Ep 71: UNIDROIT Legislative Guide on Bank Liquidation

Intro music: Insol international, in conjunction with the Early Researcher Academics Committee, presents: Insol talks.

Shuai Guo (SG) (00.23): Welcome back to a new episode of INSOL Talks. This is a special episode in collaboration with the International Insolvency Institute. My name is Shuai Guo, Assistant Professor at China University of Political Science and Law and Chairperson of INSOL ERA.

Today, I'm co-hosting this podcast with Dr. Eugenio Vaccari, Senior Lecturer at Royal Holloway University of London, III NextGen Executive Committee Member. We are extremely honoured to host 2 distinguished professors, Professor Ignacio Tirado and Ms. Myrte Thijssen from the International Institute for Unification and Private Law, UNIDROIT. To discuss is a Bank Insolvency Working Group and a recently published legislative guide on Bank Liquidation.

Eugenio Vaccari (EV) (01:08): Many thanks, Shuai, and welcome, Ignacio and Myrte. First of all, please allow me to briefly introduce UNIDROIT and our distinguished speakers. UNIDROIT is an independent intergovernmental organization with its seat in the Villa Aldobrandini in Rome. Its purpose is to study needs and methods for modernizing, harmonizing, and coordinating the private and, in particular, commercial law as between states and groups of states, and to formulate uniform law instruments, principles, and rules to achieve those objectives.

Professor Ignacio Tirado has been the UNIDROIT's Secretary General since 2018. He's also a professor of commercial, corporate, and insolvency law at Universidad Dorno de Madrid in Spain. He has been a senior legal consultant at the World Bank's Legal Vice Presidency and Financial Sector Practice, consultant for the IMF on insolvency-related matters, as well as for the Asian Development Bank on commercial legal reform. In particular, he has been director and academic co-chair of III.

Ms. Myrte Thijssen is now Senior Legal Officer at UNIDROIT. She worked in the legal service of the Dutch Central Bank in the Supervision and Regulation Department, as well as in the legal service of the Single Resolution Board, providing advice in banking crisis and dealing with litigation before the Appeal Panel and the Court of Justice of the European Union. Once again, many thanks for joining us on this panel today.

SG (02:43): Once again, thank you very much. To begin with, Ignacio, could you provide an overview of UNIDROIT's mandate and its general activities? In particular, how the bank insolvency project aligns with the mandate of UNIDROIT? Thank you.

Ignacio Tirado (IT) (02:58): Yes, thanks, Shuai. Thanks for the question, and thanks, Eugenia, for the introduction. Right, so as was already stated, UNIDROIT is an intergovernmental organization. It's 99 years old, so that means in a few months we'll be 100 years old and lots of things are going to be happening. So stay tuned for more, maybe for more podcasts in the future if this doesn't turn out to be too boring.

The work that we do is supported by a constituency which is global. We have 65 member states, which out of almost 200 countries or around 200 countries doesn't sound like much, but the truth is that it is quite a lot because it covers over 74% of the world population; more than 90% of the world market, the world GDP. So there's a very high transcontinental representation, and we're very proud of that. Because we did, we were created in the context of the League of Nations, which was a global organization, but it was mostly European at the very beginning, and it's really expanded.

The work that we did on bank insolvency, it's very important for us because on the one hand, it opens up a new line of work because UNIDROIT had not done work on insolvency, specifically speaking. It has a long-standing, very important track record on financial markets, but insolvency had been left out. So we found the niche where our colleagues from UNCITRAL were not active and whose work had been, the proposals to do work had been rejected several times, which were the insolvency of financial institutions to propose or to accept the proposal that we receive to do to the work. And I believe Myrte will be speaking about this later.

In our case, the work on banks is in the DNA of UNIDROIT, especially its relationship with financial markets. So, for example, just to name a few of our instruments, the Geneva Securities Convention, Legislative Guide on Intermediated Securities are very, very influential principles on close-up netting, which are the ones that ISDA and ISDA master agreements includes in all of its work. So people don't know it, but in the thousands and thousands of derivative contracts that are signed, our instrument is reflected daily by the thousands.

So having this work together with another related new area of work, such as digital assets and private law, meant a lot. And I should just close by saying that all of the past week, we finished our 105th session of our governing council, and we had received a proposal from the government of Italy, which was later also supported in its presentation by the European Banking Institute to do work on the insolvency of insurance companies. That will completely close the circle of those type of insolvent entities, which because of their systemic potential, do not fit well with corporate insolvency laws. And therefore, we are very keen on this work.

One last point, the work we did, we did together with the Financial Stability Institute, which is part of the Bank of International Settlements. And doing the work with the Basel institutions, with dozens of central banks and international organizations and active in that area was quite unique. I don't know if you know this, but when it comes to establishing the framework for banks. No one leaves Basel, and this was the time when Basel accepted to partner up with an outside organization, and we take a lot of pride in that.

EV (06:44): Thank you so much, Ignacio, for this introduction. Just to understand a bit more, I mean, the time references that you made, this podcast is being recorded on 26 May 2025. Now, I would like to turn to the Bank Insolvency Working Group. Myrte, could you walk us through this project? How has it started and what was the formulation process of the legislative guide on bank reputation?

Myrte Thijssen (MT) (07:08): Yes, thank you. It's a pleasure to join you today. Well, UNIDROIT starts its project on the proposal of other organizations or bodies or of its member states. And in the case of the Bank Insolvency Project, the project was proposed by the European Banking Institute, the EBI, together with the Bank of Italy. And the background was that since the global financial crisis that started in 2007, a lot of work was done at the international level to try and improve the ability to deal with bank failures, but the focus was on banks that could be systemic in failure. So generally the largest and most interconnected banks.

In 2011, the Financial Stability Board adopted the key attributes of effective resolution regimes for financial institutions. And that's the international standard for resolution regimes for banks that could be systemic in failure. And it has been adopted by domestic regimes all over the world. But at the same time, international guidance was lacking on how to manage the failure of other banks, so those that are not systemic in failure. And since there is no international guidance, we see a lot of differences in jurisdictions for legal regimes. So some jurisdictions have just regular business insolvency law that also applies to banks without any modifications or specifications.

Other jurisdictions have a fully-fledged dedicated bank liquidation law. And you see that the tools and procedure under all those regimes differs a lot. So the aim of the Bank Insolvency Project was to examine those different approaches, see what are the pros and cons of those different approaches, in order to try to come up with guidance that could help jurisdictions design the most effective type of bank liquidation framework for those non-systemic banks.

So how was this done in terms of process? Well, UNIDROIT has an established working methodology whereby the instruments are always developed by working groups of international experts. In the case of the Bank Insolvency Project, the working group was chaired by Mia Bariati. She's a member of our governing council. And it consisted of a group of international area of insolvency law and crisis academics and insolvency practitioners. They come from all over the world, so both from common law and civil law jurisdictions. So those are the individuals.

And in addition, the working group also benefited from the participation of institutions, so what we call observers in the working group. And those included, in the case of the Bank Insolvency Project, several relevant international organizations, such as the IMF and the World Bank, also III, UNCITRAL, IADI, the International Association of Deposit Insurers, several regional bodies, and also many national banking supervisors, deposit insurers, and bank resolution authorities from all over the world. And their input has really been essential for the project because they have the technical expertise, they have experience in dealing with bank failures. So we are very happy that they contributed so actively to the development of the legislative guide throughout the process.

So overall, the working group consisted of experts from 26 jurisdictions from across the five continents. And it produced a legislative guide in the course of seven working group sessions over three years, so from December 2021 till now, more or less. And within the working group, there was a drafting committee, so a smaller group of experts that was

responsible for the actual drafting of the chapters based on the working group's discussions. And when there was a full draft available last year in 2024, we held an online consultation where everybody who wished to do so could provide feedback on the draft legislative guides. And that consultation was very helpful and very successful. So we received a lot of constructive feedback from different types of stakeholders from different parts of the world, including, again, resolution authorities that had not participated in the working group. but also insolvency practitioners. So we had feedback from INSOL as well, for example, and from banking associations. So after that feedback was considered by the working group in November of last year, the legislative guide was finalized in the beginning of this year and sent to our governing council, which approved it last week. So overall, the process has been very robust and inclusive, and we believe that is also reflected in the outcome.

SG (11:39): Thank you very much, Myrte. Such a great achievement. Back to Ignacio. Would you mind sharing us with more the key elements of this guide and how does it relate to the existing international standard in the field of banking, insolvency and resolution? Thank you.

IT (11:54): Right. So apologies, this might be a little bit long. I think as to the content of the guide, maybe the most important thing to underscore from the beginning is the limits of it. Let me explain. As I'm sure in the area of the failure of financial institutions, there is quite a lot out there, far from merely guidance or transnational law instruments, which are for a government to freely decide, but rather there is an important regulatory framework, which is deemed almost mandatory for those countries that want to have a sound legal system of to deal with the insolvency of financial institutions. But these refer mostly to those institutions that have a systemic component. So we stay clear of the work or of the remit of the key attributes of the Financial Stability Board, for example, as well as any relevant rules that derive directly from that instrument. So we are not only fully compliant with it, but we usually try to to stay clear. So whenever there is something which has been regulated by the key attributes, we just refer to the key attributes unless there is very specific parts that need to be fleshed out in the case of liquidation or smaller entities. But in principle, we stay clear of that.

Same happens with the IADI core principles on effective deposit insurance systems, because for those, that is also a very well-recognized standard. And we take all of it as a red line and we build around it, but never trespass, if you will indulge me with the metaphor. Then, of course, to the extent that the elements of corporate insolvency are related, and in the case of liquidation, that is a possibility, we do also work, stand on the shoulders of the World Bank ICR principles and the work done in the past by UNCITRAL.

So based on those existing frameworks, we build and fill the gaps that were not there, which concern smaller and non-systemic institutions, and especially the area of liquidation, where there was basically no standard whatsoever. It was a complete blank in the advisory documents. And that is something which was much needed, as we've ascertained along the way, there was a lot of need for this type of work. So the guide includes 105 recommendations, but it is a very discursive instrument. So it does analyze the different possibilities and opts for several policy options whenever it's very clear. There

was consensus amongst all the central banks and the international financial institutions that this would be a best practice.

In this context, the guide has 10 chapters. The first chapter is an introductory chapter, but I would really encourage the reader to stop and read very carefully this chapter because it informs the entire instrument and it has perhaps the most meaningful discussion. For an academic is no doubt the most important part because although it's less detailed, it does include very interesting discussion on the merits of the finality of the insolvency or liquidation of a bank. And believe me, every word, every coma, every line was discussed to the nausea. So everything is there because of a reason and there is a lot behind it. So If we ever publish toile of this instrument, which is normally not the case because we only do that for treaties, a lot would be learned by a researcher.

So we identify 5 key objections. I'm going to name them for you. We speak about value maximization, which is a typical corporate insolvency one, but it's usually not the main element in insolvency of banks. depositor protection and directly linked with it financial stability. The, and this was quite controversial in the discussion, the avoidance of loss to public funds and certainty and predictability was a more general wishful thinking type of objective.

Of course, the fact that we focus on value maximum, sorry, on depositor protection, financial stability and avoiding loss to public funds, you can tell that we are in the realm of banks and that things are quite different compared to corporate insolvency.

As to the chapters, we have them divided into several building blocks. The first building block in the organization, because this is supposed to provide a script for the legislator to address every single item that's necessary to draft a proper bank liquidation legislation. So we believe you have to start from choosing the players in an insolvency liquidation and that requires therefore designing and defining whether you want to opt for one of the two models that we've, let's say for taxonomic and clarity purposes, divided into the different options that the legislator has to face. One is the administrative model and the other one would be the court-based model. Although in truth, there is no pure administrative model or court-based model. There's just somewhere in between. How close you are to the admin model or to the core-based model will define many of the trends of the procedure.

We do identify as a priority or as a better option or one that has more benefits, the administrative model. And basically the idea is if you have a core-based model, then try to make sure that's okay, but try to make sure that this model incorporates the different elements that make an administrative model superior in abstract terms. So fine to have the, no one legislates in a vacuum, there's already something there. So fine, you don't need to overhaul your entire system, but if you do have a court-based system, ensure that these, that, and that element of an admin model is included in the court-based option. So that basically means that even in the case of court-based models, there is a need for strong involvement of the administrative authority, whichever it is, the resolution authority, liquidation authority, whatever you want to call it.

We do provide guidance for both types of models. And to give you 2 examples, in the case, for example, of an admin model, we add flexibility by including the possibility of the

liquidation authority appointed a liquidator, which might be even a private sector liquidator to do the work, so long as this liquidator is actually within the reins of the defined and set by the liquidation authority. And the other way around, one of the main problems, for example, if a court-based model is very difficult for these type models to do preparation for liquidation and to let's say, define a strategy ex-ante and start implementing it from an early point.

So we envisage the possibility, following the example of some systems like the UK or the Dutch system, to appoint prospective liquidators, which is also an interesting object of analysis for an insolvency specialist. The second building block refers to guidance for the opening of the liquidation process of banks, and here there is a clear, very clear difference between corporate insolvency and ordinary corporations and banks. As you know, we work on deposit taking institutions. The fact that there are deposits already explains very clearly that you cannot treat them as an ordinary corporation because as you know, banks are sitting on a barrel of gunpowder. They have their assets in mid to long term while they have their liabilities in the short term. So deposits can be withdrawn and that creates risks of bank runs and other elements. So that just wouldn't work. Apart from that banks are supervised and regulated, and therefore there are liquidity ratios there.

So all of that are very precious instruments that are in the hands of those institutions that should deal with the insolvency of a bank that are not usually available in the insolvency of a corporation, that have to and be considered when designing the insolvency, the trigger for insolvency. So we basically work around the concept of non-viability for the opening of liquidation proceedings. And the analysis has to be forward-looking, and it's not a specific moment in time that's considered.

Another element which is interesting, which has triggered a lot of discussion, is the fact that if you have a system where there is resolution and liquidation separate, which is very often the case, then the triggers of resolution and liquidation must be aligned. And this is something which is well discussed at the guide and is interesting.

Third building block concerns effective liquidation powers. Very important, the most important, unlike what's present right now in many countries, those few countries that have specific regulation for the liquidation of banks do not envisage the possibility of applying liquidation powers which concern going concern sales, going concern transfers, the, for example, the transfer of assets and liabilities of a failure bank to another bank, the famous purchase and acquisition type of instrument. All of that is usually not included. How to do that, how to provide financing, how to use the deposit insurance schemes for all of this is something reflected and pondered upon in detail in the guide. And it's one of the most important parts of the guide, the most innovative ones.

I think specific rules which might not be, wouldn't be present in corporate insolvency are present and described and justified. To give you some examples of the possibility to proceed the transfer of assets and liabilities without notifying anyone, not the shareholders, not the creditors. There's the coordination of this type of independently of the model court-based or administrative, especially in the court-based model, the need to coordinate the implementation of this tool always with the administrative authority,

supervisory authority. Also, although this is more widespread in corporate insolvency, of course, the possibility of transferring contracts without the acceptance of the counterparty is key. But this is something which is also important in corporate insolvency, but we stress it especially here.

There are, in our opinion, special rules that need to be implemented for avoidance. Using avoidance powers for the implementation of bank insolvency scheme is just wrong unless there is a very clear case of bordering with criminal activity of fraud. So normally, these type of activities or acts that could be avoided should be dealt with, as is the case with damage suffered through exposed compensation, so you don't stand in the way of an effective and quick solution to the insolvency of a bank.

Chapters 7 and 8, these are chapters, this is the 4th building block, refers to creditor hierarchy, and this is a very interesting part which I would really encourage our insolvency expert friends to look into. There's a very interesting discussion as to the priority given to deposits. You should know that in the discussion here, there was a big divide between a few jurisdictions that didn't think that giving any priority to creditor for deposits, who has had deposits or paid a depositor, this person or this creditor should not have a priority, others very strongly believed otherwise. In the end, some sort of priority is recommended. And here I believe the financial stability, potential financial stability concerns were won the battle, so to say. But there are very good arguments pro and con, both solutions. So we would encourage a good read of this part, also concerning hierarchy and the no credit or Warsaw and other traditional safeguards in bank insolvency are very well addressed and fully considered in the guides.

And finally, the last two, the last block and the last two elements concern the insolvency groups and the insolvency of insolvency of banks with a cross-border element. And because the realm, or the remit of the instrument is mostly about smaller institutions, non-systemic, we thought at the beginning this, because of this reality, it would not be justified to do work on groups and especially not on cross-border insolvency, but that was indeed a misunderstanding at the beginning. Basically any banks, small as it might be, have a potential or real cross-border component. So it was absolutely hard, especially when we mix both groups and cross-border elements. That's very important, of course, in all of this coordination with the instruments of UNCITRAL were fully executed and enforced. We actually shared the same experts that UNCITRAL had used in the drafting of their own instrument. So there was a lot of full coordination here. And I don't like to identify experts, but I think the work of Janis Sarra and Irit Mevorach here was fantastic, as so many along the way. So I think it's worth mentioning them here because it underlines the coordination with the insolvency work of financial. And I'll just leave it here. I could speak for a very much longer time and I apologize if I've taken too long.

EV (26:14): Thank you, Ignacio, and thank you for trying to summarize such a complex and long document in a few minutes. I know that it's a very, very difficult task, so thank you for this. Myrte, I'll get back to you. My question is about future developments. How do you perceive the potential application of the legislative guide, and in your view, how might member states utilize this guide in practice?

MT (26:36): Yes, thank you very much. So the instrument takes the form of a legislative guide. So as Ignacio also mentioned, the addressees here are legislators and policymakers. And we very much hope that they will use the guide as a tool to help them design effective bank liquidation frameworks. We expected that the guide would be especially useful for countries that do not have specific rules for bank liquidation yet, so that either just use their general insolvency law or they don't have a specific framework for banks yet.

So they might use the guide to introduce an entire framework. At the same time, there may also be jurisdictions that already do have bank-specific rules for bank liquidation, but that would like to update their existing framework. or would like to enhance their existing framework. So since the legislative guides provides quite detailed guidance, there may be jurisdictions that have some of those rules in their frameworks already, while others may be lacking. So we think it might be useful for those countries as well. And we know that some jurisdictions are already examining the guides to use it for potential reforms in their countries. So we're very happy with that.

Now, the guides is written in a way that it can be used by any jurisdiction. Of course, it recognizes that banking sectors differ across countries, and that also legal and judicial frameworks differ. So in several chapters, it provides different options that countries can consider, and they can choose the option that is most appropriate for their own legal system.

In the legislative guide, there's a distinction we make between jurisdictions with a single-track regime and jurisdictions with a dual-track regime. So a single-track regime refers to countries that have one single framework for dealing with bank failures. This is the case, for example, in the US. And dual-track regimes are those where there is this clear distinction between resolution procedures on the one hand, generally reserved for systemic banks, and liquidation regimes on the other hand.

So in four jurisdictions that have a dual-track regime, this guide is relevant for the liquidation track. And actually, the guidance in all the chapters is relevant for those countries. For countries that have a single-track regime, so they already have one statute dealing with any kind of bank failure management, some aspects of the guide are less relevant. So for example, the part on institutional frameworks, where as Ignacio explained, the guides recommends having an administrative model, well jurisdictions that have a single-track regime, they will already have an administrative model because normally those regimes are inspired by the FSP key attributes.

So the guidance is relevant both for single and dual-track regimes, but if you wish, more relevant for those with a dual-track system. The guide doesn't prescribe at which level provisions should be included in the legal framework. So it leaves this up to jurisdictions. but it does acknowledge that most of the guidance will be expected to be included in primary law. Of course, there are recommendations in the guides, but it's not a model law. So it's not provisions that can be directly copy pasted into national legislation. It's rather, it can rather be seen as a checklist for of elements that should be included in the national

framework for a bank liquidation framework to be effective, or scripts for legislators, as Ignacio just called it.

Now, how can we help? As UNIDROIT Secretariat, we can provide training to our own member states that may wish to implement the guidance. And we will also work with other partner organizations that conduct technical assistance programs to support states in introducing or updating bank liquidation frameworks. The legislative guides can of course be used by our member states, but also by non-member states. So UNIDROIT always publishes all its instruments on its websites. So also the legislative guide on bank liquidation will be made accessible to anybody who wishes to consult it on our website for free.

And to really encourage the use of the legislative guide across the world, we will make it available in several languages. So we're starting with English and French because those are the UNIDROIT working languages, but unofficial translations in other languages will follow. And we know that already the Chinese and the Japanese translation are underway, but we expect several more languages. So we really hope that this helps in disseminating the guide across jurisdictions and enabling different countries to really use the guidance and implement it into their national frameworks.

SG (31:29): Wow, thank you, Myrte. Still a long way to go. Once again, thank you very much to Ignacio and Myrte for sharing your insights and opportunities. This has been an incredible, engaging, and informative discussion, and I'm confident our audience has gained valuable perspectives. Thank you again, and thank you to everyone for tuning in. We're looking forward to seeing you in our future events.

Outro Music (31:54): If you have enjoyed this podcast, make sure to subscribe on your favourite podcast provider so you don't miss an episode. Contact us on LinkedIn and Twitter at INSOL international using the hashtag #INSOLTalks. The information provided is intended for a general audience and reflects the personal views of the participants. Thank you for listening.