfully implement the resolution tools, public authorities were empowered to take control of the bank management, convert or write off bank capital in the absence of the existing contractual rights and obligations, and bank's creditor claims, when it is necessary to cover bank insolvency losses, or transfer bank assets, liabilities (including depositors' liabilities) and thereby share the ownership and the number of shares with other credible financial institutions, or a bridge bank, notwithstanding the contrary opinion or lack of consent on the part of the bank shareholders.

Interventions in the bank cause potential legal problems with regard to the protection of shareholders and creditors rights, especially at a time when the bank still appears to be in a state of positive net present value and is not *de facto* insolvent. Usually, early intervention involves the appointment of a temporary administrator of the bank, which provisionally takes over the bank's business areas and activities, negotiates and controls the company, by trying to find a compromise with regard to the rights of shareholders. The decisions related to external capital attraction, transfer of part or all of the bank's business to another financial institution, merger with another financial institution or decision to initiate winding up proceedings in all cases affects the rights and financial interests of the bank shareholders, including their preferential rights with regard to the governance of the bank and the rights to approve strategic transactions. Creditor rights are also affected in the sense that the bank contracts may be substantially modified by reason of the ongoing intervention. By reason of such actions on the part of public authorities, not only bank insolvency legal regulation, but also national constitutions and, if applicable, the ECHR provisions should be taken into account.

The ECHR defines corresponding shareholders' rights as "*a share in the company's assets in the event of its being wound up, and other unconditioned rights, especially vot-*

1264 BCBS. Report and Recommendations of the Cross-Border Bank Resolution Group, 2010, Recommendation No. 1.

ing rights and the right to influence the company's conduct"¹²⁶⁵ The Court makes the distinction between the right to remedies, i.e., the right to receive the rest of the company's assets when it is wound up, and the management rights, such as the right to develop the company's business strategy. These rights vary depending on the jurisdiction. *Hüpk* highlights the fundamental shareholders rights common to all jurisdictions: (i) the right to present the agenda for the shareholders' meeting and the right to call an extraordinary shareholders' meeting; (ii) the right to elect the (supervisory) board members; (iii) the right to approve fundamental operational decisions, including the statutes of the company, revision of the license, voluntary liquidation, significant asset sales; (iv) the right to receive a proportionate part of ownership of the company after settling with other creditors in the case of liquidation; (v) the right of equal treatment of shareholders falling within the same class; (vi) the shareholders are not personally liable for the debts of the company, except for the extent equal to the proportion of their investment share, and they are protected from legal claims against the company¹²⁶⁶. In addition, it is important to note that although the US are considered a pioneer of capitalism, shareholder rights are firmly defended in the EU legal framework even in a broader scope¹²⁶⁷. The US legal framework requires the adoption of only some decisions at the general meeting of shareholders and leaves the discretion in the distribution of powers to the company itself. Therefore, the fundamental governance powers belong to the Board. According to the EU law, shareholders meetings hold more important rights. Shareholders usually vote not only on the strategic decisions of the company (e.g., sales or mergers), but also on the decisions concerning parent companies, resolution or recapitalisation)¹²⁶⁸.

Under the current EU bank insolvency legal regulation, if a bank is failing or likely to fail, resolution authorities have the power to impose bank resolution tools in accordance with the resolution objectives and principles¹²⁶⁹. Unavoidably, certain tools can affect the bank's property rights, including those held by bank creditors and shareholders. Article 17 of the *EU Charter of Fundamental Rights*¹²⁷⁰ establishes the right of ownership¹²⁷¹. It should also be noted that the Charter also protects the company's share capital. Moreover, property rights are related to "civil procedural rights" under Article 6 (1) of the Charter¹²⁷²,

1265 ECoHR. *Olczak v. Poland*, Case No. 30417/96, 7 November 2002.

1266 Hüpk E. *Supra* note 78. P. 279.

1267 *Ibid*.

1268 *Ibid*.

1269 BRRD. Art. 31(2). *See more* 2 chapter 3 sec.

1270 EU Charter of Fundamental Rights. EU Official Publication. C 83/389. 2010/C 83/02 [interactive]. [accessed on 2014-11-05] <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0389:0403:lt:PDF>>

1271 "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

1272 In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial

namely the right to a fair trial. The affected parties have the right to a fair judicial process and effective compensation in accordance with Article 47 of the Charter¹²⁷³. This section analyses the extent to which the application of bank resolution tools under the EU legal framework is compatible with the obligations of the EU Member States concerning the right to property and the guarantee of a fair compensation of damages.

It should be stressed that the rights enshrined in the EU Charter of Fundamental Rights match the rights guaranteed by the European Convention on Human Rights (ECHR), therefore, insolvency procedures are considered to be legitimate in the context of property rights control and expropriation, in view of the public interest as recognized under the ECHR¹²⁷⁴. Limitation of shareholders' rights resulting from forced bank resolution is determined by the aim to keep the bank operating as a business entity, and to maintain the bank's asset value equal to the value of the operating assets, and may be proportionate and justified by the broader public interest objectives, with the aim to protect the interests of depositors¹²⁷⁵. The scope of such criteria shall be as defined in the Convention¹²⁷⁶. According to Article 1 of the Additional Protocol No 1 to the ECHR ("Property rights")¹²⁷⁷, the contracting states are obliged to control the use of property in the light of the overall public interest. However, the actual situation must meet certain conditions. In each case, the term "property" should be interpreted individually, from the perspective of implementation of the ECHR objectives. The definition should include interests that fall outside the scope of property rights in a certain national legal order that is within the ECHR system. The European Court of Human Rights broadly interprets proprietary rights. In the sense of the above-mentioned, in addition to material goods, property may also take the form of certain rights and assets consisting of various interests ("the concept

tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

1273 Everyone whose rights and freedoms guaranteed by EU law are violated has the right to an effective remedy before a court under the conditions set in this article. Everyone has the right to a hearing within a reasonable time by public and fair hearing by an independent and impartial court

1274 EHRC, First Protocol Art.1. 2 para.

1275 *Olczak v Poland* Supra note 1265. In that case, the Polish CB wrote off a part of the insolvent bank's capital and recapitalized the bank at its own expenses. Thereby, an attempt was made to protect the interests of bank customers and to avoid significant financial losses, which could bring the bank bankrupt (direct liquidation procedures). The ECHR noted that the objective pursued was apparently in compliance with the National Bank's powers set out in the Polish Law on Banks, and was consistent with the scope of the public interest concept.

1276 Article 52(3) of the EU Charter of Fundamental Rights. According to the EU law, the same level of protection, but not lower than the protection provided by the ECHR must be guaranteed.

1277 Any natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in cases where it is necessary for the public interest and subject to the conditions provided for by law and by the general principles of international law. However, the leading provisions shall not, to apply such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the taxes or other contributions or penalties for payment.

of “possessions” is not limited to “existing possessions” but may also cover assets, including claims¹²⁷⁸.

4.1.2. Key Principles Balancing Private and Public Interests in the EU Legal Framework

The ECHR identifies three fundamental legal principles that protect property rights: 1. Rule of law and legitimate expectations; 2. A legitimate public interest; 3. Proportionality between the public interest and the protection of property rights.

The principle of legitimate expectations. The ECHR has found that the first and the most important aspect of Article 1 is the requirement that the purchasing parties falling within their jurisdiction shall have the rights guaranteed under the Convention¹²⁷⁹, but any public authority intervention in the private rights of individuals must be in accordance with the law¹²⁸⁰. The principle of legitimate expectations or the principle of predictability is a general principle of law that requires any violation of property rights to have a legal basis and be primarily based on national law. Such legal basis must be: (a) available and predictable; (b) sufficiently precise; (c) foreseeable. The principle of legitimate expectations stems from the rule of law¹²⁸¹. It should be noted that all powers of legislative and executive (government) authorities shall have sufficient legal basis. To avoid the arbitrary use of powers, legal provisions must be regulated so as to be sufficiently clear and precise¹²⁸². The BRRD is characterised by clear and accurate legal regulation, which is to be achieved, harmonised and implemented in the relevant EU Member States. Moreover, it should be noted that when the competent authorities use their extensive powers and the related legal provisions governing resolution, it is unlikely that problems may arise due to the breach of this principle and the relevant provisions of the ECHR. The Convention seeks to protect against the use of powers of national authorities without sufficient legal basis. The rights and powers of resolution authorities are very explicitly regulated by the BRRD. A resolution authority may take action when a bank is insolvent or is close to insolvency threshold. This rule cannot be considered as insufficiently clear or imprecise. It is therefore assumed that in this case no problems should be encountered in application of the law, given the principle of legitimate expectations, when implementing the rights and obligations stated in the BRRD in practice.

The principle of a legitimate aim. According to second sentence of Article 1 of the Additional Protocol No 1 to the ECHR, the state can control and restrict the use of personal property rights, in accordance with the general public interest, or in order to guarantee

1278 ECoHR. *Saghinadze v. Georgia*, Case No. 18768/05, 27 May 2010. 103 para. The Court reiterates that the concept of “possessions” in the first part of Article 1 of Protocol No. 1 has an autonomous meaning which is not limited to ownership of physical goods and is independent of the formal classifications in domestic law. Accordingly, as well as physical goods, certain rights and interests constituting assets may also be regarded as “possessions”.

1279 European Convention on Human Rights. Art. 1. The latest amendments and ratification and all the declarations and reservations list is published <www.conventions.coe.int>.

1280 ECoHR. *Lelas v. Croatia*. No. 55555/08, 20 May 2010. 71 para.

1281 Bingham T. *The Rule of Law*, Allen Lane, Vol. 55, No. 3, London, 2010.

1282 ECoHR. *Sildedzis v. Poland*. Case No. 45214/99, 24 May 2005.

the payment of taxes or other contributions or penalties. The ECoHR interprets these provisions along with another principle - interference with property rights must serve legitimate expectations. The EU Member States have broad discretion in determining a legitimate aim in the context of the public interest¹²⁸³. The ECoHR has stated that will respect all decisions, particularly those adopted in the context of macroeconomic policy, unless it is established that such decisions were adopted *in a clearly wrong manner and without legal a justified legal basis*¹²⁸⁴. As discussed above, one of the primary goals of the BRRD is to maintain financial stability and minimise the losses to the public and especially taxpayers, also by ensuring comparable results that would arise in the course of ordinary bankruptcy procedures, in view of the sequence of allocation of losses to shareholders and creditors. The BRRD explicitly aims to address these challenges, therefore, its practical application should not be problematic in this field.

Principle of proportionality or fair balance. The ECoHR attempts to balance the protection of public interest and the respect for human rights. Since bank resolution tools unavoidably affect the rights of shareholders and creditors, they must be *justified* and *legitimate* in the context of public interest¹²⁸⁵. As clearly settled in the ECoHR case-law, any interference with property rights must be proportional and ensure ‘balance’ between the general public interest and private interests¹²⁸⁶. This means that the EU Member States must develop proportionate legal relations between the means applied and the ultimate aim to be achieved¹²⁸⁷. Legal balance is violated in the case when interference into property rights creates individual and excessive burden¹²⁸⁸. Eventually, the circumstances of each case determine whether the fair balance will be maintained. It is also important to consider the actions to be undertaken by the resolution authority¹²⁸⁹. The circumstances of the case must match both the content of the decision forming the basis of action on the part of the resolution authority and the appropriate bank resolution tool.

Despite the factual circumstances surrounding bank insolvency proceedings, after determining possible consequences arising from the principle of proportionality, some observations can still be made and a scientifically proven judgment reached. In the first

1283 ECoHR. *Chassagnou v. France*. Case No. 25088/94, 29 April 1999. 75 para. There must be a reasonable relationship of proportionality between the means employed and the aim pursued. Court recognises that the State enjoys a wide margin of appreciation with regard both to choosing the means of enforcement and to ascertaining whether the consequences of enforcement are justified in the general interest for the purpose of achieving the object of the law.

1284 ECoHR. *Grainger v. The United Kingdom* Case No. 34940/10, 10 July 2012, para 39. Given the exceptional circumstances prevailing in the financial sector, both domestically and internationally, at the relevant time, a wide margin of appreciation is appropriate. The Court must respect the decisions of the national authorities unless it finds them to be “manifestly without reasonable foundation”.

1285 ECHR. Art. 2 (2-11), Art. 2, 15, 17, 18.

1286 ECoHR. *Grainger v. The United Kingdom*. No. 34940/10, 10 July 2012. 35 para. In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure applied by the State, including measures depriving a person of his possessions.

1287 ECoHR. *Beyeler v. Italy*. Case No. 33202/96, 5 January 2000. 114 para.

1288 ECoHR. *Sporrong and Linnroth v. Zweden*. Series A, Case No. 52, 23 September 1982. 69 para.

1289 Legitimate public expectations may be an important factor. See more ECoHR. *Ambrosi v. Italie*. Case No. 31227/96, 19 October 2000. 32 para.

place, one of the main criteria for determining whether the principle of proportionality has been complied with, relates to the question of the *amount of compensations* to be paid to property right holders and individuals for expropriated property. According to the established case-law of the European Court of Human Rights, the amount of compensation is generally based on ‘*expropriation*’ or whether the tool essentially falls within the *scope of public interest*¹²⁹⁰. As a general rule, expropriation without payment of reasonable price for the expropriated property which directly relates to the bank’s asset value, typically results in the disproportionate interference in the personal rights, which cannot be justified on the basis of the provisions of Article 1 of Protocol No 1 ECHR.

4.1.3. The ECHR Case Law

The ECHR has examined many cases concerning possible violations of shareholder rights under the provisions of the ECHR in the context of bank resolution procedures¹²⁹¹. Before distinguishing certain balancing legal safeguards provided for in the BRRD, which seek to provide a sound compensation in the case of expropriation, it is useful to take a deeper look at the specific cases of shareholder expropriation. In 2008 ECoHR examined the complaint of the former shareholders of the UK bank *Northern Rock* against the expropriation of ownership rights in nationalising the bank. In that case, it was determined that soon before the bank nationalisation, the market value of its shares amounted to 90 pence per share¹²⁹². According to the Investors Compensation Law, adopted in 2008, an independent asset valuator, when calculating the specific amount of compensation owed to former shareholders by the Treasury, required to identify and adopt an opinion on the ability of the bank to continue its economic business activities; and thus forced insolvency (liquidation) procedures were initiated against the bank. In accordance with the facts of the case, the valuator relied on the assumption that the company was no longer viable, and there was no residual value of bank assets, which did not give rise to any compensation to former shareholders. In other words, the value of the shares was equal to zero. Nevertheless, the former shareholders of the *Northern Rock* bank appealed against the decision to the ECoHR. They based their claims on the fact that no monetary compensation was paid to shareholders. Moreover, the claim was based on the fact that the UK Government did not properly balance various public and private interests of the stakeholders (shareholders) involved when expropriating bank shares.

1290 In some cases, the ECHR makes no clear demarcation lines, by merely stating that the court thoroughly examines and verifies the legal measures applied in the light of ECHR, Article 1. Protocol. 1 and the principles relating to the right to property. For example, in *Sovtransavtp Holding v. Ukraine*, the ECoHR took the view that the factors distinguishing interests of the company interact with interference in property rights, without further qualification of distinctive features in the context of expropriation of property rights or use of control. ECHR, *Sovtransavto v. Ukraine*. No. 48553/99, 25 July 2002. 91-92 para.

1291 *Karell and Karellas v. Minister for Industry, Energy and Technology and Organismos Anasygkrotiseos Epicheiriseon AE* [1991] ECR I-2691. C-381/89, *Syndesmos Melon tis Elftheros Evangelikis Ekklissias and Others v. Greek State and Others* [1992] ECR I-2111. C-441/93, *Pafitis and Others v. Elliniko Dimosio (Greek State) and Organismos Oikonomikis Ansaygkrotisis Epicheirreon AE (OAE)* [1998] ECR I-2843.

1292 ECoHR. *Grainger v. The United Kingdom*. Case No. 34940/10, 10 July 2012. 15 para.

The following problematic aspects of the case were raised: (i) terms of compensation under the relevant national legal regulation essentially imply legal assessment of the circumstances, more specifically, whether the applied legal measures took into account the required balance between public and private interests, and whether it was possible to determine imbalance with regard to shareholders' actions; (ii) following Article 1 of Additional Protocol No 1, the right to full compensation is not guaranteed in all cases. Only aims directed at the implementation of economic reforms or measures designed to achieve essential objectives of social justice are to be regarded as legitimate aims seeking for higher public interest objectives. Therefore, the compensation may sometimes be below full market value; (iii) on the one hand, the powers of the court for judicial review are limited to the assessment whether the adopted terms of compensation exceed the boundaries of national discretion while expropriating property rights. On the other hand, expropriation without paying a reasonable compensation based on the amounts associated with the property value, normally result in disproportionate interference in property rights. In general, failure to pay compensation can be justified under Article 1 of the Additional Protocol No 1 only in extraordinary cases¹²⁹³; (iv) the ECoHR has noted that the court of appeal seized with the case took the view that the government had broad discretion in expropriating private property in the case at hand, since the disputed decisions were adopted in connection with the implementation of macroeconomic policy. Therefore, the ECoHR has agreed that in view of the exceptional circumstances prevailing at that time in the financial sector at both national and international level, and in the light of the relevant period, the broad discretion enjoyed by the government when applying the expropriation and it was the appropriate legal tool. Also, the ECoHR has noted that by reason of direct knowledge available to them, national authorities are in principle in a better position than international judges, especially considering the issue of 'public interest' and its legal qualification. Therefore, national authorities, taking the public concern and direct knowledge into account, are in a better position to assess cases when general legal tools meet the economic and social strategy of a particular society. This position is based on the fact that the national public authorities better understand the general public interest in their social and economic context. Among other things, the ECoHR has noted that it respects the policy implemented by the national legislator, unless it obviously lacks a reasoned legal basis¹²⁹⁴.

The above case analysis reveals some valuable observations and conclusions. First of all, to maintain a balance between different interests and to find the balance in relation to expropriation of property rights, the amount of compensation to be paid shall be based on the relevant asset valuation at the time of expropriation. After proving the aforementioned fact, a balance between different - public and private - interests is ensured¹²⁹⁵. Second, the ECoHR is not keen to turn into a body and become another instance dealing with complaints related to the value of the expropriated property. Therefore, the review of complaints lodged to the ECoHR is limited in the sense that the court evaluates only whether the terms of the compensation payable do not exceed the discretion of the state and whether property located on a particular territory is correctly evaluated in procedural

1293 ECoHR. *Jahn and Others v. Germany*. Case No. 46720/99, 72203/01 and 72552/01, 117 para.

1294 *Ibid.* 36 para.

1295 ECoHR. *Lithgow and Others v. The United Kingdom*, Series A, Case No. 102, 8 July 1986.

terms¹²⁹⁶. This approach will considerably complicate the ability of shareholders whose rights have been seized to review the compensation amount or the absence thereof by reason of interference in their private rights. In addition, the issue of admissibility of the complaint lodged to the ECoHR is also very limited. Therefore, it must be assumed that the review performed by the ECoHR will be mostly focused on the procedural side of the dispute, rather than dealing mainly with the lawfulness of property valuation and whether the affected parties had an opportunity to seek judicial review of resolution decisions in the national courts. In *Northern Rock* case, a decision justifying bank nationalisation was adopted. The resolution decision was performed in compliance with the public interest, after duly balancing public and private interests and in accordance with the national legal regulation. This position was based on the fact that the aim was to protect the entire UK financial sector from the financial crisis spread risk, which could spread to other financial institutions in the case of collapse of Northern Rock, i.e. institution of ordinary bankruptcy procedures. In addition, an important detail is that when the bank was facing serious financial difficulties, initially the CB was acting as a *lender of last resort*¹²⁹⁷, since it was not possible to find any other private sector solutions, which could have helped the bank to avoid liquidation¹²⁹⁸. This action on the part of the government and the CB was aimed at protecting one of the main sectors of the economy, therefore, the ECoHR, having regard to the case-law, respects the decisions adopted by national authorities, unless they are obviously unfounded¹²⁹⁹. Although financial assistance was provided to the Bank from the CB in order to protect the financial sector, this financial injection allowed the bank to continue its operations and trade for a few months only. The bank was subsequently unable to remain as a going concern in the short term and to find resolution solutions, including private sector solutions, thus it was still requiring financial support. Thus, the requirement for shareholders with regard to asset value which was estimated at zero, was far from clearly unreasonable grounds. On the contrary, it was explicitly held that such national policy and legal regulation, which apparently seeks to avoid moral hazard, in the court's judgment, was entirely legitimate. Public authorities have decided to prevent the bank's shareholders from profiting from the stock value of the property, which was mostly preserved only because of the support from the state, namely taxpayers, in the form of temporary public financial assistance in order to avoid bank bankruptcy. Among other things, a vital principle was established to the effect that the creation of expectations on

1296 Ibid. 36, 37 para.

1297 Financial aid was granted under a tripartite agreement and a memorandum of understanding between the three institutions: the Treasury, the CB and the bank. The primary goal of funding was not to protect the bank or its shareholders, but to protect the financial system as a whole, from a systemic crisis, to protect against damage to the general economy. Furthermore, this temporary financing ambition was to find a private sector solution, and in the absence of such method, in the meantime the government should adopt the laws and principles that would allow nationalising the bank and setting the compensation for the expropriated shares. Such a plan was chosen since the immediate liquidation of the bank would violate the public interest. Ibid. para 7.

1298 While on 17 February 2008 two private sector proposals regarding the future of Northern Rock appeared, both of them were related to the continuity of public support, and in consequence of that the government did not consider the proposals and did not consider that such proposals were a suitable solution for taxpayer costs. Ibid. para 12.

1299 Ibid. 39 para.

the market, which would encourage other banks and their shareholders to pursue similar public support, must be avoided, as this can lead to losses to national economy. In addition, it was noted that such a decision of the ECoHR positively affected governing bodies of other banks, by discouraging the board of directors from adopting bad business decisions in financial institutions. Finally, an important aspect is that the appellants had not proved and the court did not find that the public authorities acted with negligence or misleading supervision of Northern Rock bank activities and especially liquidity problems. Nor has it been established that the bank's liquidity problems were determined by any public legal act.

To continue with the case-law analysis, it should be noted that one of the key issues in order to balance public and private interests properly, relates to the *determination of public interest* and the extent to which it can justify the reduction of shareholders' interests and rights, and the type of intervention of the competent authorities that is adequate and proportionate. The objective of determination of the public interest requires to take into account the *decision-making mechanism and structure* and, *inter alia*, to determine whether the decision-making mechanism in all cases ensures sufficient degree of legitimacy and adequately ensures the interests of all shareholders. Normally, decisions regarding bank resolution require the consensus of several competent authorities, which better suits public interest objectives. Another aspect relates to the determination of public interest, by requiring that bank resolution procedures are legally reasoned, and a number of procedural and legal safeguards¹³⁰⁰; also in addition, the resolution procedures must be operational. As noted by the ECoHR, there is a great need for simplicity and expeditiousness of bank insolvency procedures. In *Camberrow MM5 AD v Bulgaria*¹³⁰¹ the Court noted that the sale of the insolvent bank's assets was adopted in order to implement the actions suiting best interests of all the parties involved, in particular, creditors interests. If the court were under a duty to consult with the shareholders and creditors, the bank insolvency procedure would be significantly lengthened and the term of arrangement with creditors would be substantially delayed. The Court also noted that "in the specific areas of the economy, such as the banking system stability, the counterparties can exercise broader discretion". In conclusion, the Court stated that the restriction of the controlling shareholders' rights to participate in the bank's insolvency proceedings, and more particularly the decision to sell the property of the operating part of the bank was not disproportionate in the light of legitimate public objectives, which were to protect the rights of creditors and to protect the proper administration of the assets of the bank.

In accordance with Art. 6 of the ECHR, counterparties affected by bank resolution must have the opportunity of *judicial review*. The counterparties concerned with the failing bank, if their rights are or may be affected by bank resolution tools, must be guaranteed their rights of defence, right to a fair hearing, due process and the possibility of ex-post review of the adopted decision on bank resolution in a way that would not threaten the final result, but also provide a fair financial compensation¹³⁰². Decisions taken by the administrative authorities do not automatically satisfy the requirements of Article 6 of the

1300 EHRC. Art. 1., Protocol No. 1.

1301 ECoHR. *Camberrow MM5 AD v Bulgaria*, Case No. 50357/99, 1 April 2004.

1302 Ibid. 36 para.

ECHR. Such decisions must be subject to further control and be reviewed by a legitimate body within fully reserved jurisdiction in accordance with Article 6 of the ECHR¹³⁰³. For example, in *Capital Bank AD v. Bulgaria*¹³⁰⁴, a decision was made to revoke the banking license without informing the bank in advance and without allowing the bank to raise objections, or giving any other possibility of administrative or judicial review of decisions. The Court concluded that such a decision had caused severe and far-reaching negative consequences for the bank that would automatically loose the going concern assumption, and compulsory liquidation would be commenced. Such an act is legitimate if a reasonable opportunity has been given to the bank to defend its rights before the competent authority. The court also noted that such a procedure should be confidential and closed to the public. Revocation of banking license could be conditionally suspended before a final decision is taken, for instance, in the case of an appeal under internal administrative procedure. At the same time, the Court noted that this right was not absolute and could not limit the rights of shareholders, if the legitimate aims are pursued and the means to achieve these aims are proportionate. Such restrictions are particularly inherent in bankruptcy procedure¹³⁰⁵.

In the U.S., the scope of judicial review is more limited (mainly limited to the determination of systemic risk), compared to the EU framework in the ECHR case-law. Judicial review is limited to examining whether the determination of the decision was *arbitrary and unlawful*¹³⁰⁶. Since bank insolvency procedures are characterised by predictability and certainty, the legal challenges and relative issues shall not result in failure to act or suspension of special legal measures undertaken for bank resolution purposes¹³⁰⁷.

4.2. Analysis of the US Legal Framework

This chapter examines the operation of resolution procedures in the U.S. legal framework. First of all, companies engaged in financial activities are regulated and supervised by the Federal Reserve (Fed), if they hold the SSFI status. The Treasury Secretariat, in view of the seven conditions and recommendations set by Fed, the FDIC or the Securities Commission, including the fact that the financial institution is failing or likely to fail, which may have adverse consequences for the financial stability of the United States, shall inform the bank of the intention to appoint the FDIC as a receiver. If the bank does not agree, the Federal Reserve applies to the Federal Court (based on company headquarters) to adopt a ruling on the restriction of bank's activity. According to Section 202 (a) of the

1303 In order to comply with the provisions of Article 6 ECHR, the court should, in principle, have the power to investigate any issues or facts and related regulations, which are directly related to the dispute. A common expectation may appear that the courts will apply certain limitations while reviewing the administrative decision or when adoption of the judgment requires special expertise, and the ECHR therefore noted that the decisions adopted by a legitimate body with overall jurisdiction are required in order to comply with Article 6 of the ECHR.

1304 ECoHR. *Capital Bank AD v. Bulgaria*. Case No. 49429/99, 2005 November.

1305 ECoHR. *Skrobol v. Poland*. Bylos No. 44165/98, 15 January 2002.

1306 Dodd-Frank. Sec. 202 para.

1307 One of the best examples is the case in Sweden *Custodia v. Sveriges Riksbank*. Can Swedish Authorities Handle Distress Institutions? CB. Financial Stability report. No. 2, 2006.

Dodd-Frank Act, the district court judge has 24 hours from the moment of receiving the petition: (i) to notify the bank and arrange a closed hearing; (ii) to review (limited to the extent necessary for the findings on the legality and reasonableness of the decision) and evaluate all evidence; (iii) to authorise the administrator or determine whether the actions of the Secretariat were “arbitrary, unreasonable, unlawful”; (iv) in the latter case, to provide a written statement for each particular reason, which would replace the court’s judgment. If the judge cannot implement all of these requirements within 24 hours, then the petition shall be applied in accordance with the law, by default. This means that the insolvency administrator immediately starts the resolution and/or liquidation of the bank (reorganisation is prohibited under Section 214 of the Dodd-Frank). The decision to commence bank resolution does not mean that the prohibition of judicial review is applied. The Court of Appeal or the Supreme Court’s power of review is limited to the legality and founded nature of the determination made by the Secretariat. Such regulatory framework may raise practical problems. The first observation is that bank assets are often enormous, consisting of hundreds of billions of dollars in value. A large share of these assets includes companies or risk investment funds, financial instruments contracts, complex securities and other financial contracts. Most of these transactions are illiquid or at least not easily marketable. Therefore, it is very difficult to conduct an accurate, prompt and certain valuation of their assets. For instance, in the US, this was clearly demonstrated in January 2008¹³⁰⁸, during the *Goldman Sachs* insolvency proceedings and the assets transfer to AIG. Under the existing legal regulation, the crucial determination of the Secretariat is that the bank is in default or in danger of default. If the bank has fewer assets than liabilities or fails to fulfill its obligations in due time in the ordinary course of business conditions or it is very likely that the bank will incur losses that will absorb a significant part of the bank capital, such a situation can be considered as a default¹³⁰⁹. It is therefore very likely that, in all cases, the assessment of the bank’s assets will be in the center of the dispute and subjected to appeal. At the same time, the law provides for the possibility of review and the possibility of appeal in court. This is the key safeguard against the possible errors or abuse of powers of administrative authorities. Therefore, the hearing before the expropriation is meaningless. The following hypothetical assumption illustrates the situation. According to the established practice, the Secretariat carries out resolution actions within one business day. This has become a sort of unwritten rule in the US. The procedure seems to be very complicated. The Secretariat shall adopt a resolution on the basis of the detailed documents prepared by the Fed, the FDIC and/or the SEC and in accordance with the recommendations of several institutions and the assessment made by the Treasury staff. The next morning, the bank must obtain and analyse the documents, prepare its calculations for thousands of securities and valuation of assets and promptly deliver all this for the hearing. On the same day, the judge must review large amounts of resolution-related bank documents, come to reasonable conclusions and adopt a ruling, and write an explanatory opinion within a few hours. Another option is less complicated. The judge evaluates the resolution decision and the documents to the extent whether the conduct was justified,

1308 Goldmansachs. Media Relations.Valuation & Pricing Related to Transactions with AIG. [interactivr] [accessed on 2014-05-12] <<http://www.goldmansachs.com/media-relations/in-the-news/archive/response-to-fdic-folder/valuation-and-pricing.pdf>>.

1309 Dodd-Frank. 202 (c) (4).

*non-arbitrary and legitimate*¹³¹⁰. Therefore, it is assumed that the judicial review¹³¹⁰ of resolution decisions is limited, superficial and one-sided. The courts cannot require more time, as any delays in the resolution process are forbidden, and bank resolution shall be carried out very swiftly. If the final decision were in favour of the bank, it could cause irremediable damage to its successful operations. The bank is not allowed to claim damages against the US government, asking for compensation and protecting the rights of defence¹³¹¹. The government has immunity against liabilities¹³¹².

4.3. Key Principles Balancing Private and Public Interests in the US Legal Framework

The principle of legitimate expectations. In the US legal system of bank resolution, it is firstly necessary to refer to the principle of legality, which provides legal certainty and consistency for shareholders. This principle requires that the actions of public authorities that affect private property rights are based on consistent legal regulation. In essence, it means that the conditions and legal criteria supporting the actions of competent authorities must be explicitly laid down by law. In the first place, this principle is governed in the U.S. legal framework by the detailed legal order of prompt corrective measures. The FDIA Act expressly provides for a “risk-based” system. This system estimates semi-annual financial estimations of banks as deposit-taking financial institutions, based on: (i) the likelihood that the DI Fund will suffer losses, having regard to the bank’s operational risks; (ii) different categories of bank liabilities and the concentration of both secured and unsecured depositors, with regard to defined and undefined deposits; (iii) any other factors which, according to the FDIC views, may be relevant to the assessment of the bank’s financial position; (iv) the expected insolvency losses; (v) costs for the deposit fund¹³¹³. The FDIC adopts a risk-based system as the legal basis for requiring the banks to submit detailed activity reports and expert evaluation of financial conditions of the bank. Subsequently, the FDIC analyses and assesses the financial data based on actual bank capital levels. The supervisory authority has a duty to apply sanctions and initiate bank insolvency procedures, if the bank’s equity capital fails to match the capital ratio. Thus, the US legal regime of prompt corrective actions strengthens the principle of legitimate expectations, providing for an environment in which it is possible to determine and to foresee certain actions taken by public institutions against the bank, by providing legal certainty to shareholders. The protection of legitimate expectations of shareholders is thereby enhanced, and shareholders can plan their actions according to clearly defined legal rules and form explicit

1310 The US Supreme Court has recognised that the right to due process and related issues are related, whether the parties to the dispute have enough time to be heard. *Miller v. French* U.S. 327, 350 (2000). Another opinion was expressed by the judge Souter, who stated that leaving not enough time for the Court to investigate the facts can cause ‘serious questions’ as to whether Congress could practically presume judicial role’. *Ibid.* 352.

1311 Any actions should be directed against the government in the subject of the right to a fair hearing, not against the FDIC for its decisions and actions brought against the bank during the administration.

1312 *Scheafnocker v. C.I.R.* 642 F.3d 426, 434 [2011]; *Smith v U.S.*, 51 Fed. Cl. 36, 38 [2001].

1313 FDI Section 302 (a). 12 USC 1817 (b) (1) (C).

expectations. For example, shareholders can assume what will occur to the bank's control rights or economic interests if its financial conditions decline significantly. The chance that bank shareholders will lose control of the bank or that the value of their shares will substantially decrease, forces the shareholders to supervise the managing bodies of the bank more efficiently and encourages to perform in a more socially responsible manner¹³¹⁴.

The right to a fair hearing. In the U.S. legal framework, shareholders have a more restricted legal basis to challenge the decisions and actions adopted by public authorities, compared to the EU legal framework. For example, the US courts have frequently examined whether the FDIC procedures were in compliance with the rights of defence and whether they were consistent with the US Constitution. For example, in *FDCI v. Coughatta*¹³¹⁵, the Court took the view that the FDIC must comply with three criteria, and according to them the court must assess in determining as to which FDIC procedure complies with the principle of the rights of defence, where the public authority expropriates the assets of the company. Legal protection of shareholders is also interpreted with regard to procedural aspects. First of all, it is necessary to assess whether private interests will be affected by the public authority actions and intervention in general. Secondly, the risk of inaccurate, illegal property expropriation for private interests must be assessed after applying the resolution tool during the resolution process, and the potential value of the property, if any, additional or alternative procedural safeguards. Thirdly, it is necessary to assess the government's interests, including the functions associated with possible fiscal and administrative public burden, which can be caused by alternative procedural requirements¹³¹⁶. In essence, it is considered that the rights of defence must be understood in a flexible way and the US legal regulation demands the procedural protection required in a particular situation¹³¹⁷. The court came to a conclusion that insolvency procedures assessing bank capital adequacy, and whether individual bank risk-based supervisory framework is in compliance with the rights of the defense. The court also noted that the hearing taking place before the expropriation procedures is not guaranteed by the law, because the bank has enough adequate opportunities to respond to regulatory notices by written procedure. In addition, it was noted that the government's interests were important on account of any delays or invasion of action that would importantly decrease the benefit, which is respectively related to insufficient bank capital level. The FDIC procedures satisfy the statutory rights of the defense, as they give banks a precautionary time limit to fix bank insolvency risks and lack of capital. They also provide for an opportunity to challenge and appeal against the resolution decision in accordance with the law¹³¹⁸. The decisions adopted by administrative authorities may be revoked only if illegal, ill-founded or administrative authorities exceed their powers.

1314 Alexander K. *Supra* note 79. P. 80-81.

1315 *FDCI v Coughatta*, 930 F 2d 122 (5th Cir), 502 US 857 [1991].

1316 *Ibid.* 335 para.

1317 *Ibid.* 334 para.

1318 FDIC procedures allow the bank to submit an application and supporting documents to the FDIC supervisory department. The procedures enable to request informal oral court hearings, and the FDIC can guarantee this on its own discretion "when the supervisory department determines that an informal oral hearing will be productive in the context of the relevant circumstances. 58 Fed Reg. 34357, 34359 (25 June 1993). 12 CFR 327.3.

The right to compensation. The intervention and actions of public institutions should be considered with regard to every possible loss or damage suffered by shareholders or third parties through implementing resolution powers. The terms of compensation is an important element in determining whether a public intervention is justified and does not lead to a disproportionate restriction of the rights and legitimate interests. Under the US federal banking law, shareholders have the right to a fair value of equity, calculated at the time when a receiver is appointed¹³¹⁹. In the US, shareholders' right to compensation is interpreted by *the source of strength doctrine*. The scientific literature remains critical towards the provision with regard to shareholder rights, under which the owner of shares is not personally liable for all debts of the company, except for those that are associated with the value of investment in the company, and is protected from any legal action against the company¹³²⁰. The dual responsibility right of shareholders was enshrined in the United States prior to 1992. The doctrine also relates to the fact that most banks in the United States are banking groups (holdings). The largest US banks, such as *Citibank* or *Bank of America*, own many bank subsidiaries and branches. To avoid the risk of bank holding structures leading to greater risks for banking activity, the Federal Reserve has developed and applied the requirement for banking groups to provide financial resources to bank subsidiaries. In other words, this means that the parent company's shareholders must contribute to the subsidiary, where the latter is faced with financial difficulties. If the parent company carries out its obligations under the instructions of the Federal Reserve and aims to increase the subsidiary's capital, when it is insufficiently capitalised, any transfer of bank funds or assets is protected from shareholders' claims to cover damages. The doctrine reflects that the protection required by bank creditors is higher than that provided by general commercial law. This theory is further disclosed in the US Supreme Court case *Board of Governors v. First Lincolnwood Corporation*¹³²¹. The central aspect of the case was that investors must provide additional financial support in addition to the existing range of investments, if the public body determines that the bank is failing or likely to fail. Shareholders have the duty to strengthen the subsidiary.

4.4. Impact of Bank Resolution Procedures on Bank Creditors

It has already been discussed that the DGS serves to prevent massive banks runs and minimises the danger of adverse systemic risks in the banking system. The problem of systemic risk can also be resolved through increasing the seniority of performance of the contracts concluded by the SSFI and other bank creditors.

Bank's netting agreements, bank contract execution and prohibition to conclude new contracts in bank resolution are necessary legal mechanisms that allow indirectly enhancing the possibility of satisfaction of specific bank creditors' claims and reducing the negative impact because of particular bank's insolvency.

Set-off in bank resolution procedures is an important element since the banks not only lend to borrowers, but often accept deposits from customers. Therefore, by reason of such

1319 Alexander K. *Supra* note 79. P. 87.

1320 Hüpkes E. *Supra* note 78. P. 280.

1321 *Board of Governors v. First Lincolnwood Corporation*. 439 US 234 [1978].

borrowers, the bank's net asset position is significantly weaker than the total assets position of the bank. The meaning of set-off is the point at which the debtor fails to comply with its obligations or becomes insolvent, when the bank may set-off the entire balance sheet assets of the insolvent debtor into the borrower's debt. This approach is considered to be a certain collateral for the debtor's obligations, which the bank may use if the borrower fails to fulfill his commitments. Therefore, set-off can significantly contribute to reducing the risks of bank insolvency. In the general insolvency law, the addressee of the prohibition to discharge any financial obligations is the entity in bankruptcy itself (one entity in bankruptcy it is not allowed to discharge obligations), while set-off is usually performed by other entity engaged in legal relations, by unilaterally declaring set-off. The creditor performing set-off, rather than participating with other creditors *pari passu* in satisfying its claim, obtains such satisfaction by avoiding the performance of his obligations towards the debtor. Set-off – is the right to carry out counter-homogenous claims netting, a sort of priority right when the debtor is insolvent.

The protection of financial contracts essentially means that under bank resolution, the priority of creditor's claims might be modified by departing from general insolvency law. Such a modification is understood in the doctrine as an attempt to come outside the framework of general insolvency law and to confer special higher status for specific businesses, to reduce systemic risk, negative social consequences and negative impact on the economy. Legal protection of financial contracts concluded by the bank gives the bank a better position, in comparison with other creditors.

Finally, it is important to note that, in order to prevent a systemic banking crisis, *automatic suspension of obligations* held by a bank complying with resolution conditions could not be imposed on all creditors in all cases, for example, to insured depositors. Such depositors are compensated by the DIA, or they are transferred to a healthy bank. Suspension of unsecured deposit liabilities could cause considerable difficulties, since it can lead to liquidity shortages in other healthy financial institutions¹³²².

4.4.1. Early Contract Termination and Safeguards for Counterparties. The EU Regulatory Framework

Similar to shareholders' rights, creditors' rights are protected by the ECHR. Any legally based financial claim of a creditor relates to the 'management' of the ownership right according to Art. 1 of the Additional Protocol to the ECHR, if legal regulation provides no adequate legal tools to fulfill the 'claim', in certain cases, this can result in violation of creditor's rights. Bank resolution procedures fall into the scope of that article. However, the ECoHR does not provide detailed guidelines or criteria on the certain rights that creditors should exercise within the legal framework of bank resolution. It should be noted that the procedural rights to a fair trial and due process are established in Art. 6 of the ECHR, which applies to all procedures, including the determination of civil rights. Possible violations may occur when bank resolution procedures lead to violation of creditors' rights, for example, upon amending the terms and conditions of financial contracts or extending the

1322 Marinč M., Vlahu R. *Supra* note 74. P. 137.

contractual performance deadlines, thus reducing the claim value, converting creditors' financial claims into equity, or the transfer of financial claims to a third party.

In order to make the application of bank resolution tools effective, resolution authorities shall have the power to suspend the rights of creditors and counterparties to run enforcement activities and to finalise, accelerate or otherwise terminate contracts with the failing bank. Within the EU legal framework, the termination right exercised during bank resolution is generally understood not only as the right to terminate a contract, but also as the “*right to accelerate, close out, set-off or net obligations or any similar provision that suspends, modifies or extinguishes an obligation of a party to the contract or a provision that prevents an obligation under the contract from arising that would otherwise arise.*”¹³²³ The question is which model of regulatory framework for contract termination restriction and safeguards for the parties are given preference in the new EU paradigm of bank insolvency procedures?

Primarily, fundamental principles of the restriction on termination rights upon the commencement of bank resolution procedures are to be noted. The EU resolution authorities have the power to suspend the termination rights of any party to a contract with a bank under resolution¹³²⁴. The duty of the resolution authority to publish a copy or a notice on the decree or resolution tool requiring to undertake bank resolution¹³²⁵.¹³²⁶ Obligations pursuant to contracts whose termination is not allowed are partially suspended from the date of publication of a notice suspension until 5 p.m. of the next business day¹³²⁷. Such legal regulation gives public authorities time to identify and evaluate those contracts to be transmitted to a solvent third party without the risk that the value and the extent of financial contracts will change upon using the contract termination rights by counterparties. The counterparties that stay with a failing bank, have right to terminate the contract at the end of suspension period. The key aspect of the restriction placed on contract termination in the EU legal system is that the transfer of the insolvent bank's assets to a healthy third party should not be treated as a default, which would allow exercising the right to terminate the contract. Any suspension of obligations shall not apply to (i) eligible depositors; (ii) payment and delivery obligations owed to systems or operators of systems designated for the purposes of Directive 98/26/EC, central counterparties, and central banks; eligible claims for the purpose of Directive 97/9/EC¹³²⁸. Moreover, when suspending obligations, resolution authorities shall have regard to the impact the exercise of that power might have on the orderly functioning of financial markets¹³²⁹.

Abstention from actions, suspension of certain bank obligations. First of all, bank resolution authorities have additional powers that would ensure efficient transfer of bank shares or debt instruments and assets, or rights and obligations to a third party. These powers include the power to revoke the rights of third parties to transferred property or means

1323 BRRD Art. 2 (82).

1324 BRRD. Art. 71 (1).

1325 BRRD. Art. 69 (1).

1326 BRRD. Art. 83 (4).

1327 BRRD. Art. 69 (1).

1328 BRRD. Art. 69 (4).

1329 BRRD. Art. 69 (5).

and the power to enforce contracts and guarantee the continuity of agreements with the recipient of the transferred assets and shares. However, these powers shall not affect the employees' rights to terminate the employment contract. An exception is also provided to the effect that the granted powers shall not affect the right of the counterparty to terminate the contract with the bank under resolution or the banking group entity for reasons other than the replacement of the bank under resolution with another bank¹³³⁰. Second, in order to ensure that resolution authorities, when transferring assets and liabilities to a private sector purchaser or bridge institution, have enough time to identify the financial contracts that need to be transferred, finalised or otherwise terminated, it might be appropriate to impose proportionate restrictions on counterparties' rights to close out, accelerate or otherwise terminate financial contracts before the transfer is made. Such a restriction is necessary to allow public authorities to obtain a true picture of the balance sheet of the failing bank, without the changes in value and scope that extensive exercise of termination rights would entail. In order to interfere with the contractual rights of counterparties to the minimum extent necessary, the restriction on termination rights should apply only in relation to the crisis prevention measure or crisis management measure, including the occurrence of any event directly linked to the application of such a measure, and contract termination rights arising from any other default, including failure to pay or supply a guarantee payment, should remain¹³³¹. Third, in order to preserve legitimate capital market arrangements in the event of a transfer of some, but not all, of the assets, rights and liabilities of a failing institution, it is appropriate to include safeguards to prevent the splitting of linked liabilities, rights and contracts, as appropriate. Such a restriction on selected practices in relation to linked contracts should extend to contracts with the same counterparty covered by security arrangements, financial collateral arrangements transferring title, set-off arrangements, close out netting agreements, and structured financing arrangements. Where the legal safeguard applies, resolution authorities shall be bound to transfer all the linked contracts within a protected arrangement, or leave them all with the residual failing bank. Those safeguards should ensure that the regulatory capital treatment of exposures covered by a netting agreement for the purposes of Directive 2013/36/EU is not affected. Fourth, when exercising their resolution powers, the resolution authorities have the power to cancel or modify the terms of a contract to which the bank under resolution is a party or substitute a recipient as a party¹³³². Bank resolution tools shall not, *per se*, be deemed to be an enforcement event or insolvency proceedings under a contract, including payment and delivery obligations, as well as provision of collateral¹³³³. That requirement is mainly applied due to the fact that upon bank resolution, substantive obligations under the contract, including payment and delivery obligations, and provision of collateral, continue to be performed, it shall not, therefore, *per se* make it possible for anyone to (a) exercise any termination, suspension, modification, netting or set-off rights, including in relation to a contract entered into by: (i) a subsidiary, the obligations of which are guaranteed or otherwise supported by the parent undertaking or by any group entity; (ii) any banking

1330 BRRD. Art. 87.

1331 BRRD. Recital (94).

1332 BRRD. Art. 64 (1) (f).

1333 BRRD. Art. 68 (1).

group entity which includes cross-default provisions; (b) obtain possession, exercise control or enforce any security over any property of the credit institution or any group entity in relation to a contract which includes cross-default provisions; (c) affect any contractual rights of the credit institution or any group entity in relation to a contract which includes cross-default provisions¹³³⁴. A suspension or restriction of a contract shall not constitute non-performance of a contractual obligation for the purposes of early intervention and resolution¹³³⁵. All of the provisions contained herein shall be considered to be overriding mandatory provisions against the provisions of contractual obligations under the Regulation¹³³⁶. Eventually, the regulation provides for the *power to restrict the enforcement of security interests*. Resolution authorities have the power to restrict secured creditors of a bank under resolution from enforcing security interests in relation to any assets of that bank at the end of the next business day¹³³⁷.

These necessary restrictions on contractual rights of the new bank resolution procedures are governed and counterbalanced by protection measures of counterparties, which aim - inability of public authorities to split the relevant obligations, rights and contracts, i.e., in the case of partial property transfer, linked arrangements would be transferred in full or not at all moved. The arrangements include close-out netting arrangements, set-off arrangements for financial security transfer of title to the collateral agreements, collateral agreements and structured finance arrangements. The protection of in the EU is discussed below in more detail.

The first safeguard is *asset valuation*. This duty is set to ensure that, following the bank resolution operation, or actions, an independent property valuer shall carry out independent bank assets valuation as soon as possible. This assessment is separated from the assessment carried out *ex ante* for resolution purposes. The main purpose of such evaluation is to assess whether shareholders and creditors would have faced better treatment if the bank under resolution had entered into ordinary insolvency proceedings. Therefore, the valuation of assets shall determine (i) the treatment that shareholders and creditors, or the relevant deposit guarantee schemes, would have received if the bank under resolution with respect to which the resolution action or actions were effected had entered into ordinary insolvency proceedings at the time when the decision was taken by the resolution authority; (ii) the actual evaluation that shareholders and creditors have received at the time of resolution; and (iii) if there is any difference between the treatment referred to in point (a) and the treatment referred to in point (b).¹³³⁸ In addition, a very important point is that in performing the valuation of assets (a) it is assumed that the bank under resolution with respect to which the resolution action or actions have been effected, would have entered into normal insolvency proceedings at the time when the decision was taken by the resolution authority to put the bank under resolution; (b) it is assumed that the resolution action or actions had not been effected; (c) disregard of any provisions of extraordinary public financial support to the bank under resolution¹³³⁹.

1334 BRRD. Art. 68 (3).

1335 BRRD. Art.68 (5).

1336 Regulation (EU) No. 593/2008. Art. 9.

1337 BRRD. Art. 70 (1).

1338 Ibid. Art. 74 (2).

1339 Ibid. Art. 74 (3).

The second safeguard – *shareholder and creditor evaluation by partial asset transfer and the application of bail-in*. The EU legal framework provides the obligation to ensure that after recourse to one or more bank resolution tools and, in particular, shareholders and creditor protection objectives: (a) except for in cases covered by bail-in, where one or more conversion authorities shall transmit only part of the rights, assets and liabilities, shareholders and the creditors whose claims have been transferred, would be compensated at least the amount they would have received if the bank is liquidated by bringing ordinary bankruptcy proceedings at the time of the adoption of the resolution authority; (b) when the resolution authorities apply the bail-in tool, shareholders and creditors, whose claims are neither written off or converted into equity securities are not exposed to greater losses than those which they would have incurred if the bank were liquidated by bringing ordinary bankruptcy proceedings at the time of the adoption of the resolution authority¹³⁴⁰. If the outcome of the discussed assets assessments finds that any of the shareholders or creditors, or DGS suffered greater losses than they would have experienced in the case of bank liquidation under normal insolvency proceedings, they are entitled to compensation i.e., the payment of difference from resolution financing arrangements¹³⁴¹.

Third safeguard of private interests - *counterparties safeguard on the partial assets transfer*. This measure ensures the appropriate protection of counterparties: (a) *collateral arrangements* under which a person holds the actual or imputed part of the transferred asset or part of the rights, regardless of whether this part is backed by specific assets or rights or variable property mortgage or similar agreement; (b) *financial collateral arrangements* under which the ownership is transferred, or under which a collateral provider supplies a collateral to ensure the fulfillment or coverage of specific obligations, by transferring full ownership of assets to the collateral beneficiary, by providing in the conditions that the collateral beneficiary shall transfers the assets, provided that the specific obligations are met; (c) *set-off arrangements* under which two or more claims or obligations to be met by the restructured bank and the counterparty against each other, may be offset in relation to each other; (d) netting arrangements; (e) covered bonds; (f) structured financing arrangements, including securitisations and instruments used for hedging purposes, which form an integral part of the cover pool and are secured in a manner similar to covered bonds in accordance with national law, according to which the collateral is provided and held by the purchasing party or a trustee, agent, or the person appointed¹³⁴².

Protection of financial collateral, netting arrangements and set-off agreements. The EU legal framework establishes that in order to ensure adequate protection of financial collateral arrangements, which transfer ownership and netting arrangements and set-off arrangements so as to prevent the transfer of certain rights and obligations that are protected under a financial collateral arrangement, forming the basis for title transfer, under offsetting arrangement or netting agreement between the bank under resolution and another person. In addition, the availability of additional powers to modify or terminate the rights and obligations protected under a security financial collateral arrangement, under which the ownership is transferred, under offsetting agreement or offsetting agreement is lim-

1340 Ibid. Art. 73 .(a), (b).

1341 Ibid. Art. 75.

1342 Ibid. Art. 76 (2).

ited. These agreements are considered to be protected if the counterparties have the right to set off or settle those rights and obligations¹³⁴³. Therefore, to ensure the availability of insured deposits, the resolution authority may: (a) transfer the insured deposits, which are part of that agreement, without transferring any other assets, rights and obligations forming part of the same agreement; (b) transfer, modify or terminate such assets, rights or liabilities, without transfer of insured deposits¹³⁴⁴.

Protection of collateral arrangements. In the EU framework, adequate protection of commitments secured by collateral arrangement must be ensured, thus the following is not allowed in bank resolution: (a) the transfer of assets securing an obligation, unless the transfer is accompanied by the obligation and the collateral benefit; (b) the transfer of secured obligation, unless accompanied by the transfer of the collateral benefit; (c) the transfer of the collateral benefit, unless accompanied by the transfer of the secured obligation; (d) modification or termination of the collateral arrangement by using additional powers, if the obligation remains unsecured due to such amendment or termination¹³⁴⁵. Despite this obligation, where it is necessary to ensure the availability of insured deposits, the resolution authority may transfer the insured deposits forming part of the collateral agreement, excluding any other assets, rights and obligations that are part of the same agreement, and carry out the transfer, modification or termination of such assets, rights and liabilities, without transferring the insured deposits¹³⁴⁶.

Protection of structured financing arrangements and covered bonds. The EU legal framework provides for an obligation to ensure adequate protection for structured finance arrangements and to prevent: (i) the transfer of some, but not all assets, rights and obligations that make up all or part of a structured financing agreement, including covered bonds and securitisation and instruments used for hedging purposes, with the bank under resolution as a party to such instruments; (ii) terminate or change the assets, rights and obligations that make up all or part of a structured financing agreement, by using additional powers, including covered bonds and securitisation and instruments used for hedging purposes, and agreements to which the restructured bank is a party¹³⁴⁷. In order to ensure the availability of insured deposits, the resolution authority is granted the following statutory rights: (a) to transfer the insured deposits, forming part of any of the above-mentioned agreement, without transferring any other assets, rights and obligations, which are part of the same agreement, and (b) to transfer, modify or terminate the assets, rights or obligations, without transferring the insured deposits.¹³⁴⁸

Protection of trading, clearing and settlement systems. Application of any bank resolution tool cannot affect the operation of systems and rules of systems covered by Directive 98/26/EC, whereby the resolution authority: (a) transfers a part (but not all) of the assets, rights and liabilities of the bank under resolution to another entity; (b) exercises the resolution powers to withdraw or amend the terms of the contract, to which the restructured

1343 Ibid. Art. 77 (1).

1344 Ibid. Art. 77 (2).

1345 Ibid. Art. 78 (1).

1346 Ibid. Art. 78 (2).

1347 Ibid. Art. 79 (1).

1348 Ibid. Art. 79 (2).

bank is a party, or replace the recipient as a party to such contract. Transfer, cancellation or amendment cannot cancel the transfer order in violation of Article 5 of Directive 98/26/EC. In addition, the resolution cannot entail any changes or denial of transfer orders and offsetting, use of funds, securities or credit instruments, or collateral security¹³⁴⁹.

4.4.2. Contract Termination Restrictions and Protection of Counterparties. The US Regulatory Framework

The doctrine explains the reasons why bank resolution procedures are not subject to the US Bankruptcy Code, more specifically, the provisions governing automatic suspension of obligations only after application to initiate bankruptcy proceedings has been accepted, termination restrictions and priority ranking of creditors' claims, *inter alia*, by the fact that the FDIC is required to carry out resolution actions in a very prompt manner¹³⁵⁰. In addition, any collective insolvency proceedings of a company facing financial difficulties suspends individual investors' efforts to recover their claim to the largest extent possible. The US Bankruptcy Code governs the automatic suspension of obligations of an insolvent entity by providing the right to automatically suspend all the obligations of the insolvent entity. Accordingly, this suspends all formal and informal collective efforts and the 'race' undertaken by creditors with regard to the borrower's assets. Exceptional control of bank insolvency procedures is established in Chapter II of the Dodd-Frank Act. This act holds a partially similar position, but an exception is made for all cases limiting shareholder and creditor claims, except for shareholder, creditor rights to make payments, adopt decisions relating to their claims or any other methods for meeting their claims¹³⁵¹. After opening the insolvency procedure, that provision grants the bank with the right to terminate the rights enjoyed by bank counterparties (except for qualified financial contracts¹³⁵²), *ipso facto* implementing the provisions within 90 days from the start of the insolvency procedures, i.e., from the date of appointment of the receiver¹³⁵³. The courts are also not allowed to adopt a ruling or issue a writ of execution directed against the debtor's assets without the consent of the FDIC¹³⁵⁴. At the same time, it is important to note that the start of receiver's appointment under the provisions of Chapter II does not automatically suspend any disputes or legal proceedings to which the bank is a party. Therefore, the FDIC must submit an application-petition to the court requesting to suspend the judicial procedures with regard to the bank. Courts remain under an obligation to approve the petition, but the suspension cannot exceed 90 days¹³⁵⁵. Similar terms make the FDIC act quickly in deciding whether to approve or disapprove the claims raised by bank creditors. Pursuant to the provisions of Chapter II, the procedure for approving creditors' claims is defined in

1349 Ibid. Art. 80.

1350 Bliss R., Kauffman. G. *Supra* note 75. P. 51- 52.

1351 Dodd-Frank. 210 (a) (1) (M).

1352 Ibid. 210 (c) (13) (C) (ii).

1353 Ibid. 210 (c) (13) (C) (i).

1354 Ibid.210 (a) (9) (C).

1355 Ibid. 2010 (a) (8).

the same terms as in the US Bankruptcy Code¹³⁵⁶. However, the decision on the approval or not of creditor claims must be adopted within 180 days from the date of appointment of the receiver (in some cases, this period may be extended)¹³⁵⁷. If more speedy decision-making is necessary in order to avoid 'irreparable damage' to the applicant, the FDIC must decide in 90 days¹³⁵⁸. The FDIC may disapprove all or part of the financial claim lodged on time, if it finds that the facts do not meet the 'sufficient standard of evidence in accordance with the FDIC assessment'. However, if the claim is not approved, the applicant may still apply to courts to determine the size of its financial claim, namely the federal court¹³⁵⁹. It should be noted that, according to the U.S. legal framework, the FDIC has the right to approve or refuse to approve any transaction carried out by the counterparties of a contract, if it establishes the right to judicial review of the decision within a 'reasonable period'¹³⁶⁰. The parties concerned whose contracts were refused execution shall be entitled to damages, and may acclaim them at a later stage. However, claims for compensation, additional damage (such as losses related to fines), lost profits, moral damage, pain and suffering is not permitted by law¹³⁶¹. The distinctive feature, in comparison with the general provisions of the US Bankruptcy Code, is that upon bank resolution FDIC is empowered to enter into loan agreements and continue their performance. The FDIC is authorised to carry out and secure 'any agreement increasing the creditworthiness and reliability of a financial institutions or interim financial institution'¹³⁶². Such regulation is introduced with the purpose to ensure the operational nature of bank resolution procedures conducted by the receiver. According to the substance of this legal regulation, the FDIC can select only the most advantageous bank business lines for bank resolution.

Suspension of contracts and refraining from action. Some of the differences between the Bankruptcy Code and Chapter II of the Dodd-Frank Act are of little significance. For example, Article 210 (a) (11) of the Dodd-Frank Act establishes the suspension of the rights and powers of creditors in the light of the illegal, fraudulent intentions and behaviour or preferential conditions for the transfer of assets, as provided for in Sections 547 and 548 of the US Bankruptcy Code. These provisions are almost identical. An important difference is the application of the *bona fide* principle to the purchaser of bank assets. This means that the bank's assets are transferred to another bank following the value determined by the 'reference price standard' in assessing whether the transfer of assets of the bank under resolution is optimal and at least hypothetically complies with the creditor's rights and interests¹³⁶³. Another difference from normal bankruptcy law is that claims with regard to intentional, fraudulent transfer to non-insiders. The Bankruptcy Code provides for and

1356 Ibid. 210 (a) (4), 210 (c) (3) (E). FDIA. 12 U.S.C. 1821 (e) (3). Persons whose rights against the bank are uncertain and who have come to the conclusion that their rights may be differently defined and modified by a receiver in accordance with the FDIA. 12 U.S.C. 1821 (e) (3). The FDIC is authorised to assess uncertain and disputed claims lodged by creditors in the same way as the bankruptcy court.

1357 Dodd-Frank. 210 (a) (3) (A) (i).

1358 Ibid. 210 (a) (3) (A) (i).

1359 Ibid. 210 (a) (4).

1360 Ibid. 210 (c) (1) (2).

1361 Ibid. 210 (c) (3) (A), (B).

1362 Ibid. 210 (a) (12) (D).

1363 Ibid. 210 (a)(11) (H) (i) (II).

allows the trustee to challenge this kind of unfair transfers of creditor claims and to challenge the transaction, regardless of the borrower's financial situation during transfer¹³⁶⁴. In contrast, Section II of the Dodd-Frank Act provides that the receiver must intervene only if such transactions resulted in the company's insolvency or have been carried out when the company had already been insolvent¹³⁶⁵. Another difference is that there are no provisions analogous to Section 544 of the Bankruptcy Code, which, *inter alia*, confers the rights on the trustee to defend creditor claims, ensuring the security of the debtor's assets. This law is interpreted in conjunction with Section 210 (a) (1) (d) of the Dodd-Frank Act, which provides that the FDIC, acting as a financial institution's receiver, might pursue recovery of bank assets held in other financial institutions, liquidate and close the legal person in view of all the completed payments and property transfers.

Qualified financial contracts. Financial contracts are generally the main non-banking or investment banking assets. For example, derivatives are key investment banking products. In essence, in simple terms, it is a bilateral contract with the value based on changes in interest rates, currencies or other inputs, when a certain event defined in the contract occurs (for example, the company starts failing in its obligations). One of the main objectives of the Dodd-Frank Act is to control the risks arising out of derivative contracts, by providing for the obligation to carry out and further trade in derivative instruments even after the commencement of insolvency procedures¹³⁶⁶.

Before the Dodd-Frank Act came into force, financial institutions facing financial difficulties were confronted with major challenges encountered in managing the assets related to financial arrangements. Banks had to follow the general insolvency regime and ordinary provisions of the Bankruptcy Code, the so-called automatic suspension of obligations after initiating bankruptcy proceedings. Under the Bankruptcy Code, institution of bankruptcy proceedings against a bank allowed terminating all agreements with the distressed institution or to carry out financial contract offsetting agreements and set-off, when calculating net obligations, seize the available collateral to the extent permitted by the net liabilities managed by the financial institution. Automatic suspension of obligations did not apply to financial counterparties. Even after the suspension of all obligations, certain exceptional bank counterparties could be classified as financial contracts: repos, urgent prior commitments, commodity futures, securities contracts, asset swaps. There were no rules *ipso facto* governing the provisions or the preferential transfer of such or disputing the transactions vitiated by deception and the related instruments. In other words, the essence of the new legal regulation is that the rights of the counterparties related to financial contracts arising out of the latter cannot be remain unaffected by the bankruptcy process. The goal of such rule – is to reduce bank rescue with the use of public finances. The Dodd-Frank Act chose a different legal approach to the treatment of financial contracts at the time of bank insolvency. On the one hand, this act maintains the approach to suspension of the financial obligations during resolution. The related parties still retain immunity with regard

1364 11 U.S.C. Sec. 548 (a) (1) (A).

1365 *Ibid.* 210 (a) (i), (ii).

1366 Skeel D.A. The New Financial Deal: Understanding the Dodd-Frank Act and its (unintended) Consequences, Research Paper No. 10-21. Institute for Law and Economics. 2010. P. 4.

to preferential and fair transfer of financial contracts to another financial institution¹³⁶⁷. However, the suspension of obligations is considered in a broader sense than in the Bankruptcy Code, as it applies to all counterparties of qualified financial contracts, and not only to certain counterparties referred to in the Bankruptcy Code. For example, while all asset swaps are benefiting from the protection guaranteed by the Bankruptcy Code in the case of insolvency¹³⁶⁸, only the identified counterparties to the transaction, such as securities, commodities trading, futures contract brokers, stock exchange transactions brokers can obtain the benefits from the rules governing the protection of suspension of obligations provided for in the Bankruptcy Code¹³⁶⁹. In addition, it is true that part II of the Dodd-Frank Act regulates the protection of contractual rights of counterparties and makes it clear that the appointment of the bank's receiver cannot change the rights of the parties of financial contracts. For example, "no one shall be allowed to refrain or prevent the implementation of any rights which this person may terminate, liquidate or otherwise accelerate any qualified financial contracts of an insolvent financial institution, these rights and obligations arise from the date of appointment of the receiver (FDIC), or at any other time after the appointment¹³⁷⁰. However, the Dodd-Frank Act provides for the possibility to suspend (at least temporarily) some important contractual rights of an insolvent bank. First, *ipso facto* the provisions (contract termination, offsetting agreements, set-off) are suspended from the date of the appointment of the receiver. The obligations shall be suspended until the next business day, 5 p.m., or until the moment when qualified financial contracts are transferred to another financial institution¹³⁷¹. Similarly, the Act prohibits non-performance, by forbidding "suspension, effect, or cancellation of payment obligations" related to the parties of financial contracts only with regard to financial institution's insolvency, or the fact that the FDIC is appointed to act as receiver¹³⁷². It provides for an exception. According to the provisions of Dodd-Frank Act, temporary suspension of the payment obligations of the insolvent financial institution is allowed¹³⁷³. This exception, among other things, covers the suspension of qualified financial contracts traded through clearing organizations. If the FDIC fails to meet any "reserves, collateral, payment obligations under the rules of the clearing organisation, the latter shall be entitled to act without delay and refrain from all of its rights and the implementation of measures in accordance with its internal rules and applicable law¹³⁷⁴.

Suspension of *ipso facto* clauses, in line with contract suspension for the defaulting party and payment obligations default (at least temporary) clauses, the Dodd-Frank Act gives the right and time to the FDIC to terminate qualified financial contracts or to transfer them to another financial institution. The scheduled time is limited. Termination of

1367 Dodd-Frank. 210 (c) (8) (C) (i).

1368 11 U.S.C. 101 (53C), 546 (g).

1369 Ibid. 546 (e).

1370 Dodd-Frank. 210 (c) (8) (A) (i) .

1371 Ibid. 210 (c) (10) (B).

1372 Ibid.210 (c) (8) (F) (i), (iii). It is presumed that these provisions are restored after qualified financial contracts are transferred to a third party (for approval in the case if a third party subsequently becomes insolvent).

1373 Ibid.210 (c) (8) (F) (i).

1374 Ibid.210 (c) (8) (G).

contract fail to take place, and the payment obligation becomes enforceable again after (i) the contract is transferred to another legal entity, such as a bridge bank; (ii) until the next business day, 5 p.m., when the FDIC is appointed as a receiver¹³⁷⁵. However, the counterparty is unable to implement the termination rights only because qualified financial contracts were transferred to the temporary bank assigned with a conservator or receiver, the bankruptcy trustee, or other legitimate custodian, or who would have otherwise to undergo ordinary insolvency procedure. The FDIC does not have the same contract performance and default powers as those conferred by the Bankruptcy Code on the bankruptcy trustee and debtors, whose claims are secured. The Bankruptcy Code allows debtors with claims secured by assets to select an enforceable contract with a counterparty. Instead of approving several contracts for the calculation of the total obligation of the debtor, the Bankruptcy Code allows strategic actions of the secured debtor. For example, the takeover of secured agreement (by ensuring full payment to the counterparty), and by rejecting those contracts without a collateral (making sure the transaction parties are treated as regular unprotected lenders, who usually recover lower portion of the claim). The Dodd-Frank Act explicitly prohibits selective 'choices, since it requires that the FDIC terminates all or any financial contracts with the respective bank counterparty¹³⁷⁶. The same 'all or nothing' principle applies to decisions taken by the FDIC when transferring financial contracts to a bridge bank. The FDIC can transfer all or none of the financial contracts of a particular counterparty. Contract transfer must include not only the contract but also any other requirements associated with the counterparty, or any equity instrument or a credit enhancing security obligations under the contract¹³⁷⁷.

The descriptive part of the Dodd-Frank Act II ensures that the insolvency of a financial institution does not affect the execution of financial contracts. The appointment of an administrator shall not lead to any changes in the contracts. After the contracts are transferred to the bridge bank, they are performed according to their original terms, as if nothing had changed. For example, all enforceable contracts provide borrowers with collateral the ability to benefit from healthy financial institutions from third countries. In essence, according to the Dodd-Frank Act, departing from the provisions of the US Bankruptcy Code, the following main objectives are pursued: to encourage FDCI operational decision-making, to avoid bank rescue with public finances, by forcing the bank counterparties to accept losses, as well as to minimise the financial burden on taxpayers¹³⁷⁸.

4.4.3. Loss Allocation. Priority of Creditors' Claims

In order to purify the development and the potential of possible bank resolution strategies, it is important to determine the creditors assuming losses incurred by reason of bank insolvency and the extent of such losses, and the creditors to be protected from bank resolution decisions. All regulatory models of bank insolvency procedures dealing with distressed banks are associated with the mechanism of distribution of loss resulting from

1375 Ibid. 210 (c) (8) (F) (ii), (10) (B) (i).

1376 Ibid. 210 (c) (11).

1377 Ibid. 210 (c) (9) (A).

1378 Ibid.204 (A), 206.

bank insolvency. It is important to reveal the parties bearing the first losses in the event of bank resolution and whether such losses are fully allocated to the the bank counterparties, and whether a certain share of the financial burden and losses is borne by taxpayers.

In conventional bankruptcy cases of corporate entities, distribution of losses is consolidated in the main insolvency laws. The most important aspect of distribution of losses in general insolvency law is that the financial claims ranking at the top of the creditors' sequence are satisfied at first place, whereas lower-ranking claims are satisfied only if any funds remain in the insolvent entity. Losses are allocated on the *pro rata* basis according to the hierarchy of creditors' claims. Another important principle of general insolvency law is that creditors of the same class are treated in an equal manner. This principle recalls equal treatment of creditors (*par conditio creditorum*). It is based on the idea that in collective insolvency procedures creditors of the same ranking must obtain a proportion of their claims on an equal footing with other creditors of the same class¹³⁷⁹. Categorisation of creditors according to classes, for example, by distinguishing tax authorities or employees and their claims or by determining that depositors shall (not) be distinguished from the general class of creditors, depends on the following factors (i) social priorities of a particular country and granting of priority to a particular social class; (ii) the intention of the legislature. It is important to note that any change in the sequence of creditors or conferral of new rights to certain creditors impacts the pecuniary interests of other creditors and the final distribution of money from the total asset mass of the bankrupt entity.

The priority of creditor claims in the case of bank insolvency naturally affects the behaviour of creditors both before and during the banking crisis. For example, conferring "exceptionally high priority" for a certain class of creditors creates funds to finance bank rescue operations, affects the probability of the bank facing financial difficulties to obtain financing in the market, especially in times of financial distress. It also affects the creditors whose claims are ranked lower. Moreover, the priority of depositors' claims reduces cash return rates for other general creditors, encourages stronger monitoring, observation and more careful assessment of the potential risks to other bank counterparties. If the loss allocation mechanism and the creditor ranking is clear and predictable, the competent authorities review the creditors' loss allocation mechanisms and identify their social acceptability whenever a bank faces solvency problems. For example, by reason of priority of creditor claims, it is likely that losses will cause systemic contagion effect and lead to even greater losses for the whole financial system. In this case, as revealed by recent banking crisis, it is likely that public authorities will be more prone to use public financial assistance in order to protect specific creditors from losses they would suffer in the case of normal bankruptcy procedures or bank resolution. Hence, final bank resolution result is closely related to the satisfaction of creditors' expectations. The question arises as to the types of loss distribution mechanisms established in the relevant jurisdictions?

The first principle long reaffirmed in the doctrine pertains to the fact that the bank shareholders are the first to bear the losses¹³⁸⁰. This legislative direction is based on the fact that shareholders have invested their capital and automatically determined equity capital

1379 United Nations Commission on International Trade Law (UNCITRAL), Legislative Guide on Insolvency Law, 2005, Section 7.

1380 Hoelscher D.S. *Supra* note 2. P. 98.

risk after the bank became insolvent. Therefore, the initial allocation of losses to shareholders is logical, since they receive all or most of the bank's profit earned in successful life times of the bank, which means that shareholders should lose their capital when the bank's activities are unsuccessful and the bank suffers losses. Likewise, shareholders should be the last persons to recover the cash, if any, after the resolution and/or liquidation of the bank and the fulfillment of other creditor claims.

Secondly, subordinated creditors assume other bank insolvency losses. The essence of this sequence is that subordinated creditors have voluntarily agreed to act as such with regard to other general creditors, if a bank experiences financial difficulties. Basel capital standards also provide for the requirement that differences must exist between subordinated debt and other forms of debt when calculating the Tier 2 capital share¹³⁸¹.

Third, general creditors bear the remaining losses. This group of creditors generally includes unprotected depositors, conventional lenders, bond holders.

4.4.3.1. Priority of Creditor Claims. EU Regulation

The EU legal framework requires considering the order of priority of creditor claims determined in accordance with the applicable national insolvency laws of the EU Member States. Losses shall be distributed to the creditors of the bank under resolution after the shareholders in accordance with the hierarchy and priority of their claims under normal insolvency proceedings, unless expressly provided otherwise¹³⁸².

The first exception under the EU legal framework is that resolution authorities should apply the bail-in tool in a way that respects the *pari passu* treatment of creditors and the statutory ranking of claims under the applicable national insolvency law. Losses should first be absorbed by regulatory capital instruments and should be allocated to shareholders either through the cancellation or transfer of shares or through severe dilution. Where those instruments are not sufficient, subordinated debt should be converted or written down. Senior liabilities should be converted or written down if the subordinate classes have been converted or written down in full.¹³⁸³ When complying with the regulatory requirements, write down or conversion powers shall be exercised in accordance with the priority of claims under normal insolvency proceedings, in a way that produces the following results: (a) Common Tier 1 items are reduced first in proportion to the losses; (b) the principal amount of Additional Tier 1 instruments is written down or converted into

1381 Tier II capital consists of debt instruments meeting the regulatory criteria with the primary objective to seek to cover losses when a bank becomes insolvent. For example, such debt instruments are subordinated creditors with a minimum of 5 years original maturity. The common feature of the first and second level capital is that they can be written off or converted into common shares. when the issuing bank cannot afford to attract additional private capital searching for funding in the capital markets. Other debt instruments within the framework of Basel III are to be considered as contingent capital (convertible capital instruments) or bail-in debt. Later on, these measures are converted into the first level capital, until the bank reaches the threshold of non-viability. Basel III rules eliminated hybrid bank capital instruments that allowed circumventing capital rules. Chorafas N. D. Basel III, the Devil and Global Banking/ Palgrave Macmillan Studies in Banking And Financial Institutions. Great Britain. 2012. P. 5.

1382 BRRD. Art. 34 (1), (b).

1383 Ibid. Recital (77).

Common Equity Tier 1 instruments or both, to the extent required to achieve the resolution objectives or to the extent of the capacity of the relevant capital instruments, whichever is lower; (c) the principal amount of Tier 2 instruments is written down or converted into Common Equity Tier 1 instruments or both, to the extent required to achieve the resolution objectives or to the extent of the capacity of the relevant capital instruments, whichever is lower¹³⁸⁴. Where the principal amount of a capital instrument is written down, no liability to the holder of the relevant capital instrument shall remain under or in connection with that amount of the instrument, which has been written down, except for any liability already accrued and any liability for damages that may arise as a result of an appeal challenging the legality of the exercise of the write-down power¹³⁸⁵.

Another important element of the legal regulation pertains to ranking of deposits in the case of bank insolvency. According to the BRRD, Member States must make the appropriate amendments in their national law governing normal insolvency proceedings to ensure (i) a part of eligible deposits from natural persons and micro, small and medium-sized enterprises which exceeds the coverage level, (ii) deposits from natural persons, micro, small and medium-sized enterprises that would be eligible deposits shall have higher priority ranking than the ranking provided for claims of ordinary unsecured, non-preferred creditors. Covered deposits and deposit guarantee schemes subrogating for the rights and obligations of covered depositors in the case of bankruptcy have the same priority ranking which is higher than the ranking referred above¹³⁸⁶.

One more exemption under the EU resolution regulation is that the Board may recover any reasonable expenses properly incurred in connection with the use of the resolution tools or powers, as it is treated as a preferred creditor of the bank under resolution. Proceeds generated as a result of the termination of the operation of the bridge bank or the asset management vehicle, shall also be attributed to preferred creditors¹³⁸⁷.

4.4.3.2. Priority of Creditor Claims. US Regulation

The objective of protecting taxpayers from bank insolvency losses is best explained by the priority of unsecured creditors, regulated by Art. 210 (b) (1) of the Dodd-Frank legislation Art. Such regulation is significantly different from the one contained in the Bankruptcy Code, especially with regard to the ranking of claims held by the federal government as a creditor. According to the Dodd-Frank Act, the first priority in the ranking is given to administration and/or resolution costs incurred during insolvency.¹³⁸⁸ Administrative expenses consist of either monetary costs incurred by the US government or other public institutions. Second priority is given to claims related to salaries and bonuses of ordinary employees. Third priority is conferred on contributions related to employee benefit planning. Employee claims are subject to the guarantee threshold of USD 11 725 (indexed

1384 Ibid. Art. 60 (1).

1385 Ibid. Art. 60 (2).

1386 BRRD Art. 108.

1387 SRM Art. 22 (6) (d), (b), (c).

1388 Dodd-Frank Act. 210 (b) (2). Special priority is given to the administration costs incurred by the FDIC acting as an administrator of the insolvent bank.

on the basis of inflation), i.e. same as in the United States Bankruptcy Code, Part 507. After meeting the above priority claims, all other general unprotected creditor claims can be met. They are then followed by subordinated, unprotected claims relating to wages, salaries and bonuses of senior bank officials (managers) and directors. Any remaining part of the ranking goes to equity (capital) instrument holders. It should be noted that the FDIC may deviate from the scheme of this ranking only in exceptional cases, when the need arises to encourage financial stability in the market. However, the FDIC has broad powers to exclude certain classes of creditors from other creditors, contrary to the principle of equality, on the grounds that this exclusive treatment maximises the value of the insolvent bank's assets, minimises losses to creditors or is otherwise important for the bank receiver¹³⁸⁹. The FDIC, first acting as the receiver, shall immediately pay-off compensations to depositors, but also shall be entitled to postpone payments to other creditors¹³⁹⁰. Chapter 11 of the Bankruptcy Code, concerned with bank insolvency procedure, provides for the discretion whereby creditor classes may agree to obtain a smaller portion of the claim, if it is a sensible and rational solution. In addition, the borrower can take the opportunity to make limited payments to essential suppliers, vendors and other creditors, if such action contributes to the preservation of the bank's assets. The Dodd-Frank Act provides for similar regulation¹³⁹¹, which aims to preserve market stability.

Protected creditor claims, set-off and protection measures. In essence, the Dodd-Frank Act is consistent with the Bankruptcy Code. Protected creditor claims are treated more or less the same as in Section 506 of the Bankruptcy Code¹³⁹². The right to set-off is guaranteed under the Dodd-Frank legislation as well, unless such set-off cannot run smoothly by reason of bank insolvency conditions identified at that particular time. The regulation is similar to the provisions of Section 553 of the Bankruptcy Code¹³⁹³. However, some exceptions exist. Primarily this concerns the treatment of the right to set off protected creditor claims. The most important aspect is that the bank resolution procedure fails to provide adequate legal protection analogous to that ensured by Sections 361, 362 (d), 363 (e) of the US Bankruptcy Code. If the value of the collateral depreciates or significant differences appear in the property, there is no legal solution for the protected creditors to apply to the FDIC with a petition for (i) adequate protection; (ii) permission to implement contractual rights against the collateral holder. Furthermore, no legal solutions exist to organise the release of collateral of financial institutions in the event that a financial institution has not entered into capital arrangements on financial collateral. By default, the FDIC needs to harmonise the rules and regulations contained in this section with other insolvency laws which would otherwise be applicable to financial institution¹³⁹⁴. Given that other provisions of the Dodd-Frank require that creditors of the bank under resolution receive no less than they would receive in the case of bank liquidation under Chapter 7 of the Bankruptcy Code, it is likely that the FDIC will implement rules in its technical documentation that

1389 Dodd-Frank. 210 (b) (4).

1390 Ibid. 210 (a) (7) (A).

1391 After analysing Chapter II, it can be stated that the FDIC is granted broad discretion to pay or not to pay a part of the claim to creditors.

1392 Ibid. 210 (a) (3) (D) (ii).

1393 Ibid. 210 (a) (12) (A), (B).

1394 Dodd-Frank. 209 sec.

allow secured creditors to be adequately protected by remedies similar to those provided in Sections 361, 362 (d) and 363 of the Bankruptcy Code. The FDIC can unify the Dodd-Frank legislation with the provisions of the Bankruptcy Code to the extent permitted by the Dodd-Frank legislation. There is one important exception, however. The Dodd-Frank legislation allows the FDIC to sell assets freely and without creditor claim set-off and without offering adequate legal protection for creditors. When the bank's assets are sold or transferred during resolution, set-off of creditor claims is not allowed both for protected (under bankruptcy law) and unprotected creditor claims¹³⁹⁵.

Another aspect related to the ranking of creditor claims concerns the requirements for managing bodies. Title II of the Dodd-Frank Act provides that persons responsible for the bank's insolvency must be removed from the bank's management and brought to justice. This is contrary to the regulation provided in Chapter 11 of the US Bankruptcy Code, which usually allows the Board of Governors to maintain their position and to continue the company's business in the insolvent entity. Meanwhile, according to Title II of the Dodd-Frank Act and its provisions the legislator seeks to punish the bank's senior officers and the Director who have contributed to the insolvency of financial institutions. The FDIC may sue directors, officers, lawyers, accountants and other relevant persons for extremely negligent behaviour that led to "inadvertent or otherwise ill-treatment or exercise of the powers or investment in improper assets of a financial institution"¹³⁹⁶. The FDIC may also recover wage-related payments made during the two-year period in administering the insolvent bank from any existing or former governing body of the bank, which has significantly contributed to the bank's insolvency conditions¹³⁹⁷. A compensation is defined and understood in a broad sense, including salaries, bonuses, other direct benefits, guaranteed compensations and any profits derived from the sale of bank securities¹³⁹⁸. In addition, it should be noted that the Federal Reserve (or other appropriate public body) may ban senior bank officers and directors from working in other financial institutions for a maximum period of two years. The legal basis of the sanctions is the evidence that the management or directors are directly or indirectly related to or have participated in any unsafe or unreliable operations and banking practice related to any other financial institution; obtained a financial benefit or other benefits granted on the ground that this practice and the full or continuous failure to take the company's security and solvency into account has been demonstrated in practice¹³⁹⁹.

In conclusion, it must be held that modern bank resolution law provides public authorities with additional powers to suspend contracts (in all relevant jurisdictions) concluded with the bank under resolution, and to continue contractual payments and obligations during resolution. Contractual commitments may be temporarily suspended until the actions of bank resolution are pending. Such powers help ensure the effective transfer of bank shares or debt instruments and assets, rights and obligations to a third party.

1395 *Ibid.* 204 (d).

1396 *Ibid.* 201 (f), (g).

1397 *Ibid.* 210 (s). Under these rules, it is presumed that the Chief Executive Officer, the Chairman of the Board of Directors and the Head of Finance bear significant responsibility for the insolvency. 380.7 (b) (1) (i).

1398 *Ibid.* 210 (s) (3).

1399 Dodd-Frank. Sec. 213.

Resolution authorities are also vested with the rights to restrict the ability of collateral creditors of the bank under resolution to enforce their rights to collateral associated with the assets of the bank under resolution. The resolution authority must carry out their actions very promptly. Both in the EU and in the United States, certain creditor groups can be distinguished by derogation from the principle of equal treatment of creditors. In the US, such a situation is permitted because the exclusive treatment helps to increase the bank's asset value, reduce creditor losses or is necessary to secure the public interest and this is decided by the administrative authority. The EU legislation prioritises deposits corresponding to claims of individuals, micro, small and medium-sized enterprises above the insured amount.

4.5. Concluding Comments

The bank resolution regime in the relevant jurisdictions is important for national economies and meets two basic requirements: (i) resolution rules are fairly predictable, the end result of applying a particular bank resolution tool is predictable; (ii) the rules are sound enough. It should be noted that the new legal regulation has not yet been put in practice. In the relevant jurisdictions, the objectives of bank resolution regime can be achieved only in accordance with the applicable resolution principles. The prescribed bank resolution regime enables early, swift, broad, and decisive resolution actions taken by the resolution authority as soon as the bank's financial trouble is on the horizon. After analysing the legal frameworks of different jurisdictions a conclusion can be made that the major objectives of the bank resolution regime are to minimise the costs to the society and taxpayers as much as possible, to maintain the stability of the financial system and the critical banking functions. The bank resolution process requires legal certainty, transparency, and predictability, and these legal principles inevitably presume a certain approach towards shareholders and creditors of the bank. One of the key positive features of bank resolution is that after repealing the provision implying bank rescue by public funds, the chance of resolution should encourage uninsured creditors to better assess their investment-related risks. Eventually, financing arrangements for resolution are set up to ensure better achievement of resolution objectives. After analysing the practice of Lithuanian insolvent banks it appeared that the applied bank resolution tools were characterised by both advantages and disadvantages. It is particularly important to avoid the contagion effects of a systemic risk. It should be noted that the positive law of the relevant jurisdictions establishes bail-in as a new modern bank resolution tool. This tool is aimed at avoiding formal insolvency procedures through restructuring the bank's balance sheet and by ensuring its going concern to avoid negative consequences of bank insolvency procedure. These tools firstly force subordinated creditors and some senior privileged creditors to bear losses by writing off their debts or converting them into equity and thereby contributing to bank resolution. In essence, the bank resolution regime ensures that the legal effects arising from bank resolution and/or subsequent liquidation are consistent with the degree of legal protection of stakeholders affected by resolution. The safeguards established in the bank resolution law optimally balance private and public interests. Upon implementation of bank resolution in the jurisdictions at issue, the effect on creditors and shareholders is proportionate to the public interest objectives.

CONCLUSIONS AND PROPOSALS

The legal concept of bank insolvency framework

1. Banks perform critical functions in the real economy and the stability of banking conduct is in conformity with public interest. *Lex generalis* rules are inadequate to address bank insolvency issues. Firstly, *lex generalis* fails to ensure the continuity of critical functions of banks, national financial stability objectives, fails to reduce costs to taxpayers, interrupts and disturbs the bank's business operations. Secondly, due to the specific nature of banking activity, which affects the public interest, and for a number of procedural grounds, such as: the need for swift bank resolution decision-making, specific triggers for bank insolvency, objectives of different procedures, etc. Thirdly, if *lex generalis* was to apply to banks, in the case of bank resolution this would cause severe damage to both private and public interests, destabilise financial stability, that is why bank resolution regime primarily protects the public interest and only then seeks to safeguard private rights and interests.
2. The nature of bank resolution rules affects the judicial review of bank resolution decisions: the general insolvency procedure takes place under the supervision and control of the court, whereas bank resolution process should be conducted expeditiously without interruption. Bank resolution tools in all of the compared jurisdictions are therefore adopted and applied only by the administrative authorities. An appeal is permissible, but only to a very limited extent.
3. Financial stability is an international concern but cannot be resolved by efforts of one jurisdiction only. After the recent banking crisis, all of the compared jurisdictions were following international financial standards and implemented comprehensive bank insolvency regulatory reforms. At the international level, the paradigm of bank insolvency law objectives has changed. All of the relevant jurisdictions have different institutional and legal systems, and bank resolution legal regimes cannot be directly compared. Regulatory reforms were based on the agreements at the level of G20 and the FSB. During the recent banking crisis, the US and Swiss legal systems were stronger than in the EU Member States at that time. The US and Swiss public authorities did not face the challenge of harmonisation across the EU Member States. At the same time, after a shift of paradigm, the EU has introduced the most comprehensive regulation of bank insolvency law in the form of the Banking Union.
4. Risks common to all jurisdictions that may trigger bank insolvency relate to liquidity and systemic risk. The 'too big to fail' doctrine analysis has revealed that insolvency cases of large, complex banks performing systemically important functions pose a very significant legal issue. After analysing the recent banking crisis practice, it is obvious that there was a need to diminish the likelihood of insolvency not only of conventional but also of systemically important banks and to create a legal regime that would effectively deal with bank insolvencies without using taxpayer money. The practical analysis revealed that Switzerland was the most successful in dealing with the 'too big to fail' problem during the recent banking crisis.

5. Banks may turn into insolvency rather promptly, for this reason the determination of events triggering bank insolvency and regulation of the qualifying criteria plays an important role. *Ad hoc* solutions are unpredictable, that is why they fail to satisfy the objectives of legal certainty. The most comprehensive description of bank insolvency conditions and criteria is provided in the EU legal system. As bank financing and liquidity is highly dependent on the confidence of market participants, it is not possible to determine bank insolvency relying only on quantitative criteria. If the required quantitative criteria are poorly regulated in bank insolvency law, bank insolvency procedures could be wrongly initiated even against a viable, healthy bank(s). Quantitative criteria are equally developed in all jurisdictions relevant to the investigation. The EU legal framework provides for the most explicit discretionary bank insolvency criteria and the related set of rules. The US legal system is characterised by profound, exceptional traditions and differentiated bank capital adequacy rules. In the Swiss legal system, bank capital requirements are more demanding than in other compared jurisdictions. The higher the discretion given to public institutions, the greater the risk for excessive control exercised by regulatory authorities. In assessing bank insolvency threshold, regulators should focus more on financial viability assessment, based on prospective calculations and rely on economic market-based models, instead of retrospective insolvency tests based on classic methods. In particular, it is important to determine the eligibility of bank liquidity.

Bank resolution regime

6. Bank resolution is an administrative process, a special banking crisis management tool, an alternative to ordinary bank bankruptcy proceedings, aimed to ensure the continuity of essential functions performed by the bank, maintain and protect financial stability and avoid costs for taxpayers and restore long-term viability of the entire bank or certain parts of it. A bank is subjected to resolution following the resolution objectives pursued by legislation by applying bank resolution tools, such as: sale of business, bridge bank, asset separation tool, bail-in tool. The purpose of the bank resolution legal regime is to remove insolvent banks from the financial system at the lowest cost, while maintaining private and public confidence in the banking sector, properly control legal and economic risks, protect the obligations deserving or even requiring protection in order to achieve the public interest objectives of the bank: continuity of functions, maximisation of the value of bank assets, initial allocation of bank insolvency losses to the shareholders, reduction of adverse economic and social impact for the state, protection of public finances and the financial system (including payment systems), protection of depositors.
7. First, in all of the compared jurisdictions, the existing bank resolution regime is important since, in particular, it serves to avoid damage to public interest (by securing financial stability, the critical functions of the bank, and protecting deposits, customer assets and public funds). Second, it ensures the possibility for the insolvent bank to leave the market smoothly, without causing systemic disruptions or by minimising such disruptions, creates lower risk to financial stability, reduces moral hazard, and helps maintaining or restoring confidence of the market. Third, the bank resolution

regime existing in the EU, the US and Switzerland minimises the SIFI effects, positively affects borrowing decisions, plays a preventive role in enabling public authorities to restructure the bank in a manner preventing systemic damage to public and private interest breaches. Finally, the new bank resolution framework would enable quick and a safe solutions in the case of bank failure, leaving dispute resolution for a later stage.

8. All of the compared jurisdictions contain a rule that a failing bank can be liquidated under ordinary bankruptcy procedure, and liquidation should always be considered before the transformation of the bank. Bank resolution tools apply only if the bank cannot be liquidated under normal bankruptcy procedure, without avoiding negative consequences and threats to critical functions of the bank, negative impact on financial stability, the use of public financial support or deterioration of creditors' financial situation.
9. In all of the relevant jurisdictions, the main legal principles governing bank resolution regime duly balance public and private interests: the bank's shareholders are the first to assume insolvency loss, while creditors bear the loss only after the shareholders and in accordance with creditor claim hierarchy, senior bank managers are replaced, creditors belonging to the same class are treated equally, no creditor shall incur greater losses than would have been incurred if the bank was subjected to an ordinary insolvency procedure, going concern assumption is maintained (public interest), and insured deposits are protected.
10. The central principles of the bank insolvency law, balancing private and public interests, are based on public law. Bank resolution tools shall ensure legal certainty for individuals, the right of defence, must be balanced with the public and private interest, proportionate, and provide adequate compensation to the affected individuals after the intervention. The legal principles classified in the dissertation and deriving from the EU and US legal systems (namely, the principles of legitimate expectations, legitimate aim, proportionality) are justified and can be applied both individually and in conjunction, by appropriately balancing public and private interests at the time of the bank resolution procedure. As long as the relevant countries duly implement the above-mentioned legal principles and safeguards set forth in the relevant provisions of the bank resolution law, it is difficult to conceive a situation in which the fundamental private rights would be breached.
11. In all of the compared jurisdictions, bank resolution is an administrative process, with the primary objective to protect the liquidity requirements of short-term creditors, especially depositors, and manage the financial assets of the bank in order to ensure the failing bank's asset and franchise value. Therefore, bank resolution, in particular, seeks to avoid systemic contagion in the financial sector, aiming for social welfare, which cannot be equated to private objectives and absolute priority of creditors' claims. Bank resolution legal regime can be treated as the result of cost-benefit optimisation.
12. Bank resolution regime both in the EU, the US and Switzerland is a specialised area of law designed to address solvency problems faced by a failing bank, by first restructuring and only then liquidating the bank. The aims of bank resolution legal regime are fundamentally different from the general insolvency law objectives. Bank resolution rules cannot be incorporated into general insolvency law due to the existing disparities between the bank liquidation procedure and the aim to maintain bank activity or

successfully reorganise the latter. Nevertheless, ordinary bank insolvency law (bankruptcy procedure) remains extremely important in the context of bank resolution rules. All of the relevant jurisdictions apply ordinary insolvency law only when specific bank resolution rules do not apply.

13. In the EU and the US, bank resolution is financed by contributions from the industry *ex ante* to create a single bank resolution fund. The situation is different in Switzerland, where resolution and stabilisation fund still remains the prerogative of the CB, acting as a 'lender of the last resort'. In Switzerland, the Fund is established on an *ad hoc* basis when the need to protect exceptional public interest arises. Such regulation fails to comply with the features of the new banking paradigm. Where pre-financing is not enough to cover bank losses or resolution costs, the EU, and the US legal systems provide for the obligation to collect *ex post* contributions and to 'fill' the fund with the input from the banking industry. The EU bank contribution consist of flat-rate payments and the risk-adjustment premiums of the bank. The US applies an individual risk-based system. Since the EU single resolution fund system is disturbing for large banks, the new legal regulation will compel the Member States to reform their systems of deposit guarantee schemes. Although these funding structures may be combined, financing sources remain separate, which requires additional administrative resources. At the same time, this will help countries to create a system limiting the financial burden at times when private and public financial resources are exhausted in the financial markets. Resolution funds will make it possible to prevent destabilisation of the financial markets and to reduce costs to taxpayers as far as possible. Both the EU and the US provide for a backstop funding and reorganisation instrument, such as the ESM funds in the EU, and the Treasury funds in the US.

Bank resolution tools

14. In all of the compared jurisdictions, bank resolution tools are designed to mitigate the adverse effects caused by bank distress rather than to fully avoid the liquidation of the bank. Timely and appropriate application of the bank resolution tool and only then liquidation of the bank, in view of the advantages and disadvantages of the particular resolution tool explored in this dissertation, the possibility of a positive social impact appears: first, the likelihood of the systemic banking crisis diminishes and the protection from economic downturns after the banking sector crisis is ensured, and, secondly, the best possible application of the bank resolution tool reduces taxpayer losses attributable to the support provided to the bank.
15. In all of the compared jurisdictions, direct liquidation of the bank cannot serve as one of the solutions to address the financial difficulties faced by a bank, if other market players can swiftly replace critical banking functions. If a bank is failing or likely to fail, private sector solutions must be employed in the first place, for example, by selling business to other market participants. If such a solution is not possible or proves unsuccessful, other bank resolution measures could be adopted according to the 'least cost' principle with regard to the deposit insurer and the public interest.
16. In all of the compared jurisdictions, the bail-in tool will strongly contribute to the powers of public authorities dealing with both large and complex, as well as conventional

bank distress problems, when other resolution tools prove insufficient due to the absence of private buyers or where the latter are not readily available, but even if they are, the application of other measures can increase market concentration or the size of the remaining financial institutions. In the case of bank resolution, a bail-in tool provides the right to assign the insolvent bank losses to private individuals and to recapitalise the bank instead of using taxpayers' money.

17. The disadvantage of the bail-in tool in all of the relevant jurisdictions is that, although the mechanism increases the creditworthiness of the bank, it fails to provide cash to the bank. In addition, regulation requires greater clarity as to the location of the bank capital that may be subjected to the measure under consideration, also with regard to the form of maintaining the capital, i.e. the legal person of the banking group that disposes of bank debt instruments. In terms of time, it is particularly important, since the tool is applied before the use of public funds. In addition, in the result of this measure, significant parts of debt instruments held by large banks may remain unused, especially in cases where banks refinance themselves, i.e. by means of deposits. It cannot be excluded that the number of legal disputes will increase with regard to the discrimination of a particular class of creditors whose claims will be written off or converted. An overall advantage of the tool is that it will provide legal certainty with regard to the specific amount of funds required to cover bank losses, encourage early recapitalisation of banks and strengthen the bank's business continuity assumption. In all of the compared jurisdictions, the bail-in tool replaces public support with sanctions against private individuals.
18. In all of the compared jurisdictions, financial stabilisation measures are treated as a governmental measure of last resort used as an alternative to bank resolution tools. These measures are used only after assessing the possibility to apply all other bank resolution tools, when the classic bank resolution tools are not sufficient to protect the public interest. They can also take the form of public support measures to increase bank capital or bank ownership takeover by the state.

Institutional framework of bank resolution decision-making and control mechanisms

19. In all of the compared jurisdictions, the infrastructure of public institutions performing key role in the bank resolution decision-making process consists of the following critical institutions: banking supervisory authorities, deposit insurance agencies, courts. Their role is mainly related to the protection of public interest. In order for the bank resolution legal regime to function effectively, public authorities need the powers to act promptly and in some cases outside the scope of the general corporate law provisions, governance rules, often associated with the fact that intervention requires the consent of private individuals.
20. Different opinions exist as to whether priority should be given to administrative or judicial bank resolution decision-making procedures. In all of the compared jurisdictions, bank resolution decisions are taken by administrative bodies, and economic bank resolution assessments are carried out by public authorities, whereas courts must rely on them. However, judicial proceedings remain relevant for the disputed

bank resolution decisions in order to guarantee the fundamental rights of private parties (the right to a fair hearing, the right to compensation for property expropriation), legitimate expectations, proportionality of action between the public interest and the protection of property rights, and the legitimate public interest objective. Administrative decision-making procedure is more efficient, because it is swifter, which is directly related to lesser depreciation of bank assets. In addition, bank resolution decisions require specific expertise, bank resolution procedures are very complex, concerned with complicated legal issues, often undertaken at the time of banking crisis, and therefore it is presumed that administrative authorities have better knowledge, resources and operating capacity. The core element that outweighs the argumentation – is that during bank resolution, a need for cooperation with other public institutions arises, and this makes it more efficient for preparing resolution decisions, whereby decisions can be taken by a group of people – and in barely a few hours, where necessary.

21. In the EU and the US, courts apply bank resolution tool *ex ante*, and the application in court is subjected to immediate execution. Both in the EU and the US, suspension of the resolution decision would run counter the public interest. The parties may appeal against the resolution decision *ex post*. While the judicial review of administrative action-based decisions is the central safeguard for the individuals' rights as a result of possible mistakes and abuse, the right of appeal is not absolute and is subject to a number of limitations and criteria discussed in the dissertation. In addition, administrative acts are not automatically affected. In the US, the appeal is only possible against bank resolution decisions with regard to the imposition of insolvency threshold and whether the bank meets the statutory definition of a financial institution. Expropriation of property rights is justified in emergency situations only, in order to guarantee fundamental rights of the individuals. In the EU, bank resolution decisions and actions can be appealed against only when the resolution tools are applied to banks that do not meet the insolvency conditions, and only in the absence of financial stability objectives serving general interest. Both the EU and the United States allow derogations from the principle of the rights of the defence, given the primary importance of the financial stability objective, which serves the welfare of the people and the public interest.

Impact of the bank resolution regime on creditors and shareholders

22. Creditor claims are related to the administration of property rights. In the EU, the US and Switzerland, from the beginning of the bank resolution procedure the rights of the counterparties are subjected to contract termination restrictions and certain cases of suspension of bank obligations. Such restrictions are necessary for the public authorities to obtain an accurate picture of the balance sheet of the insolvent bank, disregarding the changes in value and quantity of the bank assets which may result from the intense exercise of termination rights.
23. In all of the compared jurisdictions, the hierarchy of satisfaction of creditor claims significantly differs from the hierarchy according to general insolvency law. First of all, bank insolvency losses are to be absorbed by regulatory capital instruments, and losses are distributed to shareholders by writing off shares, or by significantly redu-

cing the earnings per share, by converting debt into capital. When such measures are not adequate, the second step concerns the subordinated debt write-off or conversion. Primary liabilities of the bank are converted or written off after converting all the subordinated creditors or writing off their claims. The EU is characterised by the fact that different requirements for the sequence of bank deposits apply in the case of insolvency. Natural persons and micro-, small and medium-sized enterprises are guaranteed a part of the relevant deposits in excess of the insured amount, by giving priority over ordinary uninsured priority creditor claims. Such regulation may negatively affect these depositors, since many micro-, small and medium-sized businesses are major customers of banks. Better protection of their deposit rights may increase lending costs, e.g. banks may increase interest rates. The peculiarity of the US system is that the law allows departing from creditor hierarchy provided for in the general insolvency law only when the intention is to maintain financial stability in the market. In addition, the FDIC may distinguish certain classes of creditors, by way of derogation from the principle of *pari passu*, if this contributes to the increase in the value of bank assets and reduction of creditor losses. Switzerland is characterised by the fact that the principles governing the conversion of debt into capital and the hierarchy of creditor claims specifically is set in the restructuring plan.

24. In bank resolution, the objective of legal safeguards and criteria for balancing private and public interests through applying special bank resolution tools is to maximise legal certainty and predictability of the legal consequences arising from bank resolution. Predictability of the bank resolution process also guides the conduct of bank shareholders *ex ante*. Therefore, clear and predictable rules and principles strengthen market discipline. If it is clear that in 'bad times' bank insolvency losses will be absorbed by private individuals, shareholders and creditors, this accordingly encourages shareholders and creditors to exercise closer control of the company on their own initiative and to take early action to recapitalise the bank or to implement other measures to restore market confidence and ensure public interest. An *ex post* predictable bank resolution process allows ordinary and efficient reallocation of economic resources in a way that promotes growth and enhances overall well-being.
25. The EU legal framework provides for strong protection of private property rights of bank shareholders, while the US legal system foresees more limited legal protection of private ownership. If in both the EU and the US bank resolution tools are applied and the powers of public authorities are employed to attain public interest objectives and are used regardless of the principles of legitimate expectations, the rights of defence and the right to compensation, such a limited scope of the shareholders' rights breaches private interest. At the same time, the principles governing protection of individual rights and the related legal principles should be interpreted in conjunction with the broader public interest objectives, in order to protect financial stability, interests of other public entities, by taking into account the functions performed by banks and their importance for the overall economy.

Based on the aforementioned considerations, the following suggestions are provided for a more detailed regulation of the following provisions in the Lithuanian law:

1. **Decree No. 132 of the Board of the Bank of Lithuania of 7 September 2012 on the insolvency of credit institutions.** Taking into account the content of Section 8, Chap-

ter 1 of the dissertation and following the analysis of the EBA guidelines, it is considered more detailed regulation of insolvency conditions of credit institutions, in particular with regard to qualitative and discretionary criteria as bank insolvency triggering events. The recommended regulation of the Decree No. 132 concerns the enhanced requirements for the failing and likely to fail criteria of credit institutions, in order to set the boundaries based on the criteria governing the competencies, eligibility and good repute of the managing bodies and directors and their duty to act in a credible and fair manner. It is also recommended to clarify the Decree, by providing the conception and the criteria of not only failing, but also likely to fail bank. Taking into account the mandatory minimum level of harmonisation of the EU directives, and the EBA guidelines, it would be reasonable to specify the conditions for bank failing or likely to fail, by considering the following circumstances: (i) it is unlikely that private sector solutions and supervisory actions can protect the bank from failure within a reasonable timeframe and when ordinary insolvency laws and procedures might pose a threat to the public interest; (ii) in view of the time limits and other relevant circumstances, it cannot be reasonably expected that any of the alternative private sector solutions or supervisory actions applied to the bank, including early intervention measures and the corresponding measures of capital write-down or conversion, would prevent bank insolvency within a reasonable timeframe; (iii) the resolution and/or liquidation actions of the credit institution are necessary to secure the public interest; (iv) the credit institution requires emergency public finances, except for situations to avoid serious economic disruption or eliminate the latter and preserve financial stability; (v) the credit institution's insolvency should be determined not only on the basis of its financial and supervisory reports or documents received from other credit institutions or persons and/or, where appropriate, on the basis of the credit institution inspection (review), but also in view of the results arising from the assessment of bank assets and liabilities, prospects of the bank recovery plan, asset quality requirements; (vi) the assessment of the bank's insolvency conditions should take into account whether the restructuring actions are necessary to protect the public interest, and to assess the business nature of the credit institution, its shareholding structure, legal form, risk model, size, interconnectedness with other credit institutions and the financial system, the fact whether it provides investment services and performs investment activities, its operational capacity to continue the provision of its services, and whether credit institution insolvency and subsequent liquidation by initiating normal bankruptcy proceedings could have adverse effects for the financial markets and other institutions.

2. **The provisions of the Law of the Republic of Lithuania on Banks on bank director's selection and appointment** should provide for more detailed requirements under which a bank may be declared insolvent. It is highly recommended to clarify the rules under which bankruptcy proceedings can only be instituted on the basis of the conclusion of the supervisory authorities with regard to the bank's insolvency, and to insert the provision to the effect that the absence of any other alternative bank insolvency solutions better serving the public interest is one of the grounds for making such a conclusion. In addition, it is essential to specify the provisions to the effect that after instituting bankruptcy proceedings against the bank, notwithstanding the type of the bank resolution tool applied, losses suffered by bank creditors cannot exceed those

suffered in the case of bank resolution. ‘No creditors worse off’ must be one of the cornerstone safeguards of private rights to be enshrined in primary law.

3. **The provisions of the Law of the Republic of Lithuania on Banks** should be supplemented with regard to the hierarchy of creditor claims, to make it clear that the fourth line of creditor claims must concern claims or parts of claims raised by natural persons and micro, small and medium-sized enterprises, when they exceed the insured deposit amount. Regarding the provisions of the Law on Banks relating to information on the bank’s liquidation proceedings, it would be useful to clarify the requirements and to provide more detailed regulation with regard to the information to be supplied on bank resolution before the decision to open resolution proceedings is taken, by providing not only the court’s obligation to inform the supervisory authority and obtain the consent of the latter, but also the framework within which the application to the court to institute bankruptcy proceedings may be left unconsidered, if the Bank of Lithuania fails to notify the court of its intention to undertake resolution actions with regard to the distressed credit institution and 7 days have not passed from the date of notification. In addition, it is necessary to clarify the framework within which the court, in order to ensure the effectiveness of bank resolution, acting on the request from the Bank of Lithuania, may for the period requested (which is sufficient in view of the objective pursued) suspend any court proceedings or processes to which the bank under resolution is or may become a party.
4. **The provisions of the Law of the Republic of Lithuania on Banks** relating to the administration of bank resolution proceedings, by foreseeing the following: (i) when the competent authority adopts a decision to apply a bank resolution tool, it must be subject to court approval. The court shall consider the application as a matter of urgency and decide within 24 hours from the date of the application; (ii) The courts must support their judgment on an integrated assessment of the economic facts, performed by the Bank of Lithuania; (iii) Before taking any bank resolution actions with respect to the credit institution, an impartial, careful and realistic assessment of assets and liabilities should be carried out. Such assessment shall not be subject to individual appeal, but can be appealed against together with the resolution decision; (iv) after the application of bank resolution tool, the conditions applied shall be compared with the conditions that would have been applied to shareholders and creditors under ordinary bankruptcy proceedings; (v) if it is determined that shareholders and creditors have received a lower amount for their claims than in the case of bank resolution after initiating ordinary bankruptcy proceedings, they are entitled to recover the difference. The difference, if any, shall be paid out from the reserve (stabilisation) fund. Deposit insurance funds can also be used to finance alternative bank resolution measures, in order to prevent credit institution’s default.
5. **Additional regulation of bank business sale as a resolution tool.** It is suggested to foresee the provisions that, in the case of forced sale of the bank’s shares, the transaction must comply with specific marketing procedures and requirements laid down in the secondary legislation of the Bank of Lithuania. The Bank of Lithuania is advised to adopt secondary legislation which, in addition to the criteria listed in Article 25(8) of the Law on Banks, would regulate placing on the market of the bank **business sale tool** in more detail, by focusing on and regulating the following key criteria:

(a) business sale must be as transparent as possible and essentially abstain from distortions or fundamental misconceptions on the credit institution's assets, rights, liabilities, shares or other equity instruments which the Bank of Lithuania intends to sell, depending on the circumstances and, in particular, the need to preserve financial stability; (b) In conducting business sale, priority may not be given to individual potential buyers neither they can be discriminated. Priority is given to the buyers with lower liquidity shortage; (c) The law does not prevent the Bank of Lithuania from applying to certain potential buyers on its own initiative; (d) Before taking a decision to enforce the business sale tool, the Bank of Lithuania must assess whether: (i) no less anti-competitive alternatives of the bank resolution than the business sale tool exist; (ii) if in the case of a failed merger and acquisition transaction the bank will face insolvency and the estate of credit institutions will nevertheless be eliminated from the market through ordinary bankruptcy procedure; (iii) whether the credit institution's liquidation will not cause more harm to the competitive environment than the business sale tool; (iv) it cannot be fairly assumed that a certain commercial offer is better than the other offers on the basis of future premiums arising from the transaction, payments received for the expected benefits or gains, or impact on the market after the transaction is completed; (v) social and economic factors that may be affected after the application of the measure, such as labour relations, economies of scale, positive social consequences in the community; (e) After confidential agreement has been signed between the Bank of Lithuania and the potential buyers, the latter have the right to access the information relating to the price bid and the sale place and time, the information package, including financial data of the credit institution, legal documents, and other documents that describe a variety of bank resolution solutions to be considered by the Bank of Lithuania. During the meeting with the potential buyer, the due diligence process must be discussed, including the legal documents to be submitted. The Bank of Lithuania shall advise on the types of property held by the credit institution, classify the property according to target groups, set the extent of assets to be transferred to the buyer, the assets to be left at the credit institution, terms of sales, loss-sharing principles, such as option clauses and other relevant circumstances. The meetings should be recorded by minutes; (f) The good practice of the US bank resolution procedures should be followed in order to create standardised rules for the provision of information to potential buyers, certain information package guidelines of the property for sale and the forms of appropriate legal documents. In the confidentiality agreements, it is advisable, among other things, to disclose to the potential buyers who have signed confidentiality agreements: the intervention action plan, by providing the intervention code, the means of communication with potential customers, the weekly schedule of resolution actions, the list of buyers' employees entitled to receive information, the forms of newsletters to shareholders and creditors. In assessing the proposals, buyers need to take account of the geographical location, the competitive environment in the market, the financial conditions, asset size, and capital ratios; (g) Potential buyers may perform due diligence of a credit institution in no more than 12–15 days.

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MYKOLO ROMERIO UNIVERSITETAS
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Tomas Ambrasas

BANKO PERTVARKYMO TEISINIS REŽIMAS.
VIEŠŪJŲ IR PRIVAČIŪJŲ INTERESŲ BALANSAVIMAS.
LYGINAMOJI ANALIZĖ

Daktaro disertacijos santrauka
Socialiniai mokslai, teisė (01 S)

Vilnius, Bazelis, 2015

Daktaro disertacija rengta 2012–2015 m. Mykolo Romerio ir Bazelio universitetuose, ginama Mykolo Romerio universitete pagal Mykolo Romerio universitetui ir Vytauto Didžiojo universitetui 2011 m. birželio 8 d. Lietuvos Respublikos švietimo ir mokslo ministro įsakymu Nr. V-1019 suteiktą doktorantūros teisę.

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BANKO PERTVARKYMO TEISINIS REŽIMAS. VIEŠŪJŲ IR PRIVAČIŪJŲ INTERESŲ BALANSAVIMAS. LYGINAMOJI ANALIZĖ

Santrauka

Tyrimo problema ir aktualumas. Bankai, nepaisant didelės dinamikos finansinių paslaugų srityje, yra labiausiai paplitusios finansų institucijos pasaulyje ir atlieka itin svarbias funkcijas valstybių ekonomikoje, todėl bankų krizės yra susijusios su labai painiais ir prieštaringais socialiniais, politiniais, ekonominiais, teisiniais įvykiais. Kritines bankų funkcijas ir mokumą padeda išlaikyti veiksmingas, patikimas ir nuspėjamas bankų veiklos teisinis reguliavimas nacionaliniu ir tarptautiniu lygiu. Nors efektyvus bankų veiklos teisinis reguliavimas yra pirmiausia susijęs su kiekybiniais banko veiklos rizikų valdymo ir ribojimo kriterijais, tačiau paskutinė bankų krizė parodė, jog ne mažiau svarbus vaidmuo tenka ir kokybiniais bankų veiklos rizikų kriterijams, ypač bankų nemokumo procedūrų valdymo kriterijams, teisinėms priemonėms ir procedūroms.

Banko nemokumo procedūros ir jų kompleksiskumas teisės doktrinoje neretai apibūdinamos kaip „Gordijaus mazgas“. Teoriškai nuo modernios finansų rinkų pradžios finansų institucijų nemokumo procedūros ir teisiniai santykiai buvo aktuali tema tiek ekonomikos, tiek teisės mokslininkų darbuose. Tačiau praktiškai iki paskutinės finansų krizės, pagreitį įgijusios 2008–2009 m., valstybėse įstatymų ir kitų teisės aktų, reglamentuojančių bankų nemokumo procedūras, esmė ir procedūros labai skyrėsi, trūko sisteminio požiūrio. Paprastai nemokių bankų problemoms spręsti buvo taikomos bendrosios nemokumo teisės normos, kartu taikomos ir įprastoms įmonėms, neatsižvelgiant į specialias bankų, kaip juridinių asmenų, požymius, funkcijas, paskirtį visuomenėje. Be to, dauguma susijusių teisės aktų tik minimaliai reglamentavo banko pertvarkymo principus, tikslus buvo nenuspėjami, neišsamūs, stokojo teisinio tikrumo, stokota alternatyvių banko nemokumo problemų sprendimo būdų. Per paskutinę bankų krizę išryškėjo banko nemokumo procedūrose veikiančių asmenų – valstybės, viešųjų institucijų, kreditorių, akcininkų - skirtingi interesai, teisių ir pareigų balanso stoka. Todėl nuo finansų krizės pradžios iki šių dienų akademikai, priežiūros institucijos, politikos formuotojai, susijusios tarptautinės organizacijos pradėjo ieškoti veiksmingesnių teisinių priemonių, kurios galėtų padėti efektyviai spręsti bankų mokumo problemas nesukeliant chaoso finansų sektoriuje ir kitų neigiamų padarinių. Kyla natūralus klausimas, kas banko nemokumo procedūrų reglamentavimo srityje pasikeitė nuo paskutinės bankų nemokumo (finansų) krizės, pagreitį įgavusios 2008–2009 m.?

Praktikoje kilo klausimas, ar bendrųjų nemokumo teisės normų *lex generalis* pakanka veiksmingai spręsti nemokių bankų problemas? Paaiškėjo, kad bankų pertvarkymo teisiniai mechanizmai yra silpni, o įprasta bankroto procedūra tik retu atveju tinka bankams. Lygiagrečiai ir doktrinoje išsivyravo nuomonė, jog bankrotas (likvidavimo procedūra) neveikia bankams. Kaip valstybė turėtų reaguoti, jeigu vienas ar net keli bankai rodo požymius, kad turi rimtų finansinių ir (arba) operacinių sunkumų, yra nemokūs arba atsidūrę

ties nemokumo riba? Kokių teisinių, administracinių priemonių valstybė privalo turėti ir imtis, jeigu nori veiksmingai spręsti bankų mokumo problemas? Šie klausimai tapo pamatiniais banko nemokumo procedūrų reformų kontekste.

Iki bankų nemokumo krizės teisinis reguliavimas, susijęs su banko nemokumo procedūromis, daugumoje šalių stokojo teisinio tikrumo, todėl banko nemokumo procedūros buvo sukuriamos, administruojamos ir vykdomos *ad hoc* pagrindais. Sprendžiant banko nemokumo problemas valstybės paprastai gelbėdavo bankus panaudodamos valstybės viešuosius finansus (angl. *bail-out*) ir neleisdavo bankams bankrutuoti dėl galinčių kilti neigiamų milžiniškų pasekmių visai realiajai ekonomikai. Dėl to atsirado šalutinės rizikos, kaip antai: moralinės rizikos, sisteminės rizikos, konkurencijos iškraipymai, indėlininkų teisių apsaugos rizikos, grėsmė finansų stabilumui ir t.t. Kompetentingos institucijos ir vyriausybės dažniausiai turėdavo dvi vienodai nepageidaujamas išeitis: arba inicijuoti brangų mokumo problemų turinčio banko gelbėjimą viešaisiais finansais, arba kaip alternatyvą netgi sistemiškai svarbiems bankams su neigiamą poveikį turinčiomis pasekmėmis finansų sistemai ir plačiai ekonomikai taikyti įprastą, priverstinę banko likvidavimo procedūrą.

G20 valstybės, nustatydamos veiksmų planą 2008 m. lapkričio mėn., paragino įstatymų leidėjus, reguliuotojus ir kitas kompetentingas institucijas „*peržiūrėti bankų restruktūrizavimo teisinį reguliavimą ir bankroto įstatymus, atsižvelgiant į naują patirtį, ir užtikrinti, kad valstybės sudarys galimybes ir padės tvarkingai likviduoti bankus ir ypač dideles, kompleksiškas finansų institucijas*“. Buvo nuspręsta, jog yra gyvybiškai svarbu sukurti ir išvystyti veiksmingas teisines priemones, kurios galėtų tvarkingai, t. y. be pašalinių neigiamų pasekmių, įprastu būdu likviduoti nemokius bankus išlaikant sistemiškai svarbias bankų atliekamas funkcijas. Atsirado nauja banko pertvarkymo teisinio režimo idėja, kurio pagrindinė paskirtis – ne visiškai išvengti bankų nemokumo, o suteikti „trečiąjį nemokumo kelią“ tarp nevaldomo arba prastai valdomo, banko turtą mažinančio ir užkratą skleidžiančio, banko likvidavimo (bankroto) ir galimų papildomų rizikų, atsirandančių dėl banko akcininkų ir didžiosios daugumos kreditorių gelbėjimo viešaisiais finansais, panaudojant konkrečias pertvarkymo teisines priemones, sumažinti dėl banko bankroto atsirandančią neigiamą įtaką. Paaiškėjus, kad bankų bankrotas yra nenaudingas, nes labai greitai nutraukia ir sutrikdo banko verslo operacijas ir sunaikina tolimesnę turto vertę, o pereinamuoju laikotarpiu ir galutiniam rezultate bankas nebeišlaiko veiklos tęstinumo prielaidos, tarptautiniu lygiu valstybės buvo įpareigos sukurti plačią teisinių priemonių visumą, kurios pagrindinis tikslas, visų pirma, pertvarkyti (restruktūrizuoti) bankus ir pratęsti jų veiklą, o tuo tarpu negyvybingoms ar sistemiškai nesvarbioms banko verslo dalims taikyti įprastas bankroto procedūras.

Autoriumi formuluojant socialinių banko pertvarkymo teisinio režimo ir susijusių teisės normų kilmės šaltinį, kaip bendruomenės konvencijas, iškykla bent penkios principinio pobūdžio problemos, nagrinėtinos disertacijoje bei atitinkamai susijusios su viešųjų ir privačių interesų suderinamumu.

Pirmiausia, kilo klausimas, ar siekiant pertvarkyti ir (arba) likviduoti banką, ypač paskirstant dėl banko nemokumo atsiradusius nuostolius, tam tikrais atvejais galima viešąjį interesą iškelti aukščiau privačių interesų, o jeigu galima, tai koku teisiniu pagrindu ir kokiais teisės principais vadovaujantis.

Antra, tyrimui aktualiose valstybėse buvo peržiūrėtas arba sukurtas naujas bankų pertvarkymo teisinis režimas, kuris neatsiejamas nuo didelių įgaliojimų suteikimo kope-

tentingoms institucijoms (pvz., teisės konvertuoti banko skolos instrumentus į kapitalą, siekiant kreditorių finansuojamo banko rekapitalizavimo, atlikti intervenciją į banką ir kt.). Kita susijusi problema ta, kad paskutinės bankų krizės praktika aiškiai atskleidė, kad banko pertvarkymo teisinių priemonių panaudojimas neišvengiamai paveikia banko kreditorių ir akcininkų nuosavybės teises. Pavyzdžiui, reikalavimas gauti akcininkų pritarimą banko pertvarkymo sandoriui, kuriam reikalingas privataus sektoriaus sprendimas, gali pratęsti neaiškumą per bankų krizę. Todėl tapo labai svarbu pozityviojoje teisėje tinkamai suregulmentuoti teisinius saugiklius ir kriterijus bei įtvirtinti asmenų, dalyvaujančių banko nemokumo procedūrose, teisinę apsaugą, subalansuoti privačius ir viešuosius interesus, kas atitinkamai padėtų apsaugoti nuo galimų neigiamų teisinių pasekmių, pavyzdžiui, bylinėjimosi procesų.

Trečia, kadangi bankams, patiriantiems finansinių sunkumų, reikalingas papildomas finansavimas, atsirado tarptautiniu lygiu įtvirtinta nuostata, kad viešosios institucijos privalo turėti įgaliojimus taikyti banko gelbėjimo privačiomis lėšomis pertvarkymo priemonės (angl. *bail-in*), kas iš esmės reiškia, kad, taikant šią teisinę priemonę, prieš likviduojant banką galima nurašyti neapsaugotus ir neapdraustus kreditorių reikalavimus ir atitinkamai konvertuoti juos į banko kapitalą.

Ketvirta, tarptautiniai finansiniai standartai įtvirtino banko veiklos tęstinumo prioritetą, pirmiausia panaudojant įvairias išsamiai reglamentuotas bankų pertvarkymo teises priemonės. Be to, buvo įtvirtinta ir nuostata, kad bankų pertvarkymo teisinės priemonės turėtų būti taikomos atsižvelgiant į „mažiausios kainos“ principą ir tik tada, kai banko negalima likviduoti keliant įprastinę bankroto bylą, kartu nedestabilizuojant finansų sistemos, reikia imtis priemonių, kad būtų užtikrintas sistemai svarbių funkcijų spartus perdavimas bei tęstinumas, ir kai negalima pagrįstai tikėtis alternatyvaus privataus sprendimo, įskaitant esamų akcininkų arba trečiojo asmens vykdomą kapitalo papildinimą, kuris būtų pakankamas visiškam banko gyvybingumui atkurti.

Penkta, banko pertvarkymo teisinis režimas yra neįsivaizduojamas neveikiant privačių asmenų teisių, išikišant į sutartinius santykius, ypač finansines sutartis: užskaitos susitarimus, užtikrinimo susitarimus, susitarimus dėl finansinio įkaito, pagal kurias perleidžiama nuosavybės teisė.

Atsižvelgiant į konkrečią jurisdikciją, kurioje bankas veikia, skiriasi bankų nemokumo teisinių santykių problemos, jų sprendimo būdai teisinis reguliavimas ir t. t. Be to, nėra vienodo požiūrio į bankų nemokumo procedūrų teisinio reguliavimo harmonizavimą tarptautiniu lygiu, todėl naudinga išnagrinėti banko nemokumo procedūrų nacionalinio reglamentavimo ypatumus lyginamuoju aspektu ir atskleisti, ne tik kaip atskiroms jurisdikcijoms pavyko įgyvendinti tarptautines banko nemokumo procedūrų reguliavimo gaires, iširti, kokį teisinio reguliavimo modelį jos pasirinko, palyginti atskirų teisės sistemų teisinio reguliavimo ypatumus, rasti konvergencijas ir divergencijas bei ištyrus atskirų jurisdikcijų pozityviąją teisę atskleisti, kaip jose pavyko užtikrinti viešųjų ir privačių interesų, pasireiškiančių banko nemokumo procedūrose, pusiausvyrą, pateikti atitinkamus pasiūlymus ir rekomendacijas.

Remiantis tuo, kas išdėstyta, formuluotina pagrindinė šio **tyrimo mokslinė problema**: ar banko pertvarkymo teisinis režimas subalansuoja viešąjį ir privatų interesą?

Tyrimo tikslas – išanalizuoti teorines ir praktines banko pertvarkymo teisinio režimo problemas, kylančias viešųjų ir privačių interesų derinimo kontekste.

Šiam tikslui įgyvendinti yra iškeliami tokie **tyrimo uždaviniai**:

1. Atskleisti banko nemokumo procedūrų paradigmos pasikeitimą lėmusias priežastis ir bendrąsias koncepcines naujosios paradigmos nuostatas.
2. Išskirti banko pertvarkymo teisinio režimo sampratą ir išgryninti skiriamuosius požymius, sąlygas, išanalizuoti banko pertvarkymo teisines priemones, rasti jų privalumus ir trūkumus.
3. Lyginamuoju požiūriu išanalizuoti viešųjų institucijų, dalyvaujančių pertvarkant bankus, vaidmenį bei sprendimų dėl bankų pertvarkymo priėmimo mechanizmus.
4. Remiantis identifikuotomis bankų pertvarkymo teisinio režimo savybėmis išanalizuoti poveikį viešiesiems ir privatiems interesams ir interesų suderinamumą atskirų jurisdikcijų pozityviojoje teisėje.

Tyrimo objektas – banko pertvarkymo teisinio režimo veikimas bei įgyvendinimas.

Mokslinio tyrimo naujumas. Banko nemokumo procedūras reglamentuojančių teisės aktų silpnosios vietos ir įstatymų leidėjų paliktos spragos tampa akivaizdžios tik bankų krizės ir (arba) didesnio tarpvalstybinio banko nemokumo atveju, todėl dėl paskutinės finansų krizės šios spragos tapo labai ryškios, susiformavo gausi banko nemokumo teisinius santykius nagrinėjančių teismų praktika, kuri Lietuvoje moksliskai nebuvo analizuota. Tyrimas išsiskiria ir tuo, kad teisės doktrina banko nemokumo procedūrų kontekste yra traktuojama kaip labai svarbus teisės šaltinis. Ši pozicija grindžiama, be kita ko, tuo, kad valstybėse daugiausiai egzistuoja bendrosios kompetencijos, nespecializuoti teismai, kurie dažnai stokoja žinių apie bankininkystę. Kadangi tiek Lietuvoje, tiek Šveicarijoje nėra specializuotų nemokumo bylas nagrinėjančių teismų, todėl manytina, kad tyrimo naujumas pasireiškia ir šiuo aspektu.

Atsižvelgiant į išdėstytą darbo problematiką, aktuali ir nauja tiek bankų nemokumo procedūrų teisės koncepcija, tiek sistematika, tiek praktinis veikimas. Kaip išspręstos teisinės dilemos skirtingose teisinėse sistemose ir ar jos apskritai išspręstos? Atsižvelgiant į šiuolaikinės ekonomikos tarptautinį pobūdį, į tarptautinių bankų paplitimą ir šių bankų grupių įtaką pasaulio ekonomikos raidai, banko nemokumo procedūrų analizė reikšminga ir globaliu mastu. Teisinio apibrėžtumo ir aiškumo stoka lemia neišspręstų problemų integraciją į didesnius konfliktus, apipintus įvairiausiomis teisinėmis interpretacijomis. Tokiu būdu neužtikrinamas teisės, kaip visuomeninių santykių reguliavimo ir priešingų interesų derinimo, funkcijų veikimas. Priešingai, nėra pašalinamos prielaidos, galinčios stabdyti visuomeninių santykių stabilumą, nesukuriamos šių santykių vystymosi ir raidos priemonės. Autoriaus nuomone, tokia tyrimo objekto ir problemos ištis neatitinka teisės mokslo ir šiuolaikinio darnaus verslo plėtros tendencijų.

Nepaisant pasaulinio susidomėjimo tyrimo tema, tiek Lietuvoje, tiek Šveicarijoje iki šios dienos egzistuoja akivaizdus trūkumas moksliskai patikrintos informacijos, skirtingų reglamentavimo modelių ir požiūrių skirtingose pasaulio jurisdikcijose analizės. Atlikus kokybišką ir išsamų mokslinį temos tyrimą gali būti sukurtos prielaidos aptiktoms teisinio reguliavimo ir teismų praktikos spragoms pašalinti, tobulinant analizuojamos srities teisinio reguliavimo bazę, pateikiant teismų praktikai atitinkamus pasiūlymus ir rekomendacijas. Temos mokslinis naujumas reiškiasi ir tyrimo kompleksiskumu. Taip pat Lietuvai

reikia įgyvendinti kai kurias bankų sąjungos direktyvų nuostatas bei perkelti jas į nacionalinę teisę, o SRM reglamentą taikyti tiesiogiai, todėl šiuo tyrimu galėtų būti remtasi peržiūrint Lietuvos teisinę sistemą.

Paradoksalu, tačiau Lietuvoje taip plačiai eskaluota ir eskaluojama banko nemokumo procedūrų sritis Lietuvoje yra savotiškoje teisinėje nežinomybėje. Šios problemos taip pat nepadaeda spręsti „išlaptinti“ priežiūros institucijos sprendimai bei itin ribotos apimties kompetentingų institucijų studijos, susijusios su banko nemokumo procedūrų analize Lietuvoje. Vadinasi, teorinį siūlomo disertacinio darbo naujumą pabrėžia visuomenėje vykstantys (vykę) didelį rezonansą sukelianys praktiniai procesai, išreikštų pavienių asmenų nuomonių menkas pagrindimas. Problemos sudėtingumą ir tyrimo reikšmę lemia ir autorius šiame įvade išdėstytos priežastys. Be to, atlikus kokybišką mokslinį tyrimą atsirastų pagrindas tikėtis, kad pateiktos rekomendacijos padės formuoti vieningą ir socialinius poreikius atitinkančią teismų praktiką. Manytina, kad tyrimo rezultatai būtų svarbūs tiek Lietuvos, tiek Šveicarijos mokslinei teisės doktrinai ir gali būti naudojami pedagoginėje ir edukacinėje veikloje. Pavyzdžiui, susidomėjimas tema ir jos analizės poreikis taip pat pastebimas Mykolo Romerio universitete dėstomoje bankroto teisės ir bankų teisės magistrantūros studijų programoje. Manytina, jog autoriaus pateikta išsami banko nemokumo procedūrų analizė paskatintų papildomus šios srities mokslinius tyrimus bei pradėtų diskursą, leisiantį toliau sėkmingai puoselėti tiek nemokumo teisės, tiek bankų teisės doktrinos formavimą, vystyti ir tobulinti nemokumo procese dalyvaujančių asmenų interesų apsaugą, sudarant šios srities veiklai papildomo teisinio užtikrinimo. Iki šiol Lietuvos privatinės teisės mokslas tokių poreikių nepatenkino, dėl to autoriaus siūloma disertacinio darbo tema laikytina svarbia tiek praktikai, tiek teorijai.

Taip pat pažymėtina, kad gerai funkcionuojanti valstybės teisinė sistema skatina tiek finansų rinkų, tiek finansinių tarpininkų veiklą. Literatūroje įsitvirtinusi prezumpcija, pagal kurią galime skirstyti valstybes pagal nacionalinės teisinės sistemos efektyvumą, ypač atliekant finansinius sandorius. Tokia nuostata grindžiama tuo, jog skirtingos finansų sistemos turi skirtingą teisinio reguliavimo lygį, ypač pabrėžiant kreditorių ir akcininkų teisių apsaugą ir susijusias reglamentavimo taisykles. Taigi, finansinis valstybės išsivystymo lygis priklauso nuo egzistuojančių teisinių priemonių visumos ir jų efektyvumo. Be kita ko, svarbus tyrimas ir įstatymų leidėjams, ypač valstybių vyriausybėms (vykdomajai valdžiai), kurios atlieka ypatingus veiksmus banko nemokumo procedūrų kontekste. Pirmia, vyriausybė siekia apsaugoti nuosavybės teises, užtikrinti sutarčių įvykdymą. Antra, vyriausybių reguliavimas reikalingas siekiant skatinti tinkamas informacijos nuostatas, kad finansuotojų (investuotojų) lėšos būtų panaudojamos tinkamiausiu būdu ir kad investuotojai galėtų priimti geresnius investavimo sprendimus, panaudodami savo pinigus. Trečia, vyriausybės organizuoja finansų institucijų teisinį reguliavimą siekdamas išlaikyti jas mokias.

Tyrimas daugiausiai grįstas lyginamosios teisės metodologija. Įstatymų leidėjai visame pasaulyje jau seniai konstatavo, kad daugumai klausimų geri įstatymai negali būti priimti be lyginamosios teisės pagalbos: ar analizė vykdoma bendrų studijų tam tikru teisiniu klausimu forma, ar atskaitų, pranešimų, skirtų konkrečiai temai ar klausimui aptarti, analizės forma. Be kita ko, lyginamosios teisės teisininkai, mokslininkai paprastai teikia siūlymus, ką jų pačių teisinė sistema turėtų priimti ir įdiegti į nacionalinę teisę (kokias teises priemones), atsižvelgiant į atitinkamą nagrinėjamą problemą ir jos sprendimą,

kuris pasiteisino užsienio valstybėje bei suderinus atitinkamus aspektus, kaip antai: skirtumai teismų procedūrose, įvairių institucijų įgaliojimai, ekonomikos pajėgumai ar bendras socialinis kontekstas. Taip pat ne mažiau svarbu yra tai, kad praktinis lyginamosios teisės panaudojimas yra pagrįstas nacionalinių teisinių taisyklių interpretacija, be to, lyginamoji teisė vaidina svarbų vaidmenį ir teismams interpretuojant teisės normas ir jas taikant. Galiausiai lyginamoji teisė atlieka svarbią funkciją teisiniame švietime. Manytina, kad bendrajame teisės moksle nedovanotina klaida būtų apsiriboti tik studijuojant nacionalinę teisę, nes nūdienos visuomenė yra itin mobili, o tai taip pat padeda geriau suvokti savo pačių nacionalinę teisės sistemą bei pasimokyti iš kitų.

Tikimės, kad šis darbas taps efektyviu bei naudingu instrumentarijumi tiek teismams, sprendžiantiems tokio pobūdžio bylas, tiek įstatymų leidėjui, tobulinančiam teisinį reglamentavimą, tiek ir teisės teoretikams, analizuojantiems su šia tematika susijusias mokslines problemas.

Ginamieji disertacijos teiginiai:

- 1) Tyrimui aktualiose jurisdikcijose pasikeitė banko nemokumo procedūrų paradigma. Pokytis pasireiškė tuo, jog privatus akcininkų ir kreditorių interesas tapo subordinuotu viešajam interesui – užtikrinti banko veiklos tęstinumą ir tuo pačiu finansų sistemos stabilumą. Banko pertvarkymas ir tik po to sekantis dalies banko likvidavimas padeda optimaliai subalansuoti viešuosius ir privačius interesus.
- 2) Nemokių arba artimiausioje ateityje galinčių tapti nemokiais bankų pertvarkymas yra inicijuojamas viešųjų, administracinių institucijų, paprastai teismui atliekant tik antrinį vaidmenį. Nors pertvarkymo veiksmai turi poveikį banko akcininkams ir kreditoriams, tačiau administracinis pertvarkymo sprendimų priėmimo mechanizmas yra operatyvesnis ir veiksmingesnis lyginant su teisminiu pertvarkymo sprendimu, išlaikantis finansų stabilumą, geriau apsaugantis kreditavimo discipliną rinkoje.
- 3) Žlungančio banko akcininkų ir kreditorių teisių gynimo priemonės iš esmės apsiriboja tik *ex post* apskundimo teismine tvarka galimybe. Teisinės priemonės, skirtos prieštarauti kompetentingų pertvarkymo institucijų sprendimams, yra labai ribotos. Toks privačių asmenų teisių apribojimas yra būtinas, siekiant platesnių finansinio stabilumo tikslų, tačiau turi būti suderintas su fundamentalioomis asmenų teisėmis (teisės į gynybą, teisės į kompensaciją) ir teisės principais (teisėtų lūkesčių, proporcingumo).
- 4) Tyrimui aktualiose jurisdikcijose pasikeitus banko nemokumo teisinių santykių reguliavimo paradigmai, banko pertvarkymo priemonės yra pakankamos *ex ante* užkirsti kelią banko nemokumui, o *ex post* - veiksmingai kovoti su banko nemokumo pasekmėmis.

Tyrimo metodologija. Moksliniame tyrime laikomasi kokybinės metodologijos požiūrio į tyrimą. Šis požiūris, naudojant kokybinės analizės metodus, leidžia suprasti banko pertvarkymo teisinį režimą bei susijusias problemas. Pagrindiniai darbe taikyti teoriniai ir empiriniai metodai: lingvistinės, sisteminės, loginės ir kritinės analizės, dokumentų analizės.

Darbe remtasi metodologinėmis teisės tyrimų nuostatomis (metodologiniai pagrindai), kurios tinkamesnės dinaminei teisės formai. Tyrime vyrauja pozityvioji metodologija, tradicinis mokslas, kuris suvokia teisę kaip teisės normų visumą, objektyviai išreikštą valstybės priimtuose teisės aktuose. Tyrimui būdingi ir hermeneutikos mokslinio pažinimo metodai (interpretavimas), kurie padeda pažinti teisę, ją suprasti, aiškinti ir teisei veikti. Teisės mokslas kildinamas ne tik iš faktų, jis *inter alia* reiškia interpretacijas, turimų žinių taikymą naujiems tyrimo objektams. Taigi, tyrimo objektas yra iš esmės grįstas interpretacijos ir supratimo teorija bei tyrimui būdingi kokybiniai metodai, derinamos patirtys su bandymu suprasti prasmes. Autorius šiame tyrime interpretuoja tekstą bei gryna banko nemokumo procedūras ieškodamas interesų balanso tarp skirtingų viešų ir privačių interesų, veikiančių banko pertvarkymo teisiniuose santykiuose. Remiantis šiais mokslinio tyrimo metodologiniais pagrindais ir atsižvelgiant į suformuotus darbo tikslus bei uždavinius, atliekant tyrimą, buvo naudoti įvairūs duomenų rinkimo ir duomenų analizės metodai. Tyrime laikomasi jurisprudencijos esmės: 1) nustatyti socialinės tikrovės faktus ir reiškinius, jų savybes; 2) paaiškinti (atskleisti priežastinius šių faktų ryšius); 3) įvertinti tiriamą reglamentavimo tikrovę ir jos naudingumą.

- 1) *Lingvistinės analizės metodas* naudotas interpretuojant nacionalines banko nemokumo procedūras reglamentuojančias teisės normas, įvairių instancijų ir jurisdikcijų teismų sprendimus, tarptautinių organizacijų atliktas banko pertvarkymo teisinio režimo studijas, atskiras ES, JAV, Šveicarijos nacionalinių įstatymų formuluotes bei teises sąvokas.
- 2) *Dokumentų analizės metodas* pasitelktas renkant ir analizuojant Lietuvos ir ES, JAV, Šveicarijos jurisdikcijų norminius teisės aktus, rekomendacinio pobūdžio tarptautinius teisės aktus, aiškinamuosius kompetentingų institucijų dokumentus, teismų sprendimus bei teisės doktriną: specialios mokslinės publikacijos, monografijos, vadovėliai, konferencijų medžiaga. Metodas taip pat naudotas ir tarptautinių organizacijų ir kitų viešųjų institucijų studijų bei publikacijų analizei. Metodas leido ištirti srities profesionalų rengtus ir su banko pertvarkymo teisinio režimo veikimu ir principais susijusius dokumentus. Pradiniai tyrimo duomenys sekė iš bendrųjų teisės aktų, tyrimo ribose aktualių jurisdikcijų bankroto įstatymų, bankų įstatymų, indėlių ir įsipareigojimų investuotojams draudimo įstatymų, kitų nemokių bankų veiklą reglamentuojančių teisės aktų. Renkant disertacinio darbo duomenis naudoti ES, JAV ir Šveicarijos bibliotekų fondai bei atitinkamų universitetų duomenų bazės, įvairūs reputaciją turintys interneto šaltiniai.
- 3) *Sisteminis metodas* naudotas siekiant sistemiškai įvertinti, suklasifikuoti bankų nemokumo procedūras, jų teisinės aplinkos reguliavimą tiek tarptautiniu lygiu, tiek nacionaliniu lygiu. Šis metodas leido ištirti banko pertvarkymo teisinį režimą iš kitų banko nemokumo procedūrų kaip kompleksinį teisės reiškinį, kartu atsižvelgiant į socialinį ir ekonominį kontekstą, padėjo nustatyti tikslią banko pertvarkymo teisinio režimo vietą jurisdikcijų teisės sistemose, tiek *lex generalis*, tiek *lex specialis* sisteminius ryšius (darant pagrįstas prielaidas apie konkrečios bankų nemokumo teisės normos prasmę, atskleidžiant prigimtį ir reikšmę).
- 4) *Loginis metodas* taikytas darant pagrįstus surinktų tyrimo faktų, susijusių su banko nemokumo teisiniais santykiais apibendrinimus, formuluojant tarpines ir galutines tyrimo išvadas.

- 5) *Apibendrinimo metodas* kartu su loginiu padėjo nustatyti banko pertvarkymo teisinio režimo savybes, suklasifikuoti bendrojo ir specifinius požymius, tikslus, sąlygas, svarbą, apibendrinti disertacijos skyrius.
- 6) *Teleologinis metodas* padėjo išsiaiškinti tam tikrų banko pertvarkymo teisinių priemonių reguliavimo objektyvias priežastis, atskleisti banko nemokumo procedūrų tikslus, aiškinimo ribas. Metodas buvo taikytas nacionalinių, užsienio valstybių teisės aktų, teismų sprendimų analizei, nustatant veiksnius ir priežastis, banko nemokumo pagrindus. Be kita ko, pasitarnavo atskleidžiant banko nemokumo procedūrų, akcininkų, kreditorių, viešųjų institucijų poveikio vertinimą ir atitinkamų teisės normų teksto prasmę, interpretavimo galimybių ribas. Pažymėtina, kad metodas naudotas lygiagrečiai su istoriniu, lingvistiniu ir sisteminės analizės metodais, nustatant teisės aktų kūrėjų pozicijas konkrečiau tiriamo klausimo atžvilgiu, tiriant paskutinės bankų krizės pamokas, banko nemokumo procedūrų istorines ištakas.
- 7) *Lyginamasis metodas* tyrime svarbus lyginant skirtingas banko rūšis, skirtingas banko nemokumo procedūrų rūšis, skirtingų valstybių ir teisės tradicijų teises konstrukcijas, susijusias su banko pertvarkymo teisių režimu, veikimu ir vykdymu, vertinant skirtingose šalyse egzistuojančias banko pertvarkymo teisinio režimo koncepcijas, banko pertvarkymo priemonių teisinį reguliavimą ir jų taikymo teisinę praktiką. Metodas suteikė galimybę peržengti vienos teisinės sistemos ribas ir ieškoti, ar kitoje valstybėje nėra sukurtos priimtinesnės ir labiau pagrįstos probleminių klausimų sprendimų formulės. Taip pat leido sugretinti skirtingų valstybių banko pertvarkymo režimo teisinio reguliavimo ir atskirų jo institutų įgyvendinimo ypatumus, nustatyti naujus požiūrius ir vyraujančias idėjas, išsamiai pagrįsti tyrimo argumentus. Šiuo metodu atskleisti skirtingų teisiųjų sistemų panašumai ir skirtumai, išgrynintos universaliai problemos. Metodas naudotas kaip intelektualinė autoriaus veikla, susijusi su teise (objektas) ir palyginimu (procesas), tiek *makro* (stiliaus ir idėjų lyginimas skirtingų jurisdikcijų bei teisėkūros metodų ir procedūrų), tiek *mikro* (lyginant nebūtinai visų trijų jurisdikcijų teisinį reguliavimą) požiūriu. Tyrimas atliekamas remiantis ir tvarkant teisinę medžiagą bei klasifikuojant banko nemokumo procedūras, išsiaiškinant konkrečios jurisdikcijos banko pertvarkymo teisinio režimo vaidmenį. Taikant metodą ieškota, kaip susijusios bankų pertvarkymo taisyklės buvo sukurtos ir išvystytos skirtingų jurisdikcijų įstatymų leidėjų arba teismų. Metodas padėjo nustatyti bei išsiaiškinti praktinį pertvarkymo teisinio režimo kontekstą, kuriame jis yra taikomas, kad būtų galima suprasti, kodėl užsienio teisinė sistema jai būdingu būdu išsprendžia aktualias problemas ir kodėl neišsprendžia.
- 8) *Analitiniu – kritiniu metodu* buvo pažvelgta į banko pertvarkymo teisinio režimo, pertvarkymo priemonių, poveikio akcininkams ir kreditoriams trūkumus ir įgyvendinimo disfunkcionalumą, taip pat banko pertvarkymo teisinio režimo atsiradimo priežastis. Metodas padėjo atlikti viešųjų ir privačių interesų, sąveikaujančių banko pertvarkymo teisiniame režime, tarpusavio santykio išvalgą. Remiantis šiuo metodu įvertinta, kaip teisė tenkina tam tikro meto privačių ir viešųjų asmenų teisių saugos poreikius. Metodas pasireiškė ir galiojančios teisės kritika, neigimu bei teisės idealizavimu (geidžiamos teisės vizija).

Moksliniame darbe taip pat naudoti kiti mokslinio tyrimo metodai: *genetinis* padėjo nustatyti nagrinėjamų banko nemokumo procedūrų ir atitinkamų teisės normų atsiradi-

mą ir raidą; *dedukcijos* – reikšmingas analizuojant abstrakčias teisės normose įtvirtintas taisykles ir sukonkretinant jų taikymo praktikoje atvejus; *indukcijos*- nagrinėjant konkrečiose bylose teismų sprendus klausimus ir pateikiant jų apibendrinimus su atitinkamomis išvadamis; *istorinis metodas*- atskleidžiant banko pertvarkymo režimo genezę, teisės normų prasmę, teisės taikymo įvairovę lemiančius veiksnius, reguliavimo skirtingose šalyse raidą, veiksnius lėmusius pokyčius; *statistinis metodas*- apdorojant statistinę tyrimo medžiagą.

Darbo struktūra. Atsižvelgiant į suformuotus tyrimo uždavinius, darbo dėstomąją dalį sudaro keturios pagrindinės dalys.

Pirmoje dalyje yra aptariamos bendrosios banko nemokumo procedūrų nuostatos, koncepciniai klausimai. Patikslinami kai kurie disertacijos terminologijos aspektai, apibūdinamos kartinės bankų funkcijos ir sąveika su viešuoju interesu, aptariamas paskutinės bankų krizės poveikis ekonomikai, apžvelgiamos banko nemokumo procedūrų ištakos. Aiškinama, kodėl bankų nemokumo problemoms spręsti yra netinkamos bendrosios nemokumo teisės normos. Atskleidus bendrąją banko nemokumo procedūrų sampratą, be kita ko, išskiriant ir banko pertvarkymo procedūrą, analizuojamas banko nemokumo procedūrų tarpusavio ryšys, su banko nemokumo sąlygų nustatymu susiję klausimai, išskiriami tiek kiekybiniai, tiek kokybiniai, tiek diskreciniai kriterijai. Taip pat šioje dalyje apibendrinamos banko nemokumo procedūrų regioninio ir tarptautinio unifikavimo tendencijos, atskleidžiamas banko nemokumo procedūrų paradigmų pasikeitimas pasaulyje. Toks aptarimas labai svarbus siekiant objektyviai atskleisti banko pertvarkymo teisinio režimo kilmę, raidą bei teises savybes, kurios vėliau buvo inkorporuotos į tirtintų jurisdikcijų nacionalinę teisę. Be to, prieš detalizuojant konkrečias situacijas, kurios gali būti vertinamos kaip bankų pertvarkymo teisiniame režime sąveikaujančių viešųjų ir privačių interesų suderinamumas, aptariami bendrieji banko nemokumo procedūrų kvalifikavimo požymiai, išskiriami bendrieji visų banko nemokumo procedūrų tikslai.

Antroji dalis skiriama išimtinai bankų pertvarkymo teisinio režimo, kaip itin svarbios banko nemokumo procedūros, analizei. Atsižvelgiant į tai, kad bankų pertvarkymo teisinis reguliavimas, sekant tarptautiniais finansiniais standartais, turi būti sukurtas taip, kad ne tik apsaugotų privačius akcininkų ir kreditorių interesus, bet ir siektų platesnių, viešųjų teisinio reguliavimo tikslų, kurie yra gyvybiškai svarbūs efektyviam ekonomikos veikimui, šioje dalyje analizuojama skirtingų valstybių taikomos bankų pertvarkymo taisyklės bei susijusi administracinė praktika. Atskleidžiama bankų pertvarkymo samprata, analizuojama, kodėl bankų pertvarkymo teisinis režimas toks svarbus valstybėms, pateikiami bankų pertvarkymo teisės principai. Didelis dėmesys skiriamas aptariant atskirų jurisdikcijų bankų pertvarkymo sąlygas (t. y. kada turėtų būti pradėtas bankų pertvarkymas). Detalizuojami specialūs bankų pertvarkymo tikslai. Galiausiai atsižvelgiant į tai, kad efektyvesnės bankų pertvarkymo teisinės priemonės yra būtinos prevenciškai siekiant išvengti žalos, šioje darbo dalyje nagrinėjamos konkrečios klasikinės bankų pertvarkymo teisinės priemonės (banko verslo pardavimas, banko turto, teisių, sandorių ir įsipareigojimų perdavimas, turto atskyrimas, laikinas bankas, banko gelbėjimas privačiomis lėšomis), gryninamas atskirų teisinių priemonių veiksmingumas, atsižvelgiant į siekį išsaugoti finansų stabilumą ir kuo labiau sumažinti ekonominį ir socialinį bankų nemokumo problemų poveikį.

Trečioje dalyje analizuojama viešųjų institucijų, kurios siekia užtikrinti banko pertvarkymo veiksmų spartą, garantuoti nepriklausomumą ir išvengti interesų konfliktų, įgalioji-

mus, sprendimų priėmimo ir kontrolės mechanizmus, teisės skųsti sprendimus galimybė (teisė į gynybą), turto ir įsipareigojimų vertinimo tvarka ir tikslai, ieškomas optimalus teisinio reguliavimo modelis, kuris būtų veiksmingas, sprendžiant, kas turėtų priimti sprendimus dėl bankų pertvarkymo administracinės institucijos – kreditoriai ar teismai? Išskiriamos pagrindinės viešosios institucijos ir jų vaidmuo bankų pertvarkymo procese. Analizuojama, ar nevertėtų įsteigti atskirų, specializuotų teismų ar teisėjų kolegijų, sprendžiančių tik finansų institucijų nemokumo problemas.

Ketvirtoje dalyje labiausiai į tyrimo problemą orientuotoje dalyje analizuojamas bankų pertvarkymo procedūrų poveikis ir apribojimai banko akcininkams, kreditoriams. Aiškina, kad pagrindinių susijusių asmenų teisių apribojimas yra būtinas siekiant platesnių, finansinio stabilumo tikslų, vertinamas tokių apribojimų proporcingumas. Nagrinėjama, kokiais atvejais taikant banko pertvarkymo teises priemones ir įgaliojimus gali būti ribojamos akcininkų ir kreditorių teisės ir ar su pertvarkymo veiksmais susijęs kišimasis į akcininkų ir kreditorių teises atitinka pagrindines asmenų teises bei yra proporcingas. Aptariami akcininkų ir kreditorių teisių apsaugos ir skirtingų interesų aspektai. Atliekant teismų praktikos analizę, išskiriami pagrindiniai teisės principai, kriterijai, balansuojantys privačius ir viešuosius interesus, vykdam banko pertvarkymą. Aptariamas poveikis asmens nuosavybės teisėms, analizuojama nuostolių, atsirandančių dėl banko nemokumo, padengimo tvarka ir kreditorių reikalavimų tenkinimo eilės ypatumai. Išgryninami teisiniai saugikliai (pavyzdžiui, poveikį patiriantys akcininkai ir kreditoriai neturėtų patirti didesnių nuostolių nei nuostoliai, kurie būtų patirti, jei bankas būtų likviduotas), padedantys užtikrinti viešų ir privačių interesų balansą pertvarkant bankus.

Tyrimo pabaigoje formuluojamos išvados ir pateikiamos rekomendacijos.

Pagrindinės tyrimo išvados:

Dėl banko nemokumo procedūrų teisinės koncepcijos

1. Bankai atlieka ypąč svarbias funkcijas visai realiajai ekonomikai, todėl jų veiklos stabilumas atitinka viešąjį interesą. *Lex generalis* normos netinkamos bankų mokumo problemoms spręsti. Visų pirma, dėl to, kad neužtikrina bankų ypatingos svarbos funkcijų tęstinumo, valstybių finansinio stabilumo tikslų, nemažina išlaidų mokesčių mokėtojams, nutraukia ir sutrikdo banko verslo operacijas. Antra, dėl specifinės bankų veiklos prigimties, kurioje pasireiškia viešas interesas, ir dėl eilės procedūrinių priežasčių: operatyvių bankų pertvarkymo sprendimų poreikio, specifinio banko nemokumo sąlygų nustatymo, skirtingų procedūrų tikslų ir pan. Trečia, jeigu *lex generalis* būtų taikomos bankams, pertvarkymo atveju tai sukeltų rimtų nuostolių tiek privatiems, tiek viešiesiems asmenims, finansų stabilumo destabilizavimą, todėl banko pertvarkymo teisės normos pirmiausia gina viešąjį interesą, ir tik po to siekia užtikrinti privačių asmenų teises ir interesus.
2. Banko pertvarkymo taisyklių prigimtis daro poveikį banko pertvarkymo sprendimų teisminei kontrolei: įprasta nemokumo procedūra vyksta teismui prižiūrint ir kontroliuojant, priešingai, banko pertvarkymas turi būti atliekamas operatyviai ir nepertraukiamai, todėl banko pertvarkymo priemonės visose lygintose jurisdikcijose yra patvirtinamos ir taikomos tikslai administracinių institucijų. Apskundimas teismine tvarka yra įmanomas, tačiau tik labai ribotoje apimtyje.

3. Finansų stabilumas yra tarptautinė problema, kuri negali būti išspręsta vienos jurisdikcijos pastangomis. Po paskutinės bankų krizės visos lygintos jurisdikcijos, sekdamos tarptautiniais standartais, įgyvendino visapusiškas banko nemokumo procedūrų reguliavimo reformas. Tarptautiniu lygiu pasikeitė banko nemokumo procedūrų tikslų paradigma. Visos tyrimui aktualios jurisdikcijos pasižymi skirtingomis institucinėmis ir teisinėmis sistemomis, todėl banko pertvarkymo teisiniai režimai negali būti tiesiogiai palyginami. Reglamentavimo reformos buvo grindžiamos susitarimais G20 ir FSB lygiu. Per paskutinę bankų krizę JAV ir Šveicarijos teisinė sistema buvo stipresnė nei ES valstybių narių tuo metu. JAV ir Šveicarijos viešosios institucijos nesusidūrė su harmonizavimo iššūkiu įvairiose ES valstybėse narėse. Kita vertus, pasikeitus paradigmai, ES įdiegė išsamiausių banko nemokumo procedūrų reglamentavimą bankų sąjungos formatu.
4. Bendros visoms jurisdikcijoms banko nemokumą galinčios paskatinti pagrindinės rizikos – likvidumo ir sisteminė rizika. *Too big to fail* doktrinos analizė atskleidė, jog didelių, kompleksišku, atliekančių sistemiskai svarbias funkcijas bankų nemokumas yra labai reikšminga teisės problema. Išanalizavus paskutinės bankų krizės praktiką, akivaizdu, jog atsirado poreikis sumažinti ne tik įprastų, bet ir sistemiskai svarbių bankų bankroto tikimybę ir sukurti tokį teisinį režimą, kuris leistų veiksmingai kovoti su bankų nemokumo problemomis be mokesčių mokėtojų pinigų. Praktikos analizė atskleidė, kad per paskutinę bankų krizę sėkmingiausiai *too big to fail* problemas sprendė Šveicarija.
5. Bankas nemokus gali tapti labai greitai, todėl ypatingas vaidmuo tenka banko nemokumą paskatinusių sąlygų nustatymui ir kvalifikuojančių kriterijų reglamentavimui. *Ad hoc* bankų nemokumo sprendimo būdai yra nenuspėjami, todėl neatitinka teisinio tikrumo tikslų. Išsamiausiai banko nemokumo sąlygų kriterijai apibūdinami ES teisinėje sistemoje. Kadangi bankų finansavimas ir likvidumas labai priklauso nuo rinkos dalyvių pasitikėjimo, nėra įmanoma, nustatinėjant banko nemokumą, vadovautis vien tik kiekybiniais nemokumo kriterijais. Jeigu privalomi kiekybiniai kriterijai teisės aktuose silpnai reglamentuoti, yra rizika, kad gyvybingam, sveikam bankui(-ams) gali būti neteisingai pradama banko nemokumo procedūra. Kiekybiniai kriterijai vienu metu išvystyti visose tyrimui aktualiose jurisdikcijose. ES teisinėje sistemoje suteikiami didžiausi diskreciniai nemokumo kriterijai. JAV teisinė sistema pasižymi ypatingai giliomis, išskirtinėmis tradicijomis bei diferencijuotais banko kapitalo pakankamumo kriterijų reikalavimais nemokumo atžvilgiu. Šveicarijoje bankų kapitalo reikalavimams keliami didesni reikalavimai nei kitose lygintose jurisdikcijose. Kuo didesnė diskrecija suteikiama viešosioms institucijoms, tuo labiau padidėja rizika dėl reguliavimo institucijų pernelyg didelės kontrolės. Įvertinant banko nemokumą, reguliuotojai turi labiau koncentruotis į banko finansinio gyvybingumo vertinimą, paremtą perspektyviniais skaičiavimais, remtis ekonominiais, rinkos aplinkybėmis paremtais modeliais, o ne klasikiniais, retrospektyviais mokumo standartais ir testais. Ypač svarbu nustatyti banko likvidumo atitikimą reikalavimams.

Dėl banko pertvarkymo teisinio režimo

6. Banko pertvarkymas – administracinis procesas, tam tikras bankų krizės valdymo įrankis, įprastinės banko bankroto bylos alternatyva, siekianti užtikrinti banko esminių funkcijų tęstinumą, išlaikyti ir apsaugoti finansų stabilumą, išvengti išlaidų mokėčių mokėtojams ir atstatyti viso banko ar jo tam tikrų dalių ilgalaikį gyvybingumą. Bankas pertvarkomas siekiant teisės aktuose įtvirtintų pertvarkymo tikslų, taikant banko pertvarkymo priemones: verslo pardavimo priemonę, laikinojo banko priemonę, turto atskyrimo priemonę, gelbėjimo privačiomis lėšomis priemonę. Banko pertvarkymo teisinio režimo paskirtis – mažiausiomis sąnaudomis pašalinti nemokų banką iš finansų sistemos kartu išlaikant privačių asmenų ir visuomenės pasitikėjimą bankų sektoriumi, tinkamai suvaldyti teises ir ekonomines rizikas, apsaugoti tuos įsipareigojimus, kuriuos naudinga ar netgi privaloma apsaugoti siekiant viešo intereso tikslų: banko funkcijų tęstinumas, banko turto vertės maksimizavimas, banko nemokumo nuostolių pirminis priskyrimas akcininkams, ekonominio ir socialinio neigiamo poveikio valstybėje sumažinimas, viešųjų finansų ir finansų sistemos (įskaitant mokėjimų sistemą) apsauga, indėlininkų apsauga.
7. Visose lygintose jurisdikcijose dabartinis banko pertvarkymo teisinis režimas yra svarbus tuo, jog, visų pirma, padeda išvengti viešojo intereso pažeidimo atvejų (išsaugomas finansinis stabilumas, ypatingos svarbos banko funkcijos, indėlių, klientų turto ir viešųjų lėšų saugumas). Antra, užtikrina galimybę nemokiam bankui sklandžiai pasitraukti iš rinkos, nesukeliant sisteminių sutrikimų arba juos minimizuojant, sukelia mažesnio laipsnio pavojų finansų stabilumui, sumažina moralines rizikas, padeda išlaikyti ar atstatyti pasitikėjimą rinkoje. Trečia, ES, JAV, Šveicarijoje dabartinis bankų pertvarkymo teisinis režimas minimizuoja SSFI statusą turinčių bankų mokumo problemas, teigiamai veikia skolinimosi sprendimus, atlieka prevencinį vaidmenį, įgalina viešąsias institucijas banką pertvarkyti taip, kad būtų išvengta sisteminės žalos ir viešojo bei privataus intereso pažeidimo atvejų. Galiausiai naujas banko pertvarkymo teisinis reguliavimas leidžia greitus ir saugius sprendimus mokumo problemų turintiems bankams, numatant susijusius banko pertvarkymo ginčus spręsti vėlesnėje stadijoje.
8. Visose lygintose jurisdikcijose reglamentuota taisyklė, jog žlungantis bankas iš esmės gali būti likviduotas pagal įprastą bankroto procedūrą, o likvidavimas visada turi būti apsvaustomas prieš pertvarkant banką. Banko pertvarkymo priemonės taikomos tik tuomet, kai bankas negali būti likviduojamas pagal įprastą bankroto procedūrą, nesukeliant neigiamų pasekmių, grėsmės kritinėms banko funkcijoms, neigiamo poveikio finansų stabilumui, viešosios finansinės paramos panaudojimo arba kreditorių ir jų turto padėties pabloginimo.
9. Visose lygintose jurisdikcijose pagrindiniai banko pertvarkymo teisinio režimo principai tinkamai suderina viešuosius ir privačius interesus: banko akcininkai pirmieji prisiima nemokumo nuostolius, kreditoriai prisiima nuostolius tik po akcininkų ir pagal kreditorių reikalavimų tenkinimo eilę, vyresnieji banko pareigūnai yra pakeičiami, tos pačios klasės kreditoriai traktuojami vienodai, joks kreditorius negali patirti didesnių nuostolių pertvarkant banką nei jis patirtų vykdant įprastą bankroto procedūrą, išlaikomas banko veiklos tęstinumas (viešasis interesas), apdrausti indėliai apsaugomi.

10. Pagrindiniai teisės principai, balansuojantys privačių asmenų ir viešųjų asmenų interesus, pagrįsti viešąja teise. Pertvarkymo priemonės turi užtikrinti privatiems asmenims teisinį tikrumą, teisę į gynybą, turi būti subalansuotos su viešuoju ir privačiu interesu, naudojamos proporcingai, bei atlikus intervenciją, suteikti adekvačią kompensaciją nukentėjusiems privatiems asmenims. Disertacijoje suklasifikuoti iš ES ir JAV teisinių sistemų išplaukiantys teisės principai (*teisėtų lūkesčių, teisėto tikslo, teisinės pusiausvyros principas*) yra pagrįsti, gali būti taikomi ir pavieniui, ir kartu, tinkamai suderina viešąjį ir privatų interesą banko pertvarkymo metu. Tol, kol tirtos valstybės tinkamai ir pareigingai įgyvendins minėtus principus ir saugiklius sunku numatyti situaciją, kuomet pagrindinės asmens teisės bus pažeistos.
11. Visose lygintose jurisdikcijose banko pertvarkymas yra administracinis procesas, kurio pagrindinis tikslas apsaugoti likvidumo poreikius trumpalaikiams kreditoriams, ypač indėlininkams, ir suvaldyti finansinį banko turtą tokiu būdu, kuris užtikrintų žlungančio banko turto vertę ir frančizės vertę. Todėl banko pertvarkymas, visų pirma, siekia išvengti sisteminės rizikos išplitimo atvejų finansiniame sektoriuje, antra, siekia socialinės gerovės, kuri negali būti sutapatinama su privačių asmenų tikslais, absoliutaus kreditorių reikalavimų prioritetu. Banko pertvarkymo teisinis režimas gali būti traktuojamas kaip išlaidų-naudos optimizavimo rezultatas.
12. Bankų pertvarkymo teisinis režimas tiek ES, tiek JAV, tiek Šveicarijoje yra specializuota teisės sritis, skirta žlungančio banko mokumo problemoms spręsti banką pertvarkant ir tik po to likviduojant. Bankų pertvarkymo teisinio režimo tikslai fundamentaliai skiriasi nuo bendrosios nemokumo teisės tikslų. Banko pertvarkymo taisyklės negali būti inkorporuotos į įprastą nemokumo teisę dėl esančių skirtumų tarp banko likvidavimo procedūros ir siekio išlaikyti banko veiklą arba ją sėkmingai reorganizuoti. Nepaisant to, įprasta nemokumo teisė (bankroto procedūra) išlieka ypač svarbi banko pertvarkymo teisinio režimo taisyklių kontekste. Visose tyrimui aktualiose jurisdikcijose įprastos nemokumo teisės normos bus taikomos tik tada, kai specifinės banko pertvarkymo taisyklės netaikomos.
13. ES ir JAV banko pertvarkymas finansuojamas renkant įmokas iš bankų industrijos *ex ante*, sukuriant bendrą bankų pertvarkymo fondą. Kitokia situacija yra Šveicarijoje, kur pertvarkymo, stabilizavimo fondas vis dar yra CB prerogatyva, veikiant kaip „paskutiniam skolintojui“. Šveicarijoje fondas steigiamas *ad hoc* pagrindais tuomet, kai reikia užtikrinti išskirtinius valstybės interesus. Toks reguliavimas neatitinka naujosios bankų pertvarkymo paradigmos savybių. Kai išankstinio finansavimo nepakanka banko pertvarkymo nuostoliams ar sąnaudoms padengti, ES ir JAV teisinėje sistemoje numatoma rinkti *ex post* rinkliavas, papildomai „pripildyti“ fondą iš bankų industrijos. ES bankų įmokos susideda iš fiksuoto dydžio įmokų ir banko individualia rizika paremtų įmokų. JAV surkurta banko individualia rizika paremta sistema. ES pertvarkymo fondo sistema yra neparanki dideliems bankams. ES valstybes nares naujas teisinis reguliavimas privers reformuoti indėlių garantijų sistemų fondų sistemas. Nors ir leidžiama sujungti šias finansavimo struktūras, tačiau finansavimo šaltiniai išlieka atskiri, tai pareikalaus papildomų administracinių resursų. Kita vertus, tai padės valstybėms sukurti finansinę naštą apribojančią sistemą, kuomet privatus ir viešieji finansiniai resursai rinkose yra išsekę. Pertvarkymo fondo lėšos leis ateityje lengviau išvengti finansų rinkų destabilizavimo ir, kiek įmanoma, sumažinti mokesčių mokė-

tojams tenkančias sąnaudas. Tiek ES, tiek JAV yra numatyta ir atsarginė pertvarkymo finansavimo priemonė (angl. *backstop*) – ESM lėšos ES, Išdo lėšos JAV.

Dėl banko pertvarkymo priemonių

14. Visose lygintose jurisdikcijose banko pertvarkymo priemonės yra skirtos ne visiškai išvengti banko likvidavimo, tačiau sušvelninti neigiamus padarinius, atsirandančius dėl banko mokumo problemų. Laiku ir tinkamai pritaikius banko pertvarkymo teisinę priemonę ir tik po to likviduojant banką, atsižvelgiant į disertacijoje ištirtus konkrečios pertvarkymo priemonės privalumus ir trūkumus, atsiranda teigiamo socialinio poveikio galimybė: pirma, mažinama sisteminės bankų sektoriaus krizės tikimybė ir saugoma nuo ekonominės gerovės nuosmukių po bankų sektoriaus krizių ir, antra, dėl tinkamo banko pertvarkymo mechanizmo pritaikymo, kiek įmanoma, sumažinami dėl paramos bankui mokesčių mokėtojams tenkantys nuostoliai.
15. Visose lygintose jurisdikcijose tiesioginis banko likvidavimas negali būti viena iš banko mokumo problemų sprendimo priemonių, jeigu kritinės banko funkcijos gali būti greitai pakeistos kitų rinkos žaidėjų. Bankui esant nemokiam arba artimiausioje ateityje tapsiančiam nemokiu, visų pirma, turi būti naudojamos privataus sektoriaus sprendimai, pavyzdžiui, atliekamas verslo pardavimas, įtraukiant kitus rinkos dalyvius. Jeigu toks sprendimas yra neįmanomas arba nesėkmingas – gali būti taikomi kiti banko pertvarkymo būdai, vadovaujantis „mažiausios kainos“ principu indėlių draudėjo, viešojo intereso atžvilgiu.
16. Banko gelbėjimo privačiomis lėšomis priemonė visose lygintose jurisdikcijose reikšmingai prisidės prie viešųjų institucijų galimybės spręsti tiek didelių ir kompleksiškių, tiek ir įprastų bankų mokumo problemas, kai kitos pertvarkymo priemonės nepakankamos, nes nėra jokių privataus sektoriaus pirkėjų arba jie lengvai neprieinami, o jeigu ir yra, kitų priemonių taikymas padidintų rinkos koncentraciją ar likusių finansų institucijų dydį. Pertvarkymo atveju gelbėjimo privačiomis lėšomis priemonė suteikia teisę priskirti nemokaus banko nuostolius privatiems asmenims ir rekapitalizuoti banką nepanaudojant mokesčių mokėtojų pinigų.
17. Bendras visoms tirtoms jurisdikcijoms gelbėjimo privačiomis lėšomis trūkumas tas, kad, nors priemonė padidina banko kreditingumą, tačiau nesuteikia bankui grynųjų pinigų. Be to, reglamentuojant reikalingas didesnis aiškumas, kur banko kapitalas, kuriam gali būti taikoma priemonė, yra ir turi būti laikomas ir kokia forma, t.y. kuris bankų grupės juridinis asmuo disponuoja banko skolos priemonėmis. Laiko prasme tai ypač svarbu, nes priemonė naudojama dar prieš viešųjų finansų panaudojimą. Taip pat didelių bankų reikšmingos skolos priemonių dalys gali būti nepanaudojamos, taikant šią priemonę, ypač tais atvejais, kai bankai refinansuoja patys save, t.y. indėliais. Neatmestina ir tai, kad padidės teisminių ginčijų dėl konkrečios klasės kreditorių, kurių reikalavimai bus nurašomi arba konvertuojami, diskriminavimo. Pagrindinis bendras privalumas, kad ši priemonė suteiks teisinį aiškumą dėl konkretaus piniginių lėšų kiekio, kuris reikalingas padengti banko nuostolius ir paskatins ankstyvą banko rekapitalizaciją bei sustiprins banko veiklos tęstinumo prielaidą. Priemonė visose lygintose jurisdikcijose pakeičia viešąją paramą sankcijomis privatiems asmenims.
18. Visose lygintose jurisdikcijose finansinio stabilizavimo priemonės yra kraštutinė vyriausybės lygmens banko mokumo problemų sprendimo alternatyva, naudojama tik

įvertinus visų kitų pertvarkymo priemonių panaudojimo galimybes. Šios priemonės naudojamos tada, kai klasikinių banko pertvarkymo priemonių nepakanka siekiant apsaugoti viešą interesą. Tai ir valstybės paramos priemonės banko kapitalui padidinti, ir banko nuosavybės perėmimas valstybės nuosavybėn.

Dėl viešųjų institucijų ir sprendimų kontrolės mechanizmo

19. Visose lygintose jurisdikcijose viešųjų institucijų, atliekančių vaidmenį pertvarkymo procese, infrastruktūra susideda iš šių pagrindinių institucijų: bankų priežiūros institucijos, indėlių draudimo institucijos, teismų. Jų vaidmuo yra daugiausiai susijęs su viešojo intereso apsauga. Siekiant, kad bankų pertvarkymo teisinis režimas veiktų efektyviai, reikalinga, kad viešosios institucijos turėtų įgaliojimus veikti greitai ir tam tikrais atvejais nesilaikant įprastų bendrovių teisės nuostatų, valdymo taisyklių, kurios paprastai susijusios su tuo, jog atliekant intervenciją reikia gauti privačių asmenų sutikimą.
20. Yra skirtingų vertinimų, ar teikti prioritetą administracinėms, ar teisminėms pertvarkymo sprendimų priėmimo procedūroms. Visose lygintose jurisdikcijose pertvarkymo sprendimai priimami administracinėse institucijose, bankų pertvarkymo ekonominius vertinimus atlieka viešosios institucijos, o teismai privalo jais remtis. Tačiau teismo procedūros ginčijamiems banko pertvarkymo sprendimams išlieka reikalingos siekiant garantuoti fundamentalias privačių asmenų teises (teisė į gynybą, teisė į kompensaciją už nuosavybės nusavinimą), teisėtus lūkesčius, veiksmų proporcingumą tarp viešo intereso ir nuosavybės teisių apsaugos, teisėtą viešo intereso tikslą. Administracinė sprendimų priėmimo procedūra yra efektyvesnė, nes yra operatyvesnė, tai tiesiogiai susiję su mažesniu banko turto nuvertėjimu. Be to, pertvarkymo sprendimai reikalauja specifinių, ekspertinių žinių, o banko pertvarkymo procedūros yra itin kompleksiškos, jose sprendžiamos sudėtingos teisinės problemos, dažnai per bankų krizę, todėl preziumuojama, kad žinių, resursų ir operacinių gebėjimų daugiau turi administracinės institucijos. Kertinis nusveriantis argumentas – pertvarkant banką iškyla poreikis bendradarbiauti su kitomis viešomis institucijomis, todėl ruošiant pertvarkymo sprendimus tai yra operatyvesnis būdas, sprendimai gali būti priimami žmonių grupėje, prireikus – vos per kelias valandas.
21. ES, JAV banko pertvarkymo teisinę priemonę teismai taiko *ex ante*, prašymo svarstymas teisme yra skubaus vykdymo. Tiek ES, tiek JAV pertvarkymo sprendimo sustabdymas prieštarautų viešajam interesui. *Ex post* šalys gali skųsti pertvarkymo sprendimą. Nors administracinių veiksmų sprendimų peržiūrėjimas yra centrinis asmenų teisių saugiklis tiek dėl galimų klaidų, tiek dėl piktnaudžiavimo, tačiau teisė pateikti skundą nėra absoliuti, taikomi įvairūs, tyrime aptarti ribojimai, kriterijai, be to, administraciniai aktai nėra automatiškai paveikiami. JAV galima skųsti tik pertvarkymo sprendimus dėl nemokumo sąlygų nustatymo ir dėl to, ar bankas atitinka įstatyme numatytą finansų institucijos sąvoką. Nuosavybės teisių nusavinimas pagrįstas tik esant neatidėliotinoms aplinkybėms ir tada, kai garantuojamos fundamentalios asmens teisės. ES galima skųsti pertvarkymo veiksmus tik tada, kai pertvarkymo priemonės buvo pritaikytos bankams, kurie neatitinka nemokumo sąlygų, ir tik tuomet, kai nėra visuotinės svarbos finansų stabilumo tikslų. Tiek ES, tiek JAV leidžiama nukrypti nuo

privatų asmenų teisės į gynybą principo, atsižvelgiant į svarbesnį finansinio stabilumo tikslą, kuris tarnauja tautos gerovei ir viešajam interesui.

Dėl banko pertvarkymo teisinio režimo poveikio kreditoriams ir akcininkams

22. Kreditorių reikalavimai susiję su nuosavybės teisių valdymu. ES, JAV, Šveicarijoje bankui pradėjus pertvarkymo procedūras taikomi apribojimai sandorio šalių teisėms nutraukti sutartį ir tam tikri banko įsipareigojimų vykdymo sustabdymo atvejai. Tokie apribojimai būtini tam, kad viešosios institucijos susidarytų tikrą nemokaus banko balanso vaizdą be banko turto vertės ir kiekio pakeitimų, kurie atsirastų dėl intensyvaus pasinaudojimo nutraukimo teisėmis.
23. Visose lygintose jurisdikcijose kreditorių reikalavimų tenkinimo eilė reikšmingai skiriasi nuo bendrosios nemokumo teisės numatytos eilės. Pirmiausia tuo, kad banko nemokumo nuostolius dengia reguliuojamojo kapitalo priemonės ir nuostoliai akcininkams paskirstomi arba panaikinant akcijas, arba labai sumažinant pelną, tenkantį vienai akcijai, konvertuojant skolą į kapitalą. Kai tokių priemonių neužtenka, antras žingsnis - subordinuotos skolos nurašymas arba konvertavimas. Pirmaeiliai banko įsipareigojimai konvertuojami arba nurašomi po to, kai visi subordinuotos klasės kreditoriai konvertuojami arba jų reikalavimai nurašomi. ES pasižymi tuo, kad skiriasi indėlių reikalavimų eiliškumas banko nemokumo atveju. Fiziniais asmenims ir labai mažoms bei mažoms ir vidutinėms įmonėms užtikrinama atitinkančių indėlių dalis, kuri viršija draudimo sumą, suteikiamas prioritetas prieš paprastus neapdraustus pirmenybinių kreditorių reikalavimus. Toks reguliavimas gali daryti neigiamą poveikį šiems indėlininkams, nes dauguma labai mažų, mažų, vidutinių įmonių yra didelių bankų klientai. Esant didesnei jų indėlių teisių apsaugai, tai gali padidinti skolinimo kaštus, pavyzdžiui, bankai gali padidinti palūkanų normą. JAV sistemos ypatumas tas, kad galima nukrypti nuo bendrosios nemokumo teisės kreditorių eilės tik tada, kai siekiama išlaikyti finansų stabilumą rinkoje. Be to, FDIC gali išskirti tam tikras kreditorių klases, nukrypstant nuo kreditorių lygiateisiškumo principo, jeigu tai prisideda prie banko turto vertės padidinimo, kreditorių nuostolių sumažinimo. Šveicarija pasižymi tuo, jog skolos konvertavimo į kapitalą principai ir kreditorių reikalavimų eiliškumas nustatomi restruktūrizavimo plane.
24. Pertvarkant banką, viešus ir privačius interesus balansuojančių teisinių saugiklių ir kriterijų, taikant specialias banko pertvarkymo priemones, tikslas – pasiekti kiek įmanoma didesnę teisinį aiškumą ir teisinių pasekmių nuspėjamumą. Banko pertvarkymo proceso nuspėjamumas formuoja ir banko akcininkų elgesį *ex ante*. Todėl nustatant aiškias, nuspėjamas taisykles ir principus sustiprinama rinkos disciplina. Jeigu yra žinoma, kad „blogais laikais“ banko nemokumo nuostolius prisiims privatūs asmenys, akcininkai, kreditoriai, tai atitinkamai skatina akcininkų, kreditorių ketinimus atidžiau vykdyti bendrovės kontrolę savo iniciatyva ir imtis ankstyvų veiksmų rekapitalizuoti banką ar įgyvendinti kitas priemones, atstatančias rinkos pasitikėjimą ir užtikrinančias viešąjį interesą. *Ex post* nuspėjamas bankų pertvarkymo procesas leidžia įprastą ir efektyvų ekonominių resursų perskirstymą tokiu būdu, kuris skatintų augimą ir padidintų bendrą gerovę.
25. ES teisinė sistema suteikia stiprią privatų asmenų nuosavybės teisių apsaugą banko akcininkams, tuo tarpu JAV teisinė sistema labiau ribotą privatų asmenų nuosavybės

teisinę apsaugą. Jeigu tiek ES, tiek JAV banko pertvarkymo priemonės taikomos ir viešosios institucijos įgaliojimai, siekiant viešojo intereso tikslų, panaudojami neat-
sižvelgiant į privačių asmenų teisėtą lūkesčių, teisės į gynybą, teisės į kompensaciją
principus, tokia apribota akcininkų teisių apimtis pažeidžia privatų interesą. Kita ver-
tus, privačių asmenų teisių apsaugos principai turi būti aiškinami kartu su platesniais
viešojo intereso tikslais, siekiu apsaugoti finansų stabilumą, kitų viešųjų asmenų inte-
resais, taip pat turi atsižvelgti ir į bankų atliekamas funkcijas ir jų svarbą visai ekono-
mikai.

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BANK RESOLUTION REGIME.
BALANCING PRIVATE AND PUBLIC INTERESTS.
A COMPARATIVE ANALYSIS

Summary of Doctoral Dissertation
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**BANK RESOLUTION REGIME.
BALANCING PRIVATE AND PUBLIC INTERESTS.
A COMPARATIVE ANALYSIS**

Summary

Issues and interest of the research. Despite their significant dynamics in the field of financial services, banks are the most widespread financial institutions all over the world, they undertake essential, crucial functions and play a significant role in sovereign economies. Consequently, the banking crisis is ever more associated with rather sensitive and provocative social, political, budgetary and legislative events. Efficient, reliable and predictable regulation of banking activities at national and international level helps to maintain critical banking functions and solvency. Efficient and practical legal regulation of banking activities primarily relates to quantitative risk management activities of a bank and numerous limitation criteria of prudential regulation. However, the recent banking crisis highlighted the equally important role of qualitative risk criteria of banking practice and their impact assessment important, especially bank insolvency crisis management rules, legal measures and bank insolvency procedures.

Bank insolvency law and procedure, including their complexity, is commonly known as a “Gordian knot” in the legal doctrine. In theory, from the very inception of modern financial markets, insolvency procedures of financial institutions and correlated legal relations have served as a point of reference for economists, bankers, lawyers and legal researchers. In practice, until the recent banking crisis, the substance and procedure of bank insolvency laws largely diverged, and a systematic approach was missing. Typically, in order to address the sensitive bank insolvency issues general corporate insolvency law - *lex generalis* - was applied without taking into account and observing the unique characteristics, functions and purpose of the banks. In addition, most legislation imposed minimum regulation with regard to legal principles of bank resolution, and was therefore unpredictable, incomplete, lacking legal certainty, with no alternative solutions available. Normally, former regulations were restricted to the application of governmental stabilisation measures, while alternative solutions describing how to manage cases of bank insolvency were neither established nor developed. As time went by, deregulation and the lack of balance of rights and obligations of diverse groups of stakeholders operating in bank insolvency procedures, namely the state, public institutions, bank administrators, creditors, shareholders became more obvious. Due to the lack of proper legal safeguards, including the former inadequate legal framework, uncertainty and the risk of litigation increased. Accordingly, from the inception of the financial crisis, up to the present day, academics, regulators, policy-makers, and related international organisations have undertaken effort to examine possibilities for more effective sound legal measures that could assist in addressing insolvent bank issues without resulting in the chaos of the financial sector and by avoiding other severe consequences. At that point, a reasonable question arises as to the types of bank insolvency regulation procedures that have been modified since the recent global banking (financial) crisis, with its peak period in 2008–2009?

From a practical point of view, a question arose as to whether *lex generalis* was adequate to resolve the problems of an insolvent bank effectively. Legal mechanisms for restructuring banks were limited, while ordinary bankruptcy procedure was hardly suitable for banks. In parallel, it was generally recognised that ordinary bankruptcy is not suitable for banks. An issue arose: how a country should respond to the symptoms revealed by one or several banks, showing serious financial and (or) operational difficulties, distress, or that a bank is failing or likely to fail, or is insolvent? What are the legal and administrative measures that the state must have in place and what are the steps to be taken to deal with bank insolvency problems effectively? These issues became fundamental in the context of the reforms of bank insolvency law.

Before the recent banking crisis, bank insolvency regulation in most countries lacked legal certainty, and the effect of this was that bank insolvency rules and procedures were created, administered and conducted on an ad hoc basis, by a spontaneous process of banking crisis management. While the states often employed public finances and bail-out for solving and addressing bank insolvency problems and saving banks, bank liquidation procedure was applied as an alternative. At the same time, banks were prevented from initiating bankruptcy proceedings, even if they could avoid the adverse consequences for the real economy. This resulted in spill-over effects and different risks, such as moral hazard, systemic risk, distortions of competition, protection of the depositor's rights, threat for financial stability, etc. In addition, nearly every official bank restructuring decision was taken, or at least confirmed, with the approval of the political leadership. The competent authorities and the governments could choose one of the two equally undesirable options: either to initiate expensive public rescue of the failing banks by using public finances (bail-out), or to apply ordinary bankruptcy procedures as an alternative even to systemically important banks with the ensuing negative impact on the financial system as a whole and the economy in general.

G20 authorised an action plan in November 2008, and suggested that the legislators, regulators and other competent authorities “review the legal regulation of bank restructuring and bankruptcy laws, according to a new experience and [...] ensure that the states would assist for the orderly winding up of banks “. It was concluded that it was vital to establish and develop effective legal instruments that could accurately liquidate insolvent banks in an ordinary way while maintaining the systemically important banking functions. A well-defined approach, namely the bank resolution regime was supported. The central purpose of the bank resolution system was to provide the “third insolvency alternative and a new direction” between uncontrolled or inadequately managed bank liquidation procedure (bankruptcy), which usually operates together with reducing the impact of bank assets and other bank insolvency jeopardies, covered when the bank's shareholders and the majority of creditors are rescued by using public finances. Bank liquidation proceedings generally have an adverse effect. They swiftly interrupt and disturb the bank's conduct and business operations and further destroy the value of the property. During the transitional period and in the final outcome, the continuity of critical banking functions and business continuity presumption is not met. Therefore, the first priority was to resolve the bank as a going concern, by applying resolution tools and avoiding any significant adverse effect on the financial system. At the international level, jurisdictions were required to undertake a broad range of legislative measures, in particular, to restructure banks while extending

banking business activities, meanwhile non-viable or systemically insignificant parts of the banking business were subject to regular liquidation procedures.

Bank resolution procedures are an extremely complicated economic, social and legal phenomena, featuring complexity and interaction of substantial and procedural legal norms. Among other items, bank resolution regime needs to be designed not only to protect shareholders and creditors, but simultaneously to achieve the other objectives set by public authorities and vital for the efficient functioning of the economy as a whole. When formulating the source of legal regulation of social bank resolution regime and the related legal rules in the form of community conventions, at least five principal issues to be dealt with and related to the balancing of private and public interests in bank resolution regime are addressed in the dissertation.

First of all, only after making the adjustments at the international level, the issue arose with regard to the extent of the loss resulting from a bank's insolvency and those responsible for the loss. An equally important question then arises: is it possible to rely on public interest, placing it above private interests? If so, what is the legal basis and the legal principles to be followed.

Secondly, the existing regulation governing bank resolution was reviewed or modern regulation was created in the relevant jurisdictions. The new era of bank resolution regime is indissociable from the broad powers exclusively delegated to competent authorities (e.g. the right to convert bank debt instruments into capital by financing bank recapitalisation, official intervention in the bank, etc.). Simultaneously, as demonstrated in practice, applying resolution tools can create similar obstacles, where the impact on the ownership rights and expenses of creditors and shareholders are potentially interconnected (e.g. the sale of a business tool requires neither the consent of the shareholders of the bank nor of any third party other than the purchaser). For this reason, it is important to properly regulate legal principles and criteria in positive law and to establish legal safeguards that could optimally balance private and public interests, which would accordingly help protecting public interest against potential counterparty claims.

Thirdly, given that the banks in distress experience financial difficulties, additional funding is needed. This has led to the establishment of provisions on the international level, namely that public authorities must have the power to impose bail-in instruments for banks, which essentially means that the application of these legal instruments prior to liquidation of the bank can write off capital instruments and convert them into the bank's capital (shares).

Fourthly, international financial standards have encouraged the banks to apply a variety of resolution tools available to them and to assure the assumption of the banks' going concern. Moreover, the provisions were established for bank resolution procedure to be applied in accordance with the "least cost" principle or creditors' "no-worse-off-principle". Accordingly, no creditor shall incur greater losses than would have been incurred if the bank had been liquidated under normal insolvency proceedings; otherwise it could destabilise the financial system. Additionally, steps should be taken in order to ensure that systemically important functions of the bank are rapidly transferred and continued where necessary. Notably, when no alternative private sector solutions could be reasonably expected, including capital injections of shareholders or third parties, this would suffice to recover the viability of the entire bank.

Fifthly, a new approach (different from the general insolvency approach) was established to consider the satisfaction of creditor claims and a hierarchy of claims in the bank insolvency procedures. Bank resolution regime is inconceivable without considering the negative impact on creditor and shareholder rights, such as interference in the contractual relations (netting agreements, collateral agreements, financial collateral arrangements under which ownership is transferred). As a result, legal protection of creditors and shareholders becomes problematic, encouraging scientists to reconsider whether the existing regulation of bank resolution procedures adequately balances public and private interests. On the one hand, the bank resolution regime is based on public interest purposes, while maintaining financial stability and legal protection of deposits. On the other hand, bank insolvency procedures are indissociable from the limitations of private interests – shareholder, creditor ownership rights.

As long as no equal approach has been adopted towards the treatment of bank insolvency procedures, the legal framework, and the international harmonisation, it is useful to examine the appropriate national legal framework of bank insolvency procedures from the comparative perspective. It is necessary to disclose not only how separate jurisdictions succeeded to comply with the international guidelines, but also to research and explore the types of legal models that certain jurisdictions have chosen, to compare the particularities, to find the convergences and divergences and, after examining the positive law of different jurisdictions, to disclose the approaches to the balance of public and private interests, and to suggest the recommendations and proposals.

Based on the above, the primary focus of this dissertation is placed on **the main question of the research**: whether the legal regime of bank resolution appropriately balances public and private interests?

The aim of the dissertation: to analyse theoretical and practical issues of the bank resolution regime in terms of compatibility of public and private interests.

In order to achieve this purpose, the following research **tasks** are formulated:

- 1) To disclose the change of bank insolvency paradigm and the reasons behind it; to analyse general conceptual terms of a new bank resolution paradigm.
- 2) To distinguish the scientific conception of bank resolution regime, as compared to other bank insolvency procedures, and to crystallise the characteristic features, thresholds, to analyse bank resolution tools, by discovering their implementation benefits and shortcomings.
- 3) Following a comparative approach, to examine the public authorities involved in bank resolution procedures, the decision-making mechanisms of bank resolution and the relevant role of public authorities.
- 4) Based on the identified characteristics of the regime governing bank resolution, to analyse the impact of bank resolution on public and private interests and their compatibility in the positive law of various jurisdictions.

The objective of the research: operational and functional implications on the bank resolution regime.

Scope and delimitations of the research

US. *Lex specialis* of bank resolution originated in the US. The origins of the bank resolution institute influenced other legal systems and their development. The United States is to be investigated since already in early 1991, the US adopted a separate section in the Bankruptcy Code dedicated to regulating banking insolvency procedures. Simultaneously, the Federal Deposit Insurance Corporation Act was revised by the policy makers in order that the FDIC, whenever a bank is failing or likely to fail, begins acting as the bank's receiver, while at the same time performing the functions of the regulator. This is exactly the opposite model in comparison with classical bank insolvency regulation model, for instance, found in the EU. In that case, usual deposit insurance activities are limited to the collection of contributions to the fund, payment of compensations to insured depositors, in the event of subrogation, the presence of bankruptcy process. In addition, the Dodd-Frank Act established a new *Orderly Liquidation Authority* (hereinafter - OLA), which is responsible for the administration of all financial companies posing a threat to the systemic risk. The new authority amended the Bankruptcy Code and addressed the moral hazard problem created by situations when shareholders, management and unsecured creditors were protected from the consequences they would have suffered in liquidation under the Bankruptcy Code. In addition, according to the US legal practice, among other legal points, several other significant differences between bank insolvency and corporate insolvency legal regimes should be considered. Additionally, the recent banking crisis has resulted in the diversity of banks failure practices in the US. *The Washington Mutual, Bear Stearns, Lehman Brothers* (in doctrine they are often described as the largest and most complicated bankruptcy cases in the history of financial institutions) bank insolvency cases deserve special mention. Thus, the global financial crisis not only started in the US, but also caused enormous losses to the US economy since the Great Depression in 1930 the market crash resulted in multiple deposit withdrawal from banks and rapid freezing of all credit markets. While the lawmakers of other countries were still in the process of legal and regulatory reforms in a sense of bank resolution, on 21 July 2010 the US president signed the Dodd-Frank Act, extremely significant in the context of bank insolvency procedures, which had tremendous impact on the entire financial service industry. As a result, other states analysed the US legal regulation and made efforts to adapt.

Switzerland. Switzerland is to be examined since it is an extremely relevant country in the global banking sector. Swiss banks were largely created for providing services and exporting capital (capital funded both nationally and in foreign countries). By the end of 2012, the off-balance sheet assets of the two largest Swiss banks – UBS and Credit Suisse – amounted to CHF 2.5 trillion, a figure four times exceeding the total annual GDP of Switzerland. The distinguishing feature of this jurisdiction is that the Swiss banking industry is dominated by large, universal banks, with a high degree of bank concentration and, at the same time, banks are exposed to additional risks that can affect the financial system as a whole. Although Switzerland is a particularly strong country in the banking industry, historically, however, bank insolvency crisis was not an uncommon phenomenon. Banking crises occurred in the Great Depression period during 1931–1936, after the Second World War, and during the housing loan crisis in 1990. The recent international banking crisis also influenced the Swiss banking system. Moreover, most notably, Switzerland is a unique country on the European continent, as the legal, political and economic system

significantly differs from the other European countries. The financial sector is built on the basis of self-regulation, based on the assumption that such regulatory approach is the most effective and efficient way to manage and monitor banking activities. Switzerland was one of the first countries in the world, which in 2004 began developing special bank insolvency regulation and subsequently was one of the first countries to comply with the requirements of the FSB. Most notably, in response to the 2004 banking crisis, the principles of Swiss banking law underwent certain changes. The new version of the Banking Law entered into force in 2011–2012. The Ordinance of the Swiss Financial Market Supervisory Authority on the Insolvency of Banks and Securities Dealers of 30 August 2012 (recast) (January 1st, 2015), brought significant technical changes in bank insolvency procedures, which meant that banks would no longer be obliged to liquidate and revoke their licenses if there was a prospect of restructuring a failing bank. Bank insolvency procedures were accompanied by the legal act of FINMA, which came into force on 1 November 2012, and was improved on 1 January 2013. The general legal provisions governing bank insolvency were fully transformed to the *lex specialis*. Finally, it should be noted that the Swiss regulatory reforms were influenced by recent cases of banking insolvency. Two globally and systemically important financial institutions faced financial difficulties (*UBS* and *Credit Suisse*). Although losses related to the bank insolvency procedures were very significant (e.g., *UBS* wrote off non-performing loans worth about USD 53.1 billion), we will mention the entirely successful and unprecedented bank resolution cases in this dissertation.

The EU. The recent bank insolvency crisis fully revealed the loopholes of the EU legal system in the field of bank insolvency procedures, the absence of transparent and predictable regulation that would allow managing financial restructuring of distressed banks and/or normal liquidation (bankruptcy). Between 2007 and 2009, most EU Member States had no regimes governing bank resolution that could ensure ordinary bank restructuring and/or the liquidation of failing banks. The EU insolvency law was mainly regulated by national legal systems, and the lack of harmonisation was apparent. When a significant number of banks faced severe distress problems in 2008, including the major market players such as *Fortis*, *Dexia*, the effective bank resolution regime was absent. For the reasons stated above, public authorities of the EU Member States were required to take legal bank restructuring measures in a chaotic way, and they therefore struggled to fight the problems of distressed banks, froze their property and seized bank assets located within their jurisdiction. In addition, national authorities have taken ad hoc legislative measures providing government guarantees and capital injections into a failing financial institution. The EU bank insolvency regulations developed very dynamically. Before the entry into force of the Banking Union, bank resolution procedures lacked even the minimum level of harmonisation, their substance and procedures diverged significantly, depending on the Member State. *Prior to* the adoption of the *Banking Union's* proposals, some Member States individually began adopting the related amendments to the bank insolvency laws at the national level, while the others waited until the harmonisation of the bank resolution framework at the EU level. However, eventually, the need for an efficient bank resolution regime arose. The aim was to ensure a standardised bank resolution mechanism, to manage bank insolvency cases at the home Member States' disposal, which could ensure that the use of internal markets was not limited and the right of establishment of banks was not restricted due to the financial resources designed to manage their failure. Prior to the legal project of the

Banking Union, it was possible to classify bank insolvency legal regulation both in general and special terms, but the main regulation governing insolvency procedure in EU clearly excluded the specific regulation of financial institutions, and banks, from the scope and operation of primary insolvency law. Initially, only the procedural aspects of insolvency law were harmonised at the EU level. Eventually, the EU's legal system should be considered also because of the fact that, in practice, insolvency proceedings were initiated for such significant banks as *Northern Rock*, *Fortis*, *Dexia*. It must be noted that in Lithuania, the two resonant and unprecedented bank insolvency cases were those of bank *Snoras* and *Ūkio Bankas*.

The originality of the research. The scientific analysis of bank insolvency law issues is valuable and novel in many scientific aspects. The vulnerabilities of the legal acts governing bank insolvency procedures and the gaps left by legislators become evident only during the banking crisis and/or in the case of systemically important cross-border bank insolvency. As a result, after the latest banking (financial) crisis, these loopholes became particularly sharp and resulted in abundant case-law on bank insolvency, which was not scientifically analysed neither in Lithuania nor in Switzerland. Moreover, this study is distinguished by the fact that in the context of bank insolvency procedures the legal doctrine is regarded as an essential source of jurisprudence. This position is based on the fact that most countries have ordinary, non-specialised courts, which often lack knowledge about banking activities necessary for handling bank insolvency cases. Since there are no specialised insolvency courts in Lithuania and Switzerland and the case-law analysis is lacking, this research provides novelty and explores new possibilities.

Based on the above-mentioned analysis and the problematic perspectives of existing banking and insolvency law, systemic and practical aspects of the research are beneficial. What solutions were adopted to resolve the legal dilemma in different jurisdictions, and have the problems been resolved? Given the intimate link between the international nature of modern economy (globalisation), the spread of international (multinational) banks and the prevalence of banking group influence on the development of the world economy, bank insolvency law and research analysis is now the international point of reference. The lack of legal certainty and clarity affects the integration of unresolved problems into larger conflicts related to the variety of legal interpretations. Hence, the effect of the function of the law in terms of governing public relations and regulatory harmonisation of conflicting interests and functional performances is not ensured. On the contrary, the hypotheses that could prevent the stability of social ties are not eliminated, and this seems inconsistent with the individual development of certain relations and the extension of interpretations. To summarise, that does not meet the purposes of legal science and modern, sustainable business development trends, that is why the analysis of the research will also be useful in this particular regard.

Despite global attention for the research subject, to date Lithuania and Switzerland clearly lack the analysis of scientifically approved information, different regulatory models and approaches in different jurisdictions. After performing a qualified and comprehensive scientific study on the subject at issue, assumptions could be established for addressing these gaps, by improving the analysis in the field of legal and regulatory framework of bank insolvency procedures, by presenting the relevant proposals and recommendations. The originality of this scientific topic finds its expression in the complexity of the investi-

gation. Moreover, in the nearest future Lithuania will have to implement particular Banking Union directives and transpose them into national law, meanwhile the SRM regulation will be directly applicable, that is why this study could form the basis of a review of the Lithuanian legal system.

In Lithuania and Switzerland, the extensively escalated bank insolvency law is still at the level of legal uncertainty. The supervisory response is further prevented by 'secret' decisions of the supervisory authority and the strongly restricted scope of the studies conducted by the competent authorities related to the analysis of the insolvency procedures in Lithuania. Henceforth, the resonating practical processes taking place in the society and poor justification of scattered individual opinions also highlight the intended theoretical novelty of the dissertation. The complexity and significance of the research is determined by the reasons stated in this introductory part. In addition, the introduction itself likewise describes the grounds for research. It is anticipated that this qualitative scientific study will encourage to produce other reliable studies and help formulating uniform case-law meeting social needs. It is assumed that the research conclusions will serve the Lithuanian and the Swiss scientific legal doctrine and could be employed for pedagogical and educational activities. Among other things, the interest in the subject and the need for the analysis was also noted at the time of the author's lecturing work at Mykolas Romeris University on the subjects of bankruptcy law and banking law. It is assumed that the author presents a comprehensive study on bank insolvency law, which will encourage the scientific community to perform additional research in the aforementioned area and will prompt a discourse that will empower and foster bank insolvency law and banking law in general. What is more, the doctrine of the structure, development and improvement of the bank insolvency procedures also serves the interests of the related public and private interests and their legal protection through providing greater legal certainty in this field. So far, in Lithuanian and Swiss private law, the current status of education is disappointing. Additionally, the dissertation proposes an important topic both in practice and in theory.

It should be further noted that a well-functioning legal system of the state encourages both the operation of financial markets and financial intermediaries. The established presumption found in the literature states that countries can be divided into categories by comparing the efficiency of the national legal system, especially that of financial transactions. Such a position is based on the fact that different financial systems have different regulatory levels, especially with regard to the protection of creditor and shareholder rights and the related regulatory rules. Thus, the financial development of each state also depends on the level of sound legal measures as a whole and their efficiency. Among other elements, the research might be relevant for lawmakers, especially governments performing particular operations in the context of bank insolvency procedures. First, the government aims to protect ownership rights and guarantee the execution of contracts. Second, governmental regulation is needed to encourage the appropriate legal provisions on the protection of investor funds, so that their money is used in the most appropriate manner, and that the investors are able to adopt suitable investment decisions by using their funds. Third, governments organise legal regulation and supervision of financial institutions in order to maintain bank solvency.

The study is mostly based on comparative law methodology. It was presumed that most regulatory questions could not be resolved by laws without sound comparative legal

assistance, whether it takes the form of a general study or any kind of comparative analysis, or an analytical report on a particular topic. Among other things, comparative law specialists normally provide suggestions to be adopted and implemented in their national legal system, taking into account the relevant problems at issue and their solutions that proved successful in other countries, including differences in judicial procedures, powers of different institutions, economic capacity, and the general social context. An equally important fact is that comparative law is based on the interpretation of national legal rules. In addition, comparative law plays a significant role for the courts while interpreting and applying the law. Finally, comparative law plays a significant part in legal education. Limiting general legal education to the studies of national law would be unexcusable, as modern society is very mobile, and it also helps better understanding one's own domestic legal system and learning from others.

The author expects that this study will serve as a practical and useful tool to courts dealing with such types of cases, to legislators in terms of improving and developing legal regulation, and to legal theoreticians and related experts. It is also assumed that the study will assist in analysing scientific problems.

The review of references. No comprehensive research on bank insolvency law and procedures, in particular in the field of bank resolution, has been conducted in the Lithuanian jurisprudence so far. Nor is there any comprehensive research on these issues in Switzerland. In Lithuania, general insolvency law has long been overlooked and as such is in the embryonic state. In principle, the subject of bank insolvency law has been largely abandoned. Examination of the literature reveals that bank insolvency law remains terra incognita in the Lithuanian educational system. Besides the author's publications on bank insolvency procedures, some research work could be found in several research papers in Lithuanian language. In their publication entitled 'Bankruptcy Law', *Kavalnė* and *Norkus* give a general insight in banking and other financial institutions and their bankruptcy features, providing a brief description of bank liquidation procedures, key elements, and general characteristics of bank bankruptcy. *Toločko* and *Černius* provide a very general description of bank reorganisation, liquidation and bankruptcy procedures. Some causes and consequences of commercial bank insolvency were analysed by *Šadžius* from an economical, historical perspective. *Šenavičius* published the original idea of the Banking Union in the context of public administration (before the political agreement on the Banking Union legislation was reached). The author of the article briefly refers to the essential elements of the Banking Union.

It is necessary to point out that scientific publications referred above are committed to fragmented extent. However, they do not primarily analyse specific issues. In the above-mentioned works, bank insolvency procedures are examined restrictedly in order to introduce to conventional regulatory trends without reflecting the recent change of paradigm. Consequently, due to a significant change in the legal base of bank insolvency procedures, previous researches no longer satisfy the existing rules and regulatory circumstances. None of the individual studies examine bank insolvency procedures using a complex approach: examination of banking law, finance, corporate and insolvency law. None of the aforementioned studies have comprehensively accomplished and considered the bank resolution regime or examined the conditions for establishing bank insolvency, nor have they investigated the protection of shareholders, depositors' and other creditors'

rights, etc. In conclusion, this relevant subject receives little attention in the Lithuanian and Swiss doctrine and practice.

Compared to the Lithuanian legal doctrine, foreign legal sources devote much more attention to regulation of bank insolvency procedures, uncertain aspects of bank insolvency treatment, and various regional and international unification trends related to bank insolvency legal relations. *Swire*, *Hüpkes*, *Asser* and *Hoelscher* are the pioneers of bank insolvency procedures. In addition, problematic aspects of bank insolvency law were discussed by a number of other notable scientists, such as *Lastra*, *Bliss* and *Kaufman*, *Marinč* and *Vlahos*. It should be noted that the vast majority of international legal scientists dealt with the problem of compatibility of public and private interest in bank resolution regime indirectly, by investigating various legal principles or institutes. For example, they have analysed the “too big to fail“ doctrine, the interaction of private and public authorities (Deposit Insurance Agencies, Ministry of Finance, the judiciary system, the Central Bank), by legally assessing the systemic banking insolvency crisis, examining creditors’ and shareholders’ rights, etc. At the same time, from the banking crisis up to now, regulation of bank insolvency has been swiftly progressing. The most relevant pieces of legislation were adopted quite recently, providing the author with an excellent opportunity to provide a critical insight into bank insolvency law-related doctrine of different jurisdictions.

However, only some scientific papers analyse and disclose the legal aspects of bank insolvency related to the research object. In particular, the interaction of public and private interests is examined by *Hüpkes*, *Alexander*, *Hadjjemmanuil*. Individual issues of bank resolution regime, such as the bail-in mechanism, are analysed by *Huertas*, *Smits*, *Coffee*. Legal and regulatory reforms of bank insolvency are discussed by *Sarra*, *Boonstra*, also *Giovanoli*. Furthermore, a variety of authoritative publications of international organisations and public institutions, such as the *International Bank of Settlements*, *the World Bank*, *the International Monetary Fund*, and others analyse bank resolution and liquidation-related and regulatory problems. It is equally important to note that due to the extreme sensitivity of the topic, various scientific studies, often in collaboration with the academics, were commissioned by *the European Commission*, *the European Council*, *the European Parliament*, *the Financial Stability Board*, etc. The study is also based on authoritative conference materials or publications issued on their basis .

Ultimately, it must be noted that the object of the research is rather limited in the Swiss jurisprudence. Excluding above mentioned *Hüpkes* scientific works, only a few materials can be distinguished as a scientific projects. Some cross-border bank resolution aspects of the EU dealt within *Grünwald* dissertation (the thesis is written based on undeclared EU legislation before a compromise was taken in the EP – aut.note). Deposit insurance related issues in the context of financial stability discussed by *Reiser*. The interaction of banks and the Swiss economics is addressed in the *Drechel* dissertation.

The published references were addressed and taken into account up to 1 January 2015.

Interdisciplinary nature of the research. This study has an interdisciplinary character. This is determined by the selection of the object under investigation and the specific nature of bank insolvency law. This branch of law couples the accomplishments of several scientific disciplines. Among them, the most important ones are economic and legal sciences. Occasionally, the study discusses theories based on economic criteria, impact

assessment, and the definitions provided by the science of economics. For example, the assessment of bank insolvency conditions is related to the economic analysis and criteria, or the effect of bank insolvency on the market and its participants. However, the study takes into account the fact that it has been prepared by a legal researcher and will be defended in front of the Committee of Doctoral Legal Studies, which is why the scientific analysis is concentrated and based on traditional private law instruments. Particular attention is paid to addressing the current and potential regulatory mechanisms.

Defensive arguments of the dissertation:

1. The paradigm of bank insolvency procedures has changed recently in the jurisdictions relevant for the purposes of the research. The change resulted in the particular aspect, namely that private interests of shareholders and creditors have become subordinated to the public interest, which is to secure the continuity of banking services and at the same time the stability of the financial system. Bank resolution in the first place and then the ensuing ordinary liquidation of the bank helps to ensure the optimal balance of public and private interests.
2. Public administrative authorities initiate resolution of failing or likely to fail banks, while the court plays a secondary role. Although actions in the field of bank resolution affect the bank's shareholders and creditors, the administrative model of resolution decision-making is more rapid and efficient, as compared with judicial solutions of bank resolution, by maintaining financial stability and better protecting credit discipline in the market.
3. The procedural rights of the creditors and shareholders of the bank that is failing or likely to fail are essentially limited to the ex-post option of judicial review, so that the legal framework for opposing the decisions of the competent resolution authorities is very limited. Such limitation of individual rights is necessary in order to achieve wider purposes of financial stability, but at the same time it should be compatible with fundamental rights (the right of judicial review, the right to compensation) of related persons and the legal principles developed in case-law (principles of legitimate expectations and proportionality).
4. After the shift in the paradigm of legal regulation governing bank insolvency in the relevant jurisdictions, bank resolution measures are sufficient to prevent bank insolvency ex ante—and to effectively deal with the consequences of bank insolvency ex post.

The approval of research results. The results of the research are published in three peer-reviewed, official Lithuanian publications. The principal results of the thesis were presented in six different international conferences and accordingly published in their official collections of materials. The outcome of the research was also delivered in different universities, public lectures, debates and workshops. In addition, in May 2013 the author co-organised, managed and presented a report at the national scientific conference “Fraudulent bankruptcy: causes, typology, legal consequences”, hosted by Mykolas Romeris University, under the presentation title “Fraudulent bankruptcy features of the banks. Lithuanian case study”, and the author also discussed certain aspects of bank insolvency procedures in the same workshop. The results of the research were also relied on in 2013

and 2014 in cooperation with the expert in the Council of the EU in Brussels, in the Lithuanian Presidency team responsible for an extremely important field of the EU legislation, namely the Banking Union project. The author also relied on the results of the research by reading lectures in civil law and banking law at Mykolas Romeris University, and by conducting his practical and professional activities. To continue, the research results were also deliberated and reflected in the work of the Lithuanian Insolvency Law Network. Several review articles were published on the network's website. It is also necessary to highlight that the author relied on the results of the study while preparing and submitting a legal opinion together with the Business Law Department of Mykolas Romeris University on a resonant case heard in the Lithuanian Constitutional Court, revealing the interpretative peculiarities of the legal regulation concerning setting-off counterclaims, hierarchy of bank creditors in the event of bank insolvency and the related issues of bank insolvency in Lithuanian positive law.

Research methodology. The research is based on the qualitative methodological approach. This approach, relying on qualitative methods, allows perceiving the bank resolution regime and liquidation procedures together with the relevant obstacles. The research was largely based on theoretical and empirical methods: linguistic, systematic, logical, critical, document analysis. The research is dominated by active methodology, conventional science, conceiving law as an entirety of legal rules, accurately reflected in national legislation. The research also employed the methods of typical scientific knowledge, hermeneutics (interpretation), all helpful for understanding, interpreting and executing the law. Legal science is determined not only by the facts, as *inter alia* it implies interpretations and application of the existing knowledge to new fields of research. Thus, the object of the research is mainly based on the theory of analysis and understanding and characterised by qualitative methods, by combining experience and effort to explain the genuine meaning. The author of this study construes the text, crystallises and defines bank insolvency relations, by exploring the balance of public and private interests in the bank resolution regime. Based on such methodological grounds and according to the formulated aims and objectives of the study, various methods of data collection and data analysis were applied. The research is in compliance with the jurisprudence: (1) to determine social certainty of the facts, phenomenon and their characteristics; (2) to explain these facts and expose causal connections; (3) to assess the factual basis of the regulation at issue and to examine its value.

- 1) *The method of linguistic analysis* was applied for interpreting the diversity of national laws, court judgments, internationally acknowledged guidance and relevant readings, including the wording of international and the EU, US, Swiss laws and legal concepts.
- 2) *The method of document analysis* was employed by collecting and examining the regulation, non-binding international legislation, explanatory documents of competent authorities, court judgments and legal doctrine, such as special scientific publications, monographs, textbooks, journals in Lithuania, the US, Switzerland and the EU. The aforementioned method was also used for the purposes of the research to analyse different publications of international bodies and public institutions. The abovementioned method had no improper influence on

the approach selected by the researcher. Initial research data was obtained from general law, insolvency law, banking and financial law, administrative law, deposit insurance law, and other legislation governing failing or likely to fail banks in the relevant jurisdictions. The same method was also used for collecting the data for the dissertation in the EU, the US, Swiss and Lithuanian universities libraries and databases or internet references.

- 3) *The method of systemic approach* was used to estimate and classify the prevailing bank insolvency procedures, more specifically bank resolution procedures, their legal context and regulation at national and international level. This method allowed the author to examine the bank resolution regime as a complex legal phenomenon together with social, economic context and assisted in determining the correct position of bank insolvency law in the legal systems, the systemically connection between *lex generalis* and *lex specialis*.
- 4) *The logical method* was applied by consciously reviewing the available facts and details related to bank resolution relationships, by inferring interim and final conclusions of the research.
- 5) *The method of generalisation* was applied in conjunction with the logical method, in order to highlight the features of the regime governing bank resolution, classify common and specific components, abstracted in the conclusions and recommendations.
- 6) *The teleological approach* encouraged the author to disclose the objective reasons underlying regulation of different bank resolution tools; in addition, this method was adopted in examining and revealing the purposes of bank insolvency law and the limits of interpretation. Similarly, this method served the analysis of national and international laws, different court judgments, and was useful in identifying the factors and circumstances triggering bank insolvency cases, impact on shareholders' and creditors' rights, public institutions' activities and decision making mechanisms. The method proved helpful for revealing the meaning of legal texts and diagnosing limits of interpretation. It should be noted that this method was used in parallel with the historical, linguistic and systematic methods of analysis in determining the position of the legislator with regard to a particular issue of the research.
- 7) *The comparative method* remained crucial for distinguishing diverse classes of banks, different types of bank insolvency procedures, legal constructs of different countries and distinct legal traditions, as well as for the evaluation of enduring scientific concepts, their legal framework and practice. In principle, the method implies a comparison of the EU, US, and Swiss legal systems and countries. It is an intellectual activity with the law as its objectives, limitations and the comparison as its process. This method allowed crossing the boundaries of one legal system and investigating more acceptable and reliable solutions applied in other jurisdictions. It also enabled the author to align the specific features of regulation and the implementing institutes applied in different countries and to identify innovative approaches and controlling ideas in order to maintain the argumentation of the research. This method reveals differences and similarities of the legal systems and purifies universal problems. It determines original alternatives for resolving enduring puzzles. To be noted, the method was used both in terms of macro (to

compare the spirit and style of various legal systems, legislative practices and procedures) and micro (compare a range of specific, selected legal systems, the particular rules used to solve relevant problems or particular conflicts of interest) approach. The study draws an admittedly flexible dividing line between macro and micro comparison. The research was performed by relying on and processing legal materials and procedures. The aforementioned method explores how the related rules have been designed and developed by legislators or courts of different jurisdictions, in an attempt to identify and clarify the practical context of application, so that the reader can understand the reasons for particular solutions of the relevant problems in foreign legal systems.

- 8) *The method of analytical and critical thought* was used to analyse the weaknesses and implementation dysfunctional, the causes of bank resolution and (or) the liquidation legal regulatory procedures, and consideration of the public and private interests. Relying on this method, it was evaluated how the law is satisfying the protection requirements of a special period of law. The method applied for legal critique and desired law vision.

Some other research methods were employed in the scientific study: *the genetic method* served in establishing the emergence and development of bank insolvency law; *the deductive method* was relevant for analysing general rules established in legal norms and by specifying their practical application; *the inductive method* assists in examining the case-law specific matters and the appropriate conclusions; *the historical method* was applied for revealing the genesis of the bank resolution regime, the meaning of legal rules and the factors determining the variety of regulation and interpretation of the law and the development of regulation in different countries, and the factors influencing insolvency of the banks, seeking to identify the fundamental elements of the legal relationship; while the *statistical method* was useful for processing the statistic material.

The structure of the research. In line with the formulated tasks of the research, the operative part of the study consists of four main chapters.

In the first chapter, which is the opening chapter of the study, author addresses and analyses the general provisions, preconditions for and the conceptual framework of bank insolvency procedures. This chapter clarifies several terminological aspects of the thesis, defines the essential features of banks, highlights the public interest-related functions of the banks, overviews the influence of the recent banking crisis on the economy, and comments on the roots of the bank insolvency proceedings. Moreover, this chapter demonstrates why bank insolvency dilemmas are irrelevant from the perspective of general insolvency law. This section explores the conception of bank insolvency procedures, analyses the interrelation of bank insolvency procedures, problematic issues related to the establishment of bank failure, by distinguishing quantitative and qualitative as well as discretionary criteria. This chapter concludes with a summary of the types of bank insolvency procedures in different jurisdictions, reviews and summarises the unification of regional and international trends, and analyzes the recent change in the paradigm of bank insolvency law.

The second chapter is devoted to the analysis of the bank resolution regime itself. Given that the regulation of bank resolution should be designed not only to protect the private interests (shareholders and creditors), but must also to serve broader objectives of

public regulatory nature that are vital for the effective functioning of the economy, this section analyses the concept of bank resolution in different jurisdictions and the related administrative practices. The concept of bank resolution is revealed and the reasons determining the importance of bank resolution are analysed. Relevant focus is placed on the resolution conditions of banks in different jurisdictions, by detailing the specific objectives of resolution. Eventually, given the fact that the efficiency of the legal measures for bank resolution is necessary in order to avoid preventable damages in the banking industry, this part of the thesis is dedicated to the crystallisation of specific bank resolution tools (sale of bank business, the bridge bank, bail-in, asset separation tool) and their implementation schemes, depending on the objective to preserve financial stability and minimise the economic and social impact of bank insolvency.

The third chapter analyses the public authorities that aim to ensure swift measures of bank resolution and to guarantee sovereignty, seeking to avoid conflicts of public and private interests. Particular consideration is given to decision-making and controlling mechanisms in the field of bank resolution, the right to judicial review (the right to due process and effective remedy), and the procedures and objectives underlying valuation of assets and liabilities. This chapter researches the optimal regulatory model that would be the most productive in addressing the possible decision-makers in the field of bank resolution: administrative authorities, creditors or courts? This chapter *inter alia* assesses the decision-making models in different jurisdictions, overviews the key public authorities and their role in the bank resolution procedures.

The fourth chapter, which is the most crucial chapter, administers the main question of the research, analyses bank resolution procedures and their impact on the bank's shareholders and creditors. It explains that the restriction of fundamental rights of individuals is necessary for the sake of broader financial stability objectives, by assessing the proportionality of such limitations. The resolution objectives are examined in cases where the application of resolution measures and legal powers can limit shareholders' and creditors' rights and whether the interference of the resolution-related actions with the rights of creditors and shareholders complies with the fundamental rights of individuals and is proportionate. The review also establishes the rights and interests of shareholders and creditors from different perspectives. The presented case-law analysis identifies the fundamental legal principles and legal safeguards best balancing private and public interests in the bank resolution regime. This chapter discusses the impact on individual property rights, by analysing the loss allocation order, the implementation of creditors' claims and priority of claims. It also discusses the options of different treatment of creditors, investigates legal safeguards (by analysing the impact on shareholders and creditors), explains the concept that creditors should not incur losses that exceed the ones incurred in case of straight liquidation of the bank (based on ordinary bankruptcy procedure) supporting the balance of public and private interests in bank resolution procedures.

Key findings

The legal concept of bank insolvency framework

1. Banks perform critical functions in the real economy and the stability of banking conduct is in conformity with public interest. *Lex generalis* rules are inadequate to address bank insolvency issues. Firstly, *lex generalis* fails to ensure the continuity of

critical functions of banks, national financial stability objectives, fails to reduce costs to taxpayers, interrupts and disturbs the bank's business operations. Secondly, due to the specific nature of banking activity, which affects the public interest, and for a number of procedural grounds, such as: the need for swift bank resolution decision-making, specific triggers for bank insolvency, objectives of different procedures, etc. Thirdly, if *lex generalis* was to apply to banks, in the case of bank resolution this would cause severe damage to both private and public interests, destabilise financial stability, that is why bank resolution regime primarily protects the public interest and only then seeks to safeguard private rights and interests.

2. Banks may turn into insolvency rather promptly, for this reason the determination of events triggering bank insolvency and regulation of the qualifying criteria plays an important role. *Ad hoc* solutions are unpredictable, that is why they fail to satisfy the objectives of legal certainty. The most comprehensive description of bank insolvency conditions and criteria is provided in the EU legal system. As bank financing and liquidity is highly dependent on the confidence of market participants, it is not possible to determine bank insolvency relying only on quantitative criteria. If the required quantitative criteria are poorly regulated in bank insolvency law, bank insolvency procedures could be wrongly initiated even against a viable, healthy bank(s). Quantitative criteria are equally developed in all jurisdictions relevant to the investigation. The EU legal framework provides for the most explicit discretionary bank insolvency criteria and the related set of rules. The US legal system is characterised by profound, exceptional traditions and differentiated bank capital adequacy rules. In the Swiss legal system, bank capital requirements are more demanding than in other compared jurisdictions. The higher the discretion given to public institutions, the greater the risk for excessive control exercised by regulatory authorities. In assessing bank insolvency threshold, regulators should focus more on financial viability assessment, based on prospective calculations and rely on economic market-based models, instead of retrospective insolvency tests based on classic methods. In particular, it is important to determine the eligibility of bank liquidity.

Bank resolution regime

3. Bank resolution is an administrative process, a special banking crisis management tool, an alternative to ordinary bank bankruptcy proceedings, aimed to ensure the continuity of essential functions performed by the bank, maintain and protect financial stability and avoid costs for taxpayers and restore long-term viability of the entire bank or certain parts of it. A bank is subjected to resolution following the resolution objectives pursued by legislation by applying bank resolution tools, such as: sale of business, bridge bank, asset separation tool, bail-in tool. The purpose of the bank resolution legal regime is to remove insolvent banks from the financial system at the lowest cost, while maintaining private and public confidence in the banking sector, properly control legal and economic risks, protect the obligations deserving or even requiring protection in order to achieve the public interest objectives of the bank: continuity of functions, maximisation of the value of bank assets, initial allocation of bank insolvency losses to the shareholders, reduction of adverse economic and social impact for

the state, protection of public finances and the financial system (including payment systems), protection of depositors.

4. First, in all of the compared jurisdictions, the existing bank resolution regime is important since, in particular, it serves to avoid damage to public interest (by securing financial stability, the critical functions of the bank, and protecting deposits, customer assets and public funds). Second, it ensures the possibility for the insolvent bank to leave the market smoothly, without causing systemic disruptions or by minimising such disruptions, creates lower risk to financial stability, reduces moral hazard, and helps maintaining or restoring confidence of the market. Third, the bank resolution regime existing in the EU, the US and Switzerland minimises the SIFI effects, positively affects borrowing decisions, plays a preventive role in enabling public authorities to restructure the bank in a manner preventing systemic damage to public and private interest breaches. Finally, the new bank resolution framework would enable quick and a safe solutions in the case of bank failure, leaving dispute resolution for a later stage.
5. All of the compared jurisdictions contain a rule that a failing bank can be liquidated under ordinary bankruptcy procedure, and liquidation should always be considered before the transformation of the bank. Bank resolution tools apply only if the bank cannot be liquidated under normal bankruptcy procedure, without avoiding negative consequences and threats to critical functions of the bank, negative impact on financial stability, the use of public financial support or deterioration of creditors' financial situation.
6. The central principles of the bank insolvency law, balancing private and public interests, are based on public law. Bank resolution tools shall ensure legal certainty for individuals, the right of defence, must be balanced with the public and private interest, proportionate, and provide adequate compensation to the affected individuals after the intervention. The legal principles classified in the dissertation and deriving from the EU and US legal systems (namely, the principles of legitimate expectations, legitimate aim, proportionality) are justified and can be applied both individually and in conjunction, by appropriately balancing public and private interests at the time of the bank resolution procedure. As long as the relevant countries duly implement the above-mentioned legal principles and safeguards set forth in the relevant provisions of the bank resolution law, it is difficult to conceive a situation in which the fundamental private rights would be breached.
7. In all of the compared jurisdictions, bank resolution is an administrative process, with the primary objective to protect the liquidity requirements of short-term creditors, especially depositors, and manage the financial assets of the bank in order to ensure the failing bank's asset and franchise value. Therefore, bank resolution, in particular, seeks to avoid systemic contagion in the financial sector, aiming for social welfare, which cannot be equated to private objectives and absolute priority of creditors' claims. Bank resolution legal regime can be treated as the result of cost-benefit optimisation.
8. Bank resolution regime both in the EU, the US and Switzerland is a specialised area of law designed to address solvency problems faced by a failing bank, by first restructuring and only then liquidating the bank. The aims of bank resolution legal regime are fundamentally different from the general insolvency law objectives. Bank resolution rules cannot be incorporated into general insolvency law due to the existing dispari-

ties between the bank liquidation procedure and the aim to maintain bank activity or successfully reorganise the latter. Nevertheless, ordinary bank insolvency law (bankruptcy procedure) remains extremely important in the context of bank resolution rules. All of the relevant jurisdictions apply ordinary insolvency law only when specific bank resolution rules do not apply.

9. In the EU and the US, bank resolution is financed by contributions from the industry *ex ante* to create a single bank resolution fund. The situation is different in Switzerland, where resolution and stabilisation fund still remains the prerogative of the CB, acting as a 'lender of the last resort'. In Switzerland, the Fund is established on an *ad hoc* basis when the need to protect exceptional public interest arises. Such regulation fails to comply with the features of the new banking paradigm. Where pre-financing is not enough to cover bank losses or resolution costs, the EU, and the US legal systems provide for the obligation to collect *ex post* contributions and to 'fill' the fund with the input from the banking industry. The EU bank contribution consist of flat-rate payments and the risk-adjustment premiums of the bank. The US applies an individual risk-based system. Since the EU single resolution fund system is disturbing for large banks, the new legal regulation will compel the Member States to reform their systems of deposit guarantee schemes. Although these funding structures may be combined, financing sources remain separate, which requires additional administrative resources. At the same time, this will help countries to create a system limiting the financial burden at times when private and public financial resources are exhausted in the financial markets. Resolution funds will make it possible to prevent destabilisation of the financial markets and to reduce costs to taxpayers as far as possible. Both the EU and the US provide for a backstop funding and reorganisation instrument, such as the ESM funds in the EU, and the Treasury funds in the US.

Bank resolution tools

10. In all of the compared jurisdictions, bank resolution tools are designed to mitigate the adverse effects caused by bank distress rather than to fully avoid the liquidation of the bank. Timely and appropriate application of the bank resolution tool and only then liquidation of the bank, in view of the advantages and disadvantages of the particular resolution tool explored in this dissertation, the possibility of a positive social impact appears: first, the likelihood of the systemic banking crisis diminishes and the protection from economic downturns after the banking sector crisis is ensured, and, secondly, the best possible application of the bank resolution tool reduces taxpayer losses attributable to the support provided to the bank.
11. In all of the compared jurisdictions, direct liquidation of the bank cannot serve as one of the solutions to address the financial difficulties faced by a bank, if other market players can swiftly replace critical banking functions. If a bank is failing or likely to fail, private sector solutions must be employed in the first place, for example, by selling business to other market participants. If such a solution is not possible or proves unsuccessful, other bank resolution measures could be adopted according to the 'least cost' principle with regard to the deposit insurer and the public interest.
12. In all of the compared jurisdictions, the bail-in tool will strongly contribute to the powers of public authorities dealing with both large and complex, as well as conventional

bank distress problems, when other resolution tools prove insufficient due to the absence of private buyers or where the latter are not readily available, but even if they are, the application of other measures can increase market concentration or the size of the remaining financial institutions. In the case of bank resolution, a bail-in tool provides the right to assign the insolvent bank losses to private individuals and to recapitalise the bank instead of using taxpayers' money.

13. The disadvantage of the bail-in tool in all of the relevant jurisdictions is that, although the mechanism increases the creditworthiness of the bank, it fails to provide cash to the bank. In addition, regulation requires greater clarity as to the location of the bank capital that may be subjected to the measure under consideration, also with regard to the form of maintaining the capital, i.e. the legal person of the banking group that disposes of bank debt instruments. In terms of time, it is particularly important, since the tool is applied before the use of public funds. In addition, in the result of this measure, significant parts of debt instruments held by large banks may remain unused, especially in cases where banks refinance themselves, i.e. by means of deposits. It cannot be excluded that the number of legal disputes will increase with regard to the discrimination of a particular class of creditors whose claims will be written off or converted. An overall advantage of the tool is that it will provide legal certainty with regard to the specific amount of funds required to cover bank losses, encourage early recapitalisation of banks and strengthen the bank's business continuity assumption. In all of the compared jurisdictions, the bail-in tool replaces public support with sanctions against private individuals.

Institutional framework of bank resolution decision-making and control mechanisms

14. Different opinions exist as to whether priority should be given to administrative or judicial bank resolution decision-making procedures. In all of the compared jurisdictions, bank resolution decisions are taken by administrative bodies, and economic bank resolution assessments are carried out by public authorities, whereas courts must rely on them. However, judicial proceedings remain relevant for the disputed bank resolution decisions in order to guarantee the fundamental rights of private parties (the right to a fair hearing, the right to compensation for property expropriation), legitimate expectations, proportionality of action between the public interest and the protection of property rights, and the legitimate public interest objective. Administrative decision-making procedure is more efficient, because it is swifter, which is directly related to lesser depreciation of bank assets. In addition, bank resolution decisions require specific expertise, bank resolution procedures are very complex, concerned with complicated legal issues, often undertaken at the time of banking crisis, and therefore it is presumed that administrative authorities have better knowledge, resources and operating capacity. The core element that outweighs the argumentation –is that during bank resolution, a need for cooperation with other public institutions arises, and this makes it more efficient for preparing resolution decisions, whereby decisions can be taken by a group of people– and in barely a few hours, where necessary.
15. In the EU and the US, courts apply bank resolution tool *ex ante*, and the application in court is subjected to immediate execution. Both in the EU and the US, suspension of

the resolution decision would run counter the public interest. The parties may appeal against the resolution decision *ex post*. While the judicial review of administrative action-based decisions is the central safeguard for the individuals' rights as a result of possible mistakes and abuse, the right of appeal is not absolute and is subject to a number of limitations and criteria discussed in the dissertation. In addition, administrative acts are not automatically affected. In the US, the appeal is only possible against bank resolution decisions with regard to the imposition of insolvency threshold and whether the bank meets the statutory definition of a financial institution. Expropriation of property rights is justified in emergency situations only, in order to guarantee fundamental rights of the individuals. In the EU, bank resolution decisions and actions can be appealed against only when the resolution tools are applied to banks that do not meet the insolvency conditions, and only in the absence of financial stability objectives serving general interest. Both the EU and the United States allow derogations from the principle of the rights of the defence, given the primary importance of the financial stability objective, which serves the welfare of the people and the public interest.

Impact of the bank resolution regime on creditors and shareholders

16. Creditor claims are related to the administration of property rights. In the EU, the US and Switzerland, from the beginning of the bank resolution procedure the rights of the counterparties are subjected to contract termination restrictions and certain cases of suspension of bank obligations. Such restrictions are necessary for the public authorities to obtain an accurate picture of the balance sheet of the insolvent bank, disregarding the changes in value and quantity of the bank assets which may result from the intense exercise of termination rights.
17. In all of the compared jurisdictions, the hierarchy of satisfaction of creditor claims significantly differs from the hierarchy according to general insolvency law. First of all, bank insolvency losses are to be absorbed by regulatory capital instruments, and losses are distributed to shareholders by writing off shares, or by significantly reducing the earnings per share, by converting debt into capital. When such measures are not adequate, the second step concerns the subordinated debt write-off or conversion. Primary liabilities of the bank are converted or written off after converting all the subordinated creditors or writing off their claims. The EU is characterised by the fact that different requirements for the sequence of bank deposits apply in the case of insolvency. Natural persons and micro, small and medium-sized enterprises are guaranteed a part of the relevant deposits in excess of the insured amount, by giving priority over ordinary uninsured priority creditor claims. Such regulation may negatively affect these depositors, since many micro, small and medium-sized businesses are major customers of banks. Better protection of their deposit rights may increase lending costs, e.g. banks may increase interest rates. The peculiarity of the US system is that the law allows departing from creditor hierarchy provided for in the general insolvency law only when the intention is to maintain financial stability in the market. In addition, the FDIC may distinguish certain classes of creditors, by way of derogation from the principle of *pari passu*, if this contributes to the increase in the value of bank assets and reduction of creditor losses. Switzerland is characterised by the fact that the

principles governing the conversion of debt into capital and the hierarchy of creditor claims specifically is set in the restructuring plan.

18. In bank resolution, the objective of legal safeguards and criteria for balancing private and public interests through applying special bank resolution tools is to maximise legal certainty and predictability of the legal consequences arising from bank resolution. Predictability of the bank resolution process also guides the conduct of bank shareholders *ex ante*. Therefore, clear and predictable rules and principles strengthen market discipline. If it is clear that in ‘bad times’ bank insolvency losses will be absorbed by private individuals, shareholders and creditors, this accordingly encourages shareholders and creditors to exercise closer control of the company on their own initiative and to take early action to recapitalise the bank or to implement other measures to restore market confidence and ensure public interest. An *ex post* predictable bank resolution process allows ordinary and efficient reallocation of economic resources in a way that promotes growth and enhances overall well-being.
19. The EU legal framework provides for strong protection of private property rights of bank shareholders, while the US legal system foresees more limited legal protection of private ownership. If in both the EU and the US bank resolution tools are applied and the powers of public authorities are employed to attain public interest objectives and are used regardless of the principles of legitimate expectations, the rights of defence and the right to compensation, such a limited scope of the shareholders’ rights breaches private interest. At the same time, the principles governing protection of individual rights and the related legal principles should be interpreted in conjunction with the broader public interest objectives, in order to protect financial stability, interests of other public entities, by taking into account the functions performed by banks and their importance for the overall economy.

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3. “Legal aspects of bank restructuring“. *Practice and research in private and public sector, 3rd international scientific conference*, Vilnius, Mykolo Romeris university, 2013;
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12. “Banks’ insolvencies: the unique bank resolution regime“. International symposium „*Innovations and developments in business law. EU, Swiss approaches*“. Vilnius, Mykolas Romeris and Basel universities, 2015.

SCIENTIFIC PLACEMENT

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BANKO PERTVARKYMO TEISINIS REŽIMAS. VIEŠŪJŲ IR PRIVAČIŲ INTERESŲ BALANSAVIMAS. LYGINAMOJI ANALIZĖ: daktaro disertacija. – Vilnius: Mykolo Romerio universitetas, 2015. – 388 p.

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Disertacijoje lyginamuoju aspektu yra kompleksiskai nagrinėjamas specialus banko pertvarkymo teisinis režimas ir jo veikimas, susijusi administracinė praktika. Atskleidžiama bankų pertvarkymo samprata, svarba, nagrinėjamos konkrečios klasikinės bankų pertvarkymo teisinės priemonės (banko verslo pardavimas, banko turto, teisių, sandorių ir įsipareigojimų perdavimas, turto atskyrimas, laikinas bankas, banko gelbėjimas privačiomis lėšomis), gryninamas jų veiksmingumas, atsižvelgiant į siekį išsaugoti finansų stabilumą ir kuo labiau sumažinti ekonominį ir socialinį bankų mokumo problemų poveikį. Analizuojama viešųjų institucijų vaidmuo bankų pertvarkymo procese. Galiausia nagrinėjamas bankų pertvarkymo procedūrų poveikis ir apribojimai banko akcininkams, kreditoriams.

The dissertation reveals a special bank resolution regime and its implementation, the operation of related administrative practices by applying a comparative methodology. The thesis disclose bank resolution legal concept and the importance of the relevant bank resolution tools (sell of business, asset separation, bridge bank, bail-in), defining their effectiveness, taking into account the desire to safeguard the financial stability and minimize the economic and social impact of banks in distress. Also, the role of public authorities under bank resolution is discussed. Finally, the analysis of bank resolution procedures and the impact on the bank's shareholders and creditors is made.

Tomas Ambrasas

**BANK RESOLUTION REGIME.
BALANCING PRIVATE AND PUBLIC INTERESTS.
A COMPARATIVE ANALYSIS**

Doctoral Dissertation

Maketavo Jelena Babachina

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