

# **Issues in Cross-Border Bank Insolvency: The European Community Directive on the Reorganization and Winding-Up of Credit Institutions**

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## **Introduction**

It is becoming increasingly likely that a bank that is experiencing financial difficulties will have operations, or interests, in more than one jurisdiction. This was certainly the case in the collapse of Bank of Credit and Commerce International (BCCI) in 1991 and Barings in 1995. At the time of its collapse BCCI was operating in more than seventy jurisdictions and although Barings was a merchant bank with headquarters in the City of London its problems resulted from overseas operations in Singapore.

The insolvency of a bank that is operating on an international basis raises many legal problems and difficulties. For example, different jurisdictions approach insolvency from different philosophical perspectives. Some jurisdictions are more pro-debtor than others while some may favour judicial rather than administrative procedures for dealing with the insolvency procedures. Some of the problems also include conflicts of laws, differences of procedure, different treatment of assets and different approaches to set-off and netting<sup>2</sup>.

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<sup>2</sup> The different treatment of set-off led to problems in the BCCI liquidation where the laws in Luxembourg were different to those in the United Kingdom. This led to creditors not all being treated equally.

One particular problem is in relation to the recognition and implementation of insolvency proceedings, court orders or administrative actions in the context of an international bank insolvency. This paper focuses on the European approach to resolving this issue by examining the new European Community Directive on the Reorganization and Winding-Up of Credit Institutions (hereafter referred to as “the Directive”).<sup>3</sup> The introduction of the Directive is generally viewed as a significant development within the European Union which will hopefully provide a greater deal of efficiency and certainty in bank insolvency proceedings. That the scope of the Directive also extends to reorganization measures is an interesting and welcome development. This paper is not intended to be a complete guide to the Directive but instead seeks to consider some of the more important aspects.

### **Bank Insolvency issues**

Before going on to consider the background to the introduction of the Directive and to then examine some of its significant provisions, it may be helpful to highlight some of the issues that arise in the context of a bank insolvency that contains a cross-border dimension and which are of relevance before turning attention to the Directive. A brief account of these topics should assist in promoting a better understanding of the provisions of the Directive and the reasons why they have been included.

The following issues are all relevant:

- Single entity versus separate entity

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<sup>3</sup> Directive 2001/24/EC of the European Parliament and of the Council of 4<sup>th</sup> April 2001 on the Reorganization and Winding-Up of Credit Institutions.

- Comity
- Ring-fencing
- Regulatory issues in international bank insolvencies
- Universality versus territoriality
- Harmonization of bank insolvency laws?

### *Single Entity versus Separate Entity*

One issue of fundamental importance in bank bankruptcy laws is whether the insolvent bank should be treated as a “separate entity” or a “single entity”. Where the separate entity approach is used the various parts of the financial institution located in different legal jurisdictions will be dealt with in separate legal proceedings. For example a branch of a foreign bank in jurisdiction *X* will be liquidated as a separate entity in jurisdiction *Y*.<sup>4</sup> Where, however, the single entity approach is adopted there will only be one set of insolvency proceedings in which the financial institution is treated as one entity. In this situation all the assets of the institution, no matter where they are located, will be included in a single liquidation, or reorganization, process. Where the single entity approach is adopted all creditors, no matter where situated, will be entitled to lodge their claims in that one set of proceedings and will be entitled to receive the same treatment as all creditors of the same class. It is arguably fairer to use the single entity approach and it has been suggested, quite correctly, that to resolve a bank failure using the separate entity

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<sup>4</sup> See, for example, France and the United States.

approach “further hampers the rational determination of the method of resolution.”<sup>5</sup> It is certainly much harder to attempt a reorganization under the separate entity method and it is likely also to prove more expensive to administer thereby increasing costs and reducing efficiency.

### *Comity*

This has been defined as the “the courteous and friendly understanding, by which each nation respects the laws and usages of every other, so far as may be without prejudice to its own rights and interests”<sup>6</sup> and “that body of rules which the states observe towards one another from courtesy or convenience, but which are not binding as rules of international law”.<sup>7</sup>

The approach taken by countries to the recognition of foreign proceedings tends to be quite variable but is, of course, of great significance in the context of an international bank insolvency. See, for example, section 426 of the Insolvency Act 1986 in the United Kingdom which provides for cooperation between courts which exercise jurisdiction in insolvency cases. In the United Kingdom the courts have a discretion to refuse recognition if this would be contrary to public policy (although this unlikely in practice) and under section 426 the courts are required to give assistance, on the request of the

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<sup>5</sup> E. Hupkes, *The Legal Aspects of Bank Insolvency*, (Kluwer, 2000) 143.

<sup>6</sup> *The Oxford Dictionary* (Clarendon Press, 2<sup>nd</sup> Edition, 1989).

<sup>7</sup> *Osborn’s Concise Law Dictionary*, (Sweet & Maxwell, 9<sup>th</sup> Ed, 2001).

relevant foreign court, provided it is a ‘relevant’ territory i.e. designated as such<sup>8</sup>. Section 304 of the United States Bankruptcy Code provides the approach taken in that jurisdiction. In the United States the courts have to take various factors into account including the protection of United States creditors plus the existence in the other jurisdiction of a broadly similar legal framework to the United States. This will obviously limit the number of situations where a court in the United States will be either willing or able to assist a request from a foreign court.

### *Ring-fencing*

This practice is contrary to the *pari passu* principle that all claims of a similar type should be treated equally. Where ring-fencing is allowed branches of foreign banks will be treated as separate legal entities and, if necessary, will be wound-up as such. Indeed the purpose of using ring-fencing is to ensure that assets in a particular jurisdiction actually receive special protection at the expense of others. Essentially the aim is to ensure that local creditors receive preferential treatment over foreign creditors. Ring-fencing is permitted in some jurisdictions; the United States is an example of this where in the BCCI liquidation the New York court refused to make assets available to the UK liquidator. The practice of ring-fencing is frequently criticised and the UNCITRAL Model Law on Cross-Border Insolvency does not permit this. Article 13(1) of the Model Law provides “...foreign creditors have the same rights regarding the opening of, and participation in, a proceeding under (name of State)...as creditors...in this State.”

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<sup>8</sup> This covers all parts of the United Kingdom, including the Channel Isles. All of the other jurisdictions, with the exception of Ireland, are Commonwealth countries – there are only about 19 in total.

While it may be difficult to support the use of ring-fencing in principle it is worth asking whether the use of ring-fencing ever be justified? It is possible that foreign regulators may be perceived to be inefficient or lacking in powers and it may also sometimes be the case that serious concerns exist that domestic creditors will not receive equal treatment in the foreign proceedings.

### *Regulatory Issues in International Bank Insolvencies*

The role of regulators in the period prior to insolvency differs between jurisdictions and it is important to distinguish between regulatory intervention and measures which are considered to go beyond this and form part of the insolvency process. The reasons for drawing this distinction are important in relation to multi-national bank insolvency and this is a feature of the Directive which is examined below.

Clearly there is a need for co-operation between banking regulators from separate jurisdictions in both the pre-insolvency and post-insolvency phases. It is beyond the scope of this paper to discuss regulatory intervention in detail<sup>9</sup> but it is a matter of some importance as the role of the supervisory authority in the pre-insolvency phase may have a significant bearing on whether or not some form of insolvency procedure becomes necessary. This is especially relevant when banks are operating internationally as the

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<sup>9</sup> For further information on this topic see, for example, T. Asser, *The Regulatory Treatment of Banks in Distress*, (IMF, 2001), E. Hupkes, *supra* n 5., M. Giovanoli & G. Heinrich, *International Bank Insolvencies: A Central Bank Perspective*, (Kluwer, 1999).

level of risk is increased. There is therefore a need for effective regulatory co-operation in addition to adequate supervision. This can only be achieved through agreements, treaties and regional initiatives. To be effective a competent system for the exchange of information is also a very important component of an efficient system.

Despite the existence of agreements, treaties and other forms of cooperation there is a need for confidence in the other regulators. For example, how will the regulators elsewhere deal with the issue of what it does in the pre-insolvency stage? Where the regulator in state A does not feel that the regulator in state B is acting in an effective manner it will be harder to achieve effective regulatory cooperation. This has frequently been a problem in the past.

There have been a number of attempts at international bank regulatory cooperation. See, for example, the Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision<sup>10</sup> and the work of the International Monetary Fund, World Bank and European Bank for Reconstruction and Development.

### *Universality versus Territoriality*

*Universality* is the concept of the 'home' country of a bank having jurisdiction over a single insolvency proceeding. The major problem with the universal approach is that without adequate international agreement it cannot be enforced. As things stand at

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<sup>10</sup> See <http://www.bis.org/bcbs/index.htm> for information on the work of the Basel Committee plus the text of the Core Principles and the Core Principles Methodology.

present international cooperation and enforcement will be largely discretionary. *Territoriality* is the concept of the use of separate proceedings in each jurisdiction on the basis that the proceedings in the ‘home’ country do not extend beyond its borders. This approach is still used widely internationally.

### *Harmonization of bank insolvency laws?*

There is no standard approach to the issue of bank insolvency laws and while much work is being done by such bodies as the International Monetary Fund and the World Bank to suggest good practice in relation to bank insolvencies as yet there is little uniformity of approach. Indeed it is interesting to note that even in major cross-border insolvency projects such as the UNCITRAL Model Law on Cross-Border Insolvency banks are specifically excluded. The European Community Insolvency Regulation also excludes banks from its application.<sup>11</sup>

A number of questions and problems arise in deciding which type of insolvency law should be used in relation to banks and there are several possible choices. First, the implementation of a special bank insolvency law. Second, to include the laws on bank insolvency within the general banking laws of the jurisdiction and third, to use the general corporate insolvency law (with or without some special rules for banks).<sup>12</sup> A second factor, and one which is hotly debated, is whether to use a procedure which is judicial in nature as in, for example the UK and Ireland, or to have a purely

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<sup>11</sup> Council Regulation (EC) No. 1346/2000 of 29<sup>th</sup> May 2000 on Insolvency Proceedings.

<sup>12</sup> The US is an example of a country which uses a special bank insolvency law while the UK, for example, is at the other end of the spectrum by using the general corporate insolvency law.

administrative approach with court involvement restricted to certain appellate functions as in, for example, the United States.

As a result of these difficulties it would seem unlikely that there will be any major progress towards the international harmonization of bank insolvency laws in the next few years. At present there are too many differing approaches to attempt such an initiative but it does seem likely that in the near future efforts that concentrate on measures which attempt to improve cooperation between different jurisdictions may be made.

## **The Directive on the Reorganization and Winding-Up of Credit Institutions**

### *The Background to the Development of the Directive*

The development of the Directive can be traced back to 1978 after the First Banking Directive had been enacted,<sup>13</sup> but progress on producing an agreed draft proposal was slow for a number of reasons and it was not until April of 2001 that the Directive finally came into force although it will not be fully implemented until 5<sup>th</sup> May 2004, more than a quarter of a century after the Council had started to work on this. Although a proposal for such a piece of legislation was drafted by the European Commission in 1985 it was subsequently amended because of differences of opinion in the European Parliament. Although this was later resubmitted in 1988 it appears that work on the proposed

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<sup>13</sup> The First Banking Directive 77/780/EEC.

directive was stopped as a result of the implementation of the Second Banking Directive.<sup>14</sup> It was not until after the collapse of BCCI that work recommenced and it appears that by 1996 agreement on the final shape of the directive was thought to be close. However, because of a dispute between two Member States<sup>15</sup> work was delayed and did not resume until 1999. Although these delays were regrettable agreement was finally reached in 2000 and the Commission's proposals were accepted by the European Parliament and the Council with the result that the Directive entered into force on 4 April 2001.<sup>16</sup> EC Directives are binding on the Member States to which they are addressed as to the results to be achieved but it is left to the national authorities of each Member State as to how they are to be implemented. Accordingly, although the Directive is now in force, it is necessary to provide Member States with sufficient time to make the necessary preparations for implementation. In relation to this Directive Member States are to have brought into force the necessary laws, regulations and administrative provisions by 5<sup>th</sup> May 2004 in order to be fully compliant.<sup>17</sup>

It is hardly surprising given the varied legal systems of the Member States and, importantly, of the significantly different philosophical approaches to the whole question of insolvency law, that there was significant disagreement among Member States about a number of issues during the course of the discussions. In the original draft proposal by

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<sup>14</sup> Second Banking Directive 89/646/EEC.

<sup>15</sup> The dispute was between Spain and the United Kingdom and concerned references to Gibraltar in the annexes to the draft which were unacceptable to Spain. See E. Hupkes, *supra* n 5 at 164.

<sup>16</sup> For a more detailed background and history of the Directive see E. Galanti, 'The New EC Law on Bank Crisis' in (2002) *International Insolvency Review* II(1), 49 – 66.

<sup>17</sup> Article 34(1).

the European Commission the proposed directive was modelled on the principles of single entity and universality. This absolute, or strict, approach was not favoured by all Member States and there was considerable disagreement between those jurisdictions which supported a so-called “softened” or “modified” form of universality and those which supported the strict approach. According to Enrico Galanti there appeared to be something of a north-south divide on this issue with Germany and some Nordic countries arguing for a form of softened universality which would have allowed the possibility of secondary proceedings in certain situations, and the continental “Latin” jurisdictions that favoured the strict approach.<sup>18</sup> As will be seen below a compromise was reached which appears to offer a worthwhile and workable alternative approach. The principle of universality is preserved by ensuring that only one set of proceedings will be implemented. Such proceedings will be commenced in the home Member State and are subject to the laws of that state but the Directive provides a list of exceptions which will be subject either to the local law or the law of the contract. These exceptions are discussed below. This compromise solution is intended to provide protection to creditors in host Member States while at the same time ensuring that there is no possibility for further sets of legal proceedings being commenced.

### *The Aims, Objectives and Scope of the Directive*

It has been suggested that the rationale for the Directive is the need to fill the gap that exists because of the exclusion of banks from the EC Insolvency Regulation and this is undoubtedly correct.<sup>19</sup> In the opinion of this author a convincing explanation for the

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<sup>18</sup> Supra n.16 at 51.

<sup>19</sup> See Hupkes, supra n 5, at 165.

failure to include banks in the Insolvency Regulation has never been provided but it is beyond the scope of this paper to discuss this in detail. The Directive now attempts to fill this gap by providing a vital piece of legislation which becomes part of the legislative framework for banking throughout the European Community that was originally established by the First Banking Directive and which is now to be found in the Banking Consolidation Directive of 2000<sup>20</sup>.

The Directive is another piece of the overall legislative framework which aims to promote the objectives of the EU Treaty which established the European Community. In the preamble to the Directive it is stated that “(1) In accordance with the objectives of the Treaty, the harmonious and balanced development of economic activities throughout the Community should be promoted through the elimination of any obstacles to the freedom of establishment and the freedom to provide services within the Community. (2) At the same time as those obstacles are eliminated, consideration should be given to the situation which might arise if a credit institution runs into difficulties, particularly where that institution has branches in other Member States.”

To be consistent with this overall objective it was felt particularly important that a legal framework be introduced to apply in the situation where a credit institution which has branches in other Member States is found to be in distress and requires to be subjected to an insolvency procedure. The term insolvency procedure is not limited to the situation where a credit institution is so hopelessly insolvent that it requires to be liquidated but also covers reorganization measures.

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<sup>20</sup> Directive 2000/12/EC.

Not all financial institutions come within the scope of the Directive which uses the term “credit institution”. Article 1(2) provides that this Directive is applicable to all credit institutions and their branches set up in Member states other than those in which they have their head offices.<sup>21</sup> What will be considered a credit institution for the purposes of the Directive. This term “credit institution” is defined in the Banking Consolidation Directive as “an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.”<sup>22</sup> It does not apply to the central banks of the Member States or to certain other financial institutions such as credit unions, friendly societies, post office giro institutions.<sup>23</sup>

It was noted that the adoption of the directive on deposit guarantee schemes, which made it compulsory for credit institutions to be a member of the guarantee scheme in their home Member State, “ brings out even more clearly the need for mutual recognition of reorganisation measures and winding up proceedings ”.<sup>24</sup> this clearly makes sense especially as all Member States are in compliance and have implemented depositor protection schemes.

The aims of the Directive are twofold. First, the equal treatment of creditors and second, the principles of unity and universality.

The equal treatment of creditors is an important principle but one which is not necessarily easy to apply and the way in which the Directive attempts to achieve this is discussed further below. According to the Directive the equal treatment of creditors requires that

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<sup>21</sup> Article 1(1).

<sup>22</sup> Banking Consolidation Directive 2000/12/EC. Article 1(1).

<sup>23</sup> The full list of types of excluded institution is contained in Directive 2000/12/EC Article 2(3).

<sup>24</sup> The Directive Recital (5) in the Preamble.

where an institution is being wound-up it must be done so in accordance with the principles of unity and universality. To achieve this it is therefore necessary that the relevant authorities of the home Member State have sole jurisdiction over the proceedings in all Member States where the credit institution is or has been operating. It is also necessary to attempt to ensure that the legal framework provides the same outcome for creditors in each jurisdiction.<sup>25</sup>

Where a Member States does not have laws which allow for the attempted reorganisation of a financially distressed bank which has its head office in that jurisdiction there will be no alternative but to commence winding-up proceedings in the home Member State. This is true even where there are such reorganization proceedings in a host Member State where the bank has a branch. It will, of course, also be the case that where a reorganisation measure has failed to deliver the expected outcome there will also be no alternative but to commence winding-up proceedings. Accordingly the Directive is designed to ensure that there will be mutual recognition of winding-up proceedings in addition to reorganisation measures.

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<sup>25</sup> There are exceptions to this and these are discussed below.

Although the Directive does not need to address the issue of authorisation measures as this is dealt with elsewhere<sup>26</sup> it is recognised that although the withdrawal of authorisation is an inevitable consequence of a winding-up this should not act to prevent certain activities of the insolvent bank to continue as far as necessary where this will be beneficial. This, of course, needs to be subject to certain safeguards. This is considered further below.

### *FEATURES OF THE DIRECTIVE*

#### *The Single Entity Approach*

A singularly important feature of the EC approach is that credit institutions incorporated in a Member State are treated as forming a single entity which is subject to supervision by the regulator/supervisor in the home Member State i.e. the jurisdiction in which authorisation was granted. This, so called, “single passport” allows a credit institution that is licensed in any Member State to undertake business and establish branches throughout the EEA<sup>27</sup> without the need for any further authorisation or licensing. The introduction of the “single passport” has led to a proliferation of banks with branches in more than one Member State thereby ensuring that it is increasingly likely that there will be a cross-border aspect to bank failures which occur in any part of the European Union.

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<sup>26</sup> See the Banking Consolidation Directive 2000/12/EC which provides for mutual recognition.

<sup>27</sup> The European Union Member States plus Norway, Iceland and Liechtenstein.

### *Equal treatment of creditors*

The difficulties involved in harmonizing bank insolvency laws, including reorganizations, has already been discussed and instead of any ambitious attempt to achieve such harmonization the Directive has less lofty aims and objectives. One of the major features is the principle of the equal treatment of creditors in the Member States but as will be seen this is not actually fully achieved by the Directive. The Directive does, however, ensure that there is no possibility of assets being ring-fenced in any Member State.

With regard to reorganization measures it was considered to be essential that measures which have been adopted by the relevant authorities in the home Member State would be effective in all Member States. Of course, it is necessary for the authorities in the home member state to notify the relevant authorities in the other states where the credit institution is operating.

### *Universality – a single set of proceedings*

At present, if a credit institution which is operating in more than one country within the EU, is in financial difficulties and requires to be subjected to either a reorganisation procedure or a winding-up proceedings it is possible that separate legal proceedings can be commenced in each Member State where the bank is actually operating. This, apart from the increased costs involved, will inevitably lead to delays, conflicts and the possibility that not all creditors will receive equal treatment.

As already mentioned the Directive does not attempt to harmonize the bank insolvency laws of the Member States, this would be a huge undertaking and it seems that while this may become possible at some future date it is necessary to monitor the way in which the provisions of the new directive will actually work in practise.

### *The Role of the Home Member State*

In keeping with the “single entity” principle the European Commission recognized that there was a need for the insolvency related measures, both reorganisation and winding-up, to be controlled by the laws and institutions in the home Member State of the credit institution. It was considered essential that the relevant authorities, either administrative or judicial, of the home Member State are to have sole power to implement reorganisation measures. There is in fact a considerable amount of difference between the legal frameworks on reorganization procedures throughout the Community and it was recognised that it would be impossible to actually harmonize the laws and instead the establishment of mutual recognition by the Member States was introduced.

Once the Directive has been fully implemented where a bank is in financial difficulties the relevant proceedings will be commenced in the Home State of the bank and these proceedings are to be recognised in all other Member States where the bank has either branches or assets. No further formalities will be necessary as there is automatic applicability in the other Member States where the credit institution has branches.

Host Member States have no choice under the Directive but to recognise and implement the procedures under the law of the home Member State no matter how much it differs

from the laws applicable in the host Member State. This will apply even where the host Member State does not have similar measures. All Member States have laws which control the winding-up of credit institutions although these may vary between jurisdictions.<sup>28</sup> Some jurisdictions may not however have reorganization measures which are anything like those in the home Member State. This however is irrelevant and the procedure which has been commenced in the home Member State must be applied regardless in the host Member State.

Although the general rule is that the law of the home Member State will apply there are exceptions to this. Not all assets will be subject to the law of the home Member State as it was recognised that this would be problematic; some types of contracts and rights would continue, as at present, to be covered by the governing law of the contract or by the law of the host Member State. This is considered further below.

#### *Treatment of Distressed Non EU Banks*

When deciding how to formulate the Directive it was necessary to consider not only banks which operate exclusively within the geographical boundaries of the Community but also the situation where a bank which is operating within the EU actually has its head office in a non member country. It will often be the case that banks with head offices outside the EU operate branches in one or more Member States.

Article 1(2) provides that the Directive will apply to the branches of a credit institution which has its head office outside the EC only where it has branches in at least two

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<sup>28</sup> See the discussion above where the different types of approaches are considered.

Member States. In Recital 22 it is provided that in this type of situation “..each branch should receive individual treatment in regard to the application of this Directive.” It may be the case that a non EC bank operates a branch network in more than one Member State and despite the wording of the Recital the intention in this situation must be that a single insolvency proceeding in relation to all the branches within a Member State.

When dealing with a non EU credit institution it has to be decided which authorities should have responsibility for the implementation of the insolvency proceedings (regardless of whether it is to be by way of a reorganisation or a winding-up of the entity). One of the problems with such a situation is that although the head office is located outside of the EU the bank may operate in two or more Member States - where this is the case the provisions of the Directive will apply.<sup>29</sup>

For the principle of universality to be upheld it would be necessary for only one set of proceedings to be commenced. This issue was the subject of much discussion but it was not possible for agreement to be reached on how this could be done. The resulting approach taken within the Directive reflects the difficulties and the final outcome is that the principle of universality will not be applicable in such a situation. Where a non EC bank has branches in two or more Member States separate proceedings will have to be commenced in each. In the Preamble to the Directive it is suggested that in such a situation the relevant parties should endeavour to coordinate their activities.<sup>30</sup> How this is

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<sup>29</sup> The Directive. Article 1(2).

<sup>30</sup> The Directive. Recital (22) of the Preamble..

to be done is not explained in the Directive and this may prove to be one of the more interesting aspects once the Directive is fully operational.

### *Reorganization Measures*

Articles 3 to 8 are concerned with reorganization measures for credit institutions. Before going on to consider these provisions it is important to realise that there is no requirement that the banking laws of the Member States actually contain reorganization procedures for credit institutions, but where a home Member State does have such procedures these must be recognised by host Member States. What will amount to a reorganization measure? Reorganisation measures are defined in Article 2 as "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 a suspension of payments, suspension of enforcement measures or reduction of claims".<sup>31</sup>

One of the most difficult issues is where to draw the boundaries between actions which should be classified as supervisory intervention rather than insolvency related procedures and those which are reorganization measures. It is clear from the preamble that supervisory intervention is not intended to be included and recitals (8) and (9) provide some assistance by providing "(8) Certain measures, in particular those affecting the functioning of the internal structure of credit institutions or managers' or shareholders' rights, need not be covered by this Directive to be effective in Member States insofar as,

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<sup>31</sup> Reaching an agreed definition was not apparently an easy matter.

pursuant to the rules of private international law, the applicable law is that of the Home State. (9) Certain measures, in particular those connected with the continued fulfilment of conditions of authorisation, are already the subject of mutual recognition pursuant to Directive 2000/12/EC insofar as they do not affect the rights of third parties existing before their adoption.”

As the applicable law on reorganizations is to be the law of the home Member State<sup>32</sup> only the administrative or judicial authorities in that State are empowered to decide on the implementation of such a measure. It is important to appreciate that a reorganization measure that is properly commenced in the home Member State of the credit institution will automatically become fully effective in all Member States where it is operating. No further formalities are needed except for the requirement that the competent authorities in the home Member State shall, without delay, inform the competent authorities of the host Member State of the decision to adopt the reorganization measure together with all other relevant information.<sup>33</sup> If possible the communication should be made prior to the adoption of the reorganization measure but if that cannot be done it must be made immediately thereafter.

Article 6 provides that where the rights of third parties in a host Member State are likely to be affected by the implementation of a reorganization measure commenced by the relevant authorities in the home Member State, and where an appeal may be brought against the implementation of the procedure it is necessary for the relevant authority in the home Member State to publish an extract from the decision in the Official Journal of

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<sup>32</sup> The Directive. Article 3 (2). Unless otherwise agreed in the Directive.

<sup>33</sup> The directive. Article 4. The information can be communicated by any available means which allows for the possibility of using the telephone in urgent cases.

the European Communities and in two national newspapers in each host Member State. The purpose of this is stated as being to ensure that the right of appeal can be exercised in good time<sup>34</sup> but it is suggested that it would be good practice in all cases to publish the details of the implementation of reorganization measures.

The situation with regard to reorganization measures is different where the credit institution has its head office outside the EU but is operating branches in two or more Member States. In this situation the administrative or judicial authorities of the host Member State where a reorganization measure is being implemented must notify the relevant authorities in other host Member States without delay that the action is being taken. Where the competent authorities in a host Member State implement a reorganization procedure in relation to a non EU credit institution with branches in more than one Member State it is likely that the authorities in these jurisdictions will either commence reorganization proceedings or, if more appropriate or because that jurisdiction does not have such legal provisions, the winding-up of the credit institution. When this happens, as has already been noted, the universality principle will not be applicable and there is the possibility that there will be separate proceedings which are all governed by different legal rules. This is unavoidable under the Directive and although the administrative or judicial authorities of each Member State are to endeavour to coordinate their actions this clearly falls outside the scope of the universality principle.

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<sup>34</sup> The Directive. Article 6(1).

### *Winding-Up Proceedings*

Winding-up proceedings are defined in Article 2 as "collective proceedings opened and monitored by the administrative or judicial authorities of a member state with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure".

All forms of winding-up proceedings will be covered including such measures as a provisional liquidation and also include voluntary as well as compulsory proceedings. As with reorganization measures no further formalities are necessary for the winding-up to be effective in all host Member States and the general rule is that the applicable law is the law of the home Member State except for transactions that are outside the scope of the general rule (these are considered below). Article 10(1) provides that a credit institution "shall be wound up in accordance with the laws, regulations and procedures applicable in its home Member State insofar as this Directive does not provide otherwise".

While the law of the home Member State determines most of the matters covered in a winding-up there are important exceptions which are discussed further below. Article 10(2) provides a list of those matters that are to be determined by the law of the home Member State. Essentially the law of the home Member State determines such matters as which assets are included in the estate; the powers of the credit institution and the insolvency practitioner (liquidator); the conditions under which set-off may be invoked; the effects of the proceedings on the bank's current contracts; the effects on proceedings brought by individual creditors (with the exception of lawsuits which are pending. These

are dealt with by Article 32 which provides that these shall be governed by solely by the law of the Member State in which the lawsuit is pending); rules on the admission, verification and treatment of claims; rules regarding the distribution of the proceeds derived from the realisation of the assets; ranking of claims and the rights of creditors who have received partial satisfaction after the proceedings have commenced by virtue of a right in re or through a set-off; the conditions for, and the effects of, the closure of the winding-up; the rights of creditors after the closure of the winding-up proceedings; the rules relating to voidness and the avoidability or unenforceability of legal acts which have been detrimental to the whole body of creditors.

It is possible under the directive for a credit institution to be wound-up on a voluntary basis and where this is done the competent authorities in the home Member state must be consulted prior to any decision being made by the governing body of the credit institution.<sup>35</sup>

Where the credit institution has its head office in a Member State the winding-up proceedings are to be commenced in that State and it is not permitted for proceedings to be commenced in relation to the bank's branches in any other Member States.

One important feature is that judicial and administrative measures are to be given equal recognition by the Directive. At present no European Union Member State has bank

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<sup>35</sup> This does not preclude the adoption of a reorganization measure or the commencement of judicial or administrative winding-up proceedings. See the Directive, Article 11(2).

insolvency provisions that are purely of an administrative nature but this clearly provides for this possibility in the future.

What about revocation of the banking licence? One of the consequences of the commencement of winding-up proceedings against a credit institution is that authorisation to conduct regulated business must be withdrawn. Article 12 provides that where winding-up proceedings have commenced or where reorganization measures have been unsuccessful the authorisation, or licence, of the credit institution is to be withdrawn.<sup>36</sup> It is recognised that some activities may still be continued if they are necessary for the purposes of the winding-up and it is provided that the home Member State may provide that such activities are to be carried on under the supervision of, or with the consent, of the competent authorities in that State.

On the commencement of winding-up proceedings in a Member State the administrative or judicial authorities in that State are required to inform the competent authorities of host Member States without delay and by any available means of the decision to commence the proceedings.<sup>37</sup>

### *Provisions Common to Reorganization Measures and Winding-Up Proceedings*

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<sup>36</sup> This is to be done in accordance with the procedure contained in the Banking Consolidation Directive 2000/12/EC at Article 22(9).

<sup>37</sup> The Directive. Article 9(2).

Title IV, Articles 20 to 33, contains a wide range of provisions which are common to both reorganization measures and winding-up proceedings but will inevitably in practice apply mostly to the situation where a bank is being wound-up. The provisions contained in Title IV are actually exceptions, or exemptions, to the general principle that the law of the home Member State shall apply.<sup>38</sup> Recital 17 of the Preamble provides however that “the exemption concerning the effects of reorganisation measures and winding-up proceedings on certain contracts and rights is limited to those effects and does not cover other questions.....such as the lodging, verification, admission and ranking of claims concerning those contracts and rights and the rules governing the distribution of the proceeds of the realisation of the assets, which are governed by the law of the home Member State.”

The first of the exceptions is contained in Article 20 and concerns certain types of contracts and rights. First, contracts of employment are to be governed by the law of the Member State that is applicable to the employment contract. Second, contracts conferring the right to make use of or acquire immovable property<sup>39</sup> are to be dealt with by the law of the Member State where the property is situated and the law of that jurisdiction is to determine whether the property is movable or immovable. Third, rights in respect of immovable property, a ship or an aircraft subject to registration in a public register shall be governed solely by the law of the Member State under the authority of which the register is kept. A further exception to the general principle is found in Article 24 which is concerned with the enforcement rights in financial instruments which are

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<sup>38</sup> Enrico Galanti, *supra* n 16 at 59, suggests that the introduction of these exceptions signified an important compromise between the opposing parties i.e. those who wanted a strict form of universality and unity and those who wanted secondary proceedings to be permitted.

<sup>39</sup> Essentially buildings and land. Generally referred to as real property in common law jurisdictions.

subject to a registration requirement and provides that these shall be governed by the law of the Member State where the register or other form of recording system is located.

A different approach, but which still provides an exception to the general rule, is taken with regard to netting agreements, repurchase agreements and transactions carried out on regulated markets. In relation to these the Directive provides that these shall be governed solely by the law of the contract which governs such agreements.<sup>40</sup>

Articles 21, 22 and 23 are adopted from the EC Insolvency Regulation and are concerned with third parties' rights in re, reservation of title and set-off.

Article 21 provides that the opening of reorganization measures or winding-up will not affect creditors' or third parties' rights in re in respect of tangible or intangible, movable or immovable assets which belong to the credit institution and which are situated in another Member State at the time the proceedings were commenced. Article 22 is concerned with reservation of title and provides that the adoption of reorganization or winding-up proceedings shall not affect the rights of a seller (who is selling to a credit institution) based on a reservation of title where the asset is located in a Member State other than the one in which the proceedings were commenced.<sup>41</sup> Where a credit institution is selling an asset and has already delivered it to the buyer, the commencement

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<sup>40</sup> Article 25 covers netting agreements; Article 26 – repurchase agreements; Article 27 – regulated markets.

<sup>41</sup> Article 22(1).

of reorganization or winding-up proceedings will not constitute grounds for rescinding or terminating the sale and the buyer will acquire title.<sup>42</sup>

Article 23 provides that the opening of reorganization or winding-up proceedings shall not affect the rights of creditors to set-off claims against the claims of the credit institution where such a set-off is permitted by the law applicable to the credit institution's claim<sup>43</sup> and where the set-off is not avoided or unenforceable.<sup>44</sup>

What about netting agreements, repurchase agreements and transactions carried out in the context of a regulated market? Articles 25, 26 and 27 provide that these shall be governed solely by the law of the contract that governs the agreements.

### *Appeals*

Appeals against any of the actions taken in relation to a reorganization measure or a winding-up will have to be made to the relevant authorities in the home Member State in which the single set of proceedings have been commenced and the law of that State will be the applicable law of the appeal.

## **Concluding remarks**

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<sup>42</sup> Article 22(2). The asset is to be situated in a Member State other than the State in which the proceedings were commenced.

<sup>43</sup> Article 23(1).

<sup>44</sup> See Article 10(2)(1).

The Directive is undoubtedly an important development in the framework of EU banking laws. It will have the effect of producing a greater degree of certainty when dealing with bank insolvencies with a cross-border dimension. The introduction of such a piece of legislation is only possible because of the fact that there exists already a body of EC banking law and a regulatory framework which are now contained in the Consolidated Banking Directive.

Some of the more positive aspects of the Directive include:

- The introduction of the single entity principle
- The introduction of universality (although not total)
- The mutual recognition regime of both reorganization measures and winding up procedures.

The Directive is hopefully only a starting point in a process that may lead to the eventual harmonization of bank insolvency laws throughout the Member States of the EU. Whether this is achievable remains to be seen and indeed the desirability of such an outcome is a subject that would be vigorously debated. It is to be hoped at least that the Directive will provide the impetus for further EU initiatives in the area of bank insolvency law. Further developments and reforms are unlikely in the near future and what will be necessary is a close monitoring of the level of effectiveness of the provisions of the Directive when it is fully implemented by all of the Member States in May 2004.

It is also to be hoped that the introduction of the Directive will lead to other international efforts that go beyond the borders of the EU.

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