Aspects of Bank Insolvency

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Introduction

Healthy banks are a matter of utmost importance to country's economy. There is a clear link between viable banks and the financial stability of a state. This was clearly seen during the recent financial crisis.

Banking is a highly regulated industry and a bank that has become insolvent has failed to comply with various regulatory measures designed to maintain its solvency. [1] As far as banks play distinctive role in the economy of a country and there is the public interest in the safety and soundness of banking system, it is therefore of utmost importance to establish prudential regulations and operational requirements specifically for banks to ensure that they are safely managed. [2]

The thesis will focus on the issue of bank insolvency as such. Banking sector is very important for the development of a country. Banks fulfill distinctive functions in a country's economic system the importance of which is widely recognized. [3]

The insolvency of banks in several respects substantially differs from other commercial companies. This is the reason of having special regime for banks being in distress. The reason for the application of special rules during bank insolvency cases is linked with the interest of public in financial stability and with the systemic effects the bank failures may cause. The issues concerning the protection of creditors' interests are also very important. Therefore the special regulatory measures designed for banks are aimed at maintenance of their solvency.

Particular attention should be directed to insolvency issues when the multinational banks are involved. Multinational bank is a bank consisting of a "home bank and a number of foreign located banks".[4] "The legal issues arising in the failure of multinational bank are manifold. Attempts to address them on a supranational level have not been very successful so that there are no generally accepted international rules governing the insolvency of multinational banks".[5] Multinational bank insolvency issues shall be discussed when

[1] Lastra, Schiffman, 1999, p. 83.
[2] Hüpkes, 2000, pp. 9-10.
[3] Hüpkes, 2000, p.8.
[4] Calzolari, Loranth, 2005, p. 7.
[5] Hüpkes, 2000, p. 139.

examining the question of bank insolvency at large. The terms “multinational bank” and “cross-border bank” will be used interchangeably in this thesis.

The regulation of cross-border banking is one of the most important issues that have arisen after the recent financial crisis. As the maintenance of financial stability is vital for each country, the International Monetary Fund (hereinafter the “IMF”) has contributed to the creation of an EU Framework for Cross-Border Crisis Management in the Banking Sector (hereinafter the “EU Framework”). The EU Framework is an essential mechanism for the prevention of the future cross-border bank failures.

The recent financial crisis has shown that there is a need for better regulation of banks. It has become clear after the crisis that an enhanced cooperation is needed between countries in order to protect the financial stability. Several steps were taken in order to establish a framework which would be oriented to avoid the insolvency of banks. The IMF drafted the Proposed Framework for Enhanced Coordination for Cross-Border Banks. This framework is aimed at cooperation of countries in order to coordinate their resolution efforts with their counterparts in other jurisdictions to the maximum extent consistent with the interests of creditors and domestic financial stability.

In order to avoid insolvency of banks strong supervision is needed. The national supervising authority’s functions are very important in maintaining the solvency of the bank. The prudential regulation is one of the key aspects to be discussed within the supervision. The robust supervision of banks is aimed at maintenance of the solvency of banks and often the early intervention helps to avoid the future bankruptcy of a bank. The examples provided in the relevant chapters have been chosen randomly in order to better illustrate the aspects of the bank insolvency proceedings, to underline the differences between countries applying various principles (territoriality or universality, single entity or separate entity or pari passu principle) during the insolvency proceedings.

The goal of this thesis is to explore the nature of bank insolvency with a focus on applicable legal and regulatory arrangements. Specifically the thesis will try to answer the following four principal questions:

1. Why is it needed to have special regime for insolvent banks and can banks fail like any other non-financial institutions?
2. What is the legal framework for regulating banks in distress?
3. What kind of legal issues arise in case of multinational bank failures?

4. What is the basis for banking supervisory authority to intervene in case of bank insolvency?

The thesis will discuss the aspects of bank insolvency. It will not concentrate on a certain country’s legislation. When examining the legal framework for regulating banks in distress the problem will be seen from national, international and general perspectives. The problems existing in the bank insolvency at large will be examined. The relevant provisions concerning the insolvency proceedings will be discussed from the legislation of my home county, Georgia. EU legislation with regard to bank insolvency will also be examined. Multinational bank failures will be dealt with discussing the principles applied, international insolvency structures, characteristics of cross-border banks and the elements of enhanced coordination framework.

Trying to answer the questions posed above, the thesis has been structured as follows: Chapter I discusses the context of bank insolvency. It explains why the problem of insolvency is completely different for banks than for other companies and why the general insolvency law cannot be applied to banks. Chapter II envisages the issues connected with the legal framework for banks in distress. The coexistence of general insolvency law and bank insolvency law is discussed. Chapter III discusses the issues of multinational bank insolvency. It gives a general overview of legal issues arising during the failure of multinational banks. Chapter IV focuses on the importance of powers of banking supervisory authority in case of bank insolvency. The thesis ends up with the conclusion.

Chapter 1. Special Regime for Bank Insolvency

The banks need special treatment in comparison with other companies. "Banking is an inherently risky business, and it is so by design. Banks are highly leveraged institutions that raise debt to invest in risky assets. Adding to the risk is the maturity and liquidity transformation that banks tend to engage in: their assets tend to be longer-term and less liquid than their liabilities."[6]

Below I will discuss the following issues: rules applied during bank insolvency, the reasons for the existence of special regime for bank insolvency, the too-big-too fail doctrine and the need for special rules for the protection of financial stability.

1.1. Definition of Terms

Are banks different from other financial institutions? First of all we have to define what the term "bank" means. The term "bank" means any financial intermediary that accepts unsecured deposits from the public at large and extends loans to individuals or businesses.[7]

Bank is used in the meaning of credit institution.[8] "Credit institution" is defined as "an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits of its own account."[9]

As we have defined what the term "bank" means, it is possible now to refer to the meanings of bankruptcy and insolvency. While examining these terms we can see that during bank insolvency cases the application of general bankruptcy laws is excluded. This also indicates that banks have special treatment.

Let us deal with the terms "bankruptcy" and "insolvency" now. What is meant by bankruptcy? "It is likely that the term derives from banco rotto (Italian: broken bench), describing quite literally, the condition of the bench in the market place of a banker no longer able to meet his debts. Given that the bench was the place where the business was

[6] IMF Working Paper, 2010, p. 10.
[7] Hüpkes, 2000, p. 7.
[8] Hüpkes, 2000, p. 7.
[9] Article 1 of the First Council Directive; Article 1 of Directive 2000/12/EC.

conducted, the breaking of the bench graphically illustrates the first of the essential feature of bankruptcy".[10]

Terms "bankrupt" and "insolvent" are often used interchangeably.[11] Insolvency is a situation "when an individual or an organization can no longer meet its financial obligations with its lender or lenders as debts become due. Insolvency can lead to insolvency proceedings, in which legal action will be taken against the insolvent entity, and assets may be liquidated to pay off outstanding debts."[12]

Insolvency has two traditional definitions in commercial bankruptcy laws: "failure to pay obligations as they fall due (so-called equitable insolvency) and the condition when liabilities exceed assets (balance sheet insolvency)".[13]

These concepts are not the basis for the banking supervisory authority to intervene. The determination of "regulatory insolvency" is generally based on a process of risk evaluation and capital measurement. "It is the banking supervisory authority that determines when there is a ground for intervention. In other words "a bank is insolvent, when the bank regulator says so." Non-compliance with solvency requirements is generally sufficient to trigger regulatory intervention.[14]

It is vital to answer the following question: can banks fail as other institutions? "Banks that are no longer viable must just like any other company be allowed to fail." But the most important issue that arises in this case is the law which will regulate the insolvency proceedings. Is it general bankruptcy law or special insolvency law? The insolvency concept under general bankruptcy law is inappropriate to apply to banks.[15] It should be noted that "bank failures are different from the failure of other companies that lead to governments wanting to intervene.[16]

1.2. Too-Big-To-Fail Doctrine

It is of utmost importance to discuss the "Too-Big-To-Fail" doctrine. "This doctrine is

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[10] Omar, 2008, p. 3.
[11] Hüpkes, 2000, p. 12.
[12] See http://www.investopedia.com/terms/i/insolvency.asp.
[13] Lastra, Schiffman, 1999, p. 96.
[14] Hüpkes, 2000, pp. 12-13; See also: Article 8 (1) (d) of the First Council Directive.
[15] Hüpkes, 2000, p. 12.
[16] Mayes, 2004, at p.10.

understood to mean that if a bank were big enough, it would receive financial assistance to the extent necessary to keep it from failing." In case if a core bank is in trouble then government guarantees are to cover all creditors from losses except for shareholders and bondholders.[17] In case if such a bank would be in difficulties, the central bank which is the lender of last resort has to organize a bail out. The consent and the participation of the government would be needed. It has to be noted that the banking legislation of most of the countries does not envisage the steps and actions to be taken by the lender of last resort in case if a large bank would run in a crisis. It is not by chance that the banking legislation does not deal with this issue. It is intentionally done, as far as the banks should not be able to count on government support in case of an emergency situation. The crucial principle is that banks must not predict the government's response. This general approach is known as "constructive ambiguity". The latter means that central banks reserve right to intervene to preserve financial stability, though do not give explicit or implicit assurance to that end. [18]

It is argued that recently the "Too-Big-To-Fail" occurs more frequently. There are three reasons for that: Firstly, the consolidation process in the banking industry has led "more large banks posing a significant threat to financial stability" in case of their failure. Secondly, due to technological advances the big banks play a more significant role in payment systems and they "rely on uninsured wholesale funding". Thirdly, the large banks' activities have been increasing in complexity and these banks have become "too complex to fail".[19]

It is very difficult to avoid the "Too-Big-To-Fail" argument in economies where the banking system is highly concentrated. "In a sense the description 'Too-Big-To-Fail' is a misnomer. Something more along the lines of 'too big to be closed and liquidated' is meant." The case is that a bank is so big that the results of its ceasing to trade are extremely unacceptable. [20]

1.3. Rules Applied During Bank Insolvency

Rules are needed to clarify the applicable regime, whether general insolvency law or specific banking legislation will be used. "Such rules would reconcile the grounds for intervention under bank regulatory law versus the triggers for general insolvency

[17] Lastra, Schiffman, 1999, p. 6.
[18] Hüpkes, 2000, p. 16.
[19] Discussion Paper, p. 10.
[20] Mayes, 2004, pp.14-15.

procedures, and would define the role of the bank supervisor relative to other authorities, in particular the courts, in the initiation of insolvency procedures."[21] General insolvency rules are discussed below, in chapter 2.

We have to mention cross-border insolvency rules too. As an example we can review the European Commission Consultation to that end. The IMF has contributed to the European Commission Consultation through commenting on the EU Framework concerning the Cross-Border Crisis Management in the Banking Sector. It is mentioned that a solid framework for crisis management and resolution is dealt with. The resolution is defined by the IMF as the process of managing, restructuring, or liquidating an entity under the official administration of a public authority. While examining the features of the framework, it is said, that "such a framework needs to be embedded in a broader set of consistent arrangements that ensure that banks also in life conduct their business in ways that allow cost-efficiency in death." This comprises reasonable restrictions during the period when banking groups organize themselves and engage in banking activities.[22] Multinational bank insolvency issues are dealt with in chapter 3.

The EU Insolvency Regulation has to be mentioned. Though, it excludes banks from its application. The relevant issues connected with EU Insolvency Regulation will be discussed below.

The supervisors have to take into consideration financial group's legal and operational organization, as well as the crisis management and insolvency framework. The Basel Committee's Cross Border Resolution Group recommends in the Basel Core Principles that financial groups should be organized in a way that facilitates supervision and resolution.[23] The role of bank supervisors and the basis for their intervention will be discussed below in Chapter 4 of the thesis, while the relevant information concerning Basel Committee and its cross-border resolution group will be given in the same Chapter.

1.4. The Reasons for Special Insolvency Regime for Banks

In order to justify the development of a special insolvency regime for banks, "reference is

[21] Hüpkes, 2003, at p. 10.
[22] IMF Paper No.1, 2010, p. 7.
[23] IMF Paper No.1, 2010, p. 7.

made to the systemic effects of bank failures, the public interest and the need for an extremely rapid and discreet resolution mechanism."[24]

Moreover, it has to be mentioned that the need and urgency for special resolution regimes for banks, outside the general corporate insolvency framework was demonstrated by the financial crisis. The main goal of the bank resolution regime should be to protect financial stability and minimize the economic impact of bank failures through ensuring "the continued smooth functioning of payment and settlement systems, protecting the depositing public and preserving banks' important credit intermediation function". The bank resolution framework should be designed in a way that permits early intervention. The early intervention should be aimed at attempt to preserve value in a bank which is failing and to try to return it to viability or, where the latter is impossible, to ensure that the bank is liquidated in a good manner so that its liquidation has as little impact as possible. [25]

There is a close linkage between financial stability and the health of the real economy. "Economists therefore consider financial stability a public good, warranting the attention of national legislatures." Bank failures can and do happen notwithstanding the best efforts of "prudential regulation and oversight." The causes of bank failures and fatal financial problems may be "mismanagement, fraudulent activities, excessive risk-taking or adverse market conditions". In spite of the best efforts of prudential regulation, supervision and oversight after all the bank failures may still happen. Therefore, the regulatory framework must deal not only with the problems of how to prevent bank failures but also with the failing banks and banks which are on their way to fail. [26]

The banks are treated in a different way during insolvency proceedings. It has to be mentioned that the EU Insolvency Regulation excludes from its scope "insolvency proceedings concerning insurance under takings, credit institutions, investment undertakings, holding funds or securities for third parties and collective investment undertakings" These institutions are excluded from the EU Insolvency Regulation since they are subject to special arrangements". The reasons for the special position of credit institutions is that banks have a typically financial nature and play a special role in a

[24] Hüpkes, 2000, p. 19.
[25] IMF Paper No.1, 2010, pp. 15-16.
[26] Hüpkes, 2003, p. 5.

country's economy.[27] The Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganization and Winding up of Credit institutions is the logical result as the EU Insolvency Regulation excludes banks from its application.[28] This Directive deals with the issues of winding-up of credit institutions. The relevant issues connected with the Directive will be discussed below.

1.5. Three Characteristic Functions of Banks

In order to justify the special attention paid to banks, reference is commonly made to three characteristic functions of banks:[29]

- First, "a bank typically holds highly liquid liabilities, i.e. mainly deposits that are repayable at demand. On the asset side, however a bank generally holds assets in the form of loans. This result in liquidities in future, when according to the loan contracts the bank's counter parties reimburse the bank". In case of weak economic circumstances the banks' ability to meet its payment obligations may be in question that will lead to the withdrawal of deposits and the latter will cause liquidity problems threatening bank solvency.[30]
- Second, banks fulfill financial services that are very important for the economy. "They provide direct and standby sources of credit and liquidity to the economy of a country, either by supplying money in the form of loans, or by providing guarantees in the form of loan commitments". [31]
- Third, "banks constitute the transmission belt for monetary policy, that is, the linkage between the monetary policy process and the economy".[32]

These are the main reasons that the banks are treated in a different way. It is recognized that one bank's failure may lead to the failure of many banks, causing a chain reaction widespread failures and the realization of systematic risk.[33] A systematic risk is defined as the risk that the failure of one participant to comply with its contractual obligations may in turn cause the default of other participants that will lead to broader financial difficulties.[34]

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[27] Wessels, 2004, pp. 263-264.
[28] Wessels, 2004, p. 263
[29] Hüpkes, 2003, p. 3.
[30] Wessels, 2004, p. 264.
[31] Hüpkes, 2003, p.3.
[32] Hüpkes, 2003, p.3.
[33] Wessels, 2004, p. 265.
[34] De Bandt, Hartmann, 2000, at p.10.

1.6. Need for Special Rules for the Protection of the Financial System

Bank insolvency is different from a commercial bankruptcy as far as the former may cause risk to the entire economic system through the insolvent bank's counter parties. In case if the counter party is not able "to absorb the shortfall resulting from a bank's defaulting on a contract (e.g., a foreign exchange contract, repurchase agreement, securities trading, swaps option, forward transactions, etc.) it may default on its own contracts with other banks." This will cause further defaults and therefore the stability of the financial system at large will be threatened. [35]

There is a need for special rules for banks that will be able to grant preferential treatment to the participants of financial markets, though such rules may conflict with the aim of fairness to all creditors, the latter is one of the most important principles of general corporate insolvency law. It is generally agreed that such special treatment is aimed at limitation of the contagion in the financial sector. [36]

1.7. Concluding Remarks

Having examined the issues connected with the differential treatment of banks, it is clear that banks do need special treatment.

The banks are treated in a special way as there is a special interest of the public in preserving financial stability. The bank insolvencies are different from others, and therefore there is a need for special rules. The extent to which such rules are needed may vary from country to country as it depends ultimately on the infrastructural circumstances in each country and particularly the flexibility of the judicial system of a country and interplay between banking and insolvency law.[37] It has to be noted that, the special rules are needed not only for protecting the banks as such but also to protect and secure the financial system at large. The importance of application of special rules is caused by the nature of banks as they are very different from other companies by doing very risky business. The issues connected with special rules applicable in bank insolvency cases will be will be dealt with in chapter 2.

[35] Hüpkes, 2003, p. 24
[36] Hüpkes, 2003, p. 25.
[37] Hüpkes, 2003, p. 34.

Chapter 2. The Need for Legal Measures for Bank Insolvency Management

When the solvency of a bank is threatened, most banking laws envisage the supervisory measures to seek to ensure that the bank maintains its solvency and is resorted to capital adequacy. Quite often these measures include imposition of limitations on bank activities or appointment of a person who takes over the management of the bank in order to improve the bank's policies and operations that caused its precarious financial condition.[38] The role of legal measures will be discussed in this chapter together with the relevance of application of general and special laws in case of bank insolvency in general.

2.1. The Legal Framework

It is very important to effectively regulate banks and especially those in distress. The legal framework must be capable to deal efficiently with banks in financial difficulty. Transparency and consistency during the application of relevant laws is essential. The law which applies to banks in financial distress comprises both statutes of general application (i.e., general company law and the corporate insolvency law), and special statutes (i.e., bank insolvency or bank reorganization statutes) or provisions enshrined in the banking law that specifically deal with the insolvent bank.[39]

The main objective of the bank insolvency framework is to protect the stability of the financial system. It has to be mentioned that a country's legal framework very often will differentiate between two sorts of bank insolvency proceedings, though they may even be combined in a single proceeding: official administration and liquidation proceedings. In case of official administration an official authority assumes direct managerial control of a bank, bearing in mind to protect its assets, assess its actual financial condition, and finally either conduct all necessary restructuring operations or place the bank in liquidation. An official authority may be either: the banking supervisory authority, an administrator appointed by the court, or an administrator appointed by the banking supervisory authority. In contrast to official administration, the aim of liquidation proceedings is the realization of assets at the possible highest value and distribution of proceeds to creditors in an orderly and equitable manner. The result of the liquidation is the dissolution of the banks as a separate legal entity.[40] For example, in Georgia the appointment of official

[38] Lastra, Schiffman, 1999, p. 81.
[39] Hüpkes, 2000, p. 17.
[40] IMF Paper, 2009, pp. 4-5.

administrator and liquidator is vested to the National Bank of Georgia.[41] The National Bank of Georgia is the only banking supervisory authority in the country.

It is very important to discuss several issues connected with the powers and responsibilities of all agencies involved in bank insolvency. Firstly, it has to be noted that the choice of bank insolvency regime has to be made. As it has been observed by the IMF the practice of countries varies to that end. Some countries use their corporate insolvency framework and modify it for banks, others apply special legal regime for bank insolvency cases.[42] Just to illustrate the case when the application of special legal framework is favored, I'll bring the example of Georgia, which applies special legal regime in case of bank insolvency. [43]

In establishing a bank insolvency regime, the authority that commences the insolvency proceedings is very important. In most cases the banking authorities are authorized to initiate bank insolvency proceedings and in many jurisdictions they even have the exclusive jurisdiction to that end.[44] Again bringing the example from my home country, the National Bank of Georgia is authorized to initiate the insolvency proceedings of a bank and declare a bank insolvent. [45]

The conditions that give rise to the commencement of bankruptcy proceedings are not satisfactory, the law is too indefinite or there is a prolonged period after default in payment before initiating a case. For example, the Czech Act on Bankruptcy and Settlements defines insolvency generally as when a debtor does not meet its obligations to a number of creditors for an extended period of time. While the law of Russian Federation on Insolvency of Enterprises provides that the bankruptcy occurs when an enterprise is not able to meet "the demands of creditors within three months of the day they were intended to be met."[46] As we have seen the initiation of bankruptcy proceedings differs per country. Because of this situation there is a need for having effective legal measures, which would envisage the most effective timeframe for the commencement of insolvency proceedings.

[41] Law of Georgia on "Activities of Commercial Banks", Articles 32 and 37.
[42] IMF Paper, 2009, p.5.
[43] "Regulation on Announcing a Commercial Bank Insolvent and Bankrupt", Approved By the Decree No. 119 May 23, 2003 of the President of the National Bank of Georgia.
[44] IMF Paper, 2009, p. 5.
[45] Organic Law of Georgia on the "National Bank of Georgia", Article 49.
[46] Lastra, Schiffman, 1999, p. 86.

The legal measures dealing with the distressed banks should reflect a clear policy that insolvent banks have to leave banking system, as far as it is in the best interest of depositors and other creditors of the bank. This is interlinked with the supervision policy. The laws applicable in case of bank insolvency shall be consistent with bank supervision policy, so that the bank supervision and regulation stays credible, coherent and conducive in order to facilitate the maintenance of soundness of banks.[47] Basing upon the above-mentioned it is very important to have legal measures which would be capable of protecting bank depositors' interests and maintaining the bank soundness.

2.2. The Question of General Bankruptcy Law Application

The issues connected with the application of general or special bankruptcy laws in cases of bank insolvency have already been dealt with in Chapter 1, but only from the perspectives of special treatment of banks. The reason to refer to them in detail here is that the exclusion of general bankruptcy law may be examined from the banks' supervision and liquidation point of view.

The banks which are incorporated as commercial companies are subject to general company law and other related laws, such as insolvency laws. It has to be noted that some commentators deem there is no clear reason to exclude banks from the application of general insolvency law as far as the principles which apply to the resolution of failed banks would be same as principles applicable to commercial companies generally. [48] The IMF has observed that it is very rare that countries will rely only upon their corporate insolvency law and do not make consequent modifications that address the specific problems of bank insolvency. [49] Moreover, as banks are different from other commercial companies, we can say that this is a reason that general insolvency rules are not applicable in case of bank insolvency. Below the question concerning the exclusion of general insolvency law applicability will be discussed.

It is very important that the general bankruptcy law should not contain provisions that are in contradiction with a credible system of bank supervision and regulation. If we take a case when the bank supervisory authority determines that the bank is insolvent and the only way left is liquidation and not the rehabilitation then the banking license has to be revoked. If in this example bank liquidation is regulated by the general bankruptcy law

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[47] Lastra, Schiffman, 1999 p. 83.
[48] Hüpkes, 2000, pp. 17-18.
[49] IMF Paper, 2009, p. 18.

under which it can be reorganized (instead of being liquidated), this would seriously impair credibility of bank supervision and the policy on capital adequacy. Therefore, the best way out is to apply the banking law or a separate bank insolvency law the provisions of which are strictly in conformity with bank supervision and regulation policy.[50]

Another additional reason to exclude the application of general insolvency law in case of banks is that the process of liquidation of a bank is more complex than the same process of a commercial company, particularly in case of banks with a large number of depositors. As the banking business is built upon its reputation on the market place, "banks hold assets that can rapidly lose value" and in case of insolvency it is impossible to convene a creditors' meeting as there is no time for it. Moreover, it is not possible to negotiate a reorganization plan as it would require sanctioning by the court before it enters into force. This is one of the reasons to exclude the application of general insolvency and reorganization statutes. [51] Having considered the complications that will arise during the application of general insolvency rules, we can conclude that the banks need to be treated in a different way rather than other commercial companies and there is a need for the application of special bank insolvency statutes.

2.3. The Need for the Application of Special Bank Insolvency Statutes and System

"As banks are guardians of a significant portion of savings of the public and are vital sources of credit to the economy", there is a need that the bank insolvency should be managed differently rather than the insolvency of other commercial enterprises.[52] Generally bank insolvency law is seen as dealing with special provisions and these provisions authorize the bank supervisors to intervene in order to protect the interests of the bank's creditors.[53] The role of supervisory authority will be discussed in detail in chapter 4 of the thesis.

As it was mentioned above, there are countries that favor the application of corporate insolvency laws with relevant modifications while others use the special insolvency laws. Though, we have to note that recently, there has been an attitude of applying special regime. The difference between corporate insolvency proceedings and insolvency proceedings under a special regime is that in the first case the proceedings take place in

[50] Lastra, Schiffman, 1999, p. 87.
[51] Hüpkes, 2000, pp. 18-19.
[52] Lastra, Schiffman, 1999, p. 88.
[53] Hüpkes, 2000, p. 19.

the courts while in the latter case the proceedings may be either court-based or administrative in nature.[54] To illustrate the latter attitude, I will provide the example from my home country. The bank insolvency proceedings are administrative in nature in Georgia and are conducted solely by the National Bank of Georgia.

What is the objective of application of special bank insolvency provisions? We can say that the application of special bank insolvency provisions is aimed at protection of interest of bank's creditors as well as general economic interests. "The best prospects for efficient resolution of insolvent banks could be under the leadership of the bank supervisory authority" and the best methods used for the reorganization of banks in distress could be if another bank purchases the bank in distress or a new capital will be infused. [55] Another important reason for having separate bank insolvency law provisions is whether there is deposit insurance. This consideration will become relevant in regard to the injury that may be caused to the depositors and other creditors if general bankruptcy law would be applied. [56]

We have to mention that the adoption of special bank insolvency regime separate from general corporate insolvency may serve as a facilitation of timely action to and provision for consistency between the supervisory and insolvency-related functions of the banking authorities. It may also be very useful in cases when the corporate insolvency framework is rather weak and ineffective.[57]

While choosing between a court-based or administrative system, it is important to mention that there is no consensus and each system has both advantages and disadvantages. Court based system may promote greater accountability and try to ensure that the adequate protection of the rights of all affected parties is guaranteed. Though this may not be appropriate in countries which have generally slow judicial proceedings and their judiciary lacks the essential experience in banking matters. In case of special bank insolvency regime, the decision-making will be in hands of experts having experience in banking matters and this will allow them to deal with an insolvent bank quickly and efficiently. Some countries prefer a hybrid approach during which the official administration is conducted by the banking supervisory authorities, but the liquidation proceedings remain

[54] IMF Paper, 2009, p. 5.
[55] Lastra, Schiffman, 1999, p. 88.
[56] Lastra, Schiffman, 1999, p. 89.
[57] IMF Paper, 2009, p.18.

under the control of the court.[58] Though, there are countries, in which both, the official administration and liquidation proceedings are vested to the banking supervisory authority. Georgia will serve as an example. As mentioned above the National Bank of Georgia has the power to handle both official administration and liquidation proceedings. The National Bank of Georgia adopts an order which envisages the grounds for the appointment of the official administration, its duration and etc. The liquidation proceedings are conducted in accordance with the rules and regulations adopted by the National Bank of Georgia.[59]

2.4. Objectives of Bank Insolvency Measures

We have to define the objectives and nature of bank insolvency measures. The law has to define clearly the principal objectives that need to be realized in managing bank insolvency and moreover, it has to serve as a guideline for actions of the bank supervisory authorities.[60]

The bank insolvency measures serve two objectives: first, they are designed to rescue a bank and when possible avoid its liquidation and second, they protect the assets of the bank while avoiding their failure as well as the rights of the bank's creditors which is aimed at maintenance of equal treatment of all creditors.[61] The bank insolvency measures are destined to effectively regulate banks in distress and provide the best mechanism for the protection of depositors' interests.

2.4. a. Nature of Reorganization Measures in EU

We have to examine the nature of reorganization measures. To achieve this goal, it is essential to review the relevant provisions of Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganization and Winding up of Credit institutions. It has to be noted that there have been several proposals of the Directive before the adoption of its final version in 2001. Below, I'll examine the relevant provisions of both the proposals and the final version of the Directive.

The bank insolvency measures having temporary nature shall be also classified as "conservatory" or "provisional" measures. The reorganization measures are defined as

[58] IMF Paper, 2009, p. 19.
[59] Law of Georgia on "Activities of Commercial Banks", Chapter VII.
[60] Lastra, Schiffman, 1999, p. 89.
[61] Hüpkes, 2000, p. 49.

measures that are designed in a way that they intend to protect or restore the financial situation of a credit institution.[62] We can see that one of the most important aims of the reorganization measures is the protection and restoration of financial situation of a credit institution. This again underlines the relevance for the applicability of special rules in bank insolvency cases.

We can find another definition in the 1988 Proposal for a Council Directive Concerning the Reorganization and Winding-Up of Credit Institutions and Deposit-Guarantee Schemes, that measures “shall not be considered to be reorganization measures, even if they are included in the list set out in the Annex: (a) measures taken as part of the normal supervision of credit institutions as defined in Article 7 of Directive 77/780/EEC, and measures intended to deal with infringements of laws or regulations; (b) measures taken in connection with bankruptcy proceedings, an arrangement or any other winding-up procedure already initiated”.[63] This definition makes a distinction between the reorganization measures and enforcement measures on the one hand, and between the winding up procedures on the other. Though, in practice the difference is not so clear. Enforcement action is aimed at correction of the violation of prudential regulations. The latter causes financial difficulties for the bank. In this case it is very important to take measures for the preservation of financial situation and the prevention of deterioration.[64]

Under the 1996 proposal for a Council Directive Concerning the Reorganization and Winding-Up of Credit Institutions and Deposit-Guarantee Schemes “‘reorganization measures’ shall mean measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties’ ‘pre-existing rights’ including measures involving the possibility of suspension of payments, suspension of enforcement measures or reduction of claims”. According to this definition the objective of reorganization measures is to “preserve or restore the financial situation”.[65]

As noted above only in 2001 the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganization and Winding up of Credit institutions was finally adopted (Directive 2001/24/EC) and only recently implemented by all Member

[62] Article 2(1) of Proposal for a Council Directive, 31 December 1985 (85/C356/55); Article 2 (1) of Amended Proposal, 8 February 1988 (88/C36/01) cited by Hüpkes, 2000, p. 49.
[63] Proposal for a Council Directive, 31 December 1985 (85/C356/55); Amended Proposal for a Council Directive, 8 February 1988 (88/C36/01) as cited by Hüpkes, 2000, p. 49.
[64] Hüpkes, 2000, p. 50.
[65] Hüpkes, 2000, p. 51.

States, although the proposed directive was initially published in 1988. We have to note that the objectives of Directive 2001/24/EC are rather narrow and mainly aimed at the elimination of "any obstacles to the freedom of establishment and the freedom to provide services within the Community."[66] Though, the Directive 2001/24/EC provides a comprehensive definition of reorganization measures.

Moreover, the Directive 2001/24/EC has become a subject to interpretation. This is mainly caused by the definitions. The definitions contained in it namely, the definition of reorganization and the definition of winding-up proceedings are open definitions. [67] We find the following definition in the Directive 2001/24/EC: " 'reorganization measures' shall mean measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' preexisting rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims."[68]

We can conclude that it is very difficult to define these measures. As far as the measures include all measures "both pre-insolvency and insolvency".[69] The main thing to have in mind while discussing the bank insolvency measures is that they are aimed at protection of a financial institution through preserving and restoring the financial situation.

It is very important to discuss the nature and effect of the bank insolvency measures but these issues are connected with the supervisory authority's function which will be discussed in detail in Chapter 4 of the thesis.

2.5. UNCITRAL Model Law

In 1997, The United Nations Commission on International Trade Law (UNCITRAL) adopted Model Law on Cross border Insolvency. As it is suggested by its name, the UNCITRAL Model Law is a model law for adoption by individual countries. It specifies the mechanisms for coordination between courts in cross-border insolvency cases. The coordination is aimed at reduction the potential for competing and inconsistent decisions on the assets and liabilities of the debtor.[70]

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[66] Special Paper 186, 2009, p. 12.
[67] Special Paper 186, 2009, p. 12.
[68] Directive 2001/24/EC, Article 2.
[69] Hüpkes, 2000, p. 51.
[70] IMF Conference Paper, 2004, p. 14.

As it has been mentioned above, the specific features of corporate insolvency are not applicable to the financial services industry, but “two elements of approach developed by UNCITRAL are of potential relevance. First, while a court is required under the UNCITRAL framework to “recognize” the existence of insolvency proceedings in other jurisdictions, it retains broad discretion as to the degree to which it will actually defer to the decisions and requests made by the courts and insolvency officials in such jurisdictions. Second, UNCITRAL addresses a number of the specific procedural issues that can hamper coordination as a matter of practice.”[71]

The UNCITRAL Model Law does not refer to the substantive law which would be applicable to key transactions or assets. These issues are left to individual national laws. It is an important step towards the development of a common legal infrastructure aimed at close cooperation between judicial authorities and recognition of the enforceability of foreign court decisions. Many countries have included the provisions of the UNCITRAL Model Law in their national legislation. It has been adopted by Japan, Mexico, Poland, Romania and South Africa.[72] As we are talking about the financial institutions such banks, it is important to note that the host authorities will only cooperate with home authorities in case if they deem that the home authorities are willing and able to take effective action. As IMF suggests, it would be very effective to establish the “core coordination standards” derived from the UNCITRAL framework that countries need to have in order to participate in the enhanced coordination framework.[73] These aspects identified may be used in designing the effective framework for insolvency regime.

2.6. Concluding Remarks

It can be concluded that the existence of legal framework for bank insolvency is very important. Despite that there is a view concerning the application of general insolvency laws in case of banks it is clear that banks still need special treatment. The latter drives us to apply special bank insolvency laws.

It should be noted that bank insolvency measures are oriented to protect financial stability of credit institutions such banks and the interests of a great number of depositors. In creating the bank insolvency framework the UNCITRAL Model Law principles should

[71] IMF Paper, 2010, p. 16.
[72] IMF Conference Paper, 2004, p. 15.
[73] IMF Paper, 2010, p. 16.

also be taken into account. As the UNCITRAL Model Law suggest the close cooperation of countries and provides means by which the foreign insolvency representatives (liquidators, administrators) may have access to courts in another jurisdiction, it may be very useful in designing the legal framework of enhanced cooperation during cross-border insolvency cases. It would facilitate the cooperation of banking authorities during cross-border insolvency cases. The legal framework for bank insolvency would be very effective in case if it envisages the relevant features of the UNCITRAL Model Law.

Chapter 3. Aspects of Multinational Bank Insolvency

The issues connected with the multinational bank insolvency will be discussed in this chapter. "Multinational banks typically are organized as a head office with attached branches in various countries rather than as a corporate group with subsidiaries. A branch – as opposed to a subsidiary – is always backed by the capital of the entire corporate entity. A bank's presence through branch offices in more than one legal regime raises questions in connection with banking supervision and the administration of bank insolvency measures."[74]

It has to be noted that the cross-border banking has expanded rapidly over the last decade. Nowadays great number of large banks relies upon a global network of branches and subsidiaries, having centralized funding. The financial group distributes the funding under a global strategic plan.[75]

The recent financial crisis has shown that there is a need for effective resolution systems for financial institutions which will be aimed at the protection of financial stability and limitation of moral hazard.

However, the resolution system cannot be effective unless the framework applicable on a cross-border basis will not be developed. As far as a lot of systemically financial groups operate globally, it is essential that there be a coordinated application of resolution systems by the national authorities. In the contrary case, it will be very difficult to protect the continuity of essential functions and ensure that the shareholders and the creditors bear the financial burden of the resolution process.[76]

In this chapter I will deal with the issues of multinational bank insolvency. The relevant principles applicable in case of cross-border insolvency will be discussed. The insolvency structures, the absence of effective cross-border resolution framework, characteristics of cross-border banks and elements of enhanced coordinated framework will be examined.

[74] Hüpkes, 2000, p. 140.
[75] IMF Paper No.2, 2010, p. 7.
[76] IMF Paper No.2, 2010, p. 3.

3.1. Factors Causing the Globalization of Financial Services

We can name four factors that drive the globalization of financial services. These are the following: financial liberalization (countries do not have barriers to the entry of foreign financial institutions), risk diversification (financial institutions expanding abroad have the opportunity to diversify their risk, decrease reliance on their home markets and look for new business opportunities in overseas markets), servicing key corporate clients (banks support corporations expended abroad and profit from their expansion plans) and brand value in emerging markets (brand which is internationally recognized and has a local presence in foreign markets can quickly receive market share abroad).[77]

3.2. Principles Applied During Multinational Bank Insolvency

Before the commencement of liquidation in insolvency proceedings, the banking supervisory authority may take several regulatory actions in order to avoid bank failure. In case if it turns out to be impossible the actions of the supervising authority should be directed against the minimizing negative effects of the failure on the bank's creditors and the financial system at large. In case of multinational bank, this goal may be accomplished only if the measures apply equally to all branches of the bank, despite were they are located. To achieve this, the joint effort of all bank supervisory authorities is needed in order to coordinate regulatory action.[78] There are several principles applied during the multinational bank insolvency cases. These principles govern the resolution of international bank insolvency cases. There are three principles applied during multinational bank insolvencies, namely: universality and territoriality principle, separate entity and single entity principle, the parri passu principle. These principles will be discussed below.

3.2.a. Territoriality and Universality Principle

Two approaches may be mentioned (with many variations) dealing with an insolvent multinational entity. [79] Under a 'universal' approach, the insolvency proceedings are commenced against the debtor in its home country. These proceeding will purport to have 'universal reach'. This means that the "home country trustee will try to gain control over all of the debtor's assets and liabilities – including those located in other countries – to

[77] IMF Paper No.2, 2010, p. 7.
[78] Hüpkes, 2000, p. 141.
[79] Hüpkes, 2000, p. 141.

realize all assets and pay out the resulting proceeds to both domestic and foreign creditors."[80] This approach envisages no 'ring-fencing'. Applying this approach means placing all international creditors in equal conditions.[81]

We have to mention that many countries follow some form of 'territorial' approach. Under this approach a host country is authorized to start separate insolvency proceedings against a foreign debtor. The host country will not participate in, or defer to, the insolvency proceedings which are opened by the home country. While applying the 'territorial' approach, the assets and liabilities of foreign entities located in its territory are 'ring-fenced'. Moreover, the assets and liabilities of foreign entities are 'ring-fenced' for the benefit of local creditors. [82]

We have to mention that these categories are not absolute. Some countries have insolvency regimes with mixed features. For example, the USA is 'universal' for locally domiciled banks but territorial with respect to branches of foreign banks. Another example of insolvency regime with mixed features is the Directive 2001/24/EC that follows an EU-wide 'universal approach' for EU banks, but at the same time Member States are free to maintain a 'territorial approach' to branches of EU banks.[83]

As far as there are no mandatory international rules on cross-border insolvency, cooperation and recognition are largely discretionary. First of all the local supervisory authorities try to ensure that local creditors will be treated on an equal basis with creditors in foreign jurisdiction while providing any assistance to foreign authorities or recognizing foreign decisions. [84]

Generally, if proceedings are commenced in the jurisdiction, where the main office is placed, it is possible to initiate concurrent proceedings against branch offices in other jurisdictions which will be limited to the local assets. A good example for the illustration what I have just mentioned is the liquidation of BCCI group. BCCI was incorporated in Luxembourg. UK supervisory authorities regarded proceedings held in Luxemburg as

[80] IMF Paper No.2, 2010, p. 10.
[81] IMF Paper No.2, 2010, pp. 9-10.
[82] IMF Paper No.2, 2010, p. 10.
[83] IMF Paper No.2, 2010, p. 10.
[84] Hüpkes, 2000, p. 142.

main proceedings and commenced 'ancillary' proceedings in UK. Ancillary liquidation proceedings are auxiliary proceedings to the principal or main proceedings.[85]

3.2.b. Separate Entity Versus Single Entity Principle

Creditors of foreign branches of the same corporate entity may be treated in a different way in different jurisdictions because of applicable legal regime. If the multinational bank is wound up as one legal entity, this authorizes the creditors worldwide (no matter they are creditors of the head office or of a foreign branch) to submit their claims in that proceeding. This is known as a single entity approach. Alternatively, if a domestic branch is liquidated as a separate entity, only creditors of that entity may submit their claims in that proceeding. This approach is called a separate entity approach.[86]

"The resolution of a bank failure under the separate entity approach further hampers the rational determination of the method of resolution."[87] Liquidation under the single entity principle could maximize the liquidation value by integrated sales and maximize returns to creditors.[88]

Two approaches are followed by countries in order to resolve multinational bank insolvency: a strictly territorial approach (so called "ring-fencing") and an approach based on comity, the recognition of foreign decisions. The so-called "ring-fencing" approach favors the preferred treatment of local creditors of multinational entities over creditors of offices located in other jurisdictions. The example of ring-fencing would be the BCCI case, where US authorities were able to keep the assets located in the United States to satisfy US creditors.[89]

The supervisory cooperation and recognition of foreign judicial decisions may moderate the widely followed territorial approach to bank insolvency proceedings. The respects for laws of other countries and principles of comity are guiding principles in the resolution of cross-border insolvencies, especially when the foreign judgments are recognized and the local forum determines that they are neither abusive nor contrary to the policies of the forum. In most countries authorities have discretion to make international cooperation

[85] Hüpkes, 2000, p. 142.
[86] Hüpkes, 2000, p. 142.
[87] Hüpkes, 2000, p. 143.
[88] Westbrook, 1991, at 465, cited by Hüpkes, 2000, p. 143.
[89] Hüpkes, 2000, p. 143.

environment though the extent to which the authorities make use of this discretion varies per country.[90]

3.2.c. The Pari Passu Principle

A fundamental principle which underlies the single entity approach is that of national treatment (the pari passu principle). The principle means that all claims shall be treated in an equal manner and no creditor's claim should be accorded a lower priority than the other claim by virtue of his national origin. This principle is codified in Article 11(1) of the UNCITRAL Model Law: "subject to paragraph (2), foreign creditors have the same rights regarding the opening of and participating in a proceeding in this State … as creditors … in this State."[91]

The implementation of parri passu principle is very difficult due to the differences in law and multiple proceedings in different countries during international insolvency cases. The authorities apply local law deeming that it is mandatory for public policy or they think that application of foreign law would have discriminatory effect on local creditors.[92] To comment on this issue I'll bring the following example: The branch of a foreign bank which is located on the territory of Georgia is governed by the Georgian law. In case if the branch runs into financial difficulties and becomes insolvent, the banking supervisory authority will apply Georgian Law, which will govern the insolvency proceedings.

3.3. The Goals of Principles Applied During Multinational Bank Insolvency

As we have seen there are three principles governing the multinational bank insolvency cases, namely universality and territoriality principle, separate entity and single entity principle, the parri passu principle. It is within the discretion of the countries to decide which principle to apply. The insolvent multinational entity will be dealt with either by the home country authorities or by the host country authorities (universality and territoriality principle). When it comes to the applicable legal regime, the multinational entities may be treated in a different way in different jurisdictions. Then the single entity and separate entity principle comes into the play. This principle comprises the ring-fencing and comity. Under parri passu principle all claims must be treated in an equal manner. All these principles are aimed at maintenance and establishment of effective resolution framework

[90] Hüpkes, 2000, p. 143.
[91] Hüpkes, 2000, p. 146.
[92] Hüpkes, 2000, p. 146.

for multinational bank insolvency cases. The latter may be achieved through enhanced cooperation between countries' banking supervisory authorities.

3.4. International Insolvency Structures

Having discussed the principles applicable in case of multinational bank insolvencies, it is essential to discuss the rules governing a cross-border insolvency.

Effective national insolvency laws are a fundamental element in addressing cross-border insolvencies, but only national laws are not enough.[93] In has to be mentioned that in the absence of an international legal framework, the resolution of cross-border institutions is subject to different national frameworks and the national authorities must coordinate their actions. But in some jurisdictions national frameworks are not designed in a way to sufficiently authorize their supervisors of the relevant supervisory authorities to share information with their counterparts in other jurisdictions.[94] The question concerning the regulation of multinational bank insolvency is interlinked with the supervision powers. The supervision issues will be discussed in detail in chapter 4.

However, it has to be noted that there are few standard international rules that govern the failure of financial firms and banks. These few international rules that exist refer to insolvency rules within defined geographical or economic relationships.[95]

It is essential to answer this question: what sources do we have for rules to govern a cross border insolvency? We can group them into: 1) national law, 2) multilateral agreements, 3) private international norms, 4) the UNCITRAL Model Law and 5) the European Union approach.[96]

3.4.a. National Law

In the absence of unique international insolvency framework, the national law is the foundation of international insolvency law. Countries have developed general insolvency laws dealing with the failures of most enterprises and special provisions within the frames of general insolvency law concerning special types of debtors such as banks. The national

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[93] IMF Conference Paper, 2004, p. 10.
[94] IMP Paper No.2, 2010, p. 9.
[95] IMF Conference Paper, 2004, p. 10.
[96] IMF Conference Paper, 2004, p. 11.

laws adopt one of two basic positions: territoriality or universality.[97] The Georgian law adopts the position of territoriality. This means that country adjudicates claims against the assets which are located within its territory only for the benefit of creditors of insolvent local firm.[98] The question of territoriality and universality principle is discussed in this chapter, in section 3.2.a.

3.4.b. Multinational Agreements

There are two multinational conventions addressing the question of cross-border insolvency. These conventions are the Convention on Private International Law, known as Havana Convention and Convention Regarding Bankruptcy, commonly known as the Nordic Convention. "Both, the Havana Convention and Nordic Convention represent one option for addressing the conflict between national laws within geographic limitations."[99]

3.4.c. Private International Norms

Several steps were taken towards the improvement of cooperation in cross-border insolvencies. The Council of the Section on Business Law of the International Bar Association (IBA) in September 1995 approved the Cross-Border Insolvency Concordat (the Cross-Border Insolvency Concordat) and the American Law Institute adopted Principles of Cooperation in Transnational Insolvency Cases Among Members of the North American Free Trade Agreement ("ALI Principles). We have to mention that both the Cross-Border Insolvency Concordat and the ALI Principles tend to establish norms designed to harmonize separate national insolvency proceedings which involve an internationally active debtor. It has to be noted that these norms do not propose amendments to national laws.[100]

The Cross-Border Insolvency Concordat comprises general principles. These principles serve as a guideline for insolvency attorneys and courts. The principles promote the coordination of all insolvency proceedings for cross-border insolvency in a single forum. Similarly to the Cross-Border Insolvency Concordat, The ALI Principles tend to develop a mechanism for enhanced cooperation for multinational insolvency cases. The ALI Principles focus on multinational insolvencies within the North American Free Trade

[97] IMF Conference Paper, 2004, p. 11.
[98] IMF Conference Paper, 2004, p. 11.
[99] IMF Conference Paper, 2004, pp. 12-13.
[100] IMF Conference Paper, 2004, p. 13.

Agreement.[101] It is clear, that both, the Cross-Border Insolvency Concordat and ALI Principles promote coordination and cooperation between countries. The enhanced cooperation is the most important element to take into consideration while developing the cross-border insolvency framework.

3.4.d. The UNCITRAL Model Law

The UNCITRAL Model Law applies to all insolvent firms. However, it includes optional provisions authorizing a country to exclude certain companies such as banks and insurers from its application. We have to mention that UNCITRAL Model Law is an important step towards developing a common legal infrastructure.[102] Many countries have included the relevant provisions of the UNCITRAL Model Law in their domestic legislations. Despite the fact that UNCITRAL Model Law excludes banks from its coverage, its relevant aspects may be used in designing the framework for bank insolvency cases. The issues connected with the UNCITRAL Model Law are discussed in detail in the previous chapter.

3.4.e. The European Union Approach

The European Union's recent insolvency regulations tend to create a common universal approach to cross-border insolvencies within a unifying political entity. "The resolution of failed banks is addressed by EC Directive 2001/24/EC of April 4, 2001 on the Reorganization and Winding up of Credit Institutions. The EU's Insolvency Regulation seeks to establish a EU-wide insolvency process providing for non-discrimination and equal treatment of creditors, recognition of other EU insolvency proceedings and cooperation between insolvency authorities."[103] The fact that, the EU Insolvency Regulation excludes from its coverage the banks, it was the reason to adopt the Directive 2001/24/EC, which would solely deal with credit institutions – banks. The relevant issues concerning this regulation and directive are discussed in previous chapter.

3.5. The Absence of Effective Cross-Border Resolution Framework

As already mentioned above, there is no effective cross-border resolution framework for multinational bank insolvency. This undermines financial stability in a number of different respects:

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[101] IMF Conference Paper, 2004, p. 13.
[102] IMF Conference Paper, 2004, pp. 14-15.
[103] IMF Conference Paper, 2004, p. 15.

- Firstly, the national authorities' uncoordinated actions may hasten the failure of a financial institution in a manner that destroys value.
- Secondly, uncoordinated local liquidation proceedings "may prevent a recovery effort that seeks to preserve the continuity of critical functions, thereby giving rise to contagion;"
- Finally, in case when a financial institution operates in "numerous jurisdictions, the uncertainty as to how the various national authorities will coordinate their actions makes it very difficult for effective action to be taken quickly – which is essential to any strategy that seeks to both preserve value and limit contagion."[104]

We have to note that the more interconnected and integrated international financial institutions and groups become, "the more disruptive and value-destroying uncoordinated local resolution actions are likely to be."[105] The cases of Fortis and Lehman may serve as examples to that end.

Fortis Group fell into crisis in the late 2008. "In the Netherlands, the Dutch state bought Fortis' Dutch bank, its insurance arm as well as parts of ABN Amro that Fortis had recently acquired. In Belgium the Belgian Government bought Fortis' Belgian Bank (the largest component of the overall Fortis Group) and agreed to sell a 75% stake in it to BNP Paribas. BNP also bought Fortis' Belgian insurance operations and acquired a majority stake in Fortis' Luxembourg subsidiary. Completion of the resolution of Fortis was delayed for nearly six months between December 2008 and May 2009 after Belgian shareholders in Fortis succeeded in challenging the deal to sell most of the Belgian Bank to BNP Paribas."[106] Lehman Brothers is an example of competing proceedings in cross-border liquidation of a financial group. "At the time Lehman Brothers filed for bankruptcy protection in the United States in September 2008, the firm had operations around the globe involving dozens of different group entities (both branches and subsidiaries)."[107]

3.6. Three Characteristics of Cross-Border Banks

The resolution of cross-border banks is complicated by the sophisticated legal and financial structures underlying most large international banks. "Many, if not most, cross-border banks in the EU combine the following three characteristics:

[104] IMF Paper No.2, 2010, p. 12.
[105] IMF Paper No.2, 2010, p. 12.
[106] IMF Paper No.2, 2010, p. 13.
[107] IMF Paper No.2, 2010, p. 13.

- **Cross-border banks are often organized as conglomerate groups.** International banks commonly own or are affiliated to non-bank financial companies (e.g., leasing companies, insurance firms or asset management companies) located in the same or other jurisdictions as the bank. Alternatively, banks may be owned by a non-bank parent (bank holding company or insurance firm). These non-bank financial companies will typically have separate legal personality and will be licensed and supervised in their country of incorporation.
- **Cross-border activities of banks include both subsidiaries and branches.** While the organizational choice between a branch or subsidiary may not have significant operational consequences when the bank is functioning as a going concern, it may have a major impact on the conduct of insolvency proceedings. Foreign branches of a bank do not have a separate legal personality from the parent. As per the EU Winding-Up Directive for banks, host country branches of EU banks will be subject to the reorganization or winding-up proceedings that are commenced against their parent in the latter's home country. In contrast, foreign subsidiaries of an EU bank will not be immediately affected by the commencement of insolvency proceedings against the parent bank. As a rule, these subsidiaries will be resolved according to the legal framework of their own jurisdiction (and not the parent's)."[108]
- **Banking groups are interconnected through two main channels**: "(i) financial transactions among affiliates; and (ii) performance of activities within divisions."[109]

3.7. Elements of Enhanced Coordination Framework

It is clear that existing framework has some inadequacies. There are several options to improve the framework for cross-border resolution. The elements of enhanced cooperation will be discussed below.

3.7.a. Cross-Border Resolution Group

The IMF has made a proposal for the creation of enhanced coordination framework which will facilitate the resolution of cross-border bank. "Of the several international initiatives on cross-border resolution, the most important contribution to date has been that of the

[108] IMF Working Paper, 2010, pp. 33-34.
[109] IMF Working Paper, 2010, p. 34.

Cross Border Bank Resolution Group (CBRG) of the Basel Committee on Banking Supervision (BCBS)." [110]

In order to address the issues connected with the report provided by the CBRG, it would be better to define what are the functions of the BCBS and then of the CBRG.

The BCBS was established by the central-bank Governors of the Group of ten countries at the end of 1974. The BCBS is not equipped with any formal supranational supervisory authority. Its conclusions do not have legal force and were never intended to have it. "Rather, it formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements, which are best suited to their own national systems". In this way, the BCBS promotes convergence towards common approaches and common standards and does not attempt detailed harmonization of member countries' supervisory techniques.[111]

Over the past few years, the BCBS has promoted sound supervisory standards worldwide. In 1997 it developed a set of "Core Principles for Effective Banking Supervision" in close collaboration with many jurisdictions which are not members of the BCBS.The "Core Principles for Effective Banking Supervision" provide a comprehensive blueprint for an effective supervisory system. To facilitate implementation and assessment, the BCBS in October 1999 developed the "Core Principles Methodology". The Core Principles and the Methodology were revised recently and released in October 2006.[112]

The CBRG is a cross-border resolution group of the BCBS. On September 17, 2009, CBRG issued a report and recommendations regarding resolutions of financial institutions that have cross-border activities.[113]

According to the Report of the CBRG there are a number of alternative approaches available to cross-border resolution: 1. "Full 'universality' via a binding legal instrument, such as an international treaty" - such treaty needs to include obligations related to selection of lead authority and burden sharing; 2. "De-globalization of financial

[110] Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Resolution Group, March 2010, as cited in IMF Paper No.2, 2010, p. 14.
[111] http://www.bis.org/bcbs/history.htm
[112] http://www.bis.org/bcbs/history.htm
[113] Scott, 2009.

institutions" - territorial approach would be a solution in which "institutions would be separately structured for capital, liquidity, assets and operations within each jurisdiction."[114] 3. "A 'middle ground' approach – the CBRG recognized that enhanced coordination among resolution authorities might provide a solution that steers a path between territoriality and universality. The CBRG recommended that national authorities develop procedures to facilitate the mutual recognition of crisis management and resolution proceedings and/or measures."[115]

We have to note that the enhanced coordination can only be achieved through close cooperation of countries. As proposed by the IMF, there are several components, which will serve to that end. These are: facilitating coordination, adoption of coordination standards, funding of cross-border resolution and establishment of coordination procedures. These components will be discussed below. The states have to do this in order to improve the enhanced cooperation framework which will serve as a basis for the cross-border resolution.

3.7.b. Facilitating Coordination

Facilitating coordination is one of the most important elements to improve the framework for cross-border resolution. The coordination between authorities of one country with resolution authorities in other jurisdictions should be required. The authorities still have to determine that such coordination is in conformity with their own national interests. The national authorities have to bear in mind the interests of creditors and domestic financial stability while coordinating their resolution efforts with their counterparts.[116]

3.7.c. Coordination Standards

We have to mention that in case if the domestic legal frameworks are modified to establish the coordination mandate, the national authorities will be willing to cooperate with their counterparts only when they will have confidence in them. Though there are standards, which have a great importance. These standards are the most relevant: minimum level of

[114] IMF Paper No. 2, 2010, p. 15.
[115] IMF Paper No.2, 2010, p. 15.
[116] IMF Paper No.2, 2010, p. 18.

harmonization of national resolution rules,[117] robust supervision,[118] and institutional capacity to implement an international solution.[119]

3.7.d. Establishment of Coordination Procedures

In case if a group of countries satisfy the coordination standards, there still is a need for established set of procedures. The coordination framework established by UNCITRAL "a framework for the resolution of international financial groups could be designed in a manner that ensures that, in particular, there is an understanding of (a) who will take leadership in the initiation and conduct of resolution proceedings and how such leadership will be exercised and (b) the modalities of communication and consultation that will take place during the process."[120]

3.7.e. The Funding of Cross-Border Resolution

The resolution is aimed at minimization of the need for public funding. It is important to describe how the costs are allocated in both the liquidation and recovery of banks.[121] "The insolvency liquidation of a bank typically imposes cost on pre-insolvency private stakeholders. Losses are attributed consecutively to shareholders, subordinated creditors and unsecured creditors." The recovery operations which determine whether and how the cost is shared between pre-insolvency private stakeholders are organized through these techniques: capital increase, issuance of new debt and reduction of liabilities.[122]

3.8. Concluding Remarks

Having discussed the issues connected with the multinational bank insolvency, it is important to come to the relevant conclusions. "Countries need to strengthen their resolution frameworks at the national level to ensure that ailing financial institutions and groups can be dealt with promptly and in a manner that protects the stability of the financial system. But effective action at the national level is not enough. Given the global nature of the financial services industry and its dominant institutions, national resolution

[117] IMF Paper No.2, 2010, p. 19.
[118] IMF Paper No.2, 2010, p. 21.
[119] IMF Paper No.2, 2010, p. 22.
[120] IMF Paper No.2, 2010, p. 25.
[121] IMF PaperNo.2, 2010, p. 23.
[122] IMF PaperNo.2, 2010, p. 24.

frameworks will only be effective if they facilitate cooperation between authorities at the international level."[123]

Bank insolvency affects many areas of law such as banking law, contracts and collateral law, insolvency law and administrative law, therefore a unified solution is particularly difficult to achieve. Moreover, this process involves different authorities: banking supervisory authorities, deposit protection agencies and judicial authorities. Therefore, the standardization and unification of bank insolvency law would presuppose that all concerned jurisdictions had equal supervisory standards and equally effective supervisory systems. [124]

Effective cooperation at international level, creation of supervisory systems and "core coordination mechanism"[125] would lead countries to a framework applicable to multinational bank insolvencies. Moreover, if countries cooperate in a manner offered by the IMF, namely, if they try to facilitate coordination, adopt coordination standards, regulate funding the cross-border resolution and establish the coordination procedures, this will cause the creation of effective resolution framework which would be applied in case of cross-border bank insolvency cases.

[123] IMF Paper No.2, 2010, p. 27.
[124] Hüpkes, 2000, p. 169.
[125] IMF Paper No.2, 2010, p. 27.

Chapter 4. Bank Supervision

The legislators have recognized the need to establish prudential regulations and operational requirements especially for banks to ensure their safety and a supervisory system in order to achieve compliance. Often this is the result of serious financial upheavals and the legislators take into consideration the importance of a bank's distinctive function both in the economy of a country, and the public interest in the safety and soundness of the banking system. [126]

The importance of bank supervision will be discussed in this chapter, both in terms of banks operating at national and multinational level (cross-border banking). As it has already been mentioned in previous chapters, the robust supervision is one of the most important steps in avoiding bank failures whether national or cross-border.

4.1. The Need for Regulation and Supervision

"The banks need a dedicated resolution system. This need traces back to their general importance to the economy and socially unacceptable costs of contagion and financial instability, which may arise when banks are resolved as "gone" concerns under standard corporate bankruptcy processes."[127]

It has to be noted that several steps were taken to strengthen the international coordination in banking supervision. The national authorities voluntarily implement the best practices and international standards through the enactment of legislation. They conclude memoranda of understanding with supervisors in other jurisdictions. These initiatives are aimed at granting supervisors necessary tools for understanding, monitoring and minimizing the risks connected with an organization's consolidated or group-wide activities.[128] The collaboration between supervisory authorities is vital. Most of the countries have concluded memoranda of understanding with one another. These memoranda envisage the change of information regarding the supervisory functions and information needed to exercise effective oversight on commercial banks. I can bring the example of Georgia which has concluded a number of memoranda of understanding in order to facilitate the collaboration with other supervisory authorities.

[126] Hüpkes, 2000, pp. 9-10.
[127] IMF Paper, 2011, p. 2.
[128] IMF Paper No.2, 2010, p. 11.

However, it is not only the memorandum of understanding which regulates and promotes the close cooperation of countries. The international principles are also worth mentioning. The internationally agreed principles on the supervision of cross-border banking have been in force for several decades. The BCBS issued its first statement concerning the supervision of bank's foreign establishments, which dates back to 1975.[129] Later on, in 1997 the "Core Principles of Effective Banking Supervision" were released by the BCBS. The principles are aimed at strengthening banking sector. They "address the preconditions for effective banking supervision, licensing, prudential regulation and operational requirements, methods of ongoing banking supervision, information requirements, formal powers of supervisors, and cross border banking."[130] The status of the BCBS has been dealt with in the previous chapter.

Notwithstanding the fact that the above mentioned efforts have facilitated cooperation, there still are problems in supervision at the national level. These problems mainly comprise the factors that the supervisors lack legal authority to share information with foreign counterparts, the regulatory standards are differently applied by different national supervisors and different reporting standards hinder timely data compilation.[131]

We have to note that the prudential regulations have two-fold objectives. Firstly, they tend to ensure soundness and financial safety both of a bank and a financial system at large. Secondly, they try to guarantee equal competitive conditions in the banking sector. However, the prudential regulation and oversight is not aimed at reduction of risk-taking to zero. Risk taking is interlinked with the concept of banking. It needs to be noted that the prudential regulation and oversight is not aimed at the prevention of all bank failures. "Minimizing risk-taking in order to reduce failure rates to zero would, by definition, eliminate the purpose of the banking system."[132]

It is clear that there is a need for regulation and supervision of banks. The banking supervisory authorities play very important role in protecting financial stability. In most of the countries the prudential regulation is aimed at the protection of banking sector. However, sometimes the regulation itself cannot help to stop the bank failures. Banks engage in a very risky activities and the risk-taking as it was already mentioned above is

[129] IMF Paper No.2, 2010, p. 11.
[130] Hüpkes, 2000, p. 10.
[131] IMF Paper No.2, 2010, p. 11.
[132] Hüpkes, 2000, p. 11.

very common for banks. Therefore, the role of supervisors is of utmost importance. They can define the problems by the prudential regulation and oversight. In case if the supervisors in a proper time intervene in a bank is, the outcome of the intervention may be positive. Though, it has to be noted that sometimes even the early intervention does not avoid the bank failure. The issues connected with the early intervention will be discussed below.

4.2. Regulatory Insolvency

The determination of "regulatory insolvency" is based on a process of capital measurement and risk evaluation. It is the role of banking supervisory authority to determine when there is a ground for intervention. Non-compliance with solvency requirements is generally sufficient to cause regulatory intervention. It has to be noted that most banking laws envisage wide discretion for the banking supervisory authority to determine at what point intervention is critical, also to decide "when the 'creditworthiness of the institution in question is impaired." [133]

The concept of "regulatory insolvency" is destined to ensure early intervention aimed at the minimization if not avoidance of losses to the bank's creditors and deposit insurance agency. The concept of "regulatory insolvency" should ensure timely regulatory intervention aimed at the avoidance of losses as far as the financial problems existing in a bank may not become immediately visible to bank's creditors.[134] The concept itself means that the supervisory authorities are empowered to intervene in a bank. The main idea of "regulatory insolvency" is to ensure the early intervention with the goal to avoid the losses or at least minimize them. It is called "regulatory" as far as the banking supervisory authorities regulate the process of intervention. This concept relates to general supervision conducted by the National Bank of a certain country or other supervisory authority. The main difference is that during the "regulatory insolvency" the bank in which the banking supervisors intervene is already in troubles while the general supervision means the oversight of a "healthy bank". The concept of regulatory insolvency is connected with the issue of early intervention, which will be discussed below.

4.3. Early Intervention by Supervisors

"There is an inherent tension between the two main objectives of any official action with

[133] Hüpkes, 2000, p. 13.
[134] Hüpkes, 2000, p. 13.

respect to banks: namely minimizing financial instability on the one hand; and avoiding moral hazard on the other. Addressing problems before they spiral out of control, through tough, uncompromising supervision and decisive, early intervention can help to reduce this tension though."[135]

It is recognized that it is hard to draw firm lines between "early intervention", "crisis management" and "crisis resolution". The most important is that the authorities who are in charge of supervision must possess the tools and powers in order to limit losses, protect public interest and achieve the principles and goals that underlie the financial stability.[136]

In order to avoid banking problems, an early intervention and strict exit policy is crucial. First of all, it is aimed at the enforcement of the prudential regulations, thereby "deterring banks from engaging in unsound banking practices"; second, it ensures a "level playing field" in the banking sector; third, it is designed to avoid further losses and contagion. [137]

It has to be noted that, the need for early intervention is reflected in Principle 22 of the "Core Principles for Effective Banking Supervision":

Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action. When banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way, banking supervisory authorities must have at their disposal adequate supervisory measures in order to bring timely corrective action. In extreme circumstances, the measures applied by the banking supervisors should also include the ability to revoke the banking license. [138] As I have mentioned in the previous chapter the "Core Principles for Effective Banking Supervision" have recommendatory character, but they are used as a guideline by supervisory authorities in order to enhance their supervision and avoid possible bank failures.

In case when "the banking supervisory authority failed to intervene when correction was still possible, a bank must be allowed to fail like any other non-financial company should it experience severe financial problems." Though, there are two exceptions. First, "where the failure of a large bank may place a number of financially linked banks in difficulty"

[135] IMF Working Paper, 2010, p. 39.
[136] IMF Paper No.1, 2010, p. 9.
[137] Hüpkes, 2000, p. 14.
[138] "Core Principles for Effective Banking Supervision", Principle 22, cited by Hüpkes, 2000, p. 15.

(the so called 'too-big-too-fail" exception) and second "in systemic banking problems where several financial institutions are experiencing severe financial problems" (the so called 'systemic crisis' exception). [139]

4.3.a. Early Intervention Powers in EU

Within the EU an early regulatory intervention powers are set out in Art. 136 of Directive 2006/48/EC on the Taking Up and Pursuit of the Business of Credit Institutions (the "Banking Directive"). These powers are to be applied to institutions that are otherwise failing to meet the requirements of the Banking Directive. These are the following:
"i. obliging credit institutions to hold own funds in excess of the minimum level;
ii. requiring the reinforcement of the arrangements, processes, mechanisms and strategies implemented to comply with Articles 22 and 123;
iii. requiring credit institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements;
iv. restricting or limiting the business, operations or network of credit institutions; and
v. requiring the reduction of the risk inherent in the activities, products and systems of credit institutions."[140]

The above-mentioned powers appear very robust and wide-ranging on paper but "the result of the crisis suggests they may be insufficient, that the threshold previously set for the engagement of early intervention powers was too high, or that such powers were not aligned with resolution powers."[141] For the creation of future framework other additional or more detailed early intervention tools might be valuable, namely:

- "The possibility to require a capital increase, the conversion of contingent capital into equity, and to call on any form of capital insurance or other legally-binding support commitments (e.g., from shareholders or group members). This should be in addition to the possibility to require a group restoration plan, as from public policy and financial stability perspectives a restoration of capitalization has very different implications depending on whether it happens through an increase in capital or a decrease in (risk-weighted) assets;"[142]
- "The possibility to impose temporary limits on compensation when compensation payouts risk weakening an institution (these emergency intervention powers should

[139] Hüpkes, 2000, p. 15.
[140] IMF Working Paper, 2010, p. 40.
[141] IMF Working Paper, 2010, p. 41.
[142] IMF Working Paper, 2010, p. 40.

be in addition to a more comprehensive overhaul of compensation practices as is currently under discussion). These powers should focus on variable pay components and high pay packages;"[143]

- "The possibility to require the divestment or winding-down of activities that are deemed to pose excessive risks to the soundness of a banking group;"[144]
- "The power to require a reduction of the refinancing risks in a banks' funding structure, through a lengthening of maturities and reduced reliance on wholesale markets;"[145]
- "The possibility to put limits on the growth of an institution or veto expansion plans."[146]
- "The power to demand changes to legal group structures and/or operational organization in order to facilitate supervision and ensure consistency with crisis management and resolution arrangements."[147]

Moreover, it has to be noted that the "definition among supervisors of common early intervention thresholds is crucial to effectively addressing problems of a troubled cross-border bank. Narrowly-defined, automatic triggers would not be satisfactory because it is impossible to specify in advance all relevant circumstances."[148]

Though, other elements would be desirable, such as:

- "There should be a clear escalation of supervisory interventions, according to the principle of proportionality;"[149]
- "The management and shareholders should normally be given the opportunity to redress the situation, subject to strict deadlines and oversight and provided that the institution is not at imminent risk of insolvency or subject to rapid loss of value;"[150]
- "An indicative list of triggers and thresholds (in terms of capitalization, liquidity difficulties, etc.) should be established and published in advance, so that regulatory

[143] IMF Working Paper, 2010, p. 41.
[144] IMF Paper No.1, p. 9.
[145] IMF Working Paper, 2010, p. 41.
[146] IMF Paper No.1, p. 10.
[147] IMF Paper No.1, 2010, p. 10.
[148] IMF Working Paper, 2010, p. 41.
[149] IMF Paper, 2010, p. 10.
[150] IMF Working Paper, 2010, p. 42.

uncertainty is reduced, and accountability and coordination are facilitated; "[151] and etc.

4.4. Strengthening Supervision

We have to note that the rules and regulations are necessary but not sufficient conditions to reduce the likelihood of financial crisis. "The quality of supervision is and remains a crucial factor. One of the main lessons of the current crisis is that even when the banking system is heavily regulated it remains vulnerable. No state-of-the-art set of rules is able to prevent financial crises from happening. Regulation has to be complemented by a strong supervisory regime. Clear objectives and mandates, operational independence, adequate resources, appropriate tools to identify emerging risks both at the firm and at the system level, an a wide range of remedial actions are all crucial components of a regime of effective supervision."[152]

It has to be noted that robust supervision is needed to avoid bank failures. "It is true, that for some types of financial institutions, there already exist a set of broadly accepted international standards (e.g. the Core Principles on Effective Bank Supervision)." These principles already include that "host countries should not grant market access to foreign banks if the latter are not well supervised in their home jurisdiction (and vice versa)." However "it is felt by many supervisors that these standards have not brought about a sufficient increase in quality of prudential supervision and the willingness of supervisors to intervene in all relevant countries."
In order to coordinate with foreign resolution authorities, higher quality of supervision and greater convergence on these points may be required.[153]

4.5. Supervision and Stress Testing

The supervisors should carry out the stress testing in order to avoid differences in interpretation and application of stress test scenarios and methodology. "If stress tests are performed as part of the supervisory activity on an individual institution or group of institutions, which could trigger enhance supervision or early intervention", it would be better to carry them out in a confidential manner in order to avoid "triggering negative

[151] IMF Paper No.1, 2010, p. 10.
[152] IMF Working Paper, 2010, p. 31.
[153] IMF Working Paper No.2, p. 21.

market dynamics" that could further result in complication of supervisory and resolution actions.[154]

It has to be noted that "the use of deliberately severe stress tests should not be a one-off exercise but viewed as a regular supervisory toll to assess bank-level and sector-wide resilience to shocks." The individual institutions should perform the stress test analyses as an integral part of their capital planning and risk management. [155]

It is important to note that the supervisors and institutions may periodically review the recovery plans. Particularly, the "supervisors should require and ensure that recovery plans are kept in line with findings of the supervisory programs, stress tests, and other supervisory actions, and with the institution's evolving business activities." It is essential that the supervisor had powers to require institutions to carry out necessary measures "to ensure that there are no impediments to the implementation of the plan in situation of financial stress, subject to proportionality and assessments of costs and benefits of those measures."[156]

It is clear that both stress tests and recovery plans are aimed at ensuring the stability of banks.

4.6. Concluding Remarks

For the enforcement of regulatory compliance the banking supervisory authority has a variety of measures at its disposal. Most laws grant wide discretion to the banking supervisory authority. Sometimes such discretion is too wide and may result in unpredictability and even in a tendency to delay action or it may give rise to unequal treatment.[157]

The bank supervisors play very important role. They can determine when it is possible to intervene. The early intervention may have its positive outcome. The failure of a bank may be avoided through a robust supervision.

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[154] IMF Paper, 2011, p. 11.
[155] IMF Paper, 2011, p. 11.
[156] IMF Paper, 2011, p. 12.
[157] Hüpkes, 2000, p. 48.

Conclusion

Bank insolvency involves a lot of various issues such as rules which are applied during the proceedings, legal measures for the management of bank insolvency, principles concerning the cross-border bank insolvency, cross-border resolution framework, banking supervision and etc. Banks do need special and differential treatment from other non-financial institutions. The special treatment is a result of special interest the general public has in preserving and protecting the financial stability. The special rules applied during bank insolvency proceedings vary from country to country. The special rules serve two major functions: they protect banks and preserve the financial system. Therefore, applying special rules for bank insolvency cases is of utmost importance.

One of the most important issues to be mentioned when discussing the bank insolvency is the legal framework designed for bank insolvency. Notwithstanding the fact that, several authors support the application of general rules of insolvency during bank failures, it has been discussed in the thesis that in most cases banks fall under the application of special insolvency rules. The latter motivates the legislators to draft special bank insolvency laws and regulations which can be applied during the bank failures.

It has to be noted that a resolution framework has to be designed especially for banks. Several steps were taken to that end. The IMF has proposed the structure of the framework for EU and for the cross-border banks as discussed above. Still there is a need for enhanced cooperation. The most useful structure would be to take into consideration the UNCITRAL Model Law principles when creating the bank insolvency framework. The bank insolvency framework should be designed in a way to protect financial stability of credit institutions (banks) and the interests of depositors.

The financial services have been globalized and cross-border banking has expanded consequently. Therefore the regulation of multinational banks is very important. In order to avoid multinational bank insolvency it is essential that countries strengthen their resolution frameworks at the national level. The framework has to address the issues concerning the prompt regulation of financial institutions and aimed at the protection of financial stability. It has to be noted that enhanced coordination is needed in order to regulate cross-border banks. Therefore, only the national cooperation is not sufficient. As far as many important financial institutions operate globally, it is needed that countries design their resolution frameworks oriented at cooperation on international level.

In order to effectively regulate bank insolvency cases it is needed that each country has robust supervisory standards. These standards should be designed in a way which facilitates the oversight of banks and authorize the bank supervisors for early intervention. The latter will often avoid the insolvency of banks.

Enhanced international cooperation and creation of effective supervisory systems would enable countries to apply an efficient framework during cross-border bank insolvencies.

We have to mention that most of the laws give the bank supervisors very wide discretion. Sometimes such intervention may have negative outcomes and may result in unpredictability. Sometimes it may even amount to unequal treatment. But it is up to the banking supervisory authority to decide which regulatory measures will be applied in order to avoid bank failures.

In case of existence of robust supervision, the bank failures may be avoided. It also needs to be said that sometimes the early intervention will help to avoid the bank insolvency cases. The bank supervisors have very important role to play. They can find out when there is a basis for their intervention and it is within their discretion to choose the regulatory measures which would be oriented to avoid the bank failures when it is possible.

But after all, how can the bank insolvency be avoided? It is argued by the authors that bank failures may happen in spite of the prudential regulation and oversight. Though, if supervision is effective enough it can avoid future bank failures. To my mind there is chain of recommendations which has to be followed in order to prevent bank insolvency cases. Firstly, banking supervisory authorities have to focus not only on the prevention of bank failures but also to effectively regulate problematic banks. Secondly, international cooperation would be very useful. In case if banking supervisory authorities timely exchange information with their counterparts it will facilitate the supervision and oversight. This will be fruitful especially in case of cross-border banks. Thirdly, early intervention, exploration of problems and their elimination will avoid the bank failures. Fourthly, the supervision should be so robust, to concentrate on the prevention of mismanagement of banks and excessive risk taking.

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