



# **Study on the differences between bank insolvency laws and on their potential harmonisation**

Final report

VVA, Grimaldi & Bruegel  
November – 2019

DG FISMA

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## **EUROPEAN COMMISSION**

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## 1. INTRODUCTION

The study was commissioned by the Directorate-General for Financial Services (DG FISMA) and was carried out by VVA, Grimaldi and Bruegel. This final report presents the results of all four tasks of the study, as set out below.

By analysing the differences that can be found in the legislative regimes applicable at national level to bank insolvency proceedings (Task 1) and determining how these national insolvency regimes differ from the resolution regime as set out in the Bank Recovery and Resolution Directive (BRRD) and Single Resolution Mechanism Regulation (SRMR) (Task 2), the study assesses the potential disadvantages of a non-harmonised bank insolvency regime (Task 3). Taking these disadvantages into account, several policy options are identified to address these divergences and harmonise bank insolvency regimes in EU Member States (Task 4). The feasibility, benefits, obstacles and impact of these options are discussed.

The study is based on an analysis of the national legislative frameworks applicable to insolvent banks in the EU-28, Switzerland and the US. The latter country in particular, with its FDIC being entrusted with wide administrative powers and tools to resolve failing banks, provided inspiration for the EU resolution framework. The US example therefore serves as a useful point of comparison and reference in terms of the potential for a harmonised administrative liquidation regime in the EU.

### 1.1. Structure of the report

This report is structured as follows:

- **Chapter 2** presents the analysis of differences in the legislative regimes applicable at national level to national bank insolvency proceedings (Task 1). It examines, based on an analysis of the laws applicable in various Member States, the objective of the national insolvency procedure, any applicable pre-insolvency / restructuring / stabilisation measures, the triggers of the insolvency procedure, who has standing to file for insolvency, the appointment of liquidators/administrators and their powers, how creditors are admitted to the insolvency estate, the hierarchy of claims, the tools available to manage a bank's failure, and finally the means available to challenge an insolvency proceeding.
- **Chapter 3** presents the results of the stakeholder consultation assessing the possible disadvantages of a non-harmonised bank insolvency regime (Task 3) and the potential available options in terms of the harmonisation of national regimes (Task 4). These options are assessed on their impact, feasibility, benefits and obstacles. This assessment has been conducted with input from competent national banking authorities as well as industry stakeholders at a European level.
- **Chapter 4** presents policy considerations on the current EU regime for FOLF banks. It outlines the EU regime for FOLF banks and presents a problem analysis including legislative references to the interaction between resolution and insolvency (Task 4).
- **Chapter 5** contains concluding remarks on the study and considerations on possible reform of some specific aspects of the current framework.
- **Annex 1** contains legislative acts used as reference for the analysis.
- **Annex 2** contains a set of reports which present more in detail the characteristics of national insolvency regimes for a selection of countries. These reports have been completed by national legal experts, with input being provided by the national resolution authorities.



## 1.2. Some preliminary clarifications on key concepts

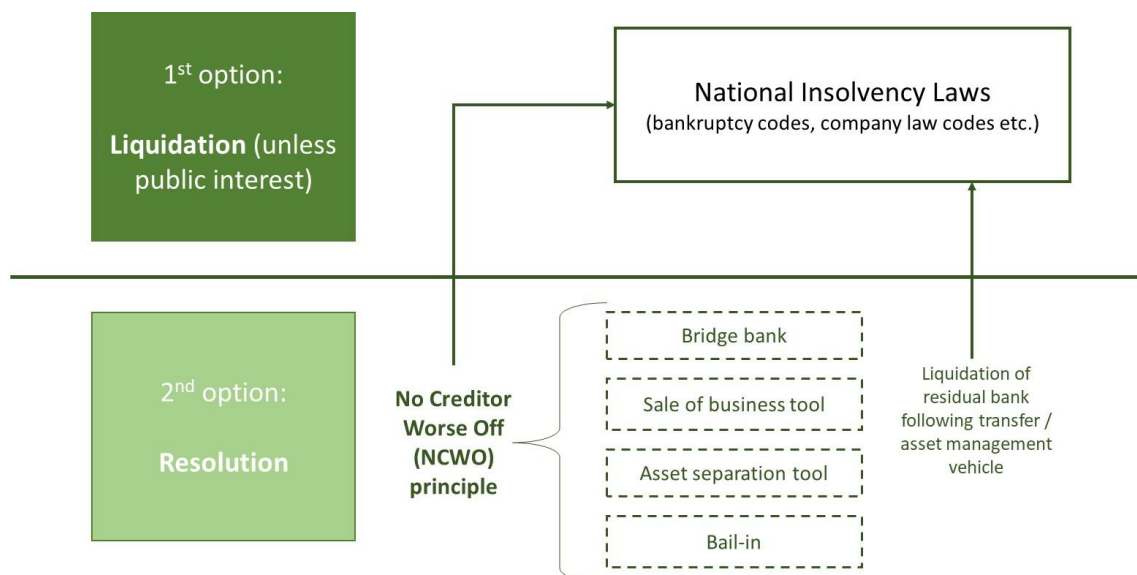
It is important to note that the term, and indeed the concept, of 'insolvency' does not necessarily refer to the same type of proceeding or the same kind of measure across jurisdictions. Also, whereas in some EU Member States 'resolution' and 'insolvency' are governed by distinct legislative acts, in other countries the two concepts are covered by a single bank insolvency legislative framework. For this report, please refer to the glossary below for definitions of key terms.

This difference in approach reflects, among other things, the historical evolution of the individual frameworks (separate resolution regimes tend to be a more recent development) and the balance between administrative and judicial responsibilities.<sup>1</sup>

The fact that some MSs enshrine the principles governing resolution and insolvency in one legal act can lead to confusion as to how they interact and the circumstances in which one or other of the procedures is used. Equally, the degree to which the two concepts are intertwined has an effect on how easy it would be to harmonise national insolvency proceedings across EU MSs.

As Figure 1 below depicts, the resolution of banks according to the rules set out in the EU Bank Recovery and Resolution Directive (BRRD) and the single Resolution Mechanism Regulation (SRMR) provides a carve out from national insolvency rules, to be utilised only if liquidation under national insolvency proceedings is not adequate to manage the failure of a certain bank. This is likely to be the case for systemically important banks which can be expected to provide critical functions to the economy. If resolution is deemed to be appropriate, the resolution authority determines which resolution tools are to be applied to the bank. The resolution tools are the sale of business tool, the bridge institution tool, the asset separation tool, and the bail-in tool.

Figure 1: Articulation of insolvency and resolution



<sup>1</sup> Financial Stability Institute, FSI Insights on policy implementation No 10, *How to manage failures of non-systemic banks? A review of country practices*, October 2018, hereinafter "BIS, 2018", available at: <https://www.bis.org/fsi/publ/insights10.pdf>

### 1.3. Glossary of key terms

The present report is based on an analysis of the **national insolvency laws** of Member States (as well as Switzerland and the United States) applicable to banks. For the purpose of this study, terms such as “national insolvency laws”, “insolvency laws applicable to banks” or “national bank insolvency proceedings” are used non-technically, to encompass all the procedures which, in our understanding, apply in the event of the failure of a bank, other than resolution as set out in BRRD/SRMR. In other words, the terms are not meant to correspond to a specific terminology available in EU or national legislation.

On the other hand, when the term “normal insolvency proceedings” is used, this corresponds to the definition in Article 2(47) BRRD, which designates collective insolvency proceedings entailing the partial or total divestment of a debtor and the appointment of a liquidator or an administrator, normally applicable to institutions under national law, and either specific to those institutions or generally applicable to any natural or legal person.

Below is a non-exhaustive list of some of the key terms used in this study. Where an Article in the definitions below is mentioned, unless otherwise stated, the Article refers to one contained in the BRRD.

- **‘resolution’** means the application of a resolution tool or a tool referred to in Article 37(9) in order to achieve one or more of the resolution objectives referred to in Article 31(2) (below);
- **‘resolution objectives’** means the resolution objectives referred to in Article 31(2), namely:
  - (a) to ensure the continuity of critical functions;
  - (b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline;
  - (c) to protect public funds by minimising reliance on extraordinary public financial support;
  - (d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC;
  - (e) to protect client funds and client assets.
- **‘resolution authority’** means an authority designated by a Member State in accordance with Article 3;
- **‘resolution tool’** means a resolution tool referred to in Article 37(3), namely:
  - (a) the sale of business tool;
  - (b) the bridge institution tool;
  - (c) the asset separation tool;
  - (d) the bail-in tool.
- **‘resolution power’** means a power referred to in Articles 63 to 72;

- **'financial institution'** means a financial institution as defined in point (26) of Article 4(1) of Regulation (EU) No 575/2013;
- **'cross-border group'** means a group having group entities established in more than one Member State;
- **'winding up'** means the realisation of assets of an institution or entity referred to in point (b), (c) or (d) of Article 1(1), namely:
  - (b) financial institutions that are established in the Union when the financial institution is a subsidiary of a credit institution or investment firm, or of a company referred to in point (c) or (d), and is covered by the supervision of the parent undertaking on a consolidated basis in accordance with Articles 6 to 17 of Regulation (EU) No 575/2013;
  - (c) financial holding companies, mixed financial holding companies and mixed activity holding companies that are established in the Union;
  - (d) parent financial holding companies in a Member State, Union parent financial holding companies, parent mixed financial holding companies in a Member State, Union parent mixed financial holding companies;
- **'asset separation tool'** means the mechanism for effecting a transfer by a resolution authority of assets, rights or liabilities of an institution under resolution to an asset management vehicle in accordance with Article 42;
- **'asset management vehicle'** means a legal person that meets the requirements laid down in Article 42(2), namely:
  - (a) it is wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority;
  - (b) it has been created for the purpose of receiving some or all of the assets, rights and liabilities of one or more institutions under resolution or a bridge institution.
- **'bail-in tool'** means the mechanism for effecting the exercise by a resolution authority of the write-down and conversion powers in relation to liabilities of an institution under resolution in accordance with Article 43;
- **'sale of business tool'** means the mechanism for effecting a transfer by a resolution authority of shares or other instruments of ownership issued by an institution under resolution, or assets, rights or liabilities, of an institution under resolution to a purchaser that is not a bridge institution, in accordance with Article 38;
- **'bridge institution'** means a legal person that meets the requirements laid down in Article 40(2), namely:
  - (a) it is wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority;
  - (b) it is created for the purpose of receiving and holding some or all of the shares or other instruments of ownership issued by an institution under resolution or some or all of the assets, rights and liabilities of one or more institutions under resolution with a view to maintaining access to critical

functions and selling the institution or entity referred to in point (b), (c) or (d) of Article 1(1).

- **'bridge institution tool'** means the mechanism for transferring shares or other instruments of ownership issued by an institution under resolution or assets, rights or liabilities of an institution under resolution to a bridge institution, in accordance with Article 40;
- **'secured liability'** means a liability where the right of the creditor to payment or other form of performance is secured by a charge, pledge or lien, or collateral arrangements including liabilities arising from repurchase transactions and other title transfer collateral arrangements;
- **'Common Equity Tier 1 instruments' (CET1)** means capital instruments that meet the conditions laid down in Article 28(1) to (4), Article 29(1) to (5) or Article 31(1) of Regulation (EU) No 575/2013;
- **'Additional Tier 1 instruments' (AT1)** means capital instruments that meet the conditions laid down in Article 52(1) of Regulation (EU) No 575/2013;
- **'Tier 2 instruments' (T2)** means capital instruments or subordinated loans that meet the conditions laid down in Article 63 of Regulation (EU) No 575/2013;
- **'national competent authority' (NCA)** means the national organisation with the legally delegated or invested power to monitor compliance of national insolvency proceedings with national statutes and laws.

## 2. ANALYSIS OF DIFFERENCES IN LEGISLATIVE REGIMES APPLICABLE AT NATIONAL LEVEL TO NATIONAL BANK INSOLVENCY PROCEEDINGS

The cross-country analysis carried out for the purpose of this study comprises an examination of the applicable insolvency proceedings at national level in all 28 EU MSs, as well as Switzerland and the US.

As a useful first point of reference, the table below provides an overview of two key groupings that we have identified:

- *Free-standing bank insolvency regimes*: this refers to regimes in which the provisions governing bank insolvency are contained in a separate statute or legislative act that is distinct from the general corporate insolvency regime (i.e. the bank insolvency regime is predominantly bank-specific).
- *Modified insolvency regimes*: this means that general corporate insolvency laws apply to banks, but they are complemented or amended by specific provisions to address bank specificities.<sup>2</sup>

**Table 1: Free-standing bank insolvency regimes vs. Modified insolvency regimes**

Free-standing bank insolvency regimes	Modified insolvency regimes
Austria (AT), Bulgaria (BG), Cyprus (CY), Greece (EL), Italy (IT), Latvia (LV), Luxembourg (LU), Netherlands (NL), Poland (PL), Slovenia (SI), Switzerland (CH), United States (US) <sup>3</sup>	Belgium (BE), Croatia (HR), Cyprus (CY), <sup>4</sup> Czechia (CZ), Denmark (DK), Estonia (EE), Germany (DE), Finland (FI), France (FR), Hungary (HU), Ireland (IE), Lithuania (LT), Malta (MT), Romania (RO), Portugal (PT), Slovakia (SK), Spain (ES), Sweden (SE), United Kingdom (UK)

A second classification is related to proceedings that can be either predominantly administrative or court-based. Bank insolvency regimes broadly take one of two possible forms:

- *Administrative bank insolvency proceedings*: the insolvency proceeding is managed by an administrative authority with little or no role for judicial authorities.
- *Court-based bank insolvency proceedings*: the proceeding is driven by a liquidator who is an officer of the court, with a generally limited role for administrative authorities.<sup>5</sup>

<sup>2</sup> BIS, 2018

<sup>3</sup> The country codes used in this reports are taken from the country codes provided by Eurostat, available at: [https://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:Country\\_codes](https://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:Country_codes)

<sup>4</sup> Cyprus has a general banking insolvency regime, which is court based, and also a special banking insolvency regime, which is run by a special liquidator controlled by the Central Bank of Cyprus. This is why it is mentioned in both columns.

<sup>5</sup> BIS, 2018

Table 2 below illustrates how bank insolvency regimes combine the various options under the two classifications in different ways. While free-standing insolvency regimes are usually administrative (e.g. EL, IT, USA), this is not true of all free-standing bank insolvency regimes. For example, in Luxembourg the regime is separate from ordinary corporate insolvency but remains court-based. Modified insolvency regimes (where the generally applicable insolvency regimes have been modified with specific provisions for certain key aspects of bank insolvency) tend to be court-based, as is the case in fifteen MSs.<sup>6</sup>

For those countries where the regime is court-based, the degree of involvement of administrative authorities varies considerably. At one end of the spectrum, in Luxembourg the proceedings are entirely judicial. In Ireland on the other hand, the liquidation committee (established after a winding-up order has been obtained from the court) is made up of individuals from the administrative authority and someone nominated by the Minister for Finance.<sup>7</sup> In Portugal, the Bank of Portugal has wide discretion to intervene in the judicial proceedings.

**Table 2: Type of regime and administrative vs court-based proceedings**

Country	Type of regime	Administrative vs court-based proceedings
Austria	Free-standing bank insolvency regime	Administrative
Belgium	Modified insolvency regime	Court-based
Bulgaria	Free-standing bank insolvency regime	Court-based
Croatia	Modified insolvency regime	Court-based
Cyprus	Free-standing bank insolvency regime <sup>8</sup>	Court-based
Czechia	Modified insolvency regime	Court-based
Denmark	Modified insolvency regime	Court-based
Estonia	Modified insolvency regime	Court-based
Finland	Modified insolvency regime	Court-based
France	Modified insolvency regime	Court-based
Germany	Modified insolvency regime	Court-based
Greece	Free-standing bank insolvency regime	Administrative
Hungary	Modified insolvency regime	Court-based

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.*

<sup>8</sup> Cyprus has a general banking insolvency regime, which is court based, and also a special banking insolvency regime, which is run by a special liquidator controlled by the Central Bank of Cyprus. This is why it is mentioned in both columns.

Country	Type of regime	Administrative vs court-based proceedings
Ireland	Modified insolvency regime	Court-based
Italy	Free-standing bank insolvency regime	Administrative
Latvia	Free-standing bank insolvency regime	Administrative
Lithuania	Modified insolvency regime	Court-based
Luxembourg	Free-standing bank insolvency regime	Court-based
Malta	Free-standing bank insolvency regime	Court-based
Netherlands	Free-standing bank insolvency regime	Court-based
Poland	Modified insolvency regime	Administrative
Portugal	Free-standing bank insolvency regime	Court-based
Romania	Modified insolvency regime	Administrative
Slovakia	Modified insolvency regime	Court-based
Slovenia	Free-standing bank insolvency regime	Administrative*
Spain	Modified insolvency regime	Court-based
Sweden	Modified insolvency regime	Court-based
Switzerland	Free-standing bank insolvency regime	Administrative
UK	Modified insolvency regime	Court-based
USA	Free-standing bank insolvency regime	Administrative

Source: own research, BIS (2018), European Parliament (2019)

\*The legislation also provides for a second, court-based step (under certain legal conditions and subject to the input of the administrative authority).

## 2.1. Objective of the insolvency procedure

National insolvency regimes for banks are generally structured around the objective of monetising the assets of the bank through its sale and distributing the proceeds in order to settle creditors' claims in a specified order of priority. While this objective of **maximising value for creditors** is common to corporate insolvency and bank insolvency, the latter regime often includes **depositor protection** as an additional, and sometimes explicit, statutory objective.

In some cases, such as in the UK, the objective of ensuring that each eligible depositor either has their account transferred to another financial institution or receives payment from the Financial Services Compensation Scheme (FSCS – the UK's statutory deposit insurance and investors' compensation scheme) actually takes precedence over the objective of achieving the best result for the bank's creditors as a whole.<sup>9</sup> This is the same in Ireland, where, in the event of a conflict between the two statutory objectives of depositor protection and maximising value for creditors, it is the former objective that receives priority.<sup>10</sup>

The objective of national insolvency procedures also differs between Member States according to whether national law allows for reorganisation / recovery of the bank as an alternative to the sale of the assets of the institution in a piecemeal fashion to repay creditors. It can be noted that the insolvency regimes of certain Member States (most notably Italy and to a lesser extent Slovenia) are geared towards **restructuring the bank and preserving its activities to the greatest extent possible, and that this is apparent in the objectives** of the insolvency procedure. In Italy, where the objectives pursued differ according to the intrinsic severity of the crisis, for a crisis that is reversible, the main objective is to safeguard market confidence in the ability of the institution to fulfil its functions.

Outside the EU, the framework applicable in the US also allows banks falling within the remit of the FDIC to undergo restructuring measures, such as the management of the bank through a receiver, and the transfer of assets and liabilities to a buyer. The objective of receivership is for the institution in question to be managed in such a way so as to maximise net return, and then terminated in an orderly and timely manner.

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<sup>9</sup> UK Banking Act 2009, s99

<sup>10</sup> Irish Central Bank and Credit Institutions (Resolution) Act 2011, s80



## 2.2. Pre-insolvency / restructuring

The BRRD provides supervisory authorities with early intervention powers, designed to prevent further deterioration of the financial conditions of a failing institution. With the transposition into national laws of the provisions of the BRRD, all Member States' legal regimes include pre-insolvency measures deriving from the Directive. These include the power of the competent authorities to require the institution's management to draw up an action programme or to change the institution's business strategy or implement an action foreseen in the recovery plan, the power to change the institution's operational structure through the appointment of a temporary administrator and/or special manager. In some Member States, however, pre-insolvency measures already existed before the adoption of BRRD as part of their national legal framework and in some cases provide measures additional to those introduced with the BRRD transposition.

The measures outlined below all have in common the objective of restructuring the institution and the fact they are applied before the bank is considered insolvent pursuant to national law. It is our understanding that these measures can apply (and have occasionally been applied)<sup>11</sup> to banks declared failing or likely to fail in line with BRRD/SRMR.

The measures however differ substantially as to the type of powers and means of implementation, as well as the conditions triggering them. In some cases, these pre-insolvency measures are actually qualified as "normal insolvency proceedings" in national law, for the purposes of BRRD transposition.

In **Austria**, for example, where the fulfilment of a credit institution's obligations to its creditors is at risk, the Financial Market Authority (FMA) may issue an **administrative ruling ('Bescheid') ordering time-restricted measures in order to avert the risk**. These administrative rulings can completely or partially prohibit withdrawals and distributions of capital and earnings, appoint an expert supervisor to prohibit the credit institutions from any transactions which might serve to exacerbate the danger, can prevent directors of the credit institution from managing the credit institution, or prohibit the continuation of business operations.<sup>12</sup> These measures must end, at the latest, after 18 months of coming into effect.

Under Austrian law, a "receivership" proceeding is also available under certain circumstances. The procedure is activated when there is a possibility for the bank's over indebtedness to be solved. Under the receivership, the bank continues its activities under the supervision of a receiver appointed by the court. The main aim of the receivership is the full recovery of the credit institution, without causing prejudice to creditors. In the course of the receivership, the bank is subject to a moratorium, which provides for temporary deferral of existing claims, and to comprehensive supervision of the management body. As soon as the receivership procedure has been opened, all claims arising prior to the receivership are deferred if they must be satisfied from the insolvency estate; the payment is delayed until the end of receivership.

In the course of the receivership, the liquidator may sell the assets out of court freely. However, in certain cases, the approval of the court and of the creditors' committee is necessary. These include (i) sale or lease of the company as a whole, (ii) sale or lease of all movable fixed and current assets or parts thereof which are necessary for continuing the business, and (iii) sale or lease of immovable assets in out of court sale.

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<sup>11</sup> An example being the application of the suspension of payments in Luxembourg to the relevant subsidiary of the Latvian bank ABLV, see [https://www.cssf.lu/fileadmin/files/Publications/Communiques/Communiques\\_2018/PR1809\\_ABLV\\_administrators\\_090318.pdf](https://www.cssf.lu/fileadmin/files/Publications/Communiques/Communiques_2018/PR1809_ABLV_administrators_090318.pdf)

<sup>12</sup> Austrian Federal Banking Act (BWG), Art 70(2)

In such cases, the intention of sale or lease is to be made public at least 14 calendar days prior to sale. Furthermore, the liquidator may request the court sale (requiring an explicit decision by the court). If the receiver comes to the decision that the material insolvency cannot be remedied, he or she may require the bankruptcy court to initiate a bankruptcy proceeding.

Some MSs provide national authorities with the means to restructure a failing bank to aid with a view to avoiding insolvency and instead aiding the recovery of the bank. The **Italian** Consolidated Law on Banking provides for a **process of special administration ('amministrazione straordinaria')**, a procedure specifically designed for banks. In particular, Article 75-bis of the aforementioned Law provides that, when the conditions for the special administration procedure laid down in Article 70 are met, instead of removing the management bodies, the Bank of Italy may decide to appoint one or more special administrators who will temporarily work together with the board of directors or other management body. In the appointment decision, the Bank of Italy will identify the role, duties and powers of the special administrators as well as the relationship with the management body. This includes the obligation of the management to obtain the preventive opinion of the special administrator for certain acts.

In **Luxembourg**, national laws provide for an **elaborate form of pre-insolvency procedure called suspension of payments**. It is triggered when one of the following conditions is present: i) the credit of the institution is shaken or when it reached an impasse regarding liquidity, ii) the execution of the institution's commitments is compromised, iii) the authorisation of the institution was withdrawn and this decision is not yet final.<sup>13</sup> Only the CSSF (Commission de Surveillance du Secteur Financier) or the credit institution itself may apply to the Tribunal for the suspension of payments. From the filing of the application with the Tribunal, the CSSF takes quasi-control of the credit institution and all payments by the institution are suspended. The suspension of payments shall be in force for a period of time not exceeding six months.

In **Bulgaria**, a **'special supervision regime'** is in place. The Bulgarian National Bank is competent, inter alia, to set the terms and conditions of the special supervision, and has the power to reduce interest rates on the bank's obligations down to their average market rate, to suspend for a set term the full or partial payment of some or all of the bank's obligations, to restrict the bank's activities, to remove from office members of the board of directors, and to temporarily suspend the voting rights of shareholders.

Most national regimes also provide for the possibility to implement restructuring actions to avoid insolvency in the form of **arrangements with creditors and shareholders**. Such arrangements, which typically entail the modification of the creditors' and shareholders' rights, generally require approval by a majority of each of the bank's class shareholders and the majority in value of each of the different classes of the bank's creditors, and should be sanctioned by the court. However, some national laws provide for the possibility of adopting such arrangements in relation to a distressed bank even without convening a creditors meeting.

In **Cyprus**, for example, the principles of the Companies Law relating to schemes of arrangement apply also to credit institutions, albeit with a couple of bank-specific stipulations. Unlike under corporate law where the procedure is capable of initiation only by the institution, a shareholder, a creditor or the liquidator, in the case of a credit institution, the Central Bank may also initiate the procedure for the approval of such a

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<sup>13</sup> Luxembourgish Law of 18 December 2015 on the resolution, reorganisation and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes, Art 122. It is our understanding that the suspension of payments is qualified as a "normal insolvency proceeding" for the purposes of BRRD transposition

scheme. Moreover, according to section 33 of the Banking Law, a scheme of arrangement may be put into effect in relation to a distressed bank even without convening a creditors meeting (as opposed to the generally applicable regime of the Companies Law) albeit to the extent the rights of shareholders are concerned with the approval of the shareholders' meeting and, in every case, with the sanction of the competent court.

In **France** too, the legal representatives of a company experiencing difficulties that it cannot overcome, but which is not yet cash-flow insolvent, can apply to the court for the opening of solvent reorganisation proceedings, known as **safeguard proceedings**. The judgment commencing safeguard proceedings opens a six-month period, called an 'observation period' (renewable for up to a total maximum period of 18 months), during which the company will negotiate with its creditors a rescheduling or waiver of debts that arose prior to the start of the safeguard proceedings. The consent of the creditors, who are part of the safeguard proceedings, is necessary.

A similar procedure is also available in Finnish law. In particular, the **Act on the Temporary Interruption of the Operations of a Deposit Bank** (1509/2001) is designed to manage a sudden bank run (where a large number of depositors or other financial institutions withdraw their deposits simultaneously over concerns of the bank's solvency). Under this Act, the Finnish Ministry of Finance has the power to decide on the interruption of operations of a bank, while a Finnish court shall have the power to decide on the opening or reorganisation measures in a bank.

If it is evident that a bank cannot meet its obligations, the bank shall, without delay, notify the Ministry of Finance, the Bank of Finland and the Financial Supervision Authority thereof. An account of the liquidity of the bank and the reasons for its weakening should be included with the notification. If, in the opinion of the Bank of Finland or the Financial Supervision Authority, the liquidity of the bank has weakened to the extent that it is likely that it cannot meet its obligations, either of these two entities shall notify the Ministry of Finance thereof without delay.<sup>14</sup>

The Ministry of Finance may interrupt the operations of a bank for a period of not more than one month if it is evident that the continuance of the operations would seriously endanger the stability of the financial markets, the undisturbed operation of the payment systems or the interests of the creditors. The Ministry of Finance may, for a special reason, decide to continue the interruption, prolonging it by one month at a time for a period not exceeding six months in total from the date of the initial interruption decision.<sup>15</sup>

During the period of interruption to the bank's operations, it may not be placed in liquidation or in bankruptcy. Any application to this effect during the period of interruption shall be deferred until the interruption procedure is terminated.<sup>16</sup> Also, the bank must, without delay after the decision to interrupt, draw up a plan indicating the manner in which it intends to reorganise its financial position or, in the case that is not possible, the manner in which it intends to terminate its operations.

The Ministry of Finance shall withdraw the interruption immediately where the preconditions for the interruption no longer exist. The Ministry shall, prior to making the decision to withdraw the interruption, request an opinion of the Bank of Finland and the

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<sup>14</sup> Finnish Act on the Temporary Interruption of the Operations of a Deposit Bank (1509/2001), Section 2

<sup>15</sup> *Ibid*, Section 3

<sup>16</sup> *Ibid*, Section 9

Financial Supervision Authority thereon.<sup>17</sup> Alternatively, the interruption shall expire when the time limit previously set has expired (in any case at the latest six months from the decision to interrupt).<sup>18</sup>

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<sup>17</sup> *Ibid*, Section 15

<sup>18</sup> *Ibid*, Section 16

## 2.3. Insolvency test (triggers of insolvency procedures)

The conditions enabling the taking of resolution action by a resolution authority are the same in all Member States, as they arise from Article 32 BRRD. However, each Member State has its own set of conditions for declaring that a bank is insolvent, which can be common to all firms undergoing bankruptcy proceedings or bank specific.

Below, we provide an overview of the conditions for triggering insolvency and we compare them with the conditions for resolution provided for in the BRRD, with particular focus on the determination that an institution is failing or is likely to fail.

### 2.3.1. Conditions for resolution under the BRRD

Article 32(1) BRRD sets out the three conditions for triggering resolution, namely:

- the institution is failing or is likely to fail (FOLF),
- having regard to timing and other relevant circumstances, there is no reasonable prospect that any private sector measures would prevent the failure of the institution within a reasonable timeframe,
- a resolution action is necessary in the public interest (meaning that resolution is necessary for the achievement of and is proportionate to one or more of the resolution objectives and the winding up of the institution under normal insolvency proceedings would not meet those objectives to the same extent).

In terms of the first criterion, the institution being in a state of failure or likely failure, Article 32(4) provides the circumstances according to which FOLF arises:

(a) **the institution infringes or** there are objective elements to support a determination that the institution **will, in the near future, infringe the requirements for continuing authorisation** in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;

(b) **the assets of the institution are or** there are objective elements to support a determination that the assets of the institution **will, in the near future, be less than its liabilities**;

(c) **the institution is or** there are objective elements to support a determination that the institution **will, in the near future, be unable to pay its debts or other liabilities as they fall due**;

(d) **extraordinary public financial support is required** except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:

(i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions;

(ii) a State guarantee of newly issued liabilities; or

(iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Article 59(3) are present at the time the public support is granted.

### 2.3.2. Balance sheet and cash flow insolvency

The grounds for opening insolvency proceedings are typically based on 'balance sheet insolvency', where liabilities exceed assets (over-indebtedness), and on 'cash flow insolvency', where the bank is unable to pay its debts as they fall due (illiquidity). Although different terminology is used to describe this state – some countries refer directly to liabilities exceeding assets (CZ, DE, HR, HU, IT, LT, LV, NL, SK) or a bank being unable to pay its debts (BE, CY, CZ, DE, DK, FI, HR, HU, IT, LV, MT, NL, RO, SE, SK, UK), while others use terms such as 'material insolvency' (AT) or inability to fulfil / falling short of obligations required (ES) to creditors (IE), – **the idea of balance sheet and/or cash flow insolvency is essentially one that is common** among EU Member States. These criteria correspond, in substance, to the BRRD assessment of FOLF in terms of Article 32(4) (b) and (c).

Interestingly, in Member States such as the Netherlands and Italy, the triggers for insolvency are closely linked with the conditions for resolution, particularly with the FOLF assessment and the absence of an alternative private sector measure or supervisory action able to prevent that failure in a timely manner. In the Netherlands, the Dutch Central Bank may request to the court the initiation of bankruptcy proceedings where the conditions referred to in Article 18(1)(a) and (b) of SRMR<sup>19</sup> are met<sup>20</sup>. Similarly, in Italy, the Minister for the Economy and Finance can initiate insolvency proceedings, based on a proposal by the Bank of Italy, where a bank meets the first two conditions for resolution mentioned under the provisions transposing Article 32(1)(a) and (b) into Italian law but not the third condition requiring that there is public interest in the application of resolution action.

However, for the majority of Member States that have not directly aligned their insolvency triggers with the conditions for resolution, particularly with the FOLF assessment, national nuances of the balance sheet and cash flow criteria exist. This can give rise to the risk that a bank that has been declared FOLF but does not meet the public interest criteria cannot be liquidated under normal insolvency proceedings for not meeting the respective conditions.

This is particularly the case in MS that do not encompass a forward-looking criterion (corresponding to the "likely to fail") in their conditions for insolvency. Several MSs (particularly CZ, DE, FR, HU, IE, IT, LT, NL, UK) include some element of forward-looking analysis in the assessment of the grounds for triggering bank insolvency. The type of analysis can vary but in many of these cases (such as in the law of IT, IE, LT or NL) this may entail an assessment that the bank is likely to become balance sheet or cash flow insolvent. These countries may be described as being more proactive in their approach, as their anticipatory nature allows action to be taken earlier than when failure of a bank appears unavoidable. However, in other Member States, the forward-looking criterion appears to be entirely missing (BG and LV as concerns over-indebtedness, DK, HR and SK as concerns illiquidity) or may become relevant only with the consent of the bank (DE, FI as concerns the illiquidity trigger).

Some insolvency laws require that the procedure is triggered only if certain conditions persist for a period of time. In some countries, illiquidity is required to persist for a minimum period of 30 days (SK), 5 days (HU) or 8 days (LV) or has to be not temporary (DK and FI). Alternatively, it may be founded if the institution has failed to pay a sum exceeding €5000 for three weeks (CY). In CY, over-indebtedness cannot constitute a

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<sup>19</sup> These provisions correspond to Article 32(1)(a) and (b) BRRD.

<sup>20</sup> It should be noted that, while there is some space for assessment by the court on whether those conditions are met, that space is very marginal, and the opinion of the Dutch Central Bank assumes a key role.

separate insolvency trigger, but must be combined with illiquidity. In DK, subordinated debt is not considered for the purpose of the illiquidity test.

### 2.3.3. Material regulatory breaches

More than a third of Member States, as well as Switzerland, include as a trigger for insolvency **the infringement of the requirements for continuing authorisation** in a manner that would justify withdrawal of this authorisation (a comparison with the first element in the definition of FOLF taken from Article 32(4)(a)). These may be referred to as “material regulatory breaches”.

In Lithuania, Part 1 of Article 84 of the Law on Banks provides that a bank may be declared insolvent if there are objective factors supporting an assessment that in the near future a bank will violate requirements applicable for the issue of the licence so that the supervisory authority would have grounds for revocation of the licence. This condition alone is sufficient to trigger insolvency proceedings.

However, in most of the Member States that include material regulatory breaches in the insolvency triggers, the withdrawal of authorisation is a necessary condition for the initiation of bank insolvency proceedings. Therefore, unlike under Art. 32(4)(a) BRRD, it may not be sufficient that material conditions for the withdrawal of authorisation are *likely* to be met, but rather authorisation actually *has* to be withdrawn.

For a few Member States, the withdrawal of authorisation might be the necessary and the *only* explicit ground to initiate bank insolvency. This is the case for example in Bulgaria and Portugal, where national law specifies that the sole trigger to commence insolvency proceedings is the revocation of the bank’s authorisation by the supervisor. In these cases, over-indebtedness and illiquidity might constitute only indirect insolvency triggers, notably where they have been included among the circumstances under which the NCAs can withdraw authorisation.

For the remaining Member States requiring a formal authorisation withdrawal, the law requires that specific insolvency triggers materialise *along with* that withdrawal.

In Cyprus, according to section 33B of the Banking Law regulating the special banking liquidation regime, the revocation of a bank’s licence may (but does not have to) constitute a reason for a bank to be wound up. “Irrespective of the provisions of the Companies Law with respect to the winding up of a company and the provisions of the Cooperative Societies Law with respect to the winding up of a cooperative society, the revocation of licence of an ACI (i.e. a bank) pursuant to section 4A, is not in itself a reason for the winding up of the subject ACI, and the winding up may occur only at the discretion of the Central Bank and following a decision of the Court of Justice after an application submitted by the Central Bank”. Moreover, the Court will only order the commencement of the special banking liquidation procedure under 33Bbis, following an application from the Central Bank of Cyprus, if the bank’s licence is revoked, if it is also established that the bank concerned keeps deposits protected by the deposit protection scheme, and if such special liquidation serves the public interest.

In Czechia, one of the three conditions to be met in order to commence insolvency proceedings against a bank is that the bank’s licence ceases to be valid. Indeed, the Czech National Bank must revoke a bank’s licence if serious shortcomings persist in the activities of a bank, if a bank faces or is in the state of insolvency, or the bank’s total capital ratio on an individual basis is lower than one third of the total capital ratio laid down in Art. 92(1)(c) of CRR (Regulation (EU) No 575/2013). The CNB may also on a discretionary basis revoke a bank’s licence if, among others:

- a) a shortcoming has been identified in the bank’s activities which can be deemed as an administrative offence pursuant to Article 36e(2)(a), (d) and (f) to (o) or Article 36e(3)(c) of the Act on Banks, or a foreign bank having its registered office



in a non-Member State carrying on activities in Czechia through its branch has committed an administrative offence pursuant to Article 36h(1)(d) or Article 36h(2)(b), (d) and (e),

b) serious shortcomings persist in the activities of a bank having its registered office in a territory other than the territory of a Member State which carries on banking activities in Czechia through its branch, or it has gone bankrupt (i.e. insolvent),

c) a final decision has been issued against a bank for a serious violation of the act laying down measures against money laundering and terrorist financing, or

d) the bank fails to comply with the requirements laid down in Part One, Four or Six of CRR, and in Art. 26(2)(a)(1) or in Art. 26(2)(c) of the Act on Banks.

In Hungary too, one of the conditions according to which the Hungarian National Bank shall initiate liquidation proceedings is if the financial institution's activity licence is withdrawn by the Hungarian National Bank pursuant to Sections 33(1)(b), 33(2)(c) or 35(3) of the Act on Credit Institutions and Financial Enterprises from 2013.

Irish law stipulates that one of the grounds on which the Irish Central Bank may present a petition to the Court for the winding-up of an authorised credit institution is when that credit institution's licence or authorisation (as applicable) has been revoked and (in the case of the holder of a licence under section 9 of the Act of 1971) that it has ceased to carry on banking business.

Romanian law provides that the withdrawal of the authorisation of the credit institution due to the impossibility of the financial recovery of a credit institution is a trigger for insolvency proceedings. According to Article 39 of the ordinance on credit institutions and capital adequacy (OUG 99/2006), the National Bank of Romania can withdraw the authorisation granted to a credit institution in the following situations (among others):

a) the credit institution no longer fulfils the conditions under which the authorisation was granted;

b) the credit institution no longer complies with the prudential requirements set out in Parts III, IV and VI of Regulation (EU) No. 575/2013 or ordered according to art. 226 par. (3) and (6) of OUG 99/2006, or there are elements that lead to the conclusion that the credit institution will no longer be able to fulfil its obligations to its creditors and, in particular, can no longer guarantee the safety of assets who were entrusted to it by its depositors;

c) the credit institution commits one of the acts provided in art. 228. of OUG 99/2006 (such as having obtained the authorisation based on providing false information, not providing certain vital information to BNR, providing incomplete or inexact information to BNR, not having liquid assets, allowing certain persons to take part in its decision board etc.)

In Switzerland, under Article 25(19) of the Banking Act, if the bank fails to comply with the capital adequacy requirements after a deadline set by FINMA, the authority may withdraw the bank's authorisation and put it into liquidation.

#### 2.3.4. Specified quantitative capital triggers

A specified quantitative capital trigger is a quantitative threshold that, if breached, can lead to the opening of insolvency proceedings. In Romania, a solvency ratio below 2% is a trigger for initiating insolvency proceedings in relation to that credit institution.



### 2.3.5. Public interest

In a few cases, **other grounds for opening insolvency proceedings** exist that are not specifically linked to actual or anticipated insolvency. For example, both the United Kingdom and Ireland have **requirements that are linked to public interest** (of particular relevance to the present report given the public interest requirement in resolution proceedings mentioned in Article 32(1)(c) BRRD).

In the UK, the grounds for triggering an insolvency proceeding are the following:

- Ground A is that a bank is unable, or likely to become unable, to pay its debts,
- Ground B is that the winding up of a bank would be in the public interest, and
- Ground C is that the winding up of a bank would be fair.<sup>21</sup>

The grounds do not apply independently, but rather apply in different combinations according to which authority is applying for the order (the Bank of England, the Prudential Regulation Authority or the "Secretary of State" – i.e. the Chancellor of the Exchequer). The only case in which the public interest test comes into play is when it is the Secretary of State applying for a bank insolvency order. In this case, he or she must be satisfied that the bank has eligible depositors and that Ground B above (that the winding up of a bank would be in the public interest) applies.<sup>22</sup> Therefore, it may be that a bank is not technically insolvent according to Ground A, but to protect its customers and the public generally, the Secretary of State is able to apply for a bank insolvency order where he or she considers that winding up the affairs of a bank is in the public interest. This provision reflects the Secretary of State's existing powers under section 124A of the Insolvency Act 1986 to present a winding-up petition against a company where that is considered to be in the public interest.

In Ireland, the Irish Central Bank may present a petition to the Court for the winding-up of an authorised credit institution on any of the following grounds:

- (a) that in the opinion of the Bank, the winding-up of that credit institution would be in the public interest;
- (b) that that credit institution is, or in the opinion of the Bank may be, unable to meet its obligations to its creditors;
- (c) that that credit institution has failed to comply with a direction of the Bank—
  - (i) in the case of the holder of a licence under section 9 of the Act of 1971, under section 21 of that Act, or
  - (ii) in the case of a building society, under section 40 (2) of the Building Societies Act 1989, or
  - (iii) in the case of a credit union, under section 87 of the Credit Union Act 1997;
- (d) that that credit institution's licence or authorisation (as applicable) has been revoked and (in the case of the holder of a licence under section 9 of the Act of 1971) that it has ceased to carry on banking business;
- (e) that the Bank considers that it is in the interest of persons having deposits (including deposits on current accounts) with that credit institution that it be wound up.<sup>23</sup>

Thus, the public interest test can in Ireland be an independent trigger for the winding-up of an authorised credit institution to occur.

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<sup>21</sup> UK Banking Act 2009, s96(1)

<sup>22</sup> *Ibid*, s96(4)

<sup>23</sup> Irish Central Bank and Credit Institutions Resolution Act, Part 7, Section 77

## 2.4. Standing to file insolvency

In general terms, 'standing' means that someone has the right to act before the court as he/she is deemed to be affected by the action of the defendant. In insolvency, standing therefore refers to those who are entitled to initiate insolvency proceedings.

In the **majority of Member States** (BG, CZ, DE, DK, EL, HR, HU, IE, LT, MT, NL, PT, RO, SK, SI, UK), the **process can be commenced by the national competent authority (NCA)**. This generally reflects the need to avoid precipitating a liquidity crisis for the bank should its creditors demand immediate repayment (a heightened concern for banks, given the leverage and maturity mismatch on their balance sheet).<sup>24</sup> In some, but not all, of those Member States, NCAs may have the exclusive right to file for insolvency. This is particularly true in those Member States where the sole insolvency trigger is the withdrawal of the credit institution's authorisation.

**Over half of the Member States** (AT, BE, CY, CZ, DK, EE, ES, FI, IE, LT, LU, LV, MT, NL, RO, SE) also enable the **insolvent bank itself to initiate the insolvency procedure**. In the Netherlands for example, a bank which has received a licence from the Dutch Central Bank or from the European Central Bank may request its own declaration of bankruptcy; in this case, the District Court shall provide the supervisor the opportunity to be heard before it decides upon the request.<sup>25</sup>

**Half of the Member States** (BE, CY, CZ, DK, EE, ES, FI, FR, LT, LV, MT, RO, SE) allow **creditors to initiate insolvency proceedings**. Interestingly, the large majority of these Member States are modified insolvency regimes, namely those where general corporate insolvency laws apply to banks, but they are complemented or amended by specific provisions to address banks' specificities.

In **seven Member States** (BE, CY, ES, FR, HR, IT, LU), the **judicial services or the public prosecutor also have the right to commence insolvency proceedings**. France is an interesting example in this regard given that the French legal regime is largely governed by the Commercial Code, and insolvency proceedings are conducted under the supervision of the commercial court with jurisdiction over the debtor.

There are several examples of cases in which a stakeholder other than those mentioned in the clusters above has standing to initiate insolvency proceedings. In the **United Kingdom**, for example, the **Secretary of State** (i.e. Chancellor of the Exchequer) may apply for a bank insolvency order only if he or she is satisfied that the bank has eligible depositors and that the winding up of a bank would be in the public interest.<sup>26</sup>

In the US meanwhile, there is no role for either creditors or judicial authorities in initiating insolvency proceedings; only the chartering agency (at state or federal level, depending on the bank's charter) and/or the primary federal regulatory agency (the Office of the Comptroller of the Currency, the Federal Reserve, and/or the FDIC) have standing to file for insolvency.

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<sup>24</sup> BIS, 2018

<sup>25</sup> Dutch Bankruptcy Act, Art 212h

<sup>26</sup> UK Banking Act 2009, s96(4)

## 2.5. Appointment of liquidators or administrators and their powers

The liquidator/administrator holds a significant role in the insolvency procedures. Taking into consideration the complexity of managing an insolvency procedure, the administrator shall in principle possess the specific knowledge and experience required and otherwise be suitable for the task. Hence, in Sweden for instance, the appointed administrator will almost invariably be a lawyer with special experience of bankruptcy administration. Similarly, in the United Kingdom, a person is eligible for appointment as a bank liquidator if qualified to act as an insolvency practitioner.

As the liquidator/administrator shall hold special expertise in insolvency proceedings, the appointment is strictly made by the Court and/or a relevant regulatory authority such as the Central Bank. **In most Member States** (BE, BG, CY, DE, DK, EE, ES, FR, HR, IE, LV, PL, PT, SE), the **appointment procedure is both judicial and administrative**, where the appointment is made by the Court upon the proposal of a national competent authority. In other MSs, the appointment procedure is either purely judicial (AT, CZ, FI, LT, LU, RO, SK, CZ) or purely administrative in the form of a national competent authority (EL, HU, IT, PL, UK + Switzerland and the US).

In addition to differences in the manner of appointment, variation exists in terms of the tasks of and powers granted to the liquidator/administrator. In certain Member States, legislation seems to grant to the liquidator/administrator the extensive task of carrying out the **management of the operations of the bank** (for example AT, BG, CY, RO, UK) and/or to **take strategic decisions on behalf of the insolvent bank**. This includes running the institution with the main objective of maximising return for creditors (AT), extending requests for termination, dissolution or nullification of transactions to which the bank is a party (BG), undertaking, in his/her official name, any act necessary for obtaining payment of any money due from a contributory or his/her estate which cannot be conveniently done in the name of the company (CY), having full powers relating to the legal entity's administration, management and representation (FR), signing contracts, making legally binding offers and confirming debts on behalf of the bank (HU), hiring or dismissing employees (LU, LT, LV), and transferring all or part of the bank's commitments to a third party, without the need for further permission from the other party (NL).

In the **US**, the FDIC, which is the receiver (administrator) for the insolvency procedure, is considered successor to the institution (bank). Hence, the FDIC is authorised to operate the institution and is endowed with "all the powers of the members or shareholders, the directors, and the officers of the institution". In this capacity they may collect all the obligations due to the institution, perform its duties, and preserve and conserve its assets. In **Czechia**, the liquidator has similarly wide-ranging powers, including to exercise shareholder rights associated with the shares included in the estate, to decide on trade secrets and other confidentiality issues, to act as an employer against the insolvent bank's employees, to ensure the operation of the insolvent bank's business, to keep accounts and to fulfil tax obligations.

In other MSs, and particularly where the regime is more focused towards the liquidation of the bank's assets to the satisfaction of creditors (for example BE, DE, ES, FI, PT), the tasks of the liquidator seem to be concentrated more on **the management of the bankruptcy estate**, including disposal of the assets, assessing creditors' rights and more generally taking measures that promote a favourable and rapid settlement of the estate.

## 2.6. Admission of creditors/debtors to the insolvency estate

Admission of creditors refers to the creditors' right to invoke their claim in the bankruptcy estate. There are two main categories of admission illustrated in this report: **proactive and reactive admission**. While the former means that the creditors must assert their claims after being notified to do so by the liquidator/administrator or the court, the latter refers to the situation whereby the liquidator/administrator or the court prepares a list of creditors and determines creditors' claims without the need for the creditors to submit proof themselves.

### 2.6.1. Proactive admission of creditors

**In the vast majority of Member States**, as well as Switzerland and the US, the **admission of creditors is proactive**, requiring that creditors present their claims in writing to the liquidator.

Depending on the Member State, creditors are notified in different manners. In some cases, the publication of the decision to initiate the liquidation procedure is sufficient notification, and the deadline for the submission of claims begins with that publication. In other situations, the liquidator is required to inform each creditor, through individualised communication, of their obligation to file their claims and the time limits in which to do so. In any case, pursuant to Directive 2001/24/EC, known creditors who have their home office, normal place of residence or head office in another Member State are always individually informed of the need to lodge their claims, regardless of the Member State in which the liquidation procedure takes place.

The time limit for declaring a claim differs between Member States, and can be anywhere between 1 and 3 months. In the US, the receiver (administrator) shall promptly publish a notice to creditors to present their claims, together with proof thereof, to the receiver by a date specified in the notice, which shall be not less than 90 days after the publication.

**A clear example of proactive admission of creditors is the German model.** In Germany, the procedure to determine the claims involves the registration of the claims by the creditors, a verification meeting to confirm the eligibility of the registered claims, as well as court rulings over any disputes regarding the eligibility of certain claims. A creditor who has a claim to the assets of the debtor at the time of commencement of the insolvency proceedings must register this claim with the administrator, as only those claims that are registered are considered by the administrator (even if a court has already determined the eligibility of a claim). For the registration to take effect, the reason for the claim needs to be outlined and any evidence of the existence of the claim, i.e. any contracts or bills, needs to be filed with the application. The insolvency administrator then enters all registered claims into the insolvency table and marks the date of the registration of the claim. The timeline for the registration is three months, but a late registration is still possible in the verification meeting.

### 2.6.2. Reactive admission of creditors

In very few Member States, however, the admission of creditors is reactive. In **Italy**, the liquidators will inform each creditor about the amount of the claims and the sums already paid before entering into liquidation, as they result from the bank's book records.

### 2.6.3. Exemption from the general rule in some MSs

In some MSs, although the general rule for admission of creditors is proactive, there can be exemptions for certain specific claims where the admission becomes instead reactive. In **Bulgaria**, for instance, the claims of, among others, the depositors in the

bank are deemed to have been presented and are recorded ex-officio by the liquidator in insolvency in the list of claims. In **Estonia**, claims related to the Guarantee Fund or eligible deposits shall be released from the obligation to submit a proof of claim. In **Greece**, creditors whose names are submitted to the special liquidator by the credit institution itself during the pre-insolvency procedure, as well as employees and public and social insurance instruments, are deemed to be included in the list of creditors, without them being obliged to announce their claims. In **Finland**, a claim may exceptionally be considered without it being lodged with the administrator if there is no dispute about the basis or the amount of the claim. In **Slovenia**, creditors who notified their claims during the compulsory settlement proceedings do not need to renotify their claims. In **Portugal**, despite the need for creditors to lodge their claims with the liquidator, the list of recognised creditors drawn up by the liquidator can also include creditors who have not submitted a claim, but who are nevertheless known to the liquidator (for example because they are mentioned in the bank's accounting records).

In **Italy**, although the general rule is reactive, within 60 days starting from the liquidation decree publication in the Italian Official Journal, creditors and clients entitled to restitutions of financial instruments according to the relevant legislative provisions who have not received any communication by the liquidators may also ask for the recognition of their claims towards the bank.

## 2.7. Hierarchy of claims

Each Member State has a specific insolvency hierarchy. Hence, when a bank goes into normal insolvency proceedings, creditors are allocated to different classes, according to the national ranking of creditors. The first part of this section gives an overview of the different classes of creditors provided under the insolvency laws of the Member States.

Then, given the relevance of the issue of lack of harmonisation of the ranking of liabilities, the second part of the present section assesses more extensively the potential impact of the divergences between the ranking in insolvency and the order of loss absorption in resolution on the application of the BRRD principle of “No Creditor Worse Off” (NCWO) in resolution than in insolvency, as well as from a cross border point of view.

### 2.7.1. Overview of the hierarchy of claims

The hierarchy of claims across MSs is presented in reverse order, to mirror the hierarchy in resolution and provide a better overview of their interaction.

#### 2.7.1.1. Subordinated claims

All Member States provide in their insolvency ranking for the existence of subordinated claims, i.e., claims that are to be repaid after all other preferred and ordinary unsecured claims have been fully repaid. These subordinated claims include own funds instruments, either through a specific mention in the law to CET1, AT1 or T2 instruments, or through the statutory recognition of subordination mutually agreed between the contractual parties.

Some Member States, such as **Germany**, **Portugal** and **Spain**, provide in their national law for legal grounds for subordination. This means that certain types of claims, such as shareholders’ loans, claims related to services provided free of charge and claims of persons especially related to the debtor, are statutorily subordinated. However, the framework of Member States, of which **Italy** and **Ireland** are two examples, appears to only contemplate the possibility of subordination arising exclusively from the terms agreed by the contractual parties.

#### 2.7.1.2. Senior claims

Member States all have a residual category of claims, which encompasses all unsecured claims which cannot be deemed either as preferred or as subordinated.

With the amendments introduced to Article 108 BRRD by the BCHD and the creation of non-preferred senior debt instruments, this category was split in two. Under those amendments, banks are now able to issue debt instruments which rank above own funds instruments and the remaining subordinated liabilities but below other senior liabilities. To be able to benefit from this new ranking, instruments must have an original contractual maturity of at least one year, not containing embedded derivatives or be derivatives themselves and include an explicit reference to their lower ranking in the relevant contractual documentation related to their issuance and, where applicable, the prospectus. The new directive was required to be incorporated by Member States into their national law by 29 December 2018.

#### 2.7.1.3. Preferred claims

Preferred claims are a separate class of claims which may include employment wages, taxes, and claims to Social Security. These claims are paid with preference over all the other claims which are to be repaid from the proceeds of the insolvency estate.

In compliance with Article 108(1) BRRD, all Member States have granted a preference to covered deposits and to deposit guarantee schemes (DGSs) subrogating to the rights and obligations of covered deposits in insolvency. Preference is also granted to that part of eligible deposits from natural persons and micro enterprises / SMEs which exceeds the coverage level provided for in DGS Directive of 2014<sup>27</sup> (DGSD)<sup>28</sup>, though lower than the preference provided to covered deposits. Interestingly, the relative position of these deposits within the national insolvency ranking is not the same: in some Member States, such as **Latvia** and **Croatia**, these claims are ranked above all (or almost all) other preferred claims. In a larger number of Member States, however, namely **Italy**, **Denmark** and **France**, they are one of the lowest ranked of all preferred claims.

Apart from the preferences granted to the deposits mentioned in Article 108(1), certain Member States, including **Italy**, **Cyprus**, **Greece** and **Portugal**, have provided in their national law for a preferred treatment also for deposits outside of the scope of that provision. Under these national provisions, eligible corporate deposits and deposits excluded from DGS coverage rank above ordinary unsecured claims but still below the deposits referred to in Article 108(1)<sup>29</sup>.

Furthermore, it is worth noting that some Member States, such as **Cyprus** and **Slovenia**, have provisions stating that certain claims excluded from bail-in under Article 44(2) that did not yet benefit from any preference should also have a preferred ranking in insolvency.

#### 2.7.1.4. Secured creditors

Across all the MSs, the stacking order of insolvency procedures has, at its top, secured liabilities, including transactions secured by financial instruments. Secured liabilities also include covered bonds and liabilities in the form of financial instruments held for hedging purposes.

Secured creditors are paid off first, as in a standard procedure, before any other creditors (including depositors). For financial collateral arrangements, the financial collateral held by the insolvent bank is enforced immediately as soon as the bank becomes insolvent, as the Financial Collateral Directive<sup>30</sup> prohibits Member States from applying their national insolvency rules to those arrangements.

The secured claims class includes creditors whose claims are secured *in rem*, typically through a lien, pledge or mortgage over property or assets of the bank. These creditors have the right to seize the property and obtain full payment of their credit from the sale of the *in rem* security. Additionally, in some Member States, such as **Portugal**, creditors who benefit from a special preference granted by the law over specific moveable or immovable assets of the debtor are also included in the secured claims category.

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<sup>27</sup> Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, OJ L 173, 12.6.2014, p. 149–178

<sup>28</sup> And to deposits that would be eligible deposits from natural persons and micro enterprises / SMEs were they not made through branches located outside the EU of institutions established within the EU.

<sup>29</sup> It is worth noting that the review clause in Article 3 Directive (EU) 2017/2399 requires the Commission to assess by the end-2020 whether there is a need for any further amendments at the European level with regard to the ranking of deposits in insolvency.

<sup>30</sup> Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements OJ L 168, 27.6.2002.



Secured claims are segregated from the general insolvency estate before the hierarchy of claims is established, meaning they are repaid with the proceeds from the liquidation.

#### 2.7.1.5. *Claims arising from insolvency proceedings*

Claims arising from insolvency proceedings typically include judicial costs, the remuneration of the liquidator and management expenses related to the proceedings. In some Member States, they are the first claims to be repaid. This is the case for example in Denmark, Latvia and the Netherlands, where national law states that the claims against the estate of insolvency are the first to be repaid and that the creditors of a subordinated group will be paid only after the full payment of these first claims. In other Member States, the claims arising from insolvency proceedings receive a separate treatment and they are paid as they fall due. Spanish law for example states that the debts against the insolvency estate will be paid “upon their respective maturity dates out of the debtor’s assets (other than those assets attached to the specially privileged debts)”.

#### 2.7.2. *Interaction between the ranking of creditors in insolvency and the order of loss absorption in resolution*

As a rule, the BRRD requires that shareholders of the institution under resolution bear first losses and that creditors of the institution are then called upon to contribute to loss absorption and to the recapitalisation of said institution in accordance with the order of priority of their claims under national insolvency proceedings (Article 34(1)(a) and (b) BRRD). Nevertheless, the BRRD itself provides for some exceptions to that order of priority. These rules are to be observed not only when deciding what claims to write down and converted and in what amount but also when setting the conversion rates for claims that are to be converted into capital<sup>31</sup>.

Based on the combined provisions of Articles 48, 60 and 108 (as amended) of the BRRD, the loss-absorption waterfall in resolution is the following:

1. Common Equity Tier 1 items (CET1);
2. Additional Tier 1 (AT1) instruments;
3. Tier 2 (T2) instruments;
4. Subordinated debt that is neither Tier 1 nor Tier 2 capital in accordance with the hierarchy of claims in insolvency under national law;
5. Other eligible liabilities, in accordance with the hierarchy of claims in insolvency under national law. These include:
  - 5.1. Non-preferred senior debt instruments, which rank below all other ordinary unsecured claims;
  - 5.2. Eligible deposits from natural persons and micro and SMEs that exceed the amount of covered deposits; these deposits rank higher than ordinary unsecured claims<sup>32</sup>;
  - 5.3. Covered deposits and deposit guarantee schemes subrogated to their rights, which rank higher than the deposits mentioned in the previous point.

The different hierarchy of creditors in insolvency thus has a direct impact on the application of BRRD across Member States. Furthermore, considering that one of the guiding principles of resolution is that no creditor shall incur greater losses than would

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<sup>31</sup> And, naturally, when the resolution strategy relies on the use of the sale of business tool or the bridge institution tool, also when deciding on which instruments are to absorb losses by being left behind at the remaining institution and/or are to be converted into capital of the bridge institution.

<sup>32</sup> Also benefitting from this ranking are deposits that would be eligible deposits from natural persons and micro and SMEs were they not made through branches located outside the Union of institutions established within the Union.



have been incurred if the bank had been wound up under normal insolvency proceedings, any deviations from the ranking of creditors in insolvency has the potential to result in a breach of that principle.

### 2.7.3. Own funds and other subordinated claims

Bank's own funds will be composed of the highest quality capital items: capital instruments, share premium accounts related to such capital instruments, retained earnings, reserve capital, other accumulated comprehensive income, additional reserves and funds for general banking risk (CRR Article 26(1)). To determine if a given financial instrument is eligible for CET1 purposes, its compliance with requirements laid down in CRR Article 28 and 29 must be analysed. For the purposes of this analysis, it is relevant to note that CRR Article 28(1)(j) provides that one of the eligibility criteria of CET1 instruments is that the instrument must rank below all other claims in the event of insolvency or liquidation of the institution.

Items categorised as AT1 instruments also serve the purpose of loss absorption on a going-concern basis. These items are capital instruments that meet the conditions set out in CRR Article 52 and share premium accounts related to such instruments, as provided for in CRR Article 51. According to CRR Article 52(1)(d), to qualify as AT1 instruments, instruments must rank below Tier 2 instruments in the event of the insolvency of the institution.

T2 instruments are also able to absorb losses on a going-concern basis through the application by the relevant authority of the powers to write-down and convert capital instruments. Capital instruments qualify as T2 instruments where the conditions set out in CRR Article 63 are met and to the extent specified in CRR Article 64. Together with the share premium accounts related to such instruments<sup>33</sup>, they form the T2 items of an institution. As provided for by CRR Article 63(1)(d), an instrument only qualifies as T2 instrument where, under the provisions governing said instrument, the claim on the principal amount of the instrument ranks below any claim from eligible liabilities instruments<sup>34</sup>. The wording of this criterion results from the amendments introduced to CRR by Regulation (EU) 2019/876. Previously, the criterion referred only to the need for the claims to be wholly subordinated to claims of all non-subordinated creditors.

The eligibility criteria for AT1 and T2 instruments laid down in the above mentioned CRR Articles 52(1)(d) and 63(1)(d) do not provide for an absolute ranking; rather, they only require that AT1 instruments rank below T2 instruments and, in turn, that T2 instruments rank below eligible liabilities instruments. Indeed, these criteria, by themselves, do not prevent other subordinated liabilities from ranking *pari passu* with these capital instruments or even between them. In some Member States, this currently allows for the possibility of a discrepancy between the order of loss absorption in resolution and the creditor ranking in insolvency, depending on the statutory provisions governing subordinated claims in insolvency as well as on the specific liability structure of each bank. This is the case of **Spain**, where, according to national law, claims that are statutorily subordinated (i.e., by virtue of the law) rank below claims arising from AT1 and T2 instruments (which are only contractually subordinated, even if their ranking is statutorily recognised). These statutorily subordinated claims include, most relevantly for the purposes of bank resolution, claims by parties especially related to the debtor, which encompass the banks' directors, certain shareholders and companies belonging to the same group. In practice, this means that, while in insolvency these claims by related parties would only be repaid after the claims arising from AT1 and T2 instruments have been fully satisfied, in resolution they can only contribute to loss

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<sup>33</sup> As well as the elements referred to in points (c) and (d) of Article 62 CRR, where relevant.

<sup>34</sup> I.e., liabilities that comply with the conditions set out in Article 72b, to the extent that they do not qualify as CET1, AT1 or T2 items, as per CRR Article 72a(1).

absorption and recapitalisation of the bank after those capital instruments have been affected.

Additionally, certain capital instruments are only eligible for CET1, AT1 or T2 items during the grandfathering period provided for in Articles 483 to 491 CRR, provided they meet the conditions specified in those provisions. At the expiration of the grandfathering, if those instruments cannot be requalified as own funds, they would still rank *pari passu* to CET1, AT1 or T2 instruments but would only bear losses in resolution at a later stage of the resolution waterfall.

Regardless, these potential discrepancies between the loss-absorption waterfall in resolution and the ranking in insolvency have since been addressed through the amendments introduced by Directive (EU) 2019/879 in BRRD. Accordingly, BRRD Article 48(7) now requires that all claims resulting from own funds items have, in national laws governing normal insolvency proceedings, a lower priority ranking than any claims that do not result from an own funds item<sup>35</sup>. With this rule, a specific requirement in the order of loss absorption in resolution (that own funds instruments be the first to absorb losses) now has a direct reflection in the insolvency hierarchy, thus contributing to eliminating many divergences. However, it should be noted that this provision is not immediately applicable, as Member States have until 28 December 2020 to incorporate the amendments to BRRD into their national law.

Still in what concerns own funds, it should be noted that the current insolvency framework of some Member States traditionally does not make a statutory distinction between the claims arising from CET1, AT1 and/or T2 instruments. In some cases, the law ranks these instruments as *pari passu* with other subordinated claims, leaving that distinction to the contractual clauses.

Moreover, shareholders' loans and intra-company loans receive different treatment across Member States concerning the hierarchy of creditors. In certain Member States, such as France, there is no preferred treatment / ranking for external debts compared with intragroup debts. External debts rank *pari passu* with internal debts within a same category (unsecured debt, subordinated debt, secured debt). On the contrary in others, they rank senior to unsecured creditors.

In Poland, receivables of shareholders under a loan or another act in law of similar effects, in particular deliveries of goods with postponed payment date, performed for the benefit of a bankrupt company within the period of 5 years prior to the day of the declaration of insolvency, along with interests, take precedence in the hierarchy of creditors over non-preferred senior debt instruments but are nevertheless only repaid after the satisfaction of the remaining unsecured creditors.

In Croatia, claims of parent undertakings as owner of instruments used by subsidiaries to meet minimum requirements for own funds and eligible liabilities (MREL) on an individual basis rank junior to all subordinated claims but senior to own funds.

In Portugal, subordinated liabilities (other than own funds) held by persons specially related to the institution (including shareholders and legal entities who are part of the same group) rank above contractually subordinated liabilities.

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<sup>35</sup> Additionally, the second subparagraph of this provision sets out that, to the extent that an instrument is only partly recognised as an own funds item, the whole instrument shall be treated as a claim resulting from an own funds item and shall rank lower than any claim that does not result from an own funds item.

#### 2.7.4. Non-preferred senior debt instruments

The 'non-preferred senior debt instruments' created by Directive (EU) 2017/2399 give rise to ordinary unsecured claims with a specific ranking in insolvency, as they rank above own funds instruments and the remaining subordinated liabilities but below other senior liabilities.

Considering that the creation of this new category of debt instruments produces its direct effects in the national insolvency frameworks, through the amendment of the respective rankings, which then has indirect effects in the order of loss absorption and recapitalisation to be followed in resolution, there is no room for discrepancies between resolution and insolvency in this context.

#### 2.7.5. Deposits

Article 108 BRRD provided a minimum harmonisation of the hierarchy of certain depositors, requiring that the exceeding part of covered deposits of natural persons and micro SMEs<sup>36</sup> ranks immediately after the covered deposits and is senior to other unsecured liabilities. Given that the special treatment granted by the BRRD to these deposits is achieved through amendments to the national laws governing normal insolvency proceedings, alignment with the order of loss absorption in resolution and repayment of creditors in insolvency is ensured.

While Article 108(1) BRRD has reduced the disparity between national bank insolvency regimes in what concerns deposits, it has not completely eliminated such disparities, allowing Member States to provide for further depositor preference.

Whilst Member States must ensure that claims arising from the uncovered portion of eligible deposits of natural persons and micro and SMEs ranks senior to ordinary unsecured claims, some Member States, such as Cyprus, Hungary, Italy, Portugal, Greece and Slovenia, confer special protection also to the uncovered portion of eligible deposits of non-SMEs and to deposits excluded from the DGS guarantee.

These "other deposits" are junior to the part exceeding the coverage of deposits of natural persons and micro and SMEs but senior to other unsecured creditors, including unsecured bondholders. This means that liabilities that under BRRD can be bailed in, in national insolvency proceedings have a higher rank and are satisfied with precedence on other unsecured creditors, which in turn also impacts their position in the order of loss absorption in resolution.

When deposits other than those mentioned in Article 108(1) BRRD get higher preference, senior unsecured creditors which were previously *pari passu* with those deposits are less likely to be fully repaid in insolvency, given the usually significant amounts of deposits.

Disparities in the treatment of depositors may affect in particular cross-border resolutions, since deposits not mentioned in Article 108(1) could be seen as being less likely to be bailed-in in the Member States where they are given a preferred treatment, but more likely to be included in the scope of bail-in in others where deposits are classified *pari passu* with unsecured creditors (i.e., where there are less obstacles to their inclusion in the scope of loss absorption and recapitalisation).

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<sup>36</sup> Including deposits that would be eligible deposits from natural persons and micro and SMEs were they not made through branches located outside the Union of institutions established within the Union.

#### 2.7.6. Other considerations

It should be noted that the differences in the treatment provided to creditors in insolvency and in resolution – and any consequences these differences might have towards compliance with the NCWO principle – don't arise merely from any possible differences between the insolvency hierarchy and the order of loss absorption in resolution. In any case, the latter are being progressively mitigated by the BRRD itself through the partial harmonisations of national law governing insolvency proceedings, most recently with the introduction of paragraph 7 in BRRD Article 48.

Indeed, one must also take into consideration the fact that the resolution framework, by mandatorily excluding certain creditors from bail-in and by allowing the resolution authority to exclude other creditors from bail-in on a discretionary basis (BRRD Article 44 (2) and (3)), creates a deviation from the treatment those creditors would receive in insolvency, as there they would not be shielded from incurring losses (i.e. from not being fully repaid) pro rata with equally ranking creditors. The significance of this deviation depends on the insolvency ranking of these excluded creditors and is particularly relevant where they do not benefit from any legal preference, as in that case the likelihood of not being fully repaid in insolvency would increase. It is nevertheless important to highlight that several of the claims mandatorily excluded from bail-in are typically preferred or secured (such as secured liabilities, liabilities to employees or tax liabilities). Interestingly, after the incorporation of the BRRD in their national law, some Member States have started to amend their insolvency hierarchy to confer a preferred ranking also on the remaining claims excluded ex ante from bail-in, precisely with the purpose of reducing the likelihood of a NCWO breach in resolution.

Additionally, it is important to note that there are a number of effects triggered by the decision to open insolvency proceedings that affect the existence, amount and ranking of claims but that are not reproduced in resolution (i.e., in a going concern scenario). These include, among others, the set-off of claims in insolvency, the termination of certain securities and legal preferences or the granting of a more favourable treatment as well as the reduction of claims that were not yet due at the time of the opening of the insolvency proceedings.

## 2.8. Tools available to manage a bank's failure

In several Member States, the national insolvency regime provides for measures to manage a bank's failure which go beyond the simple liquidation of assets and the distribution of the proceeds to creditors. In some cases, these measures share similarities with the resolution tools provided by the BRRD.

### 2.8.1. Agreements with creditors

The insolvency laws in several Member States provide for the possibility to reach a **settlement agreement with the creditors**, typically within a reconstruction procedure (under which an insolvent bank will continue its business but with the suspension of pre-existing claims) where this is foreseen as part of a national insolvency regime. The purpose of this measure is in essence to get creditors to agree on a reduction in the amount of their claims. These measures, unlike pre-insolvency ones mentioned above, do not aim to restructure the bank to allow it to continue its business (therefore avoiding insolvency) but are aimed at facilitating its winding down.

In Denmark, during the reconstruction proceedings, the trustee prepares a restructuring plan and a restructuring proposal and presents them to the creditors at a meeting in the bankruptcy court. The restructuring proposal must include a compulsory composition and/or a business transfer. A compulsory composition can be a percentage reduction or cancellation of the claims against the debtor. Such a compulsory composition cannot include subordinated debt or preferred claims.

In Estonia, a compromise can be made in bankruptcy proceedings on a proposal of the debtor or the trustee after the declaration of bankruptcy with the consent of the Financial Supervision Authority.<sup>37</sup> Such a compromise is defined as an agreement between a debtor and the creditors concerning payment of debts, and involves reduction of the debts or extension of their terms of payment. The compromise proposal must contain proof that the debtor will be able to pay their debts to the extent and by the date indicated, as well as plans for continuing the business and for the rehabilitation of the debtor. Alternatively, if the assets of a credit institution cannot be sold in any other manner, the trustee may pay creditors with assets upon prior consent of three quarters of the creditors.

In Germany, an insolvency plan, aiming to preserve the company as a whole and to bring the insolvency proceedings to an end as soon as possible, can be approved by the insolvency court with the goal of reaching a settlement with the creditors, who waive a part of their claims. The amount agreed with each creditor depends on the rank and class of the claim, as well as the percentage of debt owned by the creditor. The insolvency plan is an alternative to the liquidation of assets, and it allows the debtor to be debt-free within 3-6 months.

In Italy, at any moment in the procedure, the liquidators may propose a composition (settlement) with creditors (*concordato di liquidazione*). The proposal of composition must be authorised by the Bank of Italy and must indicate the percentage to be offered to creditors, the time of payment and any guarantees. The composition can include the sale of the assets in the estate as well as all the claims of the estate that can be brought by the liquidators, subject to the authorisation of the Bank of Italy. The proposal may limit the commitments made through the composition only to the creditors admitted to the insolvency table, even temporarily, and to those who objected to the statement of liabilities or filed a late petition at the time of the proposal, but having their claims

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<sup>37</sup> "Kompromissi võib krediiasutus pankrotimenetluse käigus teha ainult Finantsinspektsiooni nõusolekul." Sec. 134 II, Credit Institutions Act of 9 February 2009.

recognised in the appeal judgements. The bank under liquidation will continue to be liable towards other creditors who do not accept to enter into the settlement.

### 2.8.2. Other tools

Insolvency laws in various Member States allow measures different or additional to the agreement with creditors to reduce their claims. As explained more in detail in the following, a few Member States have insolvency proceedings which allow extensive measures to manage the failing institution, including the possibility to sell the bank's business or parts of it.

In Italy, under the Compulsory Administrative Liquidation (CAL) proceedings, various tools are available to liquidators and to the Bank of Italy. After the positive opinion of the supervisory committee and with prior authorisation from the Bank of Italy, liquidators may sell assets and liabilities of the bank in part or as a whole, in order to preserve their value, as well as assets and legal relationships identifiable *en bloc*. The Italian law does not require the approval of creditors for this action to take place. When the conditions for the intervention of the deposit guarantee schemes are absent or their intervention is insufficient, in order to facilitate liquidation, the assignment may also include liabilities even for only a portion of them. In any case, the equal treatment of creditors and the order of priority (*pari passu*) must be respected. According to Article 96-bis, paragraph 3, of the Consolidated Banking Law, the DGS can intervene in supporting the sale of assets and liabilities, but only if it is the option that minimises costs (least cost principle). Therefore, these interventions are allowed only if they are less expensive for the DGS than the net cost of insured depositor reimbursement<sup>38</sup>.

An even more extensive regime in terms of available tools can be found in the insolvency law of Slovenia. This regime provides measures for the sale of the bank's business or part of it. The proceedings in particular allow the sale of all or individual assets, rights or liabilities of a bank in compulsory liquidation, including its contractual relationships for the provision of banking services. The transfer of assets, rights or liabilities do not require the consent of the bank's shareholders or a creditor, debtor or any third party exercising its rights in respect of the assets, rights or liabilities being transferred. The Bank of Slovenia may also establish one or more companies to which the bank's assets, rights and liabilities will be transferred, including the contractual relations entered into by the bank for the provision of banking, financial and ancillary financial services, for the purpose of separate management of the transferred assets and liabilities for the sale of these assets as a commercial whole (in a way similar to the use of an asset management vehicle in resolution).

In most Member States, however, while the sale of assets by the liquidator, including the sale in bulk, appears generally possible, the sale of the entire business, i.e. also the liabilities of the failed bank, generally requires the approval of the bank's creditors. It must be underlined in this respect that in many instances, the law is not necessarily explicit about this aspect, which leaves room for interpretation.

In Croatia, the bankruptcy administrator is obliged to cash-in the assets entering the bankruptcy estate, unless this is contrary to the decision of the creditor's assembly. The creditors may decide (on the basis of the bankruptcy administrator's report or on the opinion of an expert) to sell the debtor's assets as a whole, instead of cashing-in certain parts of the debtor's assets. The decision on the sale may be adopted by the creditors at the examination hearing or at any other assembly of creditors.

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<sup>38</sup> De Aldisio A., Aloia G., Bentivegna A., Gagliano A., Giorgianni E., Lanfranchi C., Maltese M, Towards a framework for orderly liquidation of banks in the EU, in Notes on Financial Stability and Supervision, No. 15 August 2019, p. 8.

In Denmark, a restructuring procedure is available under which the debtor maintains control of the assets and liabilities but is not allowed to enter into transactions of material significance without the consent of the restructuring trustee. Under such proceedings, an insolvent bank will continue its business as 'going concern' but a moratorium suspending pre-existing claims is enacted. The reconstruction procedures allow for the possibility of selling the whole or part of the business, but the sale can only take place when it is in accordance with a reconstruction plan approved by the bankruptcy court and the creditors.

In Estonia, the trustee has the right to sell the set the assets of the credit institution with the consent of the bankruptcy committee on the condition that the buyer secures all the claims of creditors.<sup>39</sup> The bankruptcy committee is elected by the creditors at the first general meeting of creditors.<sup>40</sup>

In Germany, upon the opening of the insolvency proceedings, the insolvency administrator will either sell the business or liquidate the assets. The business can only be sold as a whole with the consent of the committee of creditors and only if the buyer owns 5% of the business' capital, the buyer belongs to those people who have a close connection with the debtor and the buyer is a creditor with a right to segregation or a prioritised claim. In addition to selling the business (according to the conditions laid out above), the insolvency administrator can sell the institution's assets.

In Latvia, the administrator is entitled to sell assets of the credit institution without the approval of the Latvian Financial and Capital Market Commission (FCMC). The creditors, however, have the possibility to influence the procedure. The assets (property) of the credit institution are sold in public auctions, unless the meeting of creditors has decided otherwise, and the law does not provide for another alienation procedure.

In the Netherlands, the Court may (at the same time as the bankruptcy order is announced, or thereafter at the request of the liquidator) authorise the liquidator to either transfer all or part of the bank's commitments (*verbintenissen*) to a third party, or to amend the bank's commitments which it entered in the course of its business as a bank. This is the case as long as they do not include changes to certain claims (e.g. claims that are covered by pledge or mortgage on goods from the bank).<sup>41</sup>

In Portugal, the bank's assets are sold in liquidation to satisfy creditors. However the Portuguese insolvency law does not provide for measures comparable to the sale of business as provided in resolution.

In Spain, the sale of business can be carried out as part of a composition proposal to be agreed with the creditors and approved by the Court. It is also subject to the following rules:

- the sale of a business unit shall imply the transfer (without requiring the consent of the counterparty) of the rights and obligations arising from any agreements that are necessary for the continuity of the relevant professional or business activity (unless their termination has been requested in the framework of the insolvency proceedings);
- it shall also imply the transfer of any administrative licences or authorisations that are necessary to the continuity of the relevant professional or business activity, to the extent that the purchaser carries on the relevant activity in the same premises; and

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<sup>39</sup> Sec. 133 I Credit Institutions Act of 9 February 2009.

<sup>40</sup> Sec. 78 I, Bankruptcy Act of 22 January 2003.

<sup>41</sup> *Ibid*, Article 212hgb

- it shall not imply that the purchaser assumes any debt of the insolvent company that remains outstanding at the time of the sale, subject to certain exceptions, and unless the purchaser is a related party to the insolvent company.

In the US, the FDIC, as the receiver, has the power to:

- conclude purchase and assumption contracts to transfer assets and liabilities to another institution;
- place the institution in liquidation and proceed to realise the assets of the institution, having due regard to the conditions of credit in the locality
- with respect to any insured depository institution, organise a new depository institution or a bridge depository institution.



## 2.9. Available means to challenge an insolvency procedure

Among the 28 EU MSs, there are a variety of different decisions within the insolvency proceedings that may be challenged, and a number of different actors who can bring such a challenge. The wide variation across countries means that it is difficult to draw parallels between many of the legal regimes.

The means to challenge an aspect of the insolvency procedure is **generally the prerogative of creditors**, although in some countries (for example Croatia and Germany) debtors also have this right, under certain circumstances. Croatian law gives an individual debtor, and persons authorised to represent the debtor until the legal consequences of the opening of bankruptcy proceedings occur, the right to appeal against the decision to open proceedings.<sup>42</sup> Similarly in Germany, the debtor may file an immediate complaint against a request to open insolvency proceedings,<sup>43</sup> as well as an appeal against the insolvency court making provisional arrangements it deems necessary to protect the insolvency estate.<sup>44</sup> In Austria meanwhile, the debtor may contest the validity but not the rank of claims filed against him/her.<sup>45</sup>

In terms of the part of the procedure that is open to legal challenge, one aspect is a **challenge to the initiation of insolvency proceedings**. This is possible in Belgium, where the Insolvency Act allows the judgment declaring insolvency to be challenged by the debtor and interested third parties, provided it is formed within fifteen days of service of the judgment.<sup>46</sup> Similarly, in Bulgaria, a court judgment for the initiation of bankruptcy proceedings or the judgment on rejecting the petition for the initiation of proceedings may be appealed in the courts according to standard procedure, the time limit for appeal being seven days. The right to appeal is vested in the conservator (the temporary syndic in insolvency of the bank) and the Bulgarian National Bank, and the right to protest<sup>47</sup> is vested in the prosecutor. Other countries allowing challenges to the decision to initiate insolvency proceedings include Denmark, Estonia, France, Croatia, Hungary, Lithuania and Romania. Conversely, in Slovakia for example, once insolvency proceedings are started by a court decision, there appears to be no right to administrative or court appeal.

In some Member States, it is possible for creditors to **dispute the priority and/or validity of other claims**. This can be observed in Austria, Spain, Finland, Slovenia, among others, and also in Switzerland and the United States. Furthermore, Member States also provide creditors whose claims have been rejected with the possibility to ask the court to **confirm the validity of their claim or to challenge a decision of non-admission**. This is the case in Austria, Czechia, Denmark, Italy, Portugal and Slovakia, among others.

Other parts of the procedure that are open to legal challenge include a challenge to the insolvency plan (DE), the final liquidation report (IT), the report and scheme of distribution (MT) or the order finalising the liquidation procedure (HU, PL), a challenge against the decision to exclude certain assets from the insolvency estate (PL), and a challenge to the sale of the debtor's assets as a whole (HR).

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<sup>42</sup> Croatian Bankruptcy Act (OG 71/2015, 104/2017), Article 128

<sup>43</sup> German Insolvency Statute InsO, Section 21

<sup>44</sup> German Insolvency Statute InsO, Section 253

<sup>45</sup> Austrian Insolvency Code, Article 105(4)

<sup>46</sup> Belgian Insolvency Act, Book XX, Article 108

<sup>47</sup> The difference in terminology mirrors the different roles of the actors in the proceedings but in essence the prosecutor's right to protests equals the right to appeal.

### 3. STAKEHOLDER CONSULTATION ON POTENTIAL AVAILABLE OPTIONS IN TERMS OF THE HARMONISATION OF BANK INSOLVENCY REGIMES

To help identify options in terms of harmonisation of bank insolvency regimes, a consultation process was undertaken with relevant **industry associations working at the EU level** and competent national bodies. These included financial market (Austria) / stability (Finland) / supervisory (Germany) / surveillance (Luxembourg) / services (Malta) authorities, central banks (Belgium, Bulgaria, Croatia, Cyprus, Czechia, France, Greece, Hungary, Ireland, Italy, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, UK), resolution authorities (Denmark, Estonia) and the Swedish National Debt Office. In the rest of this chapter, these national bodies will be referred to as “**national respondents**”.

With the industry associations, the research method used was interviews, while national respondents were given the opportunity to answer a written questionnaire featuring open as well as closed questions. As a result, 12 national respondents replied to the written questionnaire and two industry associations were interviewed. In addition, a meeting was held with the European Banking Federation (EBF) which was attended both by a representative from the EBF and around twenty-five of its members. The answers provided by the EBF are more general in nature given that there is not yet an official EBF position on this topic.

The results of the stakeholder analysis are presented below in the form of summaries to each of the main categories of research questions asked.

#### 3.1. Main problems with the current EU regime

Opinions as to the main problems with the current EU regime differed between stakeholders. A general problem highlighted by the national respondents was the fact that the assessment of public interest is not applied homogeneously. A point raised by one of the industry stakeholders interviewed was that there is sometimes a ‘gap’ in the legal frameworks at the national level and under the BRRD when it comes to triggers for insolvency proceedings / resolution.

Moreover, it was noted by several national respondents that in some cases there is a tendency to put mid-size and even significant banks under insolvency proceedings instead of resolution, whereas in other Member States, even very small banks are wound up under the resolution procedure (as is almost exclusively the case in Denmark, for example).

Further, concerning the current resolution framework, a national respondent pointed out that it is hard to anticipate the right strategy for the resolution of an entity due to the difficulty of addressing the situation at the point of non-viability. The fact that losses and recapitalisation amounts cannot be pre-determined and may vary depending on the reasons of the failure, the restructuring costs or the price that a potential buyer would be willing to pay, may render the originally planned strategy (either insolvency or resolution) impossible to execute. Moreover, it was highlighted that only the sale of business tool has been implemented in practice and therefore the functioning of other tools is untested.

A national respondent highlighted the issue that resolvability appears to exclusively rely on MREL levels. The framework aims to ensure that the bank is resolvable by requiring higher amounts of MREL eligible liabilities. This approach can prove challenging for certain entities, whose business model does not sufficiently rely on subordinated instruments or even bond issuances, but is instead focussed on deposit taking. These entities, in order to meet the MREL requirements, may in some cases be required to

change aspects of their business models. Another national respondent added that such an approach is indeed in direct contrast with the business model followed by smaller banks. According to this respondent, a two-tier system, which provides special rules for smaller banks, would be preferable.

A national respondent also noted, with respect to resolution, that the minimum requirement for bail-in of 8% of the bank's total liabilities (including own funds) to make use of the Single Resolution Fund (SRF) makes access to it almost impossible for some smaller and less complex institutions. Also, the SRF, if engaged, may prove to be insufficient without an additional backstop. Another national respondent noted in agreement that the MREL and bail-in requirements in the BRRD reduce the scope of the mechanism to large banks and introduce serious limitations on the intervention of resolution authorities. Also, the requirement for smaller banks to meet these thresholds with own funds or AT1 or T2 instruments ultimately impacts their credit supply level (volumes and cost).

Moreover, the same national respondent calls for more flexibility in addressing systemic crises while the BRRD currently treats those the same way as idiosyncratic ones.

The answers provided by the respondents to the questionnaire indicated that the lack of a common insolvency framework for all banks can be problematic when it comes to managing the crisis of a banking group. Misalignments between insolvency procedures and resolution may indeed affect the use/choice of regimes. There are important deviations between the two frameworks, for example with the treatment of creditors, which is not fully aligned in the two procedures. Moreover, the BRRD's (and BRRD2's) single-point-of-entry (SPE) strategy introduces the concept of a group by which all losses are absorbed at the level of the point of entry, by the creditors. In normal insolvency proceedings, however, such losses would be absorbed by the creditors of the different legal entities of the group, depending on the localisation of the losses. As a consequence of this, the SPE strategy may not prove sufficiently robust.

Also, multiple national respondents pointed out a general need for faster, more effective insolvency proceedings at national level, which should be administrative in nature, rather than judicial. A national respondent specifically pointed out, raising the example of the ABLV case, that administrative and judicial authorities may have very different views of the failing of the bank. Administrative authorities evaluate the factors that influence the ability of the bank to continue to normally operate for a longer period of time while courts focus on more static indicators, such as the total amount of assets and number of creditors.

Other problems related to harmonisation, as highlighted by respondents, concern the absence of uniform creditor hierarchies and the fact that triggers for insolvency differ among Member States.

Multiple respondents provided considerations on state aid rules in their replies. One of them called for clarifications on the elements for the qualification of a preventive intervention of a deposit guarantee scheme (DGS) as state aid. Similarly, further clarifications on the articulation between burden sharing requirements under state aid rules and bail-in requirements under BRRD would be supported. Referring to the liquidation of the Cyprus Cooperative Bank (CCB) with state aid provided on the basis of a pre-BRRD framework, this national respondent also suggested the establishment of derogations from the provisions of the BRRD. Another national respondent added that when state aid is required to support an institution in distress, this circumstance, with very limited exceptions, triggers a FOLF decision (and resolution, if the other requirements are in place). As a consequence, state aid cannot be effectively applied outside resolution to address economy-wide disturbances and systemic problems. An example raised by the national respondent is the fact that it is impossible to finance with state aid, outside of the options available in resolution, a system-wide asset management company in order to effectively deal with impaired assets affecting many

institutions. A related problem highlighted by another respondent was the lack of revision of applicable Banking Communications of the European Commission on state aid control in the banking sector, and alignment of these with the more recent BRRD.

Furthermore, some respondents indicated that, in order to reduce litigation costs, the NCWO test should be simplified in the BRRD and, as another national respondent added, the assumptions that underlie this determination should be harmonised across the EU to avoid fragmentation. The respondent noted that in the absence of harmonisation, the outcomes of the NCWO assessment may differ depending on the counterfactual in liquidation and, by extension, the possibilities that national insolvency laws offer the bankruptcy trustee (including the assumptions regarding the duration of the liquidation of a systemically relevant bank). This can prevent resolution authorities from applying resolution tools and powers given that insolvency, according to the NCWO assumptions, would nearly always result in creditors being better off. As an example, the respondent indicated past experiences with bank failure in the Netherlands (DSB Bank and SNS Bank). It was observed that the bankruptcy trustee will opt for a long term (10 year) run-off, which will likely also be taken as a starting point for the NCWO assessment. As a result, creditors will nearly always be better off in insolvency proceedings.

A national respondent also focused on the market implications of the current framework, which in their view does not allow for the fast and efficient removal of a failing entity from the market without some form of recourse to public funding or DGS. This threatens to erode the reputation of depleted DGSs, implies significant losses and leads to a postponement of decisions which complicates crises.

The EBF highlighted that the existing European legal framework (Directives (EU) 2017/2399, 2002/47, 2001/24, 1998/26) already provides a large degree of legal certainty, and that it is a strong base upon which further improvements can be made. However, they noted that there is problematic lack of harmonisation of early intervention measures, as well as actions in the pre-recovery resolution phase between the supervisor and resolution authorities, and also a lack of coordination between the Single Supervisory Mechanism (SSM) and the SRB in the performance of their duties.

Moreover, it highlighted the importance of more clarity with respect to state aid control, more flexibility regarding the NCWO principle, and the fact that clarity is lacking when it comes to the treatment of the banks which are too small to be resolved, and banks which are too significant to be liquidated under national proceedings.

One EBF member expressed the need to harmonise the national creditor hierarchy given that the NCWO principle yields different outcomes in the case of a resolution of a cross-border group.

Concerning the hierarchy of creditors, another member representative remarked that a relatively high level of harmonisation of liabilities in resolution, liquidation and insolvency has already been achieved with the existing European framework (Directive 2017/2399, BRRD and BRRD2) – in particular in the lower ranks. This should be acknowledged, and before re-opening the question of harmonisation of liabilities the impacts on how banks are refinanced and on capital market access should be considered. Recommendations from respondents regarding EU legislative reforms.

The respondents presented many suggestions for the improvement of the current regimes. Almost all respondents mentioned the importance of establishing a harmonised or single insolvency regime, often with full harmonisation at least regarding creditor rankings, providing predictable equal treatment to banks at a European level. An industry stakeholder would prefer the full harmonisation of bank insolvency laws. Multiple national respondents mentioned that such a framework should distinguish between credit institutions and other financial undertakings, possibly with separate legislation. Two national respondents also suggested extending the system to insurance companies and central counterparties. Such a framework, as one national respondent

noted, could provide a precursor to the introduction of group insolvency, which was noted as an important concern.

Five national respondents suggested in different forms that extending resolution or a form of insolvency procedure at the European level to smaller banks (e.g. Less Significant Institutions in the banking union) is extremely important. The priority areas highlighted by one of these national respondents are: reviewing the super-priority granted to the DGS by the BRRD, increasing the threshold for insured depositors, and modifying the computation of the DGS least cost criterion. Moreover, two national respondents highlighted that less significant institutions have difficulties meeting necessary MREL levels while their failure may very well be of systemic relevance. Thus, a more flexible regime with respect to MREL levels should be taken into consideration.

One national respondent suggested that a possible solution to address “locally systemic” banks would be combining resolution with insolvency elements, such as the FDIC approach in the US, while minimising losses and protecting relevant creditors and non-financial borrowers, would pave the way to more complete harmonisation. This solution could involve assigning tools currently used by the BRRD to insolvency authorities in the Member States. It also suggested rebalancing the DGS framework towards alternative interventions supporting orderly liquidations. The liquidating authority should, moreover, have the option to offer guarantees or enter profit and loss sharing regimes.

It stressed moreover the importance of eliminating factors which bar the success of the resolution regime currently in place. Some resolution tools, such as the bail-in tool, cannot be applied in the absence of dedicated bank liabilities (total loss-absorbing capacity-TLAC / MREL) subscribed by qualified investors capable of absorbing the losses and recapitalising the intermediary. Without adequate MREL buffers in place, the application of the bail-in tool may generate systemic repercussions, as it might imply imposing losses on a wide range of creditors that are not equipped to adequately price the risk embedded in their claims. Moreover, since non-professionals cannot effectively monitor the bank’s situation, the application of this tool with respect to them might frustrate the above noted goals of the resolution regime.

One national respondent directly pointed out that a minimum harmonisation directive with a European Deposit Insurance Scheme (EDIS) taking the leading role, taking account of the desired general economic effects for creditors would be of importance.

Multiple national respondents noted that the practical methodology for carrying out the public interest test should be made more consistent across the EU. One national respondent pointed out that the test should be applied in a way that allows also smaller banks to be subject to the use of resolution tools.

Similarly, multiple national respondents added that the state aid framework needs to be adjusted in accordance with other recommendations. It should be used to ensure that no commercial entity has an advantage over banks in other Member States. An industry stakeholder would welcome a clearer and more predictable EU regime in this respect too.

A national respondent suggested that a more structured approach should be defined to balance the objectives of the crisis management framework and those of competition, whenever the two frameworks overlap. The national respondent suggested that whenever financial stability is at stake, supervisory/resolution authorities should have the final say and derogations from the state-aid conditionalities should be applied.

An industry stakeholder also emphasised the importance of clarifying the frameworks of resolution and liquidation in their relationships. Cross-border resolution planning should be more organised in the banking union. The EBF indicated that besides the above answers, in terms of future legislative reforms, they would welcome clarifications on the availability of the liquidity external funding during resolution, more legal certainty during

resolution processes, harmonisation of triggers, insolvency procedures and decision-making instances.

When asked more specifically about which aspects would be most important to tackle to achieve further harmonisation, the respondents provided the answers summarised below.

Most of the interviewees agreed on the importance of achieving a full harmonisation of the ranking of creditor liabilities. An industry stakeholder agreed that this is the area where most Member States would also be open for a fuller level of harmonisation. He considered, however, the political aspects of such a move as the main obstacle.

Another aspect highlighted by respondents is the need for improvements in access to external funding and the harmonisation of triggers for insolvency. Only a minority of the consulted stakeholders mentioned the need for increased harmonisation in the procedural aspects of the liquidation of banks.

An industry stakeholder also agreed that clarifying the situation where an institution can have access to central bank funding would improve the credibility of the procedure. The most important issues in this ambit are the possibility to use a broader base of collateral to acquire central bank funding and improved access, in general, to external bank funding.

Among other issues, stakeholders noted the introduction of a group insolvency framework, and state aid rules applicable to crisis management as other priority areas. One national respondent underlined the importance of establishing a specialised financial institutions insolvency mechanism which is different from general corporate insolvency with respect to Croatia.

Multiple respondents pointed out that the super-preference of covered deposits should be eliminated, or the comparative protection of other deposits be strengthened by certain measures. An industry stakeholder agreed that DGS guidance is not fully harmonised and the EU framework should allow a more flexible use of the DGS e.g. to support banking transfers.

An interviewee from the industry highlighted that state aid and other public funds receive a lot of criticism from the public and that this undermines the objectives of resolution regimes.

The representative of the EBF noted that priority areas are triggers of insolvency and access to external funding, however, they see neither a direct nor an indirect link with the insolvency regime harmonisation. Less importance was suggested to be given to the ranking of creditor liabilities. They insisted that this matter should not be reopened as changing the hierarchy may have significant repercussions. Substantial work has already been done in previous legislation, including BRRD, the 2017 directive, and BRRD2. Also, depositor preference was highlighted as less relevant, they consider that there is no need to change – the system is well-functioning and stable. Similarly, there is no need to harmonise further the use of collaterals as it is already covered by dedicated legislation.

The representative of an EBF member suggested, concerning the matter of full harmonisation of creditor liabilities, that the rigid implementation of Article 48(7) of the BRRD (as amended by BRRD2) on priority rankings results in the provision being confusing and in need of revision. They noted that the provision is confusing and should be revised as it is unclear what the approach of the Member States should be.

### 3.2. Potential obstacles to the harmonisation of bank insolvency proceedings

The national respondents and an industry stakeholder did not feel in a position to be able to evaluate the existence of obstacles to further harmonisation of insolvency for banks. One stakeholder pointed out that the implications on civil law would need comprehensive assessment. Other different fields of law (labour law, criminal law, tort law, judicial law, specific insolvency rules regarding the mutual banking groups) have also been mentioned as requiring harmonisation in the case of action regarding liquidation proceedings. Multiple interviewees mentioned possible obstacles in the national constitutions. Another highlighted that the differences between national regimes could be considered as too deep, in cases where several Member States have already availed themselves of collective industry funding mechanisms to ease the wind-down of mid-sized institutions. Finally, a representative of the industry maintained that even human rights might play a role in choosing the adequate level of protection for creditors.

One interviewee raised the concern that well-functioning national legal solutions could be impaired as a result of harmonisation. Some of the issues highlighted include the power of the judiciary in the liquidation procedure, the shared responsibility between the justice and finance ministries in managing the process which adds complexity to the negotiations involved, the existing privileges and preferences in the procedure resulting in its high complexity, and the fact that the insolvency ranking is different for banks but the insolvency procedure is the same as for other types of undertakings.

### 3.3. Arguments for and against a single bank insolvency framework with a central role of the SRB

All interviewees were presented with two set of arguments concerning the introduction of a single bank insolvency framework (for and against). They were asked to evaluate the relevance of these factors on a scale (irrelevant/somewhat irrelevant/neutral/somewhat relevant/very relevant) to the establishment of such a framework.

The opinions of stakeholders consulted were very diverse, even as not all Member States were represented among national respondents. Overall, the stakeholders who provided an answer responded towards suggesting that the presented arguments all bear some relevance, albeit to a varying degree, to such a proposal. Certain arguments seem to represent priority areas for the vast majority while some others bear comparatively low relevance.

For the majority of respondents, including also the EBF, the main difficulties for the harmonisation of insolvency were the fact that national laws exist to meet different needs of individual countries and the complexity to adapt the current legal framework. Most stakeholders also considered the administrative burden for Member States and the uneven distribution of adaptation costs among Member States as somewhat relevant.

An industry stakeholder considered the impact of most of the presented arguments irrelevant. However, they agreed that the complexity of adapting the current legal framework has major weight in the success of a single bank insolvency framework. The respondent further highlighted the relevance of national laws that exist to meet different needs of individual countries and the need for investments to build up the expertise required.

Among the arguments supporting the establishment of such a framework, stakeholders' responses were quite diverse. Most consistently, stakeholders considered enhanced transparency and the proclivity of a system to facilitate cross-border investments as relevant while also the fact that harmonisation addresses coordination failure in policies

was judged as very relevant. Most stakeholders also considered that synergies resulting from a common approach would be of benefit.

In comparison, the replies appear to be most divided concerning easier dispute resolution, macroeconomic benefits that may follow from the system, improved governance, a reduced moral hazard and introducing fairer competition.

The above picture suggests that the strongest worry of stakeholders is the complexity of the task of changing their national legal systems, while they also would strongly welcome synergies and the capacity of a single framework to enhance coordination in policymaking. This may be viewed as scepticism with respect to the success of further harmonisation coupled with high hopes for the benefits it could deliver if it were to succeed.

An industry stakeholder considered almost all factors presented as at least somewhat relevant, apart from the budgetary implications on the national and EU level. They agreed with national respondents that harmonisation addresses coordination failure in policies and the resulting synergies of a single framework are among the top priorities. Moreover, national respondents highlighted more strongly that such a solution would provide greater financial market stability and a deeper and fairer economic union.

The EBF highlighted the difficulty to clearly respond in the absence of concrete knowledge about the prospective policy concerning a single bank insolvency framework. Thus, they had very limited answers. Besides agreeing to the major difficulty of harmonisation, the EBF indicated compliance costs for the industry and the high expertise required to meet different requirements of regulation systems being somewhat relevant.

### 3.4. The impact of further harmonisation

Regarding the impact of further harmonisation, some respondents provided generic responses while others went deeper into the different areas where such an approach could have a concrete impact. Several stakeholders mentioned in general that the clarity, predictability and transparency of the system would be enhanced by further harmonisation measures. Two national respondents underlined the importance, especially in the interest of creditors and depositors, of introducing faster procedures to avoid the loss of value of the assets of a bank.

Concerning the protection of subordinated and senior creditors and unsecured depositors, the majority of the respondents took a more careful stance with respect to its potential advantages. While remaining cautious, stakeholders generally perceived that a single hierarchy of creditors, especially within insolvent banking groups, is important and could help enhance the protection of creditors. Both industry stakeholders interviewed called for an increase in protection, clarity and confidence of creditors. About half of the national respondents, however, pointed out that changes in the system, depending on the current level of protection, may lead to an increase or decrease in the level of protection depending on the current regime in place in the Member State concerned.

One national respondent pointed out that, especially with respect to a potential tiered system at the Union level for all unsecured creditors, further harmonisation may provide a level playing field as compared to the current situation, since a preferred ranking for certain creditors (and particularly for all depositors) only exists in some Member States (e.g. Italy, Slovenia).

Emphasising the need for improvement, one national respondent pointed out that while full harmonisation can be considered a long-term goal, partial harmonisation with



respect to key features of the system would provide an important step towards the increased protection of creditors.

Since wind-down would be an alternative to resolution proceedings, the majority of national respondents do not expect a decrease in budgetary costs of the given Member States (AT, IT, NL). On the contrary, an industry stakeholder highlighted that lower costs could arise for the national government in bailing out banks. A respondent highlighted that the design of the financing of a new regime will influence its budgetary impact. Yet another interviewee suggested that considering the broader benefits of such a framework (its positive impact on financial stability and the international role of the euro) the budgetary costs are non-existent. Regime predictability could also reduce the chance for general panic behaviour and contagion which in turn has an influence on the broader budgetary implications and the choices of national respondents in dealing with a potential crisis.

While three national respondents suggested that the impact of a single system would be minor on competition, the vast majority were in agreement that competition would be enhanced by a more level playing field in which the specifics of national insolvency regimes are neutralised. EU banks could become more attractive provided that their increased transparency is ensured by a single regime. Industry stakeholders pointed out, however, that market entry would be made easier for new participants as the larger institutions would have lesser playing field to dominate the market. While the national respondents overall saw little correlation between such a regime and financial stability, two of them pointed out that an improvement in the competition on the market would indirectly also contribute to financial stability.

Two national respondents agreed that a single framework would have a beneficial effect also on the cross-border harmonisation of the banking sector and the strengthening of the SRM. As a national respondent noted, it would ease group support arrangements and might help in cross-border acquisitions of distressed banks.

A national respondent pointed out that the reduction of national specificities and the introduction of a clear framework would make disputes easier to solve and ease the application of the NCWO principle. While other national respondents agreed, one warned that harmonisation might have both beneficial effects on dispute resolution (claim disputes are easier to resolve if the creditor hierarchy is uniform in cross-border cases) and also adverse consequences (if several levels of authorities are involved - SRB, European level and national authorities - there is a higher complexity in possible disputes arising). Another national respondent pointed out with reference to the Italian experience that the identification of the competent national authorities for instance to challenge a decision may be hard to identify even if there is a single entity at the European level leading the procedure.

Concerning moral hazard, national respondents generally do not see a connection, or only a marginal correlation, between the challenge of moral hazard and introducing a uniform insolvency framework. One industry stakeholder pointed out that the regime must allow banks to fail in order to introduce increased market discipline. Stakeholders were similarly modest in addressing the implications of full harmonisation on the international reputation of the Euro. Multiple stakeholders pointed out that a harmonised insolvency framework could indirectly improve international investors' confidence in euro-denominated liquid and quality assets issued by European banks.

### 3.5. Evaluation of the opinions of stakeholders regarding the preferred degree of harmonisation

Respondent authorities and industry stakeholders differed on the desirable extent of harmonisation. None of them called into question the overall benefits of harmonisation, but most followed a cautious approach by aspiring to make only viable and realistic

claims about the prospects of harmonisation. It follows that the degree of harmonisation they saw as possible varies in accordance with the range of areas involved and the scope of perceived obstacles. It is noted that many of the answers received did not directly refer to harmonisation, but rather to the improvements the stakeholders hope to achieve with respect to individual legal provisions or the relationship between individual concepts (e.g. insolvency triggers vs FOLF in resolution)

Two main trends are observable. In some fields, stakeholders were confident about full harmonisation but, as the discussed scope of the areas to be harmonised widened, a partial harmonisation (limited areas and/or targeted harmonisation) appeared to be preferable, primarily taking into consideration the interests of creditors. Overall, while respondents would generally support a full harmonisation, they proved to be sceptical about its feasibility.

In this latter context, the stakeholders also made recourse to some key areas through which the harmonisation process towards a single framework could be started and undertaken gradually or in multiple steps.

The hierarchy of creditors and depositors and the triggers for insolvency procedures (also in their relationship to resolution FOLF) seem to be very important issues where, for the respondent stakeholders, full harmonisation does not only appear preferable, but is also realistic. With reference to the section above on recommendations from respondents regarding EU legislative reform, it is worth underscoring that the EBF in principle was against this position with reference to the fact that the BRRD and BRRD2 address this issue.

Other, frequently mentioned, areas where more harmonisation appears desirable are the use of state aid and access to external funding. Also, the methodology and application of the FOLF determination and the public interest test can be viewed to constitute similar key areas.

Some stakeholders also suggested that a potential way forward could involve assigning tools similar to resolution tools in insolvency proceedings and finding ways to include smaller banks into the scope currently covered by the resolution framework as compared to national insolvency proceedings.

## 4. POLICY CONSIDERATIONS ON THE CURRENT EU REGIME FOR FOLF BANKS

In line with the mandate of the European Commission for the study, we carried out a reflection on the overall policy regime applicable to banks that are failing or likely to fail. We believe this is helpful to identify perceived shortcomings and understand whether additional useful elements for a reflection on potential avenues for further harmonisation of the insolvency laws for banks can be derived from this analysis.

### 4.1. The EU regime for FOLF banks

The expression “regime for FOLF banks” is used here to holistically encompass the various aspects of the policy framework that applies to the handling of banks that have been declared FOLF by the relevant authority. As such, the term does not refer to policies or arrangements that apply to banks that have not been determined as FOLF, such as early intervention, precautionary recapitalisation, preventative measures by DGSs (Article 11(3) DGSD), Institutional Protection Schemes (IPSS) and other forms of formal or informal arrangements for mutual protection, and any form of liquidity support to going-concern banks other than those resulting from a resolution action. Liquidity in resolution, however, is part of the regime for FOLF banks as further mentioned below.

In its current form, the EU regime for FOLF banks includes at least four components:<sup>48</sup>

- National bank insolvency proceedings, as reviewed in this report and its annexes, harmonised to a limited extent by BRRD and the BCHD of 2017;
- The EU bank resolution regime established by BRRD and SRMR and primarily managed by National Resolution Authorities (NRAs) and the Single Resolution Board (SRB), financially supported through resolution funds (national funds and SRF), with the European Stability Mechanism providing a backstop to the SRF, and possibly in the future further arrangements for liquidity in resolution;
- State aid control as applied to the banking sector, currently practiced by the European Commission in line with its Banking Communication of 2013 (2013/C 216/01);<sup>49</sup>
- Deposit guarantee schemes (DGSs), partly harmonised by the DGSD. In addition to direct pay-out to covered depositors, DGSs in some (but far from all) member states have the capacity to intervene with other modalities, referred to as “alternative measures” and acknowledged in Article 11(6) of DGSD, even though certain aspect of their treatment under state aid rules are currently being subject to ECJ proceedings.<sup>50</sup> Furthermore, in some member states, the mandatory DGS is complemented by voluntary arrangements, such as the “top-up” deposit insurance of the German Commercial Banking Association (BDB) or the voluntary arm of the Italian DGS. Unlike national bank insolvency regimes, DGSs are not described on a country-by-country basis in this study.

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<sup>48</sup> See Anna Gelpern and Nicolas Véron (2019). “An Effective Regime for Non-viable Banks: US Lessons and Considerations for EU Reform”, European Parliament ECON Committee, available at [https://www.europarl.europa.eu/RegData/etudes/STUD/2019/624432/IPOL\\_STU\(2019\)624432\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2019/624432/IPOL_STU(2019)624432_EN.pdf)

<sup>49</sup> State aid control has become so integral to the regime for FOLF banks that it was suggested by prominent authors as a “partial substitute” for a resolution authority before BRRD was proposed. See Mathias Dewatripont, Gregory Nguyen, Peter Praet and André Sapir (2010), “The role of state aid control in improving bank resolution in Europe”, Bruegel, available at [https://bruegel.org/wp-content/uploads/imported/publications/pc\\_2010\\_04\\_state\\_aid\\_-1.pdf](https://bruegel.org/wp-content/uploads/imported/publications/pc_2010_04_state_aid_-1.pdf).

<sup>50</sup> See the Tercas General Court ruling (<https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-03/cp190034en.pdf>) and the Commission’s appeal (e.g. <https://www.reuters.com/article/us-italy-banks-tercas/in-blow-to-italy-eus-vestager-appeals-ruling-over-bank-rescue-idUSKCN1SZ25U>).

The motivation for looking at these four components together is to avoid the pitfalls of a silo-bound or overly narrow scope of analysis, since there are considerable interdependencies between them. Thus, while the rest of this report is specifically about insolvency proceedings, this section places them into the broader context of the regime for FOLF banks.

## 4.2. Problem analysis

Our analysis is that the early application of the provisions in the EU regime for FOLF banks has brought to light aspects which may not have been foreseen by the legislators. These relate largely to instances where public financial support is provided in insolvency, whether from the DGS through alternative measures or various forms of state aid. The view that such financial support was not available in insolvency was shared by many analysts at the time.<sup>51</sup> The extent of its possible use only became evident with early practice.

### 4.2.1. References to the interaction between resolution and insolvency in the legislative process leading to BRRD

We did not conduct a full study of intentions expressed by legislators in the process that led to the adoption of BRRD in 2014, but limited our analysis of legislative intent to two documents: the ECOFIN conclusions of December 2010,<sup>52</sup> and the European Commission's communication on its BRRD proposal of June 2012, hereinafter "BRRD Communication" (COM (2012) 280). Further source research would be valuable to form a more refined understanding of the respective views of different parties to the legislative process.

First, the legislators appear to have envisaged resolution as relevant to all banks irrespective of their size. The ECOFIN Conclusions of December 2010 stated that "*the Council agrees that it [the future resolution framework] should (...) ensure that all classes of [credit] institutions are resolvable irrespective of their size and interconnectedness*" and further that the Council "*strongly encourages it [the Commission] to develop a framework where that [bail-in] tool effectively contributes to ensuring that resolution is a credible option for all institutions within the regime, including SIFIs, irrespective of their size, complexity and interconnectedness.*" The BRRD Communication of 2012 echoes this stance by observing that "*Since the risk posed by any individual bank to financial stability cannot be fully ascertained in advance, these powers should be available to the relevant authorities in relation to any bank, regardless of its size or the scope of its activities.*"

Second, the legislators of BRRD started from the initial assumption that insolvency proceedings are generally not fit to address issues that may arise in the case of a FOLF bank, ostensibly neglecting the existence of free-standing bank insolvency regimes in a number of member states as described in Chapter 4. The BRRD Communication states that "*insolvency proceedings are lengthy and in the case of reorganisation, they require complex negotiations and agreements with creditors, with some potential detriment for the debtors and the creditors in terms of delay, costs and outcome.*" In legislation, this is echoed for example by the language in Recital 4 of BRRD, which provides that "*the*

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<sup>51</sup> For example, Véron and Wolff (2013, page 12) wrote about bank resolution regimes that "*Unlike insolvency processes, they can result in the public assumption of significant risk and liabilities*" (emphasis added). Référence: Nicolas Véron and Guntram Wolff (2013), "From Supervision to Resolution: Next Steps on the Road to European Banking Union", Bruegel, available at [https://bruegel.org/wp-content/uploads/imported/publications/pc\\_2013\\_05.pdf](https://bruegel.org/wp-content/uploads/imported/publications/pc_2013_05.pdf).

<sup>52</sup> Council conclusions on crisis prevention, management and resolution, 3054<sup>th</sup> Economic and Financial Affairs Council meeting – Brussels, 7 December 2010 (17006/1/10); available at [https://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/118266.pdf](https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/118266.pdf).

*financial crisis has exposed the fact that general corporate insolvency procedures may not always be appropriate for institutions as they may not always ensure sufficient speed of intervention, the continuation of the critical functions of institutions and the preservation of financial stability.*" By contrast, and as detailed below, early practice demonstrated that national insolvency proceedings which consist of administrative-led processes may, at least when supported by public money, allow for quick and orderly liquidation / reorganisation of failed banks – what one stakeholder described to the authors of this report as "quasi-resolution national insolvency regimes".

Third, the legislators initially envisioned consistency between the burden-sharing in resolution under BRRD and that under insolvency, taking state aid control into account. The BRRD Communication states that "*resolution should achieve, for institutions, similar results to those of normal insolvency proceedings taking into account the Union state aid rules, in terms of allocation of losses to shareholders and creditors, while safeguarding financial stability and limiting taxpayer exposure to loss from solvency support.*"

Fourth, and presumably linked to the previous point, at an early stage the legislators envisaged reform of national bank insolvency proceedings to ensure consistency of the overall framework. In the December 2010 ECOFIN Conclusions, "*the Council agrees that (...) Medium term work on insolvency (by end 2012) is also an important element of the resolution framework.*" With reference to cross-border groups, "*the Council stresses the need for robust safeguards (in particular, in insolvency and company law) to ensure equal treatment of creditors and shareholders across home and host Member States.*" The "roadmap" annexed to the Conclusions includes an item that reads "*Insolvency proceedings: Assess what EU reform of bank insolvency regimes is required to ensure that liquidation is a realistic option for FOLF banks and to address the current deficiencies in insolvency procedures for cross-border banking group*", with the Commission to present a report by end-2012.

#### 4.2.2. Early practice

On these four points, the practice, since the full entry into force of BRRD and SRMR, has brought to light certain aspects of the legislative framework which may have not been yet addressed by the legislators in the current version of the legislative texts and may need further adjustment. An important milestone of this early experience was the case of Banca Popolare di Vicenza and Veneto Banca, two banks in the Veneto region of Italy that were declared FOLF by the ECB and were subsequently liquidated through the above-mentioned CAL regime on June 23, 2017 – hereinafter referred to as the "two Veneto banks".<sup>53</sup>

First, in the euro area, resolution has increasingly been framed by its practitioners as reserved in principle only for the largest banks, and indeed only for a subgroup of those under the direct authority of the SRB. The case of the two Veneto banks suggested that banks above €60 billion in total assets (the sum of the two banks' assets, which is relevant since they were largely treated together as one single case) could receive a negative public interest assessment from the SRB and go into insolvency as a consequence. The SRB has further entrenched this perception with the publication on 3 July 2019 of a paper on Public Interest Assessments<sup>54</sup> and the affirmation by its Chair

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<sup>53</sup> As mentioned at length in Chapter 4, Italy is far from the only case where national law allows the relevant authority to take measures which differ from the simple closure of the bank and the liquidation of all its assets one by one to satisfy creditors. Comparable measures are made available in other Member States, and could also emerge in yet more MSs from future changes in national legislation.

<sup>54</sup> Available at <https://srb.europa.eu/en/node/799>.

that “*Resolution is for the few, not the many*”.<sup>55</sup> In practice, of the five cases of significant institutions that have been determined FOLF by the ECB since its assumption of supervisory authority in November 2014, only Banco Popular Español (which had total assets of nearly €150 billion) received a positive public interest assessment, while the four others (the two Veneto banks, and ABLV and PNB in Latvia) were sent into insolvency.

Strikingly, in the second half of 2015, namely after the entry into force of BRRD but before the applicability of its bail-in tool on 1 January 2016, a number of less significant institutions in the euro area have received a positive public interest assessment after having been determined as FOLF by the relevant authorities.<sup>56</sup> Since January 2016, however, there does not appear to have been any positive public interest assessment of less significant institutions in the euro area. In Denmark, by contrast, the resolution authority made a positive interest assessment in two cases of small banks, JAK Slagelse in January 2016 and København Andelskasse in September 2018. The ensuing resolution was conducted by using, respectively, the sale-of-business tool and the bridge bank tool, with bail-in as per BRRD and no state aid involved.

Second, and in connection with the point above, practice has shown some important implications of the process for choosing between resolution and insolvency, which is operationalised through the public interest test. The test, as explicitly provided by the legislation, is based on a comparison between the available proceedings under national law and resolution.<sup>57</sup> This entails that, to the extent that insolvency allows for measures that are comparable (if not identical) to the tools available in resolution, the argument for choosing resolution instead of insolvency can be substantially weakened.

Third, there is no consistency between the respective burden-sharing requirements of insolvency, state aid control, and resolution under BRRD. The Banking Communication of 2013 only entails burden-sharing by shareholders and subordinated creditors, in contrast to the BRRD provision imposing a minimum bail-in requirement of 8 % of total liabilities including own funds for the use of a resolution fund, particularly in the case of exclusions from bail-in of certain liabilities (BRRD Article 44(5)(a)). This implies that, in many cases, the provision of state aid in insolvency is subject to less demanding requirements than in BRRD resolution. In theory, the SRB does not take the possibility of state aid in its assessment of either public interest or compliance with the NCWO principle, but in practice, the likelihood of state aid is a reality that is difficult to ignore entirely.

Fourth, and before this study, there do not appear to have been direct follow-up to the above-cited call for study of insolvency law reform in the ECOFIN Conclusions of December 2010.

In total, Gelpern and Véron (2019, page 43) identify 12 cases in the euro area (to which Latvia’s PNB Banka, which happened after their publication, must now be added), and 5 in non-euro EU member states, of banks that were determined FOLF or whose licence was withdrawn since 1 January 2016.<sup>58</sup> Of these, only one euro-area bank (Popular) and two non-euro ones (the two above-mentioned small Danish banks) received a positive public interest assessment. On that admittedly crude basis, the positive-PIA-to-FOLF-bank ratio so far is of 7.7 percent in the euro area (one of 13), and of 40 percent (two

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<sup>55</sup> Elke König, “Why we need an EU liquidation regime for banks”, *Eurofi*, 5 September 2018, at <https://srb.europa.eu/en/node/622>.

<sup>56</sup> These are the four Italian banks Banca delle Marche, Banca Etruria, Carichiati and Carife; Cooperative Bank of Peloponnese in Greece; and BANIF in Portugal.

<sup>57</sup> See in this respect, the language in Article 32(5) BRRD.

<sup>58</sup> Counting as one the multiple cases of credit union failures in Lithuania, and likewise in Poland.

of five) in non-euro EU. Stylised as it is, this observation provides an indication of the divergences in the application of the public interest assessment inside the euro area and outside of it in the EU.

It must be noted that the observation period since January 2016 has been one of generally orderly financial conditions. A major question, therefore, is how the practice on FOLF banks may evolve in a future situation of systemic fragility or crisis. Generally, crisis conditions lead to less insistence on the avoidance of moral hazard, and more on financial stability. Since bank insolvency laws can be modified on short notice in most member states given national legislative procedures, while BRRD and SRMR are subject to the much longer EU legislative cycles, it is predictable that the flexibility of national law under state aid control will be even more attractive in such conditions than the comparative rigidity of BRRD/SRMR and especially of the 8% bail-in condition. Thus, absent significant reform, the balance between BRRD resolution and national bank insolvency is likely to shift even more towards the latter in future crisis times, leading to further marginalisation of BRRD within the EU regime for FOLF banks.



## 5. CONCLUDING REMARKS AND CONSIDERATIONS FOR REFORM

### 5.1. Considerations on possible reform of specific aspects of the current framework

The analysis carried out in this study shows that insolvency regimes for banks at national level are extremely varied both in terms of general structure (administrative or judicial) and with respect to specific aspects, such as the hierarchy of claims or the triggers to initiate the proceedings.

The analysis was focused on three main aspects of the proceedings: the triggers to initiate insolvency proceedings, the ranking of liabilities and the available tools to manage bank crises.

Below we provide some considerations based on the elements we collected. These are only meant to provide input for reflection but do not aim to exhaust all possible considerations on the complex topic of the harmonisation of bank insolvency let alone the broader reform of the EU regime for FOLF banks, nor do they aim to provide detail and specific recommendations on the way forward.

With respect to triggers, we found that they are generally linked with balance sheet insolvency (liabilities exceeding assets) and/or with cash-flow insolvency (illiquidity). National specificities do arise, whether they refer to the possibility to take into account forward-looking elements (i.e., that the bank is likely to become balance sheet or cash flow insolvent) or to the prerequisite of withdrawal of the banking licence by the supervisor (which, in some cases, is the only possible ground for initiating insolvency proceedings). In some Member States, insolvency can be triggered on the basis of a specific public interest assessment.

What is more striking, however, is that the triggers to initiate national insolvency regimes are in most countries not aligned with the triggers to initiate resolution, and particularly the conditions that justify a determination that the bank is failing or likely to fail as per Article 32(1) BRRD. In most countries, a bank is declared insolvent in presence of a clear inability of the institution to repay its debts. This conclusion is generally reached only when the court or the administrative authority designated for insolvency is persuaded that the bank will not be in a position to recover from its position of distress. This assessment often entails considering potential restructuring measures, where they are available in the national law.

The question that should be posed is therefore whether further alignment between the triggers to initiate resolution and insolvency is desirable. A conclusion in this respect becomes largely a question of preferred policy approach. Our analysis seems to indicate that in several countries a bank declared FOLF may not necessarily and immediately meet also the conditions to be liquidated under insolvency proceedings. A last effort to restructure the bank may be pursued before getting to the conclusion that there is no possibility for the bank to continue as a going concern and that its liquidation is the only option. A question that policy-makers should try to address in our view is whether this is a desirable outcome or, instead, once a bank meets the FOLF conditions and there is no public interest to initiate a resolution, the only other option should be the immediate interruption of its operations and its liquidation by means of selling its assets and repaying creditors. If the latter is considered to be the optimal articulation between resolution and insolvency, a full alignment of the triggers appears as the preferable solution.

Another element of the national insolvency frameworks which was analysed in the study is the diversity with respect to the ranking of liabilities.



It should be highlighted in this respect that EU legislation has been increasingly pursuing further harmonisation of banks' liabilities ranking in the context of insolvency. In particular, an initial layer of harmonisation was achieved through the original text of the BRRD, which granted a preferred status to covered deposits and established a relative hierarchy between non-covered deposits by natural persons and SMEs and other unsecured liabilities. In addition, it established a ranking between certain categories of liabilities, to be observed in resolution.<sup>59</sup> Part of that hierarchy (particularly with respect to own fund items, i.e. Common Equity Tier 1, Additional Tier 1 and Tier 2) is reflected also in the Capital Requirement Regulation.

Subsequent legislative interventions increased the level of harmonisation. In 2017, the BCHD introduced the new category of senior non-preferred debt, which must rank below other senior liabilities but above all subordinated liabilities.

Finally, the recently adopted revision of certain provisions of the BRRD, included in the package of measures identified as "Banking Package"<sup>60</sup>, introduced the principle that own funds items must rank below any claim deriving from non-own funds items.

The combined effect of these measures leads already to a certain degree of harmonisation in the ranking of liabilities

However, the analysis carried out for the study indicates that some areas where the ranking of liabilities diverge among different national insolvency laws still exist.

In particular, some Member States introduced in their legislation, sometimes in the context of the transposition of the BCHD, a preferred ranking for unsecured deposits not held by natural persons or SMEs, which now rank above ordinary unsecured debt, but still below unsecured deposits held by natural persons and SMEs.

A reflection on whether there is room for further harmonisation of the ranking of deposits in the direction explored by these MSs (including Italy, Slovenia, Greece and Portugal) could therefore be justified. Also, in this respect, the choice of providing additional protection to deposits than what is currently provided by the harmonised legislation is strongly affected by national prerogatives. Against the further harmonisation of depositors' ranking, it could be argued that there seems to exist limited rationale for treating differently non-covered deposits from large corporates and from financial institutions and other types of banks' senior claims, including senior bondholders. On the other hand, it is important to note that the granting of a stronger preference to all deposits is aligned with the relevant role deposits play in the real economy, being the primary tool for savings and for payments, as well as in the banking activity, where they are the main pillar for the confidence that supports the banking system. Also, from the point of view of resolution, the granting of a priority ranking to all depositors helps enhance the implementation of the bail-in tool and minimises the risk of compensation claims under the NCWO principle, as the bail-in of senior bonds is regarded as carrying a lower contagion risk than that of deposits – this was the argument put forward by the ECB in favour of the introduction of a general depositor preference based on a tiered approach, in its opinion to the BCHD<sup>61</sup>. As noted below,

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<sup>59</sup> See articles 48 and 60 BRRD.

<sup>60</sup> <https://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-financial-services/package-banking-reform-package>

<sup>61</sup> Opinion of the European Central Bank of 8 March 2017 on a proposal for a directive of the European Parliament and of the Council on amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy (CON/2017/6).

general depositor preference (with all deposits ranking *pari passu*, whether or not they are insured) is also a key feature of the US regime and its implementation by the FDIC.

Besides the issue of deposits, some of the answers to our questionnaire seem to support an even more extensive harmonisation of the ranking of liabilities. An argument in this respect is that the differences in the ranking of liabilities may render the assessment of NCWO complex when carried out on a group that has subsidiaries in different countries. This is particularly true in the Banking Union, where the SRB is the resolution authority for all significant institutions and cross-border groups. At the same time, it emerges from our analysis and the answers provided in the questionnaire by stakeholders that the further harmonisation of the insolvency ranking may present particular challenges due to the strong national specificities and the need to address specific instances in different Member States.

It is also relevant to notice that, as a result of the various interventions of the EU legislator, the higher degree of harmonisation achieved so far concerns specifically the categories of liabilities that are expected to count the most in providing loss-absorption and recapitalisation capacity to the banks. These liabilities (i.e. those with the lowest ranking, from CET1 to senior non-preferred) are therefore expected to be the most exposed in case of bail-in and potentially most concerned by the NCWO assessment.

Finally, some considerations on the issue of the tools available in insolvency seem also appropriate. As outlined above, only very few national insolvency laws of Member States provide for tools which are truly comparable, in terms of scope and effectiveness, to those available in resolution. The national insolvency laws of all Member States foresee the possibility of selling the bank's assets, either in a piecemeal fashion or in bulk. However, the sale of the bank's liabilities in most cases requires the approval of creditors or the court. It is also noticeable that many national insolvency laws foresee the possibility of a sale as part of a restructuring action aimed at, where possible, re-establish the bank's financial standing and prevent it from being liquidated in insolvency.

The issue of the tools available in insolvency was addressed also in some of the answers to the questionnaire distributed to stakeholders. The question that could be asked in this respect is whether the addition of a set of tools (comparable to those available in resolution) in a harmonised way in the insolvency laws of all Member States is a desirable and feasible improvement to the current framework. The challenges of such a legislative change should indeed not be underestimated, and it may be at least partly redundant with the resolution regime as discussed below. Also, as illustrated by the answers received from stakeholders to our questionnaire, such an addition or modification to the national insolvency regimes would entail some important changes to the national frameworks, particularly in countries where the insolvency proceedings are court-based and do not foresee specific powers to impose measures such as the transfer of the entire business, particularly with respect to liabilities, without any approval from the creditors. The addition, for example, of specific powers to transfer assets and liabilities (or deposits only) may require changes to the legal foundations of the existing law in certain countries.

As for the potential benefits of the introduction of such a tool, these can in our view be best appreciated by looking at the potential impact on the functioning of the entire architecture of the regime for FOLF banks. In particular, this issue underpins two key questions, i.e. (i) whether additional tools should be added to the current crisis management framework and (ii) whether these should be available in insolvency (i.e. under national laws albeit in a harmonised fashion) or in resolution. The answers to these questions require a deeper and somehow more extensive analysis on whether and why the tools available under the current legislative framework are deemed insufficient or somehow inadequate to manage all possible situations of bank crises. In this respect, the considerations made in the following paragraphs provide relevant input for a policy reflection on this element.

## 5.2. Considerations on the revision of the regime's architecture: a European FDIC?

In line with the mandate from the Commission, besides analysing specific elements where further harmonisation could be appropriate, we also look into some of the possible features of a more consistent and predictable regime, taking inspiration partly from the experience in the United States and their single bank resolution procedure managed by the FDIC.

### 5.2.1. Unpacking the FDIC reference

The FDIC model is increasingly frequently referred to in EU debates about the reform of the regime for FOLF banks.<sup>62</sup> Calls for a "European FDIC" or "European FDIC-like regime", are somewhat ambiguous in content, given the multiple differences between the euro-area (let alone EU) and US frameworks. To mention only five key points:

- **Competent authority:** the FDIC is a single federal agency (with several regional offices) that handles all tasks related to the handling of non-viable banks in the US, irrespective of bank size or (state or federal) charter.<sup>63</sup> In the euro area, the authorities involved in the same scope of decision-making include NRAs, national DGSs, the SRB, and the European Commission in its capacity of state aid control enforcer, not to mention the role of the Commission and Council in SRB decision-making.
- **Applicable legal regime:** in the US, "banks" are a specific legal form which are not subject to court-ordered insolvency proceedings; when they fail, there is no alternative option to FDIC-led resolution. Separately, systemically important non-bank entities (including bank holding companies, i.e. financial groups that include banking operations) may either go into insolvency (bankruptcy) or be resolved by the FDIC under the Orderly Liquidation Authority (OLA) established by Title II of the Dodd-Frank Act of 2010. In the EU, both resolution and insolvency are in principle available options for all banks.
- **Tools:** the vast majority of US cases of bank resolution are handled through a Purchase and Assumption (P&A) transaction, by which some of the failed bank's liabilities (often including all deposits) and assets are transferred to another acquiring bank, while the remaining assets and liabilities are kept by the FDIC in a receivership which is then gradually wound up, with any resulting losses covered by the Deposit Insurance Fund. Within that broad concept, there are several types of P&A models. Alternative modes of resolution include pay-outs and the establishment of a bridge bank, but these are comparatively rare. In the EU, P&A-type transactions are possible under some (administrative) national insolvency proceedings, such as Italy's CAL, and in resolution with the sale-of-business tool; the related use of public money and apportionment of losses are constrained, among other determinants, by the (ever-evolving) state aid control framework and by the BRRD condition of 8 % bail-in before any use of resolution funds.
- **Priorities:** as its name suggests, the FDIC is primarily tasked with the mission of protecting deposits. Since its creation, no loss has ever been incurred on any deposit it insures. As for non-insured deposits, losses have also been limited by the frequent recourse to P&A transactions under the least-cost principle (buttressed by general depositor preference with all deposits ranking *pari passu*) and by specific initiatives

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<sup>62</sup> For example, German Federal Finance Minister Olaf Scholz wrote in November 2019 "we need common insolvency and resolution procedures for banks, building on the example of the US Federal Deposit Insurance Corporation." Source: op-ed in the *Financial Times*, 5 November 2019, available at <https://www.ft.com/content/82624c98-ff14-11e9-a530-16c6c29e70ca>.

<sup>63</sup> Credit unions, which are not labelled banks in the US, are subject to an entirely separate and parallel regime, managed by the National Credit Union Administration and not by the FDIC.

such as the Transaction Accounts Guarantee Program of 2008, which offered a temporary unlimited FDIC guarantee on non-interest-bearing deposits. By contrast, liabilities other than deposits are offered no guarantee whatsoever and always rank lower than the Deposit Insurance Fund. In the EU, uninsured deposits are junior to covered ones, and the motivations for using public funds vary considerably across Member States.

- **Funding:** the FDIC relies for most of its interventions on the Deposit Insurance Fund which is fed by a levy (“assessment”) on the remaining banks, with a credit line from the US Treasury and Congressional reassurances that allow the FDIC to claim that its deposit insurance is “backed by the full faith and credit of the United States government”.<sup>64</sup> In the EU, various resources exist at national and European levels for public financing of FOLF banks, including but far from limited to the SRF. In the near future, the latter will be fully mutualized (it currently has several national “compartments”) and will benefit from a limited financial “backstop” provided by the European Stability Mechanism.

Accordingly, calls for “FDIC with European characteristics” may refer to any or several of the following reform objectives:

- **Institutional streamlining:** reducing the number of public authorities involved in making decisions on FOLF banks, possibly going all the way to a single authority vested in a reformed SRB. In that maximalist version the SRB would (1) be acknowledged as an autonomous agency with the capacity to make binding decisions on individual cases (if not necessarily on general policy); (2) be entrusted with the management of the deposit insurance system; (3) be exempted from state aid control for its financial interventions; and (4) rely on local teams, which may or may be the existing NRAs and/or DGSs, for the implementation of its decisions but without separate decision-making discretion at the national level.
- **Legal regime predictability:** resolving the current uncertainty on whether a given bank will go into resolution or insolvency after it has been declared FOLF, namely (in the current legal framework) the application of the public-interest test. This could be done either by tightening the criteria for public interest assessment, so that their application would become predictable; or more radically, establishing – as is de facto the case in the US – that all banks are of public interest and thus would be handled through the resolution procedure if deemed FOLF. As highlighted in Chapter 6, the SRB’s current stance that “resolution is for the few, not for the many” appears significantly different from what was envisaged in the preparation of BRRD; we are not persuaded that this stance is robust and sustainable in the face of future tests.
- **Clarity on resolution options:** establishing a toolkit of reference for application to small and mid-sized banks, similar to the FDIC’s range of P&A options. The BRRD, and specifically the sale-of-business tool, provide a basis for this, but greater clarity on its future use could be provided, not least in terms of the role of alternative measures from deposit insurance in the context of a future EDIS, and the relevant treatment under state aid control.
- **Priorities:** as mentioned throughout this study and also linked to the future possible establishment of EDIS, the EU framework may benefit from further debate on general depositor preference, since this is a central tenet of the FDIC model, and more generally the ranking of liabilities.
- **Funding:** in line with the state banking union aim of breaking the vicious circle between banks and sovereign, an FDIC-like framework would rely on Europe-wide funding (possibly compartmentalized on a temporary or permanent basis, as is the case with the SRF) and phase out all national budget-backed financial resources for resolution funding, deposit insurance, and interventions in systemic banking crises.

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<sup>64</sup> See the FDIC’s own explanation of this expression, e.g. <https://www.fdic.gov/regulations/laws/rules/4000-2660.html>.

In our view, all these points are useful in considering reform of bank insolvency proceedings. Given the context of banking union, such reform should not be envisaged in isolation from EDIS, state aid control, SRB/SRM review, and more generally the agenda of completing the banking union.

Importantly, it may be noted that for the very largest banks, the EU and US/FDIC frameworks are already largely converged. In the EU, there is a general expectation that these banks would be considered of public interest, and they have significant loss-absorbing capacity in the form of MREL. Similarly in the US, the largest banks are part of groups whose holding company can be resolved by the FDIC using OLA, and are subject to TLAC requirements. These frameworks are broadly similar; they are also, of course, essentially untested, the case of Banco Popular in June 2017 being too small and idiosyncratic<sup>65</sup> to qualify as relevant precedent. Where stark differences currently exist, and the debate about a “European FDIC” thus has relevance, is for the less large banks, which is also where the likelihood of actual FOLF cases (except in the direst crisis scenarios) is higher.

For those banks that are neither very large nor very small, including what a prominent observer has called the “middle class”<sup>66</sup>, the current framework gives the options of both insolvency under national proceedings and resolution under BRRD/SRMR. The banks must be prepared for resolution (including resolution planning and compliance with MREL requirements), but there are elements (including the nature of the public interest test, incentives connected to the different requirements to access funding as well as the approach championed so far by the SRB) which suggest that a relevant space remains, at least in certain countries or in the banking union, for the application of insolvency to these banks if they are deemed FOLF. This situation under the current framework is undesirable for many reasons. First, it is onerous for the banks and perpetuates uncertainty for investors. More significantly, it contributes to the continuation of the kind of linkages between national banking sectors and sovereign credit that fed the bank-sovereign vicious circle during the recent crisis. As a result, it can be expected that resolution will keep being insufficiently used and instead of it, alternative avenues, be it exceptional financial support outside resolution or – where available – quasi-resolution measures in the context of national insolvency would be applied extensively. This could endanger the relevance and credibility of the resolution regime, while perpetuating the bank-sovereign vicious circle. Correspondingly, reform should ideally ensure that the future regime should not be dependent on national sovereign creditworthiness.

Our suggestion of approaching the potential reform with a holistic view to the entire regime for FOLF banks echoes recent policy pronouncements that include, perhaps most prominently, the June 2019 report to the Eurogroup of the High-Level Working Group Chair on the further strengthening of the banking union,<sup>67</sup> and the European Commission President-elect’s political guidelines published on the day of her election.<sup>68</sup>

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<sup>65</sup> SRB executives have declared that they had been “lucky for this first case” – see e.g. <https://www.euractiv.com/section/banking-union/news/eu-authorities-defend-populars-resolution-despite-thousands-of-complaints/>.

<sup>66</sup> See Fernando Restoy (2018), “Bail-in in the new bank resolution framework: is there an issue with the middle class?”, speech available at <https://www.bis.org/speeches/sp180323.htm>.

<sup>67</sup> Available at <https://www.consilium.europa.eu/media/39768/190606-hlwg-chair-report.pdf>.

<sup>68</sup> The latter document includes the following sentences (original emphasis): “I will also focus on completing the Banking Union. This includes a common backstop to the Single Resolution Fund, a last-resort insurance measure in the event of a bank resolution. To ensure people have peace of mind when it comes to the safety of their bank deposits, we need a European Deposit Insurance Scheme. These are the missing

In the following, we sketch out some of the core elements which in our view should be put forward for discussion in the event that the option of introducing a harmonised insolvency regime with tools and flexibility akin to those offered by the US system was to be further discussed in a policy context.

### 5.2.2. Administrative or court-ordered

As we have seen, the preparation of BRRD was largely based on the view that court-driven processes would be ill-suited to the handling of FOLF banks, at least in situations where no public funding would be available other than that provided by the available DGS. With consideration of the early experience as summarised above, this view remains valid. Indeed, those cases where insolvency proceedings have been used for sizeable banks have been steered by an administrative authority, such as the Bank of Italy in the case of CAL.

Thus, it appears advisable that the expected applicable regime for most banks should rely on administrative authority. This is especially the case as the aim should be, as in the preparation of BRRD, to remove the need for public funding other than from deposit insurance in idiosyncratic cases but also, as much as possible, in situations of systemic fragility.

### 5.2.3. Respective roles of the SRB and NRAs

Under an administrative-led process, the administrative authority in charge should naturally be either the SRB or the relevant NRA(s) or a combination thereof – given the existence of the SRB, there would be no point in considering the creation of a new authority, or for that matter a direct role for the EBA or the ECB in the handling of FOLF banks beyond what is provided under existing law. The interplay between the NRAs and the SRB, however, may be affected by a number of considerations.

- Cases of non-viability are infrequent in normal times, even in the largest member states and even more so in smaller ones. Thus, the balance of arguments in favour of a permanent administrative capability at the national level is less strong than for missions that are by their nature exercised on a continuous basis, such as banking supervision within the SSM. There is definitely a need for direct contacts with the banks and national authorities on the ground, but it is not clear that autonomous national resolution authorities are the way to address it.
- Even assuming full legislative harmonisation of the expected applicable regime, its implementation can be expected to be differentiated across member states if assigned to NRAs. In other words, predictability of the expected applicable regime is hard to establish but is considerably harder if there are multiple authorities potentially in charge, each with its own institutional legacies and idiosyncrasies. By contrast, entrusting the implementation of the regime to a single authority (i.e. the SRB) allows for easier read-across from one case to another in different member states, and also for a more effective and efficient build-up of skills, practical experiences, and communication to external stakeholders.
- A critically significant aspect, which is frustratingly absent from many discussions of this theme in Europe (and by contrast, is often referred to in the United States) is the possibility of conducting an effective franchise marketing process on a market-wide basis, which in the banking union should encompass all the participating countries. By construction, an NRA will face more challenges to seek acquirers for relevant assets and/or liabilities and/or bank businesses in member states other

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elements of the Banking Union which we should find agreement on as swiftly as possible. I will also put forward measures for a robust bank resolution and insolvency framework.” See “A Union that strives for more”, available at [https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf).



than their own than will the SRB. Conversely, franchise and asset marketing processes led by the SRB could foster cross-border banking integration through cross-border acquisitions, including of small or local banks.

- If, as is necessary to break the bank-sovereign vicious circle, the explicit and implicit guarantees and funding mechanisms (i.e. deposit insurance and intervention tools in systemic crises) are equalised and pooled at the euro-area or banking-union level, then it is hard to envisage national authorities being in charge of their implementation.

These four points, in combination with the EU principles of subsidiarity and proportionality, suggest support for assigning decision-making authority to the SRB, to a greater extent than is the case under existing EU law. At the same time, SRB processes and organisational features should ensure sufficient consultation and agreement with national authorities, especially in cases of smaller FOLF banks, possibly to a greater extent than is currently the case.

Even in current cases of SRB-led resolution under BRRD, the law (SRMR Article 28(1)) stipulates that, while the SRB is in charge of the decision of the resolution scheme, the relevant NRA(s) is in charge of its “execution” – a term that is not specifically defined in either BRRD or SRMR. This creates significant uncertainty, especially in cases where the NRA and the SRB would have significantly divergent views on the best course of action – in such case, it is far from clear that the so far untested processes established under SRMR, especially Article 29(2), would be sufficient to address the resulting challenges satisfactorily. Furthermore, the distinction between the (SRB) resolution scheme and its (national) execution may entail rigidities that could be detrimental to the process of resolution, especially in fast-moving or highly uncertain situations. Thus, it could be advisable to entrust the SRB with decision-making authority over the entire process set by the expected applicable regime, on a continuous basis and not only at key moments.

In particular, the alternative of entrusting to NRAs the operation of a harmonised administrative-led regime for FOLF medium-sized or smaller banks is unappealing if an aim of reform is to make progress towards the completion of the banking union, i.e. breaking the bank-sovereign vicious circle. Since individual member states are free to reform their bank insolvency laws and align them with whatever they deem best practice, it is not clear that implementing such an alternative vision<sup>69</sup> requires any legislative initiative at the EU level.

#### 5.2.4. Legal architecture

The above analysis leads us to conclude that the expected applicable regime should be defined by EU law. In essence, and irrespective of the semantics that may be used (whether it be referred to as resolution, insolvency proceedings, orderly liquidation, or anything else), the expected applicable regime should build on the existing legal framework of BRRD and SRMR. The alternative, of having national quasi-resolution regimes as expected applicable ones,<sup>70</sup> is undesirable in the context of an effort to complete the banking as it would contribute to perpetuating the bank-sovereign vicious circle.

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<sup>69</sup> An articulation of this vision has been recently formulated by a group of staff at the Bank of Italy: <https://www.bancaditalia.it/pubblicazioni/note-stabilita/2019-0015/index.html?com.dotmarketing.htmlpage.language=1>.

<sup>70</sup> This is the recommendation in A. De Aldisio, G. Aloia, A. Bentivegna, A. Gagliano, E. Giorgiantonio, C. Lanfranchi and M. Maltese (2019), “Towards a framework for orderly liquidation of banks in the EU”, Banca d’Italia Notes on Financial Stability and Supervision No. 15, August, available at <https://www.bancaditalia.it/pubblicazioni/note-stabilita/2019-0015/Note-stabilita-finanziaria-n15.pdf>.

One important question of legal architecture is whether that expected applicable regime should be defined in law as the default option, as is the FDIC-led resolution process for insured depository institutions in the United States, or as a preferable alternative (under a yardstick such as the NCWO principle or a least cost test) to a court-ordered default option, as is the case of resolution in BRRD, of CAL in Italy, and of orderly liquidation authority over e.g. bank holding companies under Title II of the US Dodd-Frank Act of 2010. Answering this question would require an assessment of considerations of fundamental and property rights, both at the EU level and in individual member states, which has not been performed for the present study. We thus leave it here as an open matter for further investigation.

A related but separate question is that of the lower bank significance limit, if any, for the expected applicable regime – should this apply to all banks no matter how small, or should the smaller banks be exempt? Also, how should the choice of applicable regime be made? Is the public interest test in its current form the right tool? Or should a more rigid distinction be drawn between categories of banks and their treatment in case of crisis? The arguments above, and the experience in Denmark and the United States, suggest no clear case for a positive exemption threshold. Here too, however, further exploration would be needed than has been possible for this study in order to reach a firmer recommendation.

#### 5.2.5. Burden-sharing and depositor protection

As mentioned above, we strongly recommend that the establishment of a more predictable and effective expected applicable regime for FOLF banks be envisaged not in isolation as a purely legal endeavour, but rather as part of a holistic policy vision that aims at completing the banking union and at breaking the bank-sovereign vicious circle. In this respect, it should be considered together with a review of the state aid control stance (i.e. of the Banking Communication of 2013) and of arrangements for public funding at the EU level, including EDIS and the role of the ESM. Consideration should also be explicitly given to mutual support arrangements, beyond those which fall under the scope of state aid control, as they play a critical role in at least some member states.

This recommendation, however, leaves open a number of questions relevant for expectations of depositor protection and burden sharing, both in idiosyncratic cases and in situations of system-wide fragility or crisis. Here as well, further study would be apt. These questions include, prominently in our view, the assessment of the condition enshrined in BRRD (and SRMR and the intergovernmental agreement on the SRF) of 8 % bail-in for the use of a resolution fund under Article 44(5)(a) of BRRD and their impact on banks with different liability structures, particularly when deposits play a central role in the business strategy of the institution; alternative options to the superiority of covered deposits and the priority ranking of uninsured deposits of SMEs and natural persons under BRRD; and the scope for national liquidation or restructuring aid, especially if the ESM is provided with relevant crisis-intervention instruments (as appears necessary to break the bank-sovereign vicious circle) such as for liquidity guarantees or precautionary recapitalisation, under sufficiently stringent conditions that would prevent their use in non-systemic cases. The finalisation of a credible framework for liquidity in resolution should be discussed in a similar manner.

#### 5.2.6. Implications for banking supervision

The recommendation of a single expected applicable regime for FOLF banks in the banking union, including medium-sized and smaller ones, combined with the introduction of a genuine EDIS and other components of a policy package to complete the banking union, also has implications for banking supervision. Specifically, it implies that higher expectations may need to be set on the quality and consistency of supervision of less significant institutions than is currently the case. This does not necessarily, however, entail changes to the SSM Regulation of 2013, which leaves significant interpretative scope in this area.



## ANNEX 1: Legislative acts used as reference for the analysis in this report

This annex contains a list of the legislative acts that have been assessed by the national legal experts in order to prepare the country reports. References to these acts have been made in the main report.

Country	Act
Germany	<p>Banking Act "KWG" Banking Act as amended on 9 September 1998 (BGBl. I p. 2776), last amended by Article 6 of the Law of 8 July 2019 (BGBl. I p. 1002)</p> <p>Insolvency statute "InsO" of 5 October 1994 (Federal Law Gazette I p. 2866), which was last amended by Article 24 (3) of the Act of 23 June 2017 (Federal Law Gazette I p. 1693)</p> <p>Act on the Reorganisation of Credit Institutions Reorganisation and Settlement Act of 10 December 2014 (Federal Law Gazette I p. 2091), last amended by Article 8 (10) of the Law of 8 July 2019 (BGBl. I p. 1002)</p>
Italy	<p>Italian Consolidated Banking Law, included in the Insolvency Code: Legislative Decree 1 September 1993, n. 385, Consolidated text of banking and credit laws (Consolidated Banking Law)</p> <p>Updated by the Legislative Decree 12 January 2019, n.14, Insolvency Code implementing Law 19 October 2017, n. 155, Italian Official Journal n. 38 of 14.2.2019.</p> <p>Updated by the decree-law 25 March 2019, n. 22, converted, with modifications, by the law 20 May 2019, n. 4</p> <p>Bankruptcy Law: Royal Decree March 16, 1942 and following amendments (valid until January 2020)</p> <p>Legislative Decrees n. 180/2015 Legislative Decree 16 November 2015, n. 180 Implementation of Directive 2014/59 / EU of the European Parliament and of the Council, of 15 May 2014</p> <p>Legislative decree 181/2015, 16 November 2015, n.181, Amendments to the legislative decree 1 September 1993, n. 385 and of the legislative decree 24 February 1998, n. 58, implementing Directive 2014/59 / EU of the European Parliament and of the Council of 15 May 2014</p> <p>Legislative Decree of 24 February 1998 n. 58</p>
Portugal	<p>Decree-Law n. 298/92, of December 31 – Legal Framework of Credit Institutions and Financial Companies, establishing the conditions concerning the taking-up and pursuit of the business of credit institutions and financial companies in Portugal, as well as the supervision of these entities and the legal framework for resolution (hereinafter, Banking Law)</p> <p>Decree-Law n. 199/2006, of October 25 – Regulates the reorganisation and winding up of credit and financial institutions</p> <p>Law 23/2019 of March 13 2019 that amends Decree-law n.199/2006</p> <p>Decree-Law n. 53/2004, of March 18 – Portuguese Insolvency and Recovery Code</p> <p>Decree-Law n. 262/86, of September 2 - Commercial Companies Code</p>

	<p>Insolvency and Recovery Code</p> <p>Banking Law</p> <p>Code of civil procedure</p>
Spain	<p>Law 22/2003 of 9 July, Insolvency, in Spanish Official Journal of 10 July 2003 No 164</p> <p>Law 10/2014, of 26 June, on the organization, supervision and solvency of credit institutions, in Spanish Official Journal of 27 June 2014</p> <p>Law 6/2005 of 22 April on the restructuring and liquidation of credit institutions, in Spanish Official Journal of 23 April 2005 No 97</p> <p>Law 11/2015 of 18 June on recovery and resolution of credit institutions and investment services companies, Spanish Official Journal 19 May 2015 No 146</p> <p>Royal Decree 1012/2015 of 6 November, implementing Law 11/2015 of 18 June on recovery and resolution of credit institutions and investment services companies, Spanish Official Journal 7 November 2015 No 267</p> <p>Law 9/2012 on the restructuring and resolution of credit institutions, of 14 November 2012, in Spanish Official Journal of 15 November 2012 No 275</p> <p>Royal Decree 16/2011 of 14 October which created the Deposit Guarantee Fund for Credit Institutions, in Spanish Official Journal of 15 October 2011 No 249</p> <p>Law 17/2014, of 30 September which adopts urgent measures regarding refinancing and restructuring of corporate debt, in Spanish Official Journal of 1st October 2014 No 238</p> <p>Royal Decree-Law 5/2005 (which implements EU Directive 2002/47 on financial collateral)</p> <p>Royal Decree Law 11/2017 of 23 June on urgent financial measures, in Spanish Official Journal of 24 June 2017 No 150</p>
US	<p>FDI Act 1950, Pub.L. 81-797, 64 Stat. 873, enacted September 21, 1950</p> <p>National Depositor Preference Amendment</p>

## ANNEX 2: Country reports: Germany, Italy, Portugal, Spain and US

This annex contains reports providing more extensive information on the insolvency framework for a selection of Member States.

The objective is to illustrate more in detail the divergences between existing legal frameworks at national level. At the same time, some of the frameworks analysed in this annex are relevant because they were used in recent cases to manage bank crises.

Finally, we included an illustrative description of the system applicable in the United States, given the long-standing history of application of this framework and its relevance in the context of the currently policy debate on potential reform.

It must be underlined that all the information reported in this Annex is based on legal research carried out by VVA and its network and is based on their understanding of the applicable legislation. Therefore, it is not in any way meant to provide an official or institutional interpretation of the rules applicable at national level.



# **Study on the differences between bank insolvency laws and on their potential harmonisation**

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**Country report**

**Germany**



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## 1. Introduction

Banking insolvency proceedings in Germany are governed by general insolvency law, meaning that the Insolvency Statute (Insolvenzordnung; "InsO")<sup>1</sup> is applicable. There is no special statute regarding the insolvency of financial institutions although some additional rules and provisions can be found in the Banking Act (Kreditwesengesetz; "KWG").<sup>2</sup> The BRRD was implemented in the Act on the Recovery and Resolution of Credit Institutions (Sanierungs- und Abwicklungsgesetz; "SAG").<sup>3,4</sup>

The insolvency proceedings in Germany are court based: in most cases the court appoints an insolvency administrator (Insolvenzverwalter) who is part of the administration of justice to manage the proceedings. Under certain circumstances the court can decide to opt for a self-administration process, meaning that the insolvent institution itself is responsible for the administration of the insolvent proceedings but the court appoints an insolvency trustee (Sachwalter) to supervise the proceedings and this insolvency trustee is placed under supervision of the court.<sup>5</sup>

## 2. Key findings

The insolvency proceedings shall serve the purpose of collective satisfaction of a debtor's creditors.

Although there is no special insolvency regime for credit institutions, the competent authority is responsible for the initiation of the insolvency proceedings.

The hierarchy of claims under normal insolvency law is the same as under resolution.

There are two main tools to manage a bank's failure, a liquidation of the debtor's assets tool and an insolvency plan tool.

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<sup>1</sup> Insolvency statute "InsO" of 5 October 1994 (Federal Law Gazette I p. 2866), which was last amended by Article 24 (3) of the Act of 23 June 2017 (Federal Law Gazette I p. 1693)

<sup>2</sup> Banking Act as amended on 9 September 1998 (BGBl. I p. 2776), last amended by Article 6 of the Law of 8 July 2019 (BGBl. I p. 1002)

<sup>3</sup> Reorganisation and Settlement Act of 10 December 2014 (Federal Law Gazette I p. 2091), last amended by Article 8 (10) of the Law of 8 July 2019 (BGBl. I p. 1002)

<sup>4</sup>

[https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2015/fa\\_bj\\_1512\\_bankenabwicklungg.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2015/fa_bj_1512_bankenabwicklungg.html) viewed 19.03.19.

<sup>5</sup> Foerste, Insolvenzrecht p. 28 and p. 307.

There have been no major bank failures that have led to insolvency proceedings over the bank's assets in the past 15 years.

### **3. National insolvency proceedings applicable to banks**

#### **3.1 Objective of the insolvency procedure**

The objective of insolvency proceedings is to satisfy all creditors of one debtor jointly by realising the assets of the debtor and distributing the proceeds between the creditors or alternatively by defining deviant rules to govern the reorganisation of the company in an insolvency plan.<sup>6</sup>

The central idea of German insolvency law is the proportionate satisfaction of all creditors. This idea is expressed further in the principle of joint satisfaction of all creditors and therefore the interest of the depositors of an insolvent bank and its creditors are taken into account equally.<sup>7</sup> Satisfying creditors' claims takes priority in German insolvency proceedings. The option to govern the reorganisation of the company in an insolvency plan should enable those involved to choose the most favourable type of insolvency management in individual cases to achieve better results for the creditors through continuation of the business. This can also be derived from the fact that the creditors can decide to opt for and design an insolvency plan.<sup>8</sup>

#### **3.2 Pre-insolvency/restructuring**

The Act on the Reorganisation of Credit Institutions (Gesetz zur Reorganisation von Kreditinstituten; "KredReorgG") stipulates two court-based, pre-insolvency procedures – a recovery and a restructuring procedure.<sup>9</sup>

In order to initiate the recovery procedure, the financial institution must notify the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht; "BaFin") of the necessity for recovery and submit a recovery plan.<sup>10</sup> Necessity for recovery is defined legally as being given if the criteria in Section 45 Paragraph 1 Sentences 1 and 2 of the Banking Act are applicable: if the asset, financial or return development of an institute or other circumstances justify the assumption that the requirements in Articles 92 to 386 of EU regulation Nr.

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<sup>6</sup> Section 1 of the Insolvency Statute.

<sup>7</sup> Foerste, Insolvenzrecht p.8.

<sup>8</sup> Foerste, Insolvenzrecht p.248.

<sup>9</sup> Section 1 Law on Reorganisation of Credit Institutions.

<sup>10</sup> Section 2 Law on Reorganisation of Credit Institutions.

575/2013 or in Section 10 Paragraphs 3 and 4, Section 45b Paragraph 1 Sentence 2, Section 11 or Section 51a Paragraph 1 or 2 or Section 51b of the Banking Act cannot be met permanently.<sup>11</sup> The financial institution is not obliged to notify BaFin of the necessity for recovery, but there is an obligation for the bank to inform BaFin if the insolvency triggers are applicable, and if the financial institution notifies BaFin of the necessity for recovery, this obligation to inform BaFin of the applicability of the insolvency triggers is considered to be fulfilled.<sup>12</sup>

The recovery plan can include any measures deemed appropriate in order to restructure and recover the financial institution without infringing on third-party rights. BaFin must approve the recovery plan and will then apply for the execution of the recovery plan and the Higher Regional Court will decide on the matter. If the proposal is approved a recovery advisor is appointed in order to execute the recovery plan.<sup>13</sup> The recovery procedure is considered to be a weak instrument and there is no record of it being used in past cases.<sup>14</sup>

Upon justified suggestion by BaFin, the Higher Regional Court can also take further measures if these are deemed necessary for the recovery of the credit institution and if there is the danger that the credit institution cannot fulfil its obligations towards its creditors. Such measures are, in particular, prohibiting the members of management and the owners or limiting them in the exercise of their duties, making the recovery advisor part of the management team, prohibiting or limiting extraction by the owners or shareholders or distribution of profits, checking the remuneration or bonus arrangements of the management team and potentially making changes to these for the future as well as prohibiting payments of undue benefits and replacing the consent of the supervisory body.<sup>15</sup>

The restructuring procedure can be initiated by the financial institution if the financial system is endangered and if a recovery procedure is deemed insufficient by the financial institution or if the recovery procedure has failed. BaFin does not have the decision-making power in regards to the most suitable pre-insolvency measure to be applied. It can only apply for the implementation of the pre-insolvency measure determined in the notification by the financial institution.<sup>16</sup> A restructuring plan must be submitted; this plan can infringe on shareholder rights to a certain extent and can

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<sup>11</sup> Section 2 Law on Reorganisation of Credit Institutions; Section 45 Act on Credit Institutions.2

<sup>12</sup> Section 2 Law on Reorganisation of Credit Institutions; Section 46 b Act on Credit Institutions.

<sup>13</sup> Sections 1 to 3 Law on Reorganisation of Credit Institutions; Jahn/Schmitt/Geier, Handbuch Bankensanierung und -abwicklung Rn. 25-28.

<sup>14</sup> Jahn/Schmitt/Geier, Handbuch Bankensanierung und -abwicklung, Rn. 33.

<sup>15</sup> Section 5 Law on Reorganisation of Credit Institutions.

<sup>16</sup> Section 2 and 7 Law on Reorganisation of Credit Institutions.



include measures such as the liquidation of the financial institution. Part of the restructuring plan includes transforming creditors' claims into shares (debt-to-equity-swap). The creditor needs to agree to such a procedure.<sup>17</sup>

### **3.3 Insolvency test (triggers of insolvency procedures)**

There is a duty to file a request for the opening of insolvency proceedings without culpable delay if a financial institution is unable to pay its debts as they fall due (illiquidity), if a financial institution's total liabilities exceed the total assets unless there is a positive continuation forecast (over-indebtedness) or in case of impending illiquidity, but in this last case only with the consent of the financial institution or the finance holding company.<sup>18</sup>

Illiquidity is assumed if a company has ceased making payments. The German Federal Supreme Court has laid out several criteria by which a debtor cannot be stipulated illiquid. These being if it can reasonably be expected that the debtor will make any due payments within no more than three weeks from the due date, if the illiquidity amounts to less than 10% of all due payment obligations or if there is a high probability that the debtor will be able to make payments soon and the creditor can be expected to wait (meaning that a temporary interruption of payments will not be considered enough to constitute illiquidity).<sup>19</sup>

In the case of over-indebtedness, the institution's total liabilities include accruals and the total assets include hidden reserves. Impending illiquidity means that it is highly unlikely that the debtor will be able to make due payments. In practice, the cases of over-indebtedness and impending illiquidity often go hand in hand.<sup>20</sup>

### **3.4 Standing to file insolvency**

Insolvency can only be filed by BaFin. If illiquidity, over-indebtedness or impending illiquidity occur in an institution or the institutions finance holding company, management is required to inform BaFin immediately, providing all relevant documents. BaFin will then file for insolvency with the lower district court, but in the case of impending inability to pay only with the consent of the financial institution or the institution's finance holding company.<sup>21</sup>

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<sup>17</sup> Section 8 and 9 Law on Reorganisation of Credit Institutions; Jahn/Schmitt/Geier, Handbuch Bankensanierung und -abwicklung Rn. 32.

<sup>18</sup> Section 46 b Banking Act; Section 17, 18 and 19 Insolvency Statute.

<sup>19</sup> Section 17 Insolvency Statute; German Federal Supreme Court decision of 24 May 2005 (IX ZR 123/04); Foerste, Insolvenzrecht Rn. 109 and 110.

<sup>20</sup> GTDT Restructuring & Insolvency p. 187.

<sup>21</sup> Section 46 b Banking Act.

### 3.5 Appointment of administrators and their powers

During the time it takes the court to make a decision on whether to accept or decline BaFin's filing for insolvency (this period can take days, weeks or even months), the insolvency court has to take preliminary measures in order to protect the insolvency creditors. These preliminary measures can include appointing a preliminary committee of creditors in order to enable creditors to influence the proceedings from an early stage, appointing a preliminary insolvency administrator or in cases of self-administration a preliminary insolvency trustee, and imposing a general ban on transfers of assets. The preliminary insolvency administrator has similar rights to those of the insolvency administrator and in many cases the preliminary insolvency administrator goes on to be appointed as insolvency administrator after the court's decision to open insolvency proceedings. A general ban on transfers means that should the insolvent institute transfer any of the assets belonging to the insolvency estate during the preliminary proceedings, these transfers are invalid.

Once the court has decided to open the insolvency proceedings, an insolvency administrator is appointed by the insolvency court which is the lower district court (Amtsgericht).<sup>22</sup> Before appointing the insolvency administrator the court hears BaFin's position on the suitability of the appointment. The insolvency administrator informs BaFin of all developments in the insolvency proceedings by giving BaFin the reports for the insolvency court on the proceedings. BaFin can also request further information and documents regarding the insolvency proceedings from the insolvency administrator.<sup>23</sup>

The insolvency administrator has the power to manage all the bank's assets and keeps creditors informed about insolvency proceedings.<sup>24</sup> If the insolvency court appoints a committee of creditors, the insolvency administrator needs to obtain the committee's consent for legal activities that are of high importance for the insolvency proceedings.<sup>25</sup>

Transactions made prior to the opening of insolvency proceedings and disadvantaging the insolvency creditors may be contested by the insolvency administrator (Anfechtung) to reverse asset transfers prior to an insolvency.

In order for a legal act to be challengeable, it has to have taken effect before the opening of the insolvency proceedings and it also has to have incurred a disadvantage

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<sup>22</sup> Section 2 Banking Act.

<sup>23</sup> Section 46b Banking Act.

<sup>24</sup> Section 80 Insolvency Statute and Section 46f Banking Act.

<sup>25</sup> Section 160 Insolvency Statute.

to a creditor or the creditors. This disadvantage can be a reduction in the insolvency estate or an increase of debt. The consequence of a challenge is that the legal act will be undone.<sup>26</sup> The contesting period may be up to 10 years before filing for insolvency proceedings.

### **3.6 Admission of creditors/debtors to insolvency estate**

An insolvency creditor is such a creditor who has a justified claim to assets of the debtor at the time of commencement of the insolvency proceedings.<sup>27</sup> The insolvency estate includes all assets belonging to the bank at the time of the commencement of the insolvency proceedings and everything the bank acquires during the proceedings.<sup>28</sup>

The insolvency administrator shall establish a record of all creditors and a survey of property. The assets are listed in an ordered overview (survey of property), which also lists the obligations of the bank.<sup>29</sup> These obligations include any claims, even when they are not yet due, as they are considered to be due with the opening of the insolvency proceeding.<sup>30</sup>

The procedure to determine the claims requires registration of the claims by the creditors, a verification meeting to confirm the eligibility of the registered claims as well as existing civil court rulings over any disputes regarding the eligibility. A creditor who has a claim to the assets of the debtor at the time of commencement of the insolvency proceedings can register this claim with the administrator and only those claims that are registered are considered by the administrator.<sup>31</sup> Even if a court has already determined the eligibility of a claim, the claim still needs to be registered. In order for the registration to take effect, the reason for the claim needs to be outlined and any certificates, i.e. any contracts or bills need to be filed with the application. The insolvency administrator then enters all registered claims into the insolvency table and marks the date of the registration of the claim.<sup>32</sup> The timeline for the registration is three months, but a late registration is still possible in the verification meeting.

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<sup>26</sup> Section 143 Civil Code.

<sup>27</sup> Section 38 Insolvency Statute.

<sup>28</sup> Section 35 Insolvency Statute.

<sup>29</sup> Section 153 Insolvency Statute.

<sup>30</sup> Section 41 Insolvency Statute.

<sup>31</sup> Section 174 Insolvency Statute.

<sup>32</sup> Section 175 Insolvency Statute.

This meeting has the objective of mutually determining the eligibility of the claims – the German legislator trusts that the administrator as well as the creditors will ensure the verification of the claims due to the competitive nature of the creditors with each other – by giving the creditors and the administrator the right to oppose the verification of a claim. The debtor cannot oppose the verification of a claim, but he is obliged to inform the administrator of all claims against him and the administrator can then use this information to check the eligibility of a claim.<sup>33</sup> If a claim is opposed, the claim will not be verified and therefore it will not be added to the insolvency table. The creditor who is affected by this rejection can file action against this rejection and the court will then decide on the matter. In the verification meeting, the hierarchy of claims and the claim amount are also determined.

### 3.7 Hierarchy of claims

Before the hierarchy of insolvency claims can be established, such claims that are to be segregated (Section 47 and 48 Insolvency Statute) or separated (Section 49 to 51 Insolvency Statute) from the insolvency proceedings need to be determined. If an object does not belong to the insolvency estate but the debtor has possession over this object (i.e. the debtor has borrowed an object and is obliged to return this object), the claim to retrieve such an object is not an insolvency claim. It will therefore be processed according to law outside of the insolvency proceedings and a right of segregation exists.<sup>34</sup> As such, it is not a claim that takes priority over other claims in the insolvency proceedings, but rather a claim that is segregated from the insolvency proceedings. Other claims such as claims of creditors with a right to satisfaction from objects subject to execution into immovables (immovable objects) or creditors holding a pledge are separated from the insolvency proceedings before a hierarchy of claims is established.<sup>35</sup>

Once these claims have been segregated or separated from the insolvency claims, a hierarchy of insolvency claims can be determined. The costs of the insolvency proceedings (including administrator costs) and obligations binding on the estate take priority over any other claims.<sup>36</sup> After these, the Banking Act stipulates priority to certain claims in banking insolvency cases, meaning that deposits that are covered

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<sup>33</sup> Section 97, 152 and 153 Insolvency Statute.

<sup>34</sup> Section 47 Insolvency Statute (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017); see also Section 48 Insolvency Statute.

<sup>35</sup> Section 49 to 51 Insolvency Statute (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017).

<sup>36</sup> Section 53 to 55 Insolvency Statute (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017).

take priority over deposits that are not covered.<sup>37</sup> Next in line after the claims are the general creditors' claims and then the liabilities arising from non-subordinated, unsecured non-structured debt instruments.<sup>38</sup>

Creditor and debtor can also have a contractual subordination clause, meaning they can agree in advance that a claim shall be subordinated. If such a clause exists and the rank is determined in the clause, then such a claim can be next in the hierarchy of claims. If a contractual subordination clause exists but the rank is not determined within the clause, such a claim will be listed after the claims from Section 39 (I) of the Insolvency Statute.<sup>39</sup> These claims are namely (and in the listed order from more senior to more junior claim) any interest and late payment surcharges accrued after the opening of insolvency proceedings, the creditors' costs related to the insolvency proceedings, any criminal and administrative fees, the claims for the delivery of goods or provision of services free of charge and the claims for repayment of shareholder loans and accrued interest thereon.<sup>40</sup> After these claims, any Tier 2 instruments take priority of over additional Tier 1 instruments and the most junior claims are common equity Tier 1 instruments.<sup>41</sup>

The hierarchy of claims in insolvency cases in its current form was created through the Act on Resolution Mechanisms (Abwicklungsmechanismengesetz; "AbwMechG") in which the German legislator changed the hierarchy of claims in Section 46 f of the Banking Act. Since January, 1, 2017, the claims that are not suited for a bail-in are prioritised before claims that are especially well suited for a bail-in, the same as in the hierarchy of the BRRD.<sup>42</sup> In fact, the hierarchy under national banking insolvency is used to specify the hierarchy for resolutions, meaning that the hierarchy under

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<sup>37</sup> Section 46f (4) no. 1 and 2 Banking Act (date of adoption of the Banking Act: 01.01.1935, latest change: 18.01.2019).

<sup>38</sup> Section 38 Insolvency Statute and Section 46f (6) s. 2 and 46f (7) Banking Act; Section 38 Insolvency Statute in conjunction with Section 46f (5-7) Banking Act (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017; date of adoption of the Banking Act: 01.01.1935, latest change: 18.01.2019).

<sup>39</sup> Section 39 (II) Insolvency Statute (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017).

<sup>40</sup> Section 39 (I) no. 1-5 Insolvency Statute (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017).

<sup>41</sup> Section 39 (II) and Section 199 Insolvency Statute (date of adoption of the Insolvency Statute: 05.10.1994, latest change: 23.06.2017); Jahn/Schmitt/Geier, Handbuch Bankensanierung und -abwicklung Rn. 6-16; SRB Insolvency rankings in the jurisdictions of the Banking Union p. 20.

<sup>42</sup>

[https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Fachartikel/2015/fa\\_bj\\_1512\\_bankenabwicklung\\_en.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Fachartikel/2015/fa_bj_1512_bankenabwicklung_en.html) viewed 19.08.19.

normal banking insolvency proceedings is the same as the hierarchy under resolution.<sup>43</sup>

### **3.8 Tools available to manage a bank's failure**

The Insolvency Statute stipulates two tools to manage a bank's failure: a liquidation of the debtor's assets or an insolvency plan which aims to preserve the company as a whole.<sup>44</sup>

Upon the opening of the insolvency proceedings, the insolvency administrator will either sell the business or liquidate the assets.<sup>45</sup> The business can only be sold as a whole with the consent of the committee of creditors and only if the buyer owns 5% of the business' capital, the buyer belongs to those people who have a close connection with the debtor and the buyer is a creditor with a right to segregation or a prioritised claim.<sup>46</sup> In addition to the sale of business (as a whole or in part), the insolvency administrator can sell the institution's assets under certain conditions (collectively or individually).<sup>47</sup> Even though the Insolvency Statute does not provide for a sale of business in general, in practice the insolvency administrator will often sell the business through a sale of assets.<sup>48</sup>

Once the assets have been liquidated, any costs that occurred due to the liquidation are to be deducted from the proceeds, before the estate is distributed to the creditors according to the principle of equal creditors satisfaction in proportion to the amount of the respective claim.<sup>49</sup>

Alternatively, an insolvency plan can be approved by the insolvency court. The aim of an insolvency plan is to preserve the company as a whole and to bring the insolvency proceedings to an end as soon as possible. An insolvency plan is therefore a recovery plan and consists of two parts, a descriptive part and a formative part. The descriptive part outlines the reasons for the insolvency, the financial situation, the recovery measures and the goal of the insolvency plan as well as the necessary

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<sup>43</sup> Prof. Dr. iur. Dominik Skauradszum/Dr. iur. Benjamin Herz in Deutsche Zeitschrift fuer Wirtschafts- und Insolvenzrecht, 2016 (11): 501-509.

<sup>44</sup> Section 1 Insolvency Statute.

<sup>45</sup> Section 159 Insolvency Statute; GTDT Restructuring & Insolvency p. 190.

<sup>46</sup> Section 162 Insolvency Statute.

<sup>48</sup> GTDT Restructuring & Insolvency p. 190.

<sup>49</sup> Section 195 Insolvency Statute.

steps to achieve this goal. The formative part of the insolvency plan lists the creditors and splits them into different groups according to the class and rank of their claim.<sup>50</sup>

The goal of the insolvency plan is to reach a settlement with the creditors where the creditors waive a part of their claims. The amount agreed with each creditor depends on the rank and class of the claim as well as the percentage debt owned by the creditor. The insolvency plan allows the debtor to be debt-free within three to six months, much faster than through the sale of assets by the insolvency administrator.

#### **4. Available means to challenge an insolvency proceeding**

Decisions of the insolvency court shall be subject to an appellate remedy only in those cases where the Insolvency Statute or other Statutes provide for an immediate appeal. The immediate appeal shall be filed with the insolvency court.<sup>51</sup> If the opening of the insolvency proceedings is refused, the requesting party, and the debtor if the request was refused because the debtor's assets will probably be insufficient to cover the costs of the proceedings, may bring an immediate appeal. If the insolvency proceedings are opened, the debtor may bring an immediate appeal.<sup>52</sup> Should the insolvency court make provisional arrangements it deems necessary to protect the insolvency estate, the debtor can also appeal against any such arrangements.<sup>53</sup> The creditors, the debtor and anybody involved with the debtor can appeal against the decision confirming or denying the insolvency plan.

#### **5. Conclusions**

In Germany, bank failures are dealt with under general insolvency law, with some specifications with regards to the failure of financial institutions. The objective of the insolvency proceedings, to satisfy all creditors of one debtor jointly, is achieved through the administration of two main tools – the sale of assets and the approval of an insolvency plan. The sale of assets tool can also be used to sell a business and the insolvency plan is aimed at reaching a settlement with the creditors in order for a debtor to recover debt-free in a short amount of time. The German hierarchy of claims in banking insolvency is based on the BRRD hierarchy. In fact, the hierarchy under national banking insolvency was changed in order to specify the hierarchy for resolutions, meaning that the hierarchy under normal banking insolvency proceedings is the same as the hierarchy under resolution. There have been no major

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<sup>50</sup> Section 217 to 221 Insolvency Statute.

<sup>51</sup> Section 34 Insolvency Statute.

<sup>52</sup> Section 21 Insolvency Statute.

<sup>53</sup> Section 253 Insolvency Statute.

bank failures that have led to insolvency proceedings over the bank's assets in the past 15 years.



## ANNEX 1: Interaction between national bank insolvency regimes and resolution regime – triggers for initiating insolvency procedures

BRRD Art 32 BRRD	TRIGGERS UNDER NORMAL NATIONAL INSOLVENCY	EXPLANATION OF DIFFERENCES
<p>1. a) the institution is failing or is likely to fail (FOLF)</p> <p>For the purposes of point (a) of paragraph 1, an institution shall be deemed to be failing or likely to fail in one or more of the following circumstances:</p>	<p>Illiquidity, impending illiquidity or over-indebtedness (in case of impending illiquidity only with consent)<sup>54</sup></p>	<p>The terminology used in BRRD (failing or is likely to fail) can include different scenarios that are not restricted to liquidity but can also include non-monetary scenarios (i.e. can also mean governance issues or a combination of problems resulting in failure of institution); whereas the normal national insolvency trigger is much more specific and only applies to the specific cases of illiquidity, impending illiquidity and over-indebtedness. The BRRD trigger is therefore applicable to more cases and has a wider scope of application than the normal national insolvency trigger.</p>

<sup>54</sup> Section 46 b Act on Credit Institutions.

<p>4. (a) the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;</p>	<p>N/A</p>	<p>The BRRD criterion does not exist in national insolvency law (please see above).</p>
<p>(b) the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities;</p>	<p>over-indebtedness (a financial institution's total liabilities exceed the total assets unless there is a positive continuation forecast)</p>	<p>The BRRD criterion does not exist literally in national law (please see above), but the national criterion is similar to the BRRD criterion quoted in the left-handed column, with a few minor differences (forward-looking criterion, positive continuation forecast).</p>
<p>(c) the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its</p>	<p>Illiquidity (inability to pay debts as they fall due), impending illiquidity (in case of impending illiquidity only with consent)<sup>55</sup></p>	<p>The BRRD criterion does not exist literally in national law (please see above), but the national criterion is similar to the BRRD criterion quoted in</p>

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<sup>55</sup> Section 46 b Act on Credit Institutions.

debts or other liabilities as they fall due;		the left-handed column, with a few minor differences (forward-looking criterion, positive continuation forecast).
<p>(d) extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:</p> <p>(i) a state guarantee to back liquidity facilities provided by central banks according to the central banks' conditions;</p> <p>(ii) a state guarantee of newly issued liabilities; or</p> <p>(iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Article 59(3) are present at the time the public support is granted.</p>	N/A	The BRRD criterion does not exist in national insolvency law (please see above).

<p>b) there is <b>no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure</b> of the institution within a reasonable timeframe</p>	<p>No such criterion necessary to trigger insolvency procedures under normal national insolvency law</p>	<p>The BRRD formulates an additional criterion necessary to trigger resolution which does not exist under normal national insolvency law, hence insolvency procedures could be triggered according to normal national insolvency law if reasonable prospect that any alternative private sector measures or supervisory action could prevent failure exist, but procedure would not be triggered according to BRRD. The normal national insolvency procedure has a wider scope of application in this case.</p>
<p>c) a resolution action is necessary in the <b>public interest</b></p>	<p>No such criterion necessary to trigger insolvency procedures under normal national insolvency law</p>	<p>The criteria in BRRD excludes resolution action in case of the resolution not being necessary in the public interest. This criterion does not exist in national law, the scope of application is therefore wider under normal national law.</p>

## ANNEX 2: Interaction between national bank insolvency regimes and resolution regime – tools available

TYPE OF INSTRUMENT TO BE LOOKED FOR IN NATIONAL REGIME	BRRD TOOLS Art 37(3) BRRD	TOOLS GIVEN UNDER NORMAL NATIONAL INSOLVENCY	EXPLANATION OF DIFFERENCES
Instruments whereby shareholdings, assets, rights or liabilities of the bank to be resolved are transferred (in whole or in part) to a certain buyer	a) Sale of business tool	The business can only be sold as whole with the consent of the committee of creditors and only if the buyer owns 5% of the business' capital, belongs to those people who have a close connection with the debtor and the buyer is a creditor with a right to segregation or a prioritised claim. <sup>56</sup>	In practice there is not a big difference between the BRRD tool and the normal national insolvency tool as insolvency administrators will sell the business through sale of assets. <sup>57</sup>
Instruments to transfer a shareholding or assets and liabilities to a bridge institution	b) Bridge institution tool	No equivalent under normal national insolvency	This tool is specific to BRRD, no such tool exists under normal national insolvency.
Instruments to separate assets until subsequent sale or liquidation	c) Asset separation tool	No equivalent under normal national insolvency	This tool is specific to BRRD, no such tool exists under normal national insolvency.

<sup>56</sup> Section 162 Insolvency Statute.

<sup>57</sup> GTDT Restructuring & Insolvency p.190.

Write-down (reduction in the value of assets) of financial instruments issued by the bank or claims against the bank	d) Bail-in tool	No equivalent under normal national insolvency	This tool is specific to BRRD, no such tool exists under normal national insolvency.
Others	N/A	Sale of asset tool  Insolvency Plan	Assets can be sold under normal national insolvency law.  There is also scope for an insolvency plan under normal national insolvency law.

## ANNEX 3: CASE STUDIES

There have been no major bank failures that have led to insolvency proceedings over the bank's assets in Germany. For the completeness of this report, bank insolvency cases since 2012 are listed below.

INSOLVENCY CASE # 1	DETAILED INFORMATION
<b>Name of the bank</b>	Dero Bank AG
<b>Date of failure</b>	March 14, 2018
<b>Description of the case</b>  <i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i>	<p>Dero Bank AG was a financial institution based in Munch without systematic relevance. The bank specialised in investment banking for medium-sized, capital market orientated companies. The specialisation included all forms of corporate actions, particularly bond and share issues, stock market launches, designated sponsoring as well as share purchase proposals. Sole shareholder of Dero Bank Ag was Trillium Capital S.a.r.l. (former VEM Holding S.a.r.l.; based in Luxembourg).</p> <p>On February 8, 2018, BaFin imposed a moratorium on Dero Bank AG due to impending inability to pay, forbidding the bank from accepting any payments not issued to pay debts. Clients of Dero Bank AG criticised the closure as Dero Bank AG was a small institution and not relevant for the financial system.</p> <p>On February 13, 2018, BaFin filed an application to open insolvency proceedings.</p> <p>On March 14, 2018, the lower district court in Munich opened insolvency proceedings against Dero Bank and BaFin determined a case for compensation. This meant that clients received a security of €100,000 per investor (in exceptional cases up to €500,000) from the deposit insurance fund (Entschädigungseinrichtung deutscher Banken GmbH; EdB), due to their</p>

	investments being protected by the Law on Deposit Insurance (Einlagensicherungsgesetz). <sup>58</sup>
<b>Total assets in last balance sheet before failure</b>  <i>(if available)</i>	€27 million (on December 31, 2017) <sup>59</sup>
<b>Recovery rates</b>  <i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i>	N/A
<b>Length of the proceedings</b>	N/A
<b>Costs</b>	N/A

INSOLVENCY CASE # 2	DETAILED INFORMATION
<b>Name of the bank</b>	Maple Bank GmbH
<b>Date of failure</b>	February 11, 2016

<sup>58</sup> <https://www.handelsblatt.com/finanzen/banken-versicherungen/einlagensicherung-kunden-der-insolventen-dero-bank-werden-mit-bis-zu-500-000-euro-entschaedigt/21072394.html?ticket=ST-262625-gjz7vF66dyjT0LiEYWFF-ap5> viewed 14.03.19;  
[https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2018/pm\\_180314\\_entschaedigungsfall\\_dero\\_bank.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2018/pm_180314_entschaedigungsfall_dero_bank.html) viewed 14.03.19.

<sup>59</sup> [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2018/pm\\_180131\\_.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2018/pm_180131_.html) viewed 03.04.19.



<p><b>Description of the case</b></p> <p><i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i></p>	<p>Maple Bank GmbH was a niche provider specialising in investment banking, subsidiary of Canada’s Maple Bank and was based in Frankfurt.</p> <p>On February 6, 2016, BaFin ordered a moratorium on Maple Bank GmbH due to a threat of over-indebtedness. An insolvency of Maple Bank GmbH did not pose a threat to financial stability as the bank was not systematically important (the bank was a niche provider focusing on single strategies in investment banking sector). Maple Bank GmbH was also suspected of having committed tax fraud.</p> <p>On February 11, 2016 the lower district court opened insolvency proceedings and appointed an insolvency administrator and BaFin determined a case for compensation. Creditors received a total of €2.6 billion; EdB shelled out €100,000 per depositor and the Federal Association of German Banks made up the difference by paying up €59.8 million per investor.<sup>60</sup></p>
<p><b>Total assets in last balance sheet before failure</b></p> <p><i>(if available)</i></p>	<p>€5 billion<sup>61</sup></p>
<p><b>Recovery rates</b></p> <p><i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in</i></p>	<p>N/A</p>

<sup>60</sup> <https://www.zeit.de/news/2016-03/11/banken-anleger-der-insolventen-maple-bank-mit-26-milliarden-entschaedigt-11141203> viewed 14.03.19; [https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2016/pm\\_160212\\_maple\\_entschaedigungsfall\\_en.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2016/pm_160212_maple_entschaedigungsfall_en.html) viewed 14.03.19; <https://www.handelsblatt.com/today/finance/maple-bank-insolvency-creditors-want-their-billions-back/23538334.html?ticket=ST-5007218-ULcntHltFigauBTvHSP5-ap6> viewed 03.04.2019; <https://www.handelsblatt.com/today/finance/maple-bank-insolvency-creditors-want-their-billions-back/23538334.html?ticket=ST-5007218-ULcntHltFigauBTvHSP5-ap6> viewed 03.04.19.

<sup>61</sup> <https://www.tagesschau.de/wirtschaft/bafin-maple-bank-101.html> viewed 03.04.19.

<i>case it is available, please provide details here.)</i>	
<b>Length of the proceedings</b>	N/A
<b>Costs</b>	N/A

INSOLVENCY CASE # 3	DETAILED INFORMATION
<b>Name of the bank</b>	FXdirekt Bank
<b>Date of failure</b>	January 9, 2013
<b>Description of the case</b> <i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i>	<p>FXdirekt Bank was a small financial institution based in Oberhausen, whose clients were mainly day traders making exchange transactions, transactions in precious metals, CFD-trades on shares, ETFs and Futures.</p> <p>On December 21, 2012 BaFin imposed a moratorium and on January 9, 2013, provisional insolvency proceedings commenced (lower district court in Duisburg).</p> <p>On January 22, 2013, BaFin determined a case for compensation. FXdirekt Bank was part of the compensatory fund of securities trading companies (Entschädigungseinrichtung der Wertpapierhandelsunternehmen; EdW) which secures the creditors' claims by up to 90% but with a maximum pay-out of €20,000.<sup>62</sup></p>

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[https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2012/pm\\_121221\\_fxdirekt\\_moratorium.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2012/pm_121221_fxdirekt_moratorium.html) viewed 19.03.19;  
[https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Meldung/2013/meldung\\_130124\\_fxdirekt\\_entsc\\_haedigung.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Meldung/2013/meldung_130124_fxdirekt_entsc_haedigung.html) viewed 19.03.19.

<b>Total assets in last balance sheet before failure</b>  <i>(if available)</i>	€37 million (from December 18, 2012) <sup>63</sup>
<b>Recovery rates</b>  <i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i>	N/A
<b>Length of the proceedings</b>	N/A
<b>Costs</b>	N/A

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<sup>63</sup> <https://www.handelsblatt.com/finanzen/banken-versicherungen/wertpapierhandelsbank-bafin-schliesst-fxdirekt/7556732.html> viewed 03.04.19.



# **Study on the differences between bank insolvency laws and on their potential harmonisation**

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**Country report**

**Italy**



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## 1. Introduction

In Italy, the national insolvency procedure for banks and credit institutions is the compulsory administrative liquidation (CAL) regulated by the Italian Consolidated Banking Law<sup>1</sup> (Articles 80 and following).

The general provisions of CAL are included in Article 293 and following of the recently adopted Insolvency Code<sup>2</sup>. The insolvency Code provisions are applicable to all special cases expressly provided for by the legislation, including to insurance companies. The Insolvency Code will entry into force in 2020 and it will replace the Bankruptcy Law<sup>3</sup>.

While the provisions of the Insolvency Code on the CAL are applicable to all special cases indicated by the legislation, those in the Consolidated Banking Law are applicable to credit institutions.

The BRRD has been implemented by the Italian Legislative Decrees n. 180/2015 and 181/2015<sup>4</sup>. In the context of the implementation of the BRRD, the Italian Consolidated Banking Law was revised in order to be aligned with the new provisions on recovery and resolution<sup>5</sup>.

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<sup>1</sup> Legislative Decree 1 September 1993, n. 385, Consolidated text of banking and credit laws (Consolidated Banking Law) Version updated to the decree-law 25 March 2019, n. 22, converted, with modifications, by the law 20 May 2019, n. 4, <https://www.bancaditalia.it/compiti/vigilanza/intermediari/Testo-Unico-Bancario.pdf>

<sup>2</sup> Legislative Decree 12 January 2019, n.14, Insolvency Code implementing Law 19 October 2017, n. 155, Italian Official Journal n. 38 of 14.2.2019.

<sup>3</sup> Royal Decree 16 March 1942 and following amendments.

<sup>4</sup> Legislative Decree 16 November 2015, n. 180 Implementation of Directive 2014/59 / EU of the European Parliament and of the Council, of 15 May 2014, which establishes a framework for the recovery and resolution of credit institutions and investment firms and which modifies Council Directive 82/891 / EEC, and the directives 2001/24 / CE, 2002/47 / CE, 2004/25 / CE, 2005/56 / CE, 2007/36 / CE, 2011/35 / EU, 2012/30 / EU and 2013/36 / EU and the regulations (EU), n. 1093/2010 and (EU) n. 648/2012, of the European Parliament and of the Council, Legislative Decree 16 November 2015, n.181, Amendments to the legislative decree 1 September 1993, n. 385 and of the legislative decree 24 February 1998, n. 58, implementing Directive 2014/59 / EU of the European Parliament and of the Council of 15 May 2014, which establishes a framework for the recovery and resolution of credit institutions and investment firms and which amends Directive 82/891 / EEC of the Council, and Directives 2001/24 / EC, 2002/47 / EC, 2004/25 / EC, 2005/56 / EC, 2007/36 / EC, 2011/35 / EU, 2012/30 / EU and 2013/36 / EU and regulations (EU), n. 1093/2010 and (EU) n. 648/2012, of the European Parliament and of the Council. Italian Official Journal n.267 of 16-11-2015.

## 2. Key findings

- The Italian national insolvency procedure for banks is an administrative procedure under the supervision of the Bank of Italy called Liquidazione coatta amministrativa (Compulsory administrative liquidation or CAL).
- The triggering conditions which justify the opening of resolution can all be used to initiate CAL, where the public interest condition for the starting of the resolution is not met.
- However, if the triggering conditions for CAL are met, the procedure can only be initiated by the Minister of the Economy and Finance (MEF) upon request of the Bank of Italy or of the European Central Bank, depending on the competences.
- The Italian law goes beyond the BRRD by establishing full (tiered) depositor preference in insolvency and in resolution over senior unsecured debt instruments from 1 January 2019.
- The tools available to manage the CAL include the sale of all/part of the bank's assets and liabilities. A temporary management of the on-going business may be authorized by the Bank of Italy if it is necessary to maximize the liquidation proceeds. At any moment of the procedure, the liquidators may propose a composition with creditors.
- The Italian Consolidated Banking Law also provides for an early intervention procedure to manage the bank with a view to avoid its failure (amministrazione straordinaria).

## 3. National insolvency proceedings applicable to banks

### 3.1 Objective of the insolvency procedure

Banks and other financial companies are not subject to the ordinary insolvency procedure applicable to non-financial firms; by contrast, they are subject to a special procedure named Liquidazione coatta amministrativa (Compulsory administrative liquidation or CAL) whose scope of application was limited by the Legislative Decree No. 14/2019 (so-called "Insolvency Code" implementing Law 155/2017<sup>6</sup>)<sup>7</sup> to specific categories of companies, identified by the law.

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<sup>6</sup> Italian Official Journal of 30 October 2017.

<sup>7</sup> It is noteworthy that, pursuant to Article 389 of the aforementioned Code, the provisions related to the insolvency procedures regulated by the Code shall enter into force in August 2020, i.e. within 18 months as of the publication in the Italian Official Journal (i.e., as from the 14 February 2019). For convenience, in this document, we have reported the new provisions of the Insolvency Code while quoting the corresponding provisions of the former Bankruptcy Law.

The decision to introduce a specific administrative procedure for banks' liquidation has its foundation in the "*need to combine the banking business and the autonomy of the credit institutions in their strategic, organizational and operational choices, with a system of public controls which derives from the public interest connected to the objectives of stability, efficiency and competitiveness of the system*"<sup>8</sup>. In addition, there is the need to protect the fiduciary relationship between the bank and its clients, which is at the basis of the banking activity<sup>9</sup>.

The objectives pursued by the legislator also differ depending on the intrinsic severity of the bank's crisis: in case of a reversible crisis, the main objective of the legislation appears to be to safeguard the "market confidence" in the ability of the institution to fulfil its obligations, so as to avoid it from becoming insolvent. If the crisis is irreversible, the special procedures provided by the Italian Consolidated Banking Law are intended to guarantee an orderly management of the liquidation.

The ultimate purpose of the CAL is the dissolution and liquidation of the bank. However, in order to maximize the outcomes of the procedures for the creditors and to reduce the impacts of the liquidation on the markets, it provides for certain tools, and particularly the sale of the assets and liabilities of the entity (Section 3.8).

The procedure provided by the Consolidated Banking Law implies the assessment of bank liabilities, the realisation of assets and the repayment of covered depositors and satisfaction of creditors subject to priority rights. However, banks' liquidation in Italy has taken almost always the form of assignment of assets and liabilities to another bank (purchase and assumption - P&A) contextually to the start of CAL, while the atomistic liquidation with the sale of individual assets and distribution of the proceeds to depositors and other creditors by allotment is extremely rare.

In the Italian system, P&A is regarded as the optimal outcome if arranged in advance and properly performed at the beginning of the procedure. The potential shortfall (i.e., the negative balance between assets and liabilities of the failing bank) stemming from P&A may be covered by the Italian Deposit Guarantee Schemes (DGSs) when this support is less costly than a depositors' pay-out.

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<sup>8</sup> Banche, Assicurazioni e Gestori di Risparmio, Prosperetti, Colavolpe, IPSOA, Parte VII, Sez. I, pag. 1215. The term "public interest" in the context of this quote is used non-technically, i.e. it is not meant to correspond to the public interest assessment carried out pursuant to BRRD.

<sup>9</sup> Il governo della banche in Italia, Giappichelli "Le crisi bancarie" di Monica Parrella, pag. 595.



### 3.2 Pre-insolvency / restructuring

The Italian Consolidated Banking Law provides for the "special administration", a restructuring procedure specifically designed for banks.

The special administration was initially considered as an "administrative sanction" for illegitimate behaviour assumed by the directors in violation of administrative, legislative and statutory provisions. Subsequently, it was qualified as a "precautionary measure" aimed at creditors' protection and, finally, it was transformed into a tool "addressed to integrate or replace the body in charge of the administration" when there are irregularities and violations or when the liquidity and solvability of the bank are in danger.<sup>10</sup>

In particular, Article 75-bis provides that, when the condition of the special administration laid down in Article 70 are met, instead of removing the management bodies, the Bank of Italy may decide to appoint one or more special administrators who will temporarily work together with the board of directors or other management body. In the appointment decision, the Bank of Italy will identify the role, the duties, the powers of the special administrators as well as the relationship with the management body, including the obligation of the management body to obtain the preventive opinion of the special administrator for certain acts.

Article 70 provides that the bank may be subject to special administration by the competent authority (ECB for significant institutions and Bank of Italy for less significant institutions), through the termination of the governing and supervisory bodies and consequent replacement thereof, respectively, with one or more special administrators and with a monitoring committee, appointed by the competent authority. The functions of the general shareholders' meetings, meanwhile, are suspended. The conditions for starting the special administration are the following, alternatively: (i) there are "serious breaches of laws, regulations, or bylaws"; (ii) "serious loss of assets is expected" or (iii) "the termination of the governing and supervisory bodies is requested by the governing bodies and by the extraordinary shareholders' meeting, when one of the conditions under (i) or (ii) is met".

The main task of the special administrators is to replace the board of directors and to manage the bank maintaining its normal operational capacity. The Bank of Italy may decide to issue binding instructions to the special administrators to adopt special precautions and limitations in the management of the bank, aimed at achieving the objectives pursued by the special administration.

Article 72 provides that the duty of special administrators is to assess the business conditions of the bank, to remove irregularities, and to adopt business solutions in

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<sup>10</sup> Costi R., L'Ordinamento Bancario, Capitolo XII, La disciplina delle crisi Il Mulino, 2012, p.810.

the interest of depositors and of the bank in order to ensure sound and prudent management. The duty of the monitoring committee is to supervise the special administrators and to provide them with opinions.

According to Article 73 of the Consolidated Banking Law, the special administrators take over the company, prepare a summary report and perform an in-depth analysis of the financial statements of the bank.

The general shareholders' meeting is suspended and may only be convened by the special administrators. According to Article 77-bis, the shareholders' meeting for the increase of capital in order to restore the regulatory capital can be convened up to ten days prior to the meeting if provided by the bylaws.

The opening of a special administration does not modify the legal relationships of the bank with third parties (customers, suppliers, employees, savers, borrowing businesses, etc.). The special administrator substitutes the ordinary governing body (which has been terminated) in the management of the bank and is in charge of establishing new legal relationships with third parties and to manage the existing ones<sup>11</sup>.

The special administrators may, in exceptional circumstances and in view of protecting the interests of creditors, upon authorization of the Bank of Italy and with the positive advice of the monitoring committee, suspend the payment of liabilities of any kind by the bank or the return of the financial instruments to customers<sup>12</sup>.

The suspension of payments and restitutions can be applied for maximum one month which can be extended for additional two months<sup>13</sup>.

The suspension can be qualified as a moratorium tool. During the period of suspension, no enforcement actions or precautionary measures may be initiated or continued on the assets of the bank and on the clients' financial instruments. During the same period no mortgages may be registered on the bank's immovable properties or other pre-emptive rights on the movable property of the bank may be

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<sup>11</sup> It has been concluded that the special administration of a bank is not a composition procedure of the kind inherent to an insolvency procedure, or an in-court debt-restructuring procedure, or the compulsory administrative liquidation (even that applied to the banking industry), since it does not produce the effects typical of the prohibition of individual enforcement measures, prohibition of payment of past debts. Bonfatti S., *BANKING CRISES IN ITALY (2015-2017)*, *Crisi d'impresa e Insolvenza* 30 aprile 2018.

<sup>12</sup> The suspension of payment is permitted only if there are exceptional circumstances and the need to protect the creditors' interests. It has to be considered an institute of exceptional nature, due to the very difficult conciliation of the suspension of payments with the purpose to keep the bank as going concern, The peculiarity of the provision is further confirmed by the precautions that accompany it and above all, from the very limited duration of its effects. Costi R., *L'ordinamento bancario 2012*, Capitolo XII, *La disciplina della crisi*, pag. 831.

<sup>13</sup> Article 74 (1) of the Italian Consolidated Banking Law.

obtained, except by virtue of executive judicial measures adopted prior to the beginning of the suspension period.

Under the authorisation of the Bank of Italy, the special administration may end with: i) the bank restructuring and the return to ordinary administration with appointment of a new board of directors and auditors by the shareholders; ii) the initiation of a voluntary liquidation or CAL.

With regard to parent companies, specific provisions are envisaged by the Consolidated Banking Law.

According to Article 98 of the Consolidated Banking Law, the special administration of the parent company may be ordered: if there are serious violations in the exercise of the power of instruction to the other members of the group as indicated in Article 61(4) of the Consolidated Banking Law; if one of the companies of the banking group has been subjected to bankruptcy proceedings, composition with creditors, compulsory administrative liquidation, resolution, special administration or to any other analogous procedure provided for in special laws; when an administrator has been appointed by a court order in accordance with the provisions of the Civil Code governing the reporting to the court of serious management irregularities; and when the financial or operational equilibrium of the group is seriously compromised.

The duration of the special administration is one year, but the competent authority may decide for the early termination or for an extension for another year. In the second case, the special administration can be extended also to the members of the group.

The special administrators may, after having consulted the monitoring committee and with the prior authorization of the competent authority, revoke or replace, even in part, the directors of the bank in order to introduce the changes in the management which are considered necessary. The new directors remain in office until the end of the special administration of the parent company. The revoked directors shall be exclusively entitled to compensation corresponding to the ordinary compensation for the remaining term of office but, capped at six months maximum.

Article 75 provides that at the end of the special administration, the administrators and the members of the monitoring committee shall prepare separate reports on the activities carried out during the special administration to be submitted to the Bank of Italy. The notice of the termination of the special administration is published in the Italian Official Journal.

The closure of the on-going financial year at the beginning of the special administration is postponed until the end of procedure. The special administrators will prepare the financial statements that are submitted to the Bank of Italy for its approval within four months from the termination of the administration. The financial statements are published in accordance with the law.

The financial year for which the financial statements are prepared correspond to a single tax period. Within one month from the approval by the Bank of Italy, the

management bodies replacing the special administrators shall prepare the income statement related to this period according to the tax provisions in force.

Before ceasing their functions, the special administrators will adopt all the acts necessary to prepare for the new management bodies that will take over the bank from the special administrators in order to continue the business (Article 75(3) of the Consolidated Banking Law).

### 3.3 Insolvency test (triggers of insolvency procedures)

The CAL is triggered when a bank is "*failing*" or "*likely to fail*", as defined by Article 17 of Italian Legislative Decree n. 180/2015,<sup>14</sup> and "*no alternative measures appear reasonably possible*".

The bank is considered failing or likely to fail in one or more of the following situations:

- a) irregularities in the administration or violations of legislative, regulatory or bank's by-laws provisions regulating the activity of the bank of such gravity which would justify the withdrawal of the authorisation;
- b) there are capital losses of exceptional severity, such as to deprive the bank of its entire capital or of an important part of the capital;
- c) its assets are less than liabilities;
- d) it is not able to pay its debts at maturity;
- e) there are objective elements indicate that one or more of the situations indicated in letters a), b), c) and d) will occur in the near future;
- f) there is the need of extraordinary public financial support, with the exclusion of the cases under Article 18 (precautionary recapitalisation).

It is worth highlighting therefore that the resolution and CAL triggers are fully aligned. In other words, if the FOLTF conditions as per BRRD (as transposed in Italy) are met but a resolution action is not considered in the public interest, that bank can be put into CAL based on the same FOLTF conditions.

It is also interesting to note, that, as a result of the above, the conditions that may trigger a FOLTF determination differ from (and are more encompassing than) the conditions that would justify an insolvency declaration for a non-bank company (pursuant to Article 2 of the Insolvency Code, former Article 5 of the Bankruptcy Law). Consequently, a bank could be put under CAL even if it is not insolvent.

However, it should be indicated that, in addition to the FOLTF conditions mentioned above, the CAL can be triggered by a judicial declaration of insolvency. In this case, it is currently unclear if the test of Article 2 of the Insolvency Code (former Article 5

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<sup>14</sup> This provision is directly recalled by Article 80 of the Italian Banking Law, which provides the rules on the initiation of the CAL

of the Bankruptcy Law) applies or if the specific FOLTF conditions remain applicable<sup>15</sup>.

In case of judicial declaration of insolvency, the MEF and the Bank of Italy are mandated to open the CAL, except if there is the public interest to put the bank in resolution.

With respect to the second condition required for the bank to be FOLTF, i.e. that no "*alternative measures appear reasonably possible which would prevent the failure of the institution within a reasonable timeframe*", Article 17 of the Legislative Decree n. 180/2015 indicates as possible alternative measures: (i) the reasonable prospect of any private sector intervention; (ii) the intervention of an institutional protection scheme; (iii) supervisory actions including early intervention measures; (iv) the special administration in accordance with the Consolidated Banking Law. In addition, Article 20 paragraph 1(a) makes reference to the write down or conversion of relevant capital instruments, as a tool to prevent the application of resolution/CAL.

As a result, the conditions to determine a bank as FOLTF, as well as the determination that there is no alternative private solution, can also act as triggers for CAL. However, CAL only applies if the resolution authority (the Single Resolution Board or the Bank of Italy) concludes that there is no public interest to take resolution action (Article 20 of the of Italian Legislative Decree n. 180/2015). Also,

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<sup>15</sup> Part of the literature considers that the concept of insolvency referred to in Article 5 Bankruptcy Law has a "universal" character, in the sense that it must be referred to insolvency procedures and, therefore, also in banking procedures (SANDULLI, Commento sub art. 5, in Comm. Jorio, I, Bologna, 2006, 98 ss; FORTUNATO, La liquidazione coatta delle banche dopo il Testo Unico: lineamenti generali e finalità, in Banca borsa, 1994, I, 772; TERRANOVA, L'insolvenza delle banche, ora in Stato di crisi e stato di insolvenza, Torino, 2007, 91 ss., e, in giurisprudenza, Trib. Potenza, 13 luglio 2000, in Banca borsa, 2002, II, 500, con nota di CARDUCCI ARTENISIO, L'accertamento giudiziale dell'insolvenza di banca in liquidazione coatta amministrativa). Others, supported by the jurisprudence, consider that even if, in principle, there is a superimposition of the notions of bank insolvency and corporate insolvency, de facto, the insolvency of the bank can be declared at a chronologically earlier moment, compared to that which can be obtained through the application of the general notion, inasmuch as it must already be considered existing in the presence of particular technical indicators, among which, particular importance is attributed to the result of a large and irreversible capital deficit. Cass., 21 aprile 2006, n. 9408, in Banca borsa, 2008, II, 329, con nota redazionale di CARRELLI, ed in Fallimento, 2006, 1279, con nota di BARBIERI, Accertamento dello stato d'insolvenza dell'impresa bancaria; Trib. Frosinone, 15 maggio 1998, in Riv. dir. comm. e obbligazioni, 1999, II, 101, con nota adesiva di CAPPIELLO, Lo stato di insolvenza dell'impresa in rapporto alla specificità dell'attività bancaria ed in Banca borsa, 2000, II, 317, con nota adesiva di CERCONI, L'insolvenza delle banche tra nuove questioni processuali e consolidati indirizzi di merito; nonché GALANTI, L'accertamento giudiziale dello stato di insolvenza, in Comm. Ferro – Luzzi, Castaldi, II, Milano, 1996, 1390. In tema, cfr., anche, BELLÉ, Commento sub Art. 195, cit., 1526).

this assessment is done in line with the provisions contained in BRRD and its transposing law in Italy.

The compulsory administrative liquidation is opened by a decree of the Italian Minister of Economy and Finance (MEF) upon proposal of the Bank of Italy.

In addition, based on Article 82(2) of the Consolidated Banking Law, the CAL or the resolution (if there is public interest) is triggered by the judicial declaration of insolvency. In this case, the court transmits the decision to the MEF and the Bank of Italy to assess if the insolvent bank shall be put under CAL or resolution.

In the case of the parent company, the compulsory administrative liquidation can be initiated also in case of exceptional violation in the exercise of the power of instruction towards the members of the group in order to comply with the supervisory powers of the Bank of Italy (as provided by Article 61(4) of the Consolidated Banking Law).

When the parent company is subject to the special administration or to the CAL, the other companies of the group will be put under CAL if they are insolvent. Where the companies belonging to the group are subjected to bankruptcy proceedings, compulsory administration or other insolvency proceedings, such procedures shall be converted into the CAL.

When the insolvency of the bank (both as a stand-alone institution and as a parent company of a group) has been declared by the court, the liquidators can exercise also the claw back actions under Article 166 of the Insolvency Code. Besides, the insolvency declaration makes applicable the criminal provisions embodied in the Insolvency Code.

### **3.4 Standing to initiate CAL and to file for insolvency**

As mentioned above, CAL can be initiated in different circumstances.<sup>16</sup>

In particular, the Bank of Italy (or the ECB or SRB) may start the procedure when it finds that the conditions to declare it FOLTF are present. In addition, even in case the Bank of Italy (or the ECB or SRB) does not determine the existence of the conditions to declare the bank FOLTF, a judge may still initiate the CAL if the bank is in a state of insolvency.

The CAL is initiated by a decree of the MEF, acting on a proposal of the Bank of Italy. When not initiated ex officio by the Bank of Italy, CAL may be also triggered, with the same procedure, by a reasoned request from the bank's administrative bodies, the extraordinary general meeting, or the special administrators. The request should be based on the same triggers as listed above.

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<sup>16</sup> Article 82 of the Consolidated Banking Law.

Even when the initiative comes from the banks' administrative bodies, the request is always made to the MEF by the Bank of Italy, who assesses the legal triggers to start the CAL; consequently, the MEF always triggers the CAL acting on a proposal by the Bank of Italy.

In any case, the Bank of Italy is responsible for the supervision and direction of the procedures and appoints the bodies governing them.

As indicated above, a declaration of insolvency of the bank is not necessary to initiate the CAL. The procedure to declare a bank insolvent is parallel to the CAL and is based on different rules on standing.

In particular, if a CAL has not started yet, the standing to file for judicial declaration of insolvency under Article 82 of the Consolidated Banking Law is recognized to creditors, public prosecutor, and to the special administrators.

In this case, the court of the place where the bank has its main center of interests, at the request of one or more creditors, upon application by the public prosecutor or ex officio, after hearing the Bank of Italy and the bank's legal representatives, declares the state of insolvency with decision in the court chamber. The judicial ruling is communicated to the competent Authority (in this case, the Bank of Italy) in order to start a CAL (i.e., to propose to MEF to initiate a CAL) or a resolution procedure (where the relevant triggers are met)<sup>17</sup>. When the bank is subject to special administration, the court may declare the insolvency also on appeal of the special administrators, after having heard the special administrators themselves, the Bank of Italy and the bank's ceased legal representatives.

If the bank is already under CAL, the request for the insolvency declaration may be filed by the liquidators, by the public prosecutor or ex officio, and after hearing of the Bank of Italy and the former legal representatives of the bank.

In the event of the judicial declaration of the insolvency, the provisions of Section IV of the Insolvency Code (former Article 203 of Bankruptcy Law) will apply and the liquidators will be able to perform the claw back actions to revoke the acts adopted by the former management which altered the *par condicium creditorum*, in order to restore the banks' estate<sup>18</sup>.

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<sup>17</sup> Please note that this case never occurred in the Bank of Italy experience.

<sup>18</sup> Renzo Costi, *L'ordinamento Bancario*, quoted, pg. 856. This case never occurred now. In addition, please note that this procedure is also envisaged by D. Lgs 180/2015 when the bank has already been under resolution. Article 38 of Legislative Decree n. 80/2015 provides and the bank subject to resolution is in a state of insolvency on the date of adoption of the decree to initiate the resolution, Article 82(2), of the Consolidated Banking Law is applied. The court ascertains the insolvency status of the institution subject to resolution having regard to the situation existing at the time the resolution was started. The provisions on CAL as provided of Title VI of the law (Title VII Insolvency Code) also apply when the state of insolvency is exceeded due to termination. When the insolvency is ascertained by a judicial declaration, the claw back actions and actions to revoke the acts performed in fraud of creditors can be started by the liquidators or another subject appointed by the Bank of Italy (Article 36(3) legislative Decree n. 180/2015).

The Supreme Court confirmed that the state of insolvency of a bank subjected to compulsory administrative liquidation pursuant to Article 82(2) of the Italian Consolidated Banking Law *"must be referred to the moment of adoption of the liquidation decree and it is based on the general provision of Article 5 of the Bankruptcy Law, which is applicable in the absence of autonomous definition, i.e. the absence of the liquidity and credit conditions necessary for the performance of the specific entrepreneurial activity. The peculiarity of the banking activity - which implies that the bank has multiple channels of access to funding to prevent bank-run - also gives particular relevance, [...] to the negative unbalance between assets and liabilities"*<sup>19</sup>.

### **3.5 Appointment of liquidators or administrators and their powers**

According to Article 81 of the Consolidated Banking Law, two bodies are in charge of liquidation: a) one or more liquidators; and b) a supervisory committee. The supervisory committee is composed by three to five members who appoint their chairman by majority vote. Companies may also be appointed as liquidators.

The decision of the Bank of Italy concerning the appointment of the bodies is published on the authority's website, in the form of an abstract. Within 15 days from the communication of the decision, the appointed bodies shall deposit copy of their appointment to the business register of the Commercial Chamber.

The Bank of Italy may revoke or replace liquidators and members of the supervisory committee.

From the day the liquidators take up office, moratorium is triggered and no enforcement actions can be started against the bank for the payments of the outstanding credits.

### **3.6 Admission of creditors/debtors to insolvency estate**

Within one month from their appointment<sup>20</sup>, the liquidators will inform each creditor about the amount of the claims and the sums already paid before entering into liquidation, as they result from the bank's book records. The communication is made by certified e-mail and, in any other case, by registered letter or fax at the company's headquarters or the creditor's residence. The communication is not final and it is possible for the creditor to challenge it.

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<sup>20</sup> The deadline is considered to be not binding based on established case-law.



A notice is also sent to those who are holders of property rights with respect to assets and financial instruments related to the services provided by the bank under the Consolidated Financial Law<sup>21</sup> which are in possession of the bank, as well as to clients entitled to the return of financial instruments.

Within 60 days starting from the publication of the liquidation decree in the Italian Official Journal, creditors and clients entitled to restitutions who have not received the communication by the liquidators may ask for the recognition of their claims towards the bank under CAL.

Within 30 days from the expiration of the deadline mentioned above, the liquidators shall submit to the Bank of Italy, after having heard the dismissed directors of the bank, the list of: i) admitted creditors and the amounts of the claims allowed for each, indicating the existence and the order of rights of preference; ii) holders of property rights with respect to assets and financial instruments and customers entitled to the restitution of financial instruments; iii) subjects whose claims has been denied.

Clients having the right to obtain the return of financial instruments according to the Consolidated Financial Law are registered in a special and separate section of the statement of liabilities.

Within the same deadline the liquidators shall submit to the court registry of the place where the bank has the center of its main interests: the list of preferred creditors; the holders of property rights with respect to assets and financial instruments and customers entitled to the restitution of financial instruments; and the list of creditors whose claims have been denied.

A notice concerning the lodging of the statement of liabilities with the Bank of Italy and with the court registry of the place where the bank is located shall be published in the Italian Official Journal.

Without delay, the liquidators shall communicate their determinations regarding the claims denied, in whole or in part. Those creditors who have been denied the admission to the insolvency estate may file a petition against the dismissal before the competent court, asking for their admission, within 15 days from receiving the notice.

In addition, creditors may challenge the decision to admit other creditors (competing creditors) to the insolvency estate but such petition cannot be filed against admitted unsecured creditors, contrary to the normal liquidation procedures<sup>22</sup>. In other words, claims against competing creditors' admission can

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<sup>21</sup> Legislative Decree of 24 February 1998 n. 58.

<sup>22</sup> The reason of the different procedure under the Consolidated Banking Law for claims against the admission of competing unsecured creditors compared to the procedure provided by Articles 98(3) and

only be filed against secured and privileged creditors, against such customers who are entitled to the return of financial instruments and holders of property rights with respect to assets and financial instruments [Article 87(1)].

### 3.7 Hierarchy of claims

According to Article 91 of the Consolidated Banking Law, the ranking of claims in CAL follows the hierarchy of claims under Article 221 of the Insolvency Code, with certain exceptions.

Based on Article 221 Insolvency Code, the amounts derived from the liquidation of the assets are allocated to cover the liabilities in the following order:

- 1) pre-deductible credits. Pre-deductible credits are those qualified by a specific legislative provision as well as those arising on or as a result of the administrative compulsory liquidation, such as the liquidators' fees and the costs of the liquidation procedure. These credits are satisfied with preference vis-à-vis all the other claims against the CAL under Article 221, point 1) of the Insolvency Code;
- 2) credits admitted with pre-emption (*prelazione*) according to the order assigned by the law;
- 3) unsecured creditors, in proportion to the amount of credit for which each of them was admitted, including the creditors indicated in point 2, if the collateral had not been enforced yet, or for the part for which they were not satisfied by that.

Article 91 of the Consolidated Banking Law adds the following to the hierarchy of creditors.

*"1-bis. Notwithstanding the provisions of Article 2741 of the Civil Code and Article 221 of the Insolvency Code, in the allocation of assets liquidated pursuant to paragraph 1:*

*a) the following credits are satisfied with preference over the others unsecured credits:*

- 1. the part of deposits of natural persons, micro, small and medium-sized companies eligible for repayment and exceeding the amount provided for in article 96-bis.1, paragraphs 3 and 4 (3);*
- 2. the same deposits indicated at number 1), carried out at non EU-branches of banks with registered offices in Italy;*

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209(2) of the Bankruptcy Law (Article 226 of the Insolvency Code), has to be found in the need of expeditiousness of the banks' CAL, which requires a stabilization of the administrative assessment of the credits being characterized by a very high number of debt relationships. The documentary evidence to support claims of bank's creditors has an almost certain nature which reduce the need of verification but, "above all further consideration, the need to protect depositors covered by the DGS schemes". See, Milan Court, sez II civ, 4 October 2018.

*b) the following are satisfied with preference with respect to the credits indicated in the letter a):*

- 1. covered deposits;*
- 2. the receivables due from the depositor guarantee systems as a result of the subrogation in the rights and obligations of protected depositors;*

*c) other deposits at the bank are satisfied with preference compared to other unsecured credits but after the credits indicated in letters a) and b) have been met”.*

It is to be noted that the ranking mentioned above, which is introduced in Italian law as a result of the transposition of BRRD and the Bank Creditor Hierarchy Directive<sup>23</sup> applies also in resolution. Please note however that the extension to the deposits referred to by lett. c) of the provision at stake is applicable for resolution and liquidation commencing after 1st January 2019<sup>24</sup>.

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<sup>23</sup> Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy OJ L 345, 27.12.2017

<sup>24</sup> Article 52 of the legislative Decree 180/2015, concerning the hierarchy in resolution provides:

*1. The bail-in is implemented by allocating the amount determined in accordance with Article 51 according to the order below indicated:*

*a) are reduced, up to the competition of losses quantified by the assessment provided by Chapter I, Section II: the*

*i) the reserves and the capital represented by shares, also not included in the regulatory capital, as well from other financial instruments that can be accounted in the capital primary class 1, with consequent extinction of the relative administrative and patrimonial rights;*

*ii) the nominal value of the equity instruments additional class 1, also for part not accounted in the regulatory capital;*

*iii) the nominal value of the Class 2 elements, also for the part not calculated in the capital regulatory;*

*iv) the nominal value of the subordinated debts other than the class 1 additional capital instruments or by the class 2 items;*

*v) the nominal value of the remaining liabilities eligible;*

*b) once the losses have been absorbed, or in the absence of losses, the additional class 1 capital instruments are converted, in whole or in part, into shares accounted in the class 1 primary capital;*

*c) if the previous measures are not sufficient, Class 2 items are converted, in whole or in part, into shares accounted in class 1 primary capital;*

*d) if the previous measures are not sufficient, the subordinated debts other than the class 1 additional capital instruments or the class 2 elements are converted in shares computable in the class 1 capital stock;*

*e) if the previous measures are not sufficient, the remaining eligible liabilities are converted into shares computable in class 1 primary capital.*

Therefore, the Italian law goes beyond the BRRD by establishing full depositor preference in insolvency and in resolution, over unsecured debt instruments from 1 January 2019.

These rules are making "other deposits"<sup>25</sup>, (i.e., deposits that are not granted priority treatment under Article 108 BRRD, which include for example corporate deposits for larger companies exceeding EUR 100,000) senior to other unsecured debt of the bank but junior to deposits granted priority treatment under Article 108 BRRD (i.e. covered deposits and deposits from natural persons and micro, small and medium-sized enterprises). Therefore, "other deposits" are satisfied with preference over the other unsecured creditors, included unsecured bondholders.

In addition, in order to transpose the Bank Creditor Hierarchy Directive, the Law 205/2017<sup>26</sup> introduced a new Article 12-*bis* of the Consolidated Banking Law which provides that banks can issue new category of non-preferred senior debt ("*strumenti di debito chirografario di secondo livello*") which rank junior to all other unsecured claims, but senior to subordinated liabilities<sup>27</sup> in a bank liquidation and in resolution [Article 91(1-*bis*)(lett.c-*bis*)]. These new non-preferred senior debt instruments will have a unitary notional value of at least EUR 250,000 and they may only be sold to qualified investors.

The category of shareholders and holders of equity-like instruments is excluded from hierarchy of creditors in CAL because they are not considered "creditors" but only "residual claimants". These categories include instruments designated as CET1 and AT1 for prudential purposes, while some uncertainties remain as to whether holders of hybrid subordinated instruments (T2 upper and lower) could be included in this category or should fall into the category of subordinated creditors.

It is important to note that *Article 69-septiesdecies* provides that, for intra-group financial support, the general rules of the Civil Code and Insolvency Code on the

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<sup>25</sup> Deposits are defined by Article 69-bis, c) of the Consolidated Banking Law as "*credits relating to funds acquired by banks with repayment obligations; with the exclusion of the receivables relating to funds acquired by the bank as debtor represented by financial instruments indicated by article 1, paragraph 2, of the legislative decree 24 February 1998, no. 58, or whose capital is not repayable at par, or whose capital is repayable at par only under specific agreements or guarantees agreed with the bank or third parties; deposit certificates are considered as deposits provided that they are not represented by securities issued in series*".

<sup>26</sup> Italian Official Journal of 28 December 2017.

<sup>27</sup> Article 12 of the Consolidated Italian Law and Section II, para 4 and 4.2 of the Bank of Italy's Supervisory Instructions to the banks, Circular 229 of 21 April 2009 as subsequently amended. The subordinated liabilities can be issued by the banks in form of bonds, convertible and non-convertible, and other similar securities with the following characteristics: in the event of liquidation of the issuer the debt is repaid only after all other creditors, not equally subordinated, have been satisfied; the minimum maturity of 5 years and, if perpetual, they cannot be repaid before 5 years; early repayment of the liabilities takes place only on the issuer's initiative upon authorization of the Bank of Italy.

postponement of the intragroup-credits in the hierarchy of creditors (“*postergazione*”) are not applicable to the CAL’s hierarchy. Therefore, intra-group financial support shall be included in the list of unsecured creditors.

### 3.8 Tools available to manage a bank’s failure

In the context of a CAL, the liquidators and the Bank of Italy are entitled to take the actions foreseen in Article 90 of the Consolidated Banking Law. The provision allows liquidators, with the positive opinion of the supervisory committee and with the prior authorization of the Bank of Italy, to sell assets and liabilities of the bank in part or as a whole, as well as assets and legal relationships identifiable en bloc<sup>28</sup>.

From the day the liquidators enter into office, and in any case within six days from the issuance of the decree of liquidation, the payments of liabilities of any kind are suspended as well as restitution to creditors. From the same date, no claims can be raised against the bank and no contract can be enforced.

The date of entering into office of the liquidators (day, time) is recorded by the Bank of Italy in the minutes of the taking over of the bank by the liquidators from former directors or special administrators<sup>29</sup>.

As an exception to Article 155 of the Insolvency Code, set-off takes place only if one of the parties took action before the CAL is started “*unless the set-off is provided for in a contract of financial guarantee pursuant to Legislative Decree 21 May 2004, n. 170, from a netting agreement, as defined in Article 1, paragraph 1, letter a), of the legislative decree implementing the 2014/59 directive (4) or by a compensation agreement pursuant to Article 1252 of the Civil Code (5)*”<sup>30</sup>.

The equal treatment of creditors and the order of priority (*pari passu*) must be respected in the course of the CAL. According to Article 96-bis, paragraph 3, of the Consolidated Banking Law, the DGS can intervene in supporting the sale of assets and liabilities but only if it is the option that minimizes its own costs (least cost principle); therefore, these interventions are allowed only if they are less expensive

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<sup>28</sup> Title III, Chapter 5, Section 1, para 3 the Bank of Italy’s Supervisory Instructions to the banks, Circular 229 of 21 April 2009 as subsequently amended. Legal relationships identifiable in block are “*the credits, debts and contracts that present a common distinctive element; it can be found, for example, in the technical form, in the sectors of economic destination, in the type of counterparty, in the territorial area and in any other common element that allows the identification of the complex of transferred relationships*”.

<sup>29</sup> Article 85 of the Consolidated Banking Law

<sup>30</sup> Article 83(3bis) Consolidated Banking Law.

for the DGS than the net cost of insured depositor reimbursement (De Aldisio and others, 2019)<sup>31</sup>.

The sale can take place at any stage of the procedure, even before the definition of the statement of liabilities; however, the buyer is only liable for those liabilities resulting from the statement of liabilities, taking into account the outcome of any opposition filed pursuant to Article 87.

The Consolidated Banking Law is not specific about the procedure for the sale of business or of assets, which is decided by the liquidators based on the provision of the MEF's decree. The buyer shall be identified following an open, competitive, non-discriminatory procedure at the best price<sup>32</sup>. The costs of the procedure for selection of the buyer are pre-deductible costs ex Article 221 and 222 of the Insolvency Code.

The transfer of assets which can be identified en bloc has its legal basis in Article 58 of the Consolidated Banking Law<sup>33</sup>. It provides that the transfer must be communicated to the Bank of Italy and published in the Italian Official Journal. The privileges and guarantees of any kind, released or otherwise existing in favour of

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<sup>31</sup> De Aldisio A., Aloia G., Bentivegna A., Gagliano A., Giorgiantoni E., Lanfranchi C., Maltese M, Towards a framework for orderly liquidation of banks in the EU, in Notes on Financial Stability and Supervision, No. 15 August 2019, p. 8.

<sup>32</sup> The sale of assets under the BRDD and the Legislative decree 180/2015 does not specifically differ from the procedure of the Consolidated Banking Law and of the Insolvency Code. The only aspect that presents some innovative profile concerns the specific mention of the power to sell shares and other instruments of ownership, whereas before it was only implicit in the sale of assets, liabilities, business units and legal relationships identifiable as a whole. The sale of the assets aims at protecting the interests of the depositors, who will again face a solvent bank able to continue the business, and not a bank in crisis. In fact, it is the continuation of the banking activities (more than the certainty of being able to obtain full repayment of the sums deposited) which allows to maintain the immediate and unconditional availability of the credits. In addition, the sale of the assets also has the purpose of "maximizing" revenues with respect to the atomistic liquidation, being the bank, or part of it, more marketable when it includes assets, liabilities and even the goodwill. PERRINO, *Le cessioni in blocco nella liquidazione coatta bancaria*, Torino, 2005, 21 ss.; CALDERAZZI, *Commento sub art. 90, in COSTA ( a cura di) Commento al Testo unico delle leggi in materia bancaria e creditizia*, Torino, 2013, 885 ss.

<sup>33</sup> Article 47 (3) of the D.Lgs 180/2015 provides that, in case of transfer of assets to the bridge bank, asset separation tool, if the transfer concerns credits, Article 58(3) of the Consolidated Banking Law is of application. (4) if the assignment relates to contracts, the assigned party may object to the assignee all the exceptions deriving from the contract, but not those based on other relations with the assignor. If the assignment relates to a liability, the transferor is released from the obligations of compliance. Except for their claims into a CAL, the shareholders, the holders of other holdings or the creditors of the entity subject to the resolution and the other third parties whose rights, assets, or liabilities are not subject to transfer cannot exercise claims on rights, on the assets or liabilities subject to the transfer and, towards the members of the administration and control bodies or of the management of the transferee (Article 47(7) legislative Decree n. 180/2015).

the transferor, as well as the transcripts in the public registers of the purchase deeds of the assets subject to financial leasing included in the transfer, retain their validity and their ranking in favour of the transferor without the need for any formality or annotation (Article 58(3) of the Consolidated Banking Law). In case of transfer of assets and liabilities en bloc when using one of the resolution tools, the Legislative Decree n. 180/2015 provides that Article 58 is of application<sup>34</sup>.

In case of need and in order to ensure the best liquidation of the assets and subject to the authorization by the Bank of Italy, the liquidators may continue the business of the bank or of certain parts of it, with the precautions indicated by the supervisory committee. The continuation of the business is decided when the liquidating bodies are taking up office and it excludes the legal dissolution of pre-existing legal relationships according to paragraph 2 of Article 83.

For the purpose of repaying creditors who are entitled to repayment from the insolvency estate, the liquidators may contract loans, undertake other kinds of borrowing operations and offer the bank's assets as security, in accordance with the directions and cautionary recommendations of the oversight committee and subject to authorization by the Bank of Italy.

At any moment of the procedure, the liquidators may propose a composition with creditors (*concordato di liquidazione*). The proposal of composition, which is a settlement with the creditors, must be authorized by the Bank of Italy and must indicate the percentage to be offered to the creditors, the time of payment and any guarantees. It aims at concluding the liquidation procedure with the creditors who accept the settlement. The CAL continues with all creditors who did not accepted to enter into the settlement.<sup>35</sup>

The obligation to pay the composition quotas can be assumed by third parties with partial or total release of the liquidated bank. Then the action of the creditors for the execution of the composition can only occur against the third party underwriters within the limits of the respective quota.

The composition may include the sale of the assets in the estate as well as all the claims of the estate that can be brought by the liquidators, subject to the authorization of the Bank of Italy, provided that the subject matter and legal grounds of the claim are specifically indicated.

The proposal may limit the commitments made through the composition only to the creditors included in the statement of liability even temporarily, and to those that

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<sup>34</sup> Article 58 paragraphs 5 and 6 of the Consolidated Banking Law provides that in ordinary transfer of assets and bloc, transferred creditors may obtain, within three months from the transfer, the payment of outstanding credits and, within six months, they can terminate the transferred contracts.

<sup>35</sup> Milan Commercial Court, Sez. II civ., judgement 12 September 2018.

objected to the statement of liabilities or filed a late petition at the time of the proposal, being awarded the judgments. The bank under liquidation will continue to be liable towards other creditors.

The proposed composition and the opinion of the liquidation bodies are deposited in the court registry. The Bank of Italy can establish other forms of publication.

Within thirty days from the deposit, the interested parties may file opposition with an appeal filed in the court registry, which is communicated to the liquidators.

The court decides by reasoned decree on the proposal of composition, taking into account the oppositions and the opinion of the Bank of Italy.

During the composition the liquidators can make partial distributions of assets pursuant to Article 91 of the Consolidated Banking Law.

When the composition plan is executed, the liquidators will convene the shareholders' meetings in order to vote the changes of the statutory object in relation to the withdrawal of the banking licence. In the event that the corporate purpose does not change, the liquidators will carry out the obligations for the cancellation of the bank and the deposit of the banks' books as requested by the Civil Code for the dissolution and liquidation of the corporations.

In case of failure to perform the obligations under the composition plan, the liquidators or the creditors may file a petition to the court registry in order to ask for the termination of the composition agreement. Besides, the composition agreement may be declared void in case fraud related to the size of the liabilities or of the assets.

#### **4. Available means to challenge an insolvency proceeding**

First of all, it has to be noted that the CAL decree and all the related administrative decisions can be challenged before the Italian Administrative Court (the territorial competence belongs to the Rome TAR).

Moreover, as mentioned in paragraph 3.6, Article 87 entitles the creditors whose claims have not been admitted to the statement of liabilities to challenge the decision of the liquidator before the competent courts.

Article 92 provides for the rights of creditors to challenge the final liquidation report which is submitted, together with the financial statements, the allotment plan and the report of the supervisory committee, to the Bank of Italy, which authorizes the deposit in the court registry. The action against the plan must be filed within 20 days from the publication of the notice of the deposit with the court registry on the Italian Official Journal.

Once the limitation period has expired without any legal action being started or once such actions have been decided with an enforceable judgment, the liquidators shall proceed with the final allotment or restitution.



Litigation and appeals, including those on the assessment of the state of insolvency, do not preclude the performance of the final fulfilments of obligations and the closing of the compulsory administrative liquidation procedure. In this case, the closure is subordinated to the execution of provisions or the acquisition of guarantees pursuant to Article 91, paragraphs 6 and 7.

## **5. Conclusions**

In Italy, the banks' compulsory administrative liquidation is a special insolvency regime regulated by the Consolidated Banking Law. It is managed under the Bank of Italy supervision.

The Italian Consolidated Banking Law provides for various tools in order to deal with banks' liquidation, including:

- Sale of business and assets;
- Assignments;
- Creditors' composition.

The hierarchy of creditors is characterized by an extended depositors' preference, which goes beyond the partial harmonisation introduced by Article 108 of the BRRD, providing for a preferred status for non-covered deposits compared to all other unsecured creditors.

## ANNEX 1: Interaction between national bank insolvency regimes and resolution regime – triggers for initiating insolvency procedures

TRIGGERS FOR RESOLUTION Art 32 BRRD	TRIGGERS FOR RESOLUTION UNDER THE NATIONAL LAW TRANSPOSING BRRD  Artt. 17 and 20 Legislative Decree 180/2015	TRIGGERS FOR THE NORMAL NATIONAL INSOLVENCY PROCEDURE (CAL)  Art. 80 Italian Banking Law; Artt. 17 and 20 Legislative Decree 180/2015	EXPLANATION OF DIFFERENCES BETWEEN RESOLUTION AND LIQUIDATION TRIGGERS
<p>1. a) the institution is <b>failing or is likely to fail</b> (FOLTF)</p> <p>For the purposes of point (a) of paragraph 1, an institution shall be deemed to be failing or likely to fail in one or more of the following circumstances:</p>	<p>Art. 17(1) D.Lgs. 180/15: the institution is <b>failing or is likely to fail</b> (FOLTF)</p> <p>An institution shall be deemed to be failing or likely to fail in one or more of the following circumstances and when there are objective elements indicate that one or more of the situations indicated in letters a), b), c) and d) will occur in the near future:</p>	<p>Art. 17(1) D.Lgs. 180/15: the institution is <b>failing or is likely to fail</b> (FOLTF)</p> <p>An institution shall be deemed to be failing or likely to fail in one or more of the following circumstances and when there are objective elements indicate that one or more of the situations indicated in letters a), b), c) and d) will occur in the near future:</p>	<p>No differences</p>

<p>4. (a) the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;</p>	<p>Art. 17(2) D.Lgs. 180/15, (a) irregularities in the bank's administration or infringements of laws, regulations or bylaws governing the activity of the bank of such gravity which would justify the withdrawal of the authorisation;  (b) there are capital losses of exceptional severity, such as to deprive the bank of its entire capital or of an important part of the capital;</p>	<p>Art. 17(2) D.Lgs. 180/15, (a) irregularities in the bank's administration or infringements of laws, regulations or bylaws governing the activity of the bank of such gravity which would justify the withdrawal of the authorisation;  (b) there are capital losses of exceptional severity, such as to deprive the bank of its entire capital or of an important part of the</p>	<p>No differences</p>
<p>(b) the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities;</p>	<p>c) its assets are less than liabilities;</p>	<p>c) its assets are less than liabilities;</p>	<p>No differences</p>
<p>(c) the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to</p>	<p>d) it is not able to pay its debts at maturity;</p>	<p>d) it is not able to pay its debts at maturity;</p>	<p>No differences</p>

<p>pay its debts or other liabilities as they fall due;</p>			
<p>(d) extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:</p> <p>(i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions;</p> <p>(ii) a State guarantee of newly issued liabilities; or</p> <p>(iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the</p>	<p>f) there is the need of extraordinary public financial support, with the exclusion of the cases under Article 18 (precautionary recapitalisation and government support to liquidity measures).</p>	<p>f) there is the need of extraordinary public financial support, with the exclusion of the cases under Article 18 (precautionary recapitalisation and government support to liquidity measures).</p>	<p>No differences</p>

circumstances referred to in Article 59(3) are present at the time the public support is granted.			
b) there is <b>no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure</b> of the institution within a reasonable timeframe	Art. 17(1) D.Lgs. 180/15, (b) there is <b>no reasonable prospect that any alternative measures or supervisory actions would prevent the failure</b> of the institution within a reasonable timeframe	Art. 17(1) D.Lgs. 180/15, (b) there is <b>no reasonable prospect that any alternative measures or supervisory actions would prevent the failure</b> of the institution within a reasonable timeframe".	There are no specific differences.
c) a resolution action is necessary in the <b>public interest</b>	Art. 20 D.Lgs. 180/15: recurring the conditions laid down in Art. 17, resolution is commenced when the occurrence of the <b>public interest is ascertained.</b>	Art. 80 IBL: recurring the conditions laid down in Art. 17, CAL is commenced <b>when the resolution action is not in the public interest (Art. 20 D.Lgs. 180/2015)</b>	The public interest is the condition determining the choice between liquidation and resolution: resolution in case the public interest test is passed, liquidation in the opposite case.

## ANNEX 2: Interaction between national bank insolvency regimes and resolution regime – tools available

TYPE OF INSTRUMENT TO BE LOOKED FOR IN NATIONAL REGIME	BRRD TOOLS Art 37(3) BRRD	TOOLS GIVEN UNDER NORMAL NATIONAL INSOLVENCY	COMMENTS
Instruments whereby shareholdings, assets, rights or liabilities of the bank to be liquidated are transferred (in whole or in part) to a certain buyer	a) Sale of business tool	Article 90 of the Consolidated Banking Law envisages the sale of assets and liabilities, the business or parts of the business, as well as assets and legal relationships identifiable en bloc. Under certain conditions and with the aim of facilitating the liquidation of the institution, the sale could regard even only a part of its liabilities, respecting the equal treatment of creditors as well as the <i>pari passu</i> principle (see above paragraph 3.9)	No differences
Instruments to transfer a shareholding or assets and liabilities to a bridge institution	b) Bridge institution tool	Not expressly provided for compulsory administrative liquidation	Not expressly provided for compulsory administrative liquidation
Instruments to separate assets until subsequent sale or liquidation	c) Asset separation tool	Not expressly provided for compulsory administrative liquidation	SGA was created in 1997 as bad bank of Banco di Napoli.  In 2016 was purchased by the Ministry of Finance and, in accordance with Law Decree 99/2017, and by virtue of the Ministerial Decree dated 22 February

			<p>2018, the impaired assets of the Venetian banks were transferred to SGA.</p> <p>It is not an asset management vehicle as envisaged by the BRRD/SRMR , but it is an assets' management company which - in the past was used to intervene in the transfer of assets and liabilities</p>
Write-down (reduction in the value of assets) of financial instruments issued by the bank or claims against the bank	d) Bail-in tool	There are no tools that may be compared to write-down in normal liquidation. However, the liquidators can enter into a composition agreement with all or some creditors and propose the payment of a percentage of the credits in place of the whole credits	A forceful reduction of the value of certain liabilities (as in case of bail-in) is not foreseen in the Italian CAL. Such a reduction can only be obtained as the result of an agreement (composition) with creditors ( <i>concordato di liquidazione</i> ; see above paragraph 3.9)
Others	N/A		

## ANNEX 3: CASE STUDIES

CASE # 1	DETAILED INFORMATION
<b>Name of the bank</b>	Banca Tercas and Banca Caripe
<b>Date</b>	2013 (No failure. The bank was put under special administration)
<p><b>Description of the case</b></p> <p><i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i></p>	<p>On 17 April 2012, after having proceeded to an inspection of Tercas, the Bank of Italy proposed to the Italian Ministry of Economy and Finance to put the bank under special administration under Article 70 of the TUB.</p> <p>In October 2013, the special administrator of Tercas in agreement with the Bank of Italy had contacts with Banca Popolare di Bari (BPB) which manifested its interest to inject capital in Tercas conditional on the execution of a due diligence on Tercas' and Caripe's assets and the full covering by the Interbank Deposit Protection Fund (FITD) of Tercas' negative equity.</p> <p>The special administrator of Tercas submitted to the FITD, on 30 September 2013, based on Article 29 of the FITD's Statutes, a request for a support intervention of up to EUR 280 million entailing a recapitalisation to cover the negative equity of Tercas with a commitment by the FITD to acquire impaired assets. The FITD decided to support Tercas and on 30 October 2013 asked Bank of Italy for authorisation for that support measure: on 4 November 2013, the Bank of Italy granted the authorisation. Ultimately, however, the FITD did not put the measure into effect and after a due diligence inquiry. The FITD once again asked the Bank of Italy to authorise support for Tercas, but on modified terms. The Bank of Italy authorised that support, on modified terms, in July 2014.</p> <p>In 2014 was decided the assignment of Tercas to BPB following Tercas' shareholders' meeting, called by the special administrator. The shareholders meetings decided to partially cover the losses by reducing capital to zero with cancellation of all the circulating ordinary shares; and to increase the capital up to EUR 230 million with issuance of new ordinary shares offered exclusively to BPB. That capital increase was executed on 27 July 2014, and has been paid partially offsetting a EUR 480 million credit of BPB towards Tercas (corresponding to a loan granted by BPB on 5 November 2013). On 1 October 2014, the special administration of Tercas was lifted and new management was appointed by BPB.</p>



	In 2015, the European Commission considered that FITD intervention constitutes a State aid and ordered to the beneficiary to return the amount <sup>36</sup> . In order to avoid that BPB had to return immediately the funds, a Voluntary Scheme established within FITD funded with additional "private" resources intervened in support of the bank for a total amount of 271.9 million EUR <sup>37</sup> .
<b>Total assets in last balance sheet before failure</b> <i>(if available)</i>	At the end of 2011, Tercas had a total balance sheet of EUR 5,3 billion, EUR 4,5 billion of net customer loans, EUR 2,6 billion of customer deposits, 165 branches and 1 228 employees <sup>38</sup> .
<b>Recovery rates</b> <i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i>	N.A.
<b>Length of the proceedings</b>	2 years
<b>Costs</b>	N.A

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<sup>36</sup>Case SA.39451 (2015/C) (ex 2015/NN) OJ 2016 L 203.

<sup>37</sup> On 19 March 2019 the General Court annulled the Commission's decision, as it concluded, incorrectly, that the measures granted to Tercas entailed the use of State resources and were imputable to the State. In particular, the Commission failed in demonstrating that they were taken under the actual influence or control of the public authorities and that, accordingly, they were, in fact, imputable to the State. On the contrary, according to the General Court, the case-file contains a great number of items of evidence indicating that the FITD acted independently when it adopted the measures for the benefit of Tercas. Judgment in Joined Cases T-98/16, Italy v Commission, T-196/16, Banca Popolare di Bari SCpA v Commission, and T-198/16 Fondo interbancario di tutela dei depositi v Commission, EU:T:2019:167.

<sup>38</sup> Source, European Commission, Case SA.39451 (2015/C) (ex 2015/NN).

CASE # 2	DETAILED INFORMATION
<b>Name of the bank</b>	Veneto Banca and Banca Popolare di Vicenza
<b>Date of failure</b>	23 June 2017
<b>Description of the case</b>  <i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i>	<p>On 23 June, the European Central Bank (ECB) determined that Veneto Banca S.p.A. and Banca Popolare di Vicenza S.p.A. were failing or likely to fail as the two banks repeatedly breached supervisory capital requirements<sup>39</sup>. On the same day, the SRB concluded that, given the particular characteristics of the banks and their specific financial and economic situation, resolution action was not in the public interest.</p> <p>Pending the adoption of the mentioned decisions by the ECB and the SRB, a fair and open selection procedure was activated by the Ministry of Economy and Finance (MEF) to explore the availability of third parties to invest in the two credit institutions.</p> <p>At the end of the process, Intesa San Paolo (ISP or the Buyer) presented an offer entailing the purchase of the assets and liabilities of both banks – in a liquidation scenario – with a public support and with the exclusion, on the assets side, of the NPLs and of a limited number of shareholdings, and, on the liabilities side, of equity, subordinated debt – that fully contributed to covering the losses – and some provisions for litigation and legal risks. As of the exclusion of the NPLs, it was planned the transfer of these assets to the Società per la Gestione di Attività S.p.A. (SGA), a financial entity (owned by the MEF) which is highly specialized in NPLs management.</p> <p>As regards the State Aid measures, Italian Authorities, in order to solve the crisis of BPV and VB and mitigate the effects of the bank's market exit, submitted a request for State aid measures to the EC for its assessment of compatibility with the Internal market<sup>40</sup>. On 25 June 2017, the EC approved the measures.</p>

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<sup>39</sup> <https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170623.en.html>

<sup>40</sup> The State support was granted in accordance with the 2013 Banking Communication, requiring that shareholders and subordinated bondholders fully contribute to the costs ("burden-sharing") and

	<p>Besides, on 25 June 2017, the Italian Government issued a Law Decree on the application of the compulsory administrative liquidation to the banks.</p> <p>The decree included the maximum amount of the public support measures towards the purchaser. In particular, these measures included:</p> <ul style="list-style-type: none"> <li>i) a contribution of an amount up to EUR 3.5 billion in cash to cover for a recapitalisation of the transferred activities up to a 12.5% CET1 ratio;</li> <li>ii) a lump sum payment to the buyer of an amount up to EUR 1.285 billion in cash to cover for restructuring costs of the Buyer associated with the acquisition;</li> <li>iii) a coverage of the shortfall between the value of the assets transferred to the Buyer compared to the transferred liabilities up to an amount of EUR 6.4 billion in the form of a guarantee;</li> <li>iv) besides, a portfolio of about EUR 4 billion of high risk performing loans is included in the assets and liabilities acquired by the Buyer: as part of the measure, the Buyer has the right, during 3 years following the transaction, to transfer back to the Residual Entities any loans which have become non-performing and qualify as UTP. In exchange of such transfer, the Buyer received an additional guaranteed claim towards the respective Residual Entities<sup>41</sup>;</li> <li>v) a guarantee of EUR 491 million against all liabilities related to ongoing litigation (apart from old shareholder claims) and a guarantee up to EUR 1.5 billion regarding the existence of the transferred assets;</li> <li>vi) measures to allow the transfer of tax assets of the two Banks to the Buyer and measures to</li> </ul>
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competition distortions are limited. Senior bondholders do not have to contribute and depositors remain fully protected in line with EU rules.

<sup>41</sup> In order to incentivize the Buyer to service the high risk loans appropriately and in line with the non-guaranteed loans in its portfolio, the Buyer will carry 50% of the provisioning required when a guaranteed loan is reclassified as UTP.

	<p>avoid taxation of the assets and liabilities at the moment of the transfer to the Buyer.</p> <p>The Decree provided that the non-performing loans would have been sold to SGA. As a result of the deal with ISP, the Italian State gained a senior claim on the residual entities that shall be paid with priority over unsecured creditors of the liquidations; as consequence of the NPLs' sale, the residual entities received a claim on SGA. The proceeds deriving from the management of NPLs will be transferred to the residual entities and therefore to the Italian State.</p> <p>The scope of acquisition included, in addition to the selected assets and liabilities of Banca Popolare di Vicenza and Veneto Banca, the shareholdings in Banca Apulia S.p.A. and Banca Nuova S.p.A, SEC Servizi S.c.p.a., Servizi Bancari S.c.p.a. and, subject to approval of related authorisations, in banks operating in Moldavia, Croatia and Albania.</p>
<p><b>Total assets in last balance sheet before failure</b></p> <p><i>(if available)</i></p>	<p>Veneto Banca</p> <p>Total assets as of 31.12.2016: EUR 23,426,961,499</p> <p>On 3 April 2017, the Board of Directors approved the financial statements for 2016 highlighting several negative indicators: (i) a loss of EUR 1.5 billion; and (ii) Gross NPLs of EUR 9.0 billion (up 20% year-on-year), with EUR 4.5 billion of these NPLs regarded as bad loans (up 30% year-on-year)<sup>42</sup>.</p> <p>Banca Popolare Vicenza</p> <p>Total assets as of 31.12.2016 (consolidated balance sheet): 34, 424,241,000</p> <p>On 28 March 2017, the Institution published the 2016 accounts with several negative indicators: (i) a loss of EUR 1.9 billion; and (ii) Gross NPLs of EUR 9.8 billion (up 9.3%</p>

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<sup>42</sup> DECISION OF THE SINGLE RESOLUTION BOARD IN ITS EXECUTIVE SESSION of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A. (the "Institution"), with the Legal Entity Identifier 549300W9STRUCJ2DLU64, addressed to Banca d'Italia in its capacity as National Resolution Authority (SRB/EES/2017/11)

	year-on-year), with EUR 5.1 billion of these NPLs regarded as bad debts (up 17% year-on-year) <sup>43</sup> .
<b>Recovery rates</b>  <i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i>	Not identified.
<b>Length of the proceedings</b>	2017-on going
<b>Costs</b>	With reference to state aid please see above.

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<sup>43</sup> DECISION OF THE SINGLE RESOLUTION BOARD IN ITS EXECUTIVE SESSION of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A. (the "Institution"), with the Legal Entity Identifier V3AFM0G2D3A6E0QWDG59, addressed to Banca d'Italia in its capacity as National Resolution Authority (SRB/EES/2017/12).



# **Study on the differences between bank insolvency laws and on their potential harmonisation**

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**Country report**

**Portugal**



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## 1. Introduction

In general terms, according to Portuguese banking law, if an institution is in a financially unbalanced situation or is failing or likely to fail, three actions can ensue:

- i) Early intervention action and temporary administration;
- ii) Application of a resolution measure; and
- iii) Withdrawal of authorization to carry out its activity.

The withdrawal of authorisation leads, as a general rule, to the beginning of dissolution and liquidation of credit institutions.

Therefore, in Portugal, liquidation begins with an administrative act. However, the regime that is subsequently applicable is court-based, the possibility of a pre-judicial administrative liquidation notwithstanding, as foreseen in Decree-Law N.º 199/2006, of October 25.

The main regulations governing insolvency of Portuguese credit institutions are:

- i) Decree-Law N.º 298/92, of December 31 – Legal Framework of Credit Institutions and Financial Companies, establishing the conditions concerning the taking-up and pursuit of the business of credit institutions and financial companies in Portugal, as well as the supervision of these entities and the legal framework for resolution (hereinafter, Banking Law);
- ii) Decree-Law N.º 199/2006, of October 25 – Regulates the reorganisation and winding up of credit and financial institutions;
- iii) Decree-Law N.º 53/2004, of March 18 – Portuguese Insolvency and Recovery Code;
- iv) Decree-Law N.º 262/86, of September 2 - Commercial Companies Code.

## 2. Key findings

The introduction of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR) have contributed considerably to improving the harmonisation of bank crisis management rules.

Portugal continues to have an administrative supervision structure based on the decisions of the Bank of Portugal or the ECB, as applicable. However, after the withdrawal of the authorisation to carry out its activity, the liquidation of the institution's assets and the satisfaction of its outstanding claims takes place within a judicial procedure where, nevertheless, the Bank of Portugal enjoys relevant prerogatives.

Voluntary dissolution and extrajudicial liquidation are also legally envisaged, although in Portugal insolvent banks have never been able to opt for this route, as the prerequisites require that the institution be able to repay all of its debtors in full.



Bank of Portugal is also able to request the application of pre-judicial liquidation procedures but has yet to do so.

### **3. National insolvency proceedings applicable to banks**

#### **3.1 Objective of the insolvency procedure**

In the Portuguese system there are three liquidation procedures regulated by Decree-Law N.º 199/2006, of October 25, applicable to banks:

- a) Voluntary dissolution and extrajudicial liquidation – Articles 6 and 7;
- b) Pre-judicial Liquidation – Article 7-A; and
- c) Judicial liquidation – Article 8.

Banking institutions, taking into account the complexity, the characteristics and the size of the interests involved, are dissolved only by virtue of the withdrawal of the respective authorisation or by decision of the shareholders.

Voluntary dissolution and the subsequent extra-judicial liquidation is carried out under the general terms of commercial law, in accordance with the deliberations of the members and taking into account the best interests of creditors - Articles 141 et seq. Companies Code. The Bank of Portugal, which should be notified 90 days before the dissolution of the entity, supervises these proceedings and may, at any time, request the opening of judicial liquidation. The appointed liquidator must send the annual and final reports to the Bank of Portugal.

In what specifically concerns the judicial liquidation of banking institutions, the purpose of these procedures is to certify the accounts, sell the assets and repay the creditors whose credits have been recognised.

Despite the judicial liquidation procedure being court based, the Bank of Portugal still enjoys relevant prerogatives during that procedure, such as:

- Following the withdrawal of the institution's banking license, requesting the judicial liquidation of said institution with the competent court;
- Proposing the liquidator(s) to the judge;
- Monitoring the activity of the liquidator(s);
- Requesting the competent court, whatever it deems fit;
- Examining the accounts of the credit institution and requesting from the liquidator(s) any information and elements deemed relevant;

- Presenting to the competent court, on its own initiative, any report and opinion deemed convenient; and
- Filing complaints or appeals of any judicial decision, when legally allowed.

### **3.2 Pre-insolvency/restructuring**

Following the transposition of the BRRD into national law, Bank of Portugal is empowered to apply early intervention measures and temporary administration to avoid the failure of a bank.

Under Articles 141 et seq. of the Banking Law, Bank of Portugal is empowered to apply the various early intervention measures listed in article 141 and suspend some or all the members of the bank's management bodies and appoint new members to those bodies, with the latter corresponding to a more visible level of public intervention.

Article 145-A (3) of the Banking Law establishes that temporary administrators shall have the same powers provided for in the by-laws for the position, plus the following, inter alia: veto decisions of the general shareholder meeting or of the remaining board members, revoke the decisions previously adopted by the institution's management body, promote a detailed evaluation of the financial situation of the institution, present to the Bank of Portugal proposals for the financial recovery of the institution, promote an agreement between shareholders and creditors of the institution allowing its financial recovery.

Furthermore, the temporary administrator must keep the Bank of Portugal informed of its activity and the management of the credit institution, follow the generic guidelines and strategic objectives defined by the Bank of Portugal and, where necessary, obtain its prior approval and provide all the information and cooperation required by the Bank of Portugal.

Where early intervention measures or the appointment of temporary managers does not allow the institution to recover from its financial difficulties, one of two things can happen (provided that the respective conditions for application are met): the authorisation of the institution can be withdrawn, which is followed by its judicial liquidation, or the institution can be subject to resolution measures.

### **3.3 Insolvency test (triggers of insolvency procedures)**

Pursuant to Article 5 of Decree-Law N.º 199/2006, of October 25, an institution is subject to liquidation following the withdrawal of their authorisation by the supervisory authority.

Article 22 of the Banking Law lists the grounds for the withdrawal of an institution's authorisation:

- a) The authorisation was obtained through false statements or any other irregular means, regardless of the applicable penalties;
- b) Any of the requirements for banking activity ceases to be met;
- c) The activity of the credit institution does not correspond to the authorised statutory purpose;
- d) The credit institution ceases or reduces its activity to a negligible level for a period of six months;
- e) Serious irregularities are committed in the management, accounting procedures, or internal control of the credit institution;
- f) The credit institution is unable to comply with its commitments, in particular, where it no longer provides security for the assets entrusted to it;
- g) The credit institution fails to fulfil the obligations arising out of its participation in the Deposit Guarantee Fund, the Resolution Fund or the Investor Compensation Scheme;
- h) The credit institution fails to comply with the laws and regulations governing its activity, or fails to observe the determinations of the Bank of Portugal, in such a way as to jeopardise the interests of the depositors and other creditors or the smooth operation of the money, financial or foreign exchange market;
- i) The credit institution expressly gives up the authorisation, except in the case of voluntary winding up;
- j) The members of the management and supervisory bodies, as a whole, do not give guarantees of sound and prudent management of the credit institution;
- k) The credit institution seriously or repeatedly fails to comply with the laws and regulations preventing money laundering and terrorist financing;
- l) The credit institution ceases to comply with prudential own funds requirements, rules on large exposures or liquidity rules; and
- m) The credit institution commits a "particularly serious breach", as foreseen in article 211 of Banking Law, such as unauthorised transactions, fraudulent paying up of share capital, introduction of changes in bylaws not authorised by the Bank of Portugal, fraudulent accounting, failure to comply with prudential ratios and limits, breach of conflict of interest provisions, fraudulent mismanagement, unlawful non-compliance with instructions of the Bank of Portugal, refusal to carry out or obstruction of inspections by the Bank of Portugal, failure to report some information or provision of false information or failure to comply with obligations to contribute to the Deposit Guarantee Fund or the Resolution Fund.

Furthermore, if the Bank of Portugal applies the resolution measures of sale of business or transfer of the activity to a bridge institution, transferring only part of the assets, rights and liabilities, the authorisation of the institution under resolution must be withdrawn in an adequate time frame, as per Article 145-L (2) of the Banking Law

Similarly, if after the application of any resolution measure, Bank of Portugal considers that the resolution objectives have been achieved and that the credit institution does not fulfil the requirements for maintaining the authorisation to carry

out its activity, it may revoke the authorisation of the credit institution (Article 145-AQ of the Banking Law).

The decision to withdraw the authorisation produces the same effects as the declaration of insolvency, as per Article 8 (2) Decree-Law N.º 199/2006, of October 25.

Furthermore, since 2012, the Bank of Portugal has the possibility, before judicial liquidation, of resorting to a pre-judicial administrative liquidation procedure for a period of six months, renewable for an equal period.

Pursuant to Article 7-A of Decree-Law N.º 199/2006, of October 25, the Bank of Portugal may opt for a special pre-judicial liquidation procedure when there is urgency in the beginning of liquidation operations, including to ensure the continuity of an institution's critical functions and the integrity of its assets or to safeguard the stability of the financial system. Nevertheless, the effects of insolvency, such as the suspension of payments, the trigger of the deposit guarantee scheme, the inability to sell liabilities and the acceleration of all claims, still apply, with some minor adaptations, as provided for in Article 7-B (2) of Decree-Law N.º 199/2006, of October 25, which also renders this regime of little use for successfully managing failing banks.

The pre-judicial liquidation procedure is an additional phase within the judicial liquidation procedure and is always followed by the application of the normal rules of the judicial liquidation procedure (Articles 8 et seq. of Decree-Law N.º 199/2006, of October 25).

### **3.4 Standing to file insolvency**

The competent court to open the judicial liquidation proceedings is the commerce court of the location of the debtor's head office or centre of main interest – Article 7 of the Insolvency and Recovery Code.

Judicial liquidation can only be triggered by the Bank of Portugal, following the withdrawal of the institution's authorisation – the institution itself and its creditors cannot ask the court to declare that the institution is insolvent. Bank of Portugal must request the judicial liquidation of the institution within 10 business days of the withdrawal of its authorisation.

Subsequently, the judge can only verify whether the application by Bank of Portugal meets the legal deadlines and if it is accompanied by a copy of the withdrawal decision and by the proposal of a judicial liquidator or liquidation committee, to be appointed by the court.

Any questions concerning the legality of the decision to withdraw the authorisation can only be raised outside the liquidation procedure and before the competent courts. Considering that, for credit institutions, the decision to withdraw the authorisation is

the exclusive competence of the European Central Bank, then the competent court would be the Court of Justice of the European Union.

Pursuant to Article 9 of Decree-Law N.º 199/2006, of October 25, the judge issues a decision ordering the continuation of the proceedings and appointing the liquidator or the liquidation committee. The decision also contains the following elements:

- Identification of the institution in liquidation and of its head office;
- Identification and setting of the residence of *de jure* and *de facto* administrators of the institution;
- Determination of the immediate delivery to the liquidator or liquidation committee of the elements of the accounts of the institution under liquidation and of all of its assets, even if subject to any kind of judicial seizure or attachment;
- Order of the delivery to the Public Prosecution Service, for the due effects, of the elements that indicate the practice of criminal offense;
- If there are elements that justify the opening of the incident of qualification of insolvency (to determine whether insolvency was culpable), declaration that such incident is opened, full or limited;
- Determination of the deadline for filing credit claims, of up to 30 days;
- Warning that creditors must promptly inform the liquidator of the *in rem* guarantees they have received;
- Warning debtors of the institution under liquidation that the payments or other obligations to which they are obligated should be made to the liquidator and not to the institution itself; and
- Designation of the day and time, between the 45 and the 60 following days, for the meeting of the meeting of creditors.

In what concerns pre-judicial liquidation, these procedures begin with the appointment of pre-judicial liquidators by Bank of Portugal, which are chosen on the basis of suitability and experience in the financial sector (Article 7-C(1) of Decree-Law N.º 199/2006, of October 25), and only in the aforementioned situations of urgency.

### **3.5 Appointment of liquidators or administrators and their powers**

The judge, on a proposal from the Bank of Portugal, appoints a liquidator or a liquidation committee composed of three members, depending on the complexity and difficulty of the liquidation, who are responsible for carrying out the duties of the insolvency administrator provided for in the Insolvency and Recovery Code.

With the withdrawal of the institution's authorisation (which has the same effects as the declaration of insolvency), the institution's management body is no longer allowed to use its powers of management and disposal; these powers can only be used by the liquidator or by the pre-judicial liquidator, where applicable.

The role of the liquidator or the liquidation committee mainly consists in preparing the payment of the claims against the debtor using the proceeds of the liquidation of the insolvency estate and in managing the assets of the debtor. The liquidator or the liquidation committee must obtain the prior consent of the creditors' committee for performing actions with special relevance, such as the sale of any assets for a price equal to or above €10,000 and representing at least 10% of the insolvency estate.

Pre-judicial liquidators exercise the same powers as the liquidators in judicial liquidation, with some exceptions, but need consent from the Bank of Portugal to practice certain acts, such as to sell certain assets and shares in other companies, acquire real estate and enter into certain contracts.

Pre-judicial liquidators must prepare an interim list of all the credits on the institution under pre-judicial liquidation, which will later be used in its judicial liquidation. Furthermore, pre-judicial liquidators may file a request to the Bank of Portugal, in order for the institution to partially carry on with its activity. However, in practice, the meaning of "partial continuation of the activity" (i.e. the practical scope such a request can have) is unclear due to the effects produced by the withdrawal of the authorisation, which include the acceleration of all claims and the trigger for repayment of all covered deposits.

### **3.6 Admission of creditors/debtors to insolvency estate**

Normally, the deadline for presenting the credit claim is 30 days (article 36, lett. j) of the Insolvency and Recovery Code). However, according to Article 22 of Decree-Law N.º 199/2006, of October 25, known creditors that have their domicile, habitual residence or registered office in other Member States must be notified by the liquidator.

By application of the provisions of Article 569 (2) of the Code of Civil Procedure, all creditors will benefit from the deadline granted to the last creditor to be notified, which only starts counting from the moment of the notification. Considering that the notification of creditors living abroad can be quite burdensome and take a significant amount of time, as recent insolvency cases that occurred in Portugal have shown, the deadline to claim credits may last years.

After the moment they are deemed to have been notified, creditors have a 30 day deadline to claim their credits (Article 36 (1) (j) of Insolvency and Recovery Code) and, afterwards, the liquidator or the liquidation committee will submit to the court a list of all creditors recognised by it and of those that are not. Within 10 days, any other creditors can challenge this list before the judge (Article 130 of Insolvency and Recovery Code) and, at the end of the procedure, a final decision thereon is taken by the judge.

Creditors can't file their claims during pre-judicial liquidation, where an additional phase takes place. Nevertheless, pre-judicial liquidators are required to prepare a provisional list of all known creditors.

### 3.7 Hierarchy of claims

According to Portuguese insolvency law, the liquidation expenses are to be paid first and foremost, as they fall due. These expenses, which include the costs of the judicial process, the insolvency administrator fees and the expenses of liquidation of assets, among others, are considered as credit claims over the insolvent estate – as opposed to credit claims over the insolvency, which comprise the credit claims that arose before the declaration of insolvency (in case of banks, before the withdrawal of the authorisation).

Portuguese insolvency law provides for the following classes of credit claims over the insolvency: 1) secured claims; 2) preferred claims; 3) common claims (known in EU terminology as senior claims); and 4) subordinated claims.

Secured claims include the claims with an associated *in rem* security right, such as mortgage, pledged property and retention rights, by virtue of the contractual will of the parties. The secured claims category also includes credit claims benefitting from special legal preference (e.g. certain employee and tax claims) – these are legal preferences over specific assets granted by the law. Secured claims have priority over the proceeds of the sale of the assets to which they are linked. In the event those proceeds are not sufficient to repay the entirety of the credit claim, the outstanding amount will be treated as an unsecured claim.

Preferred claims are those with general legal preferences granted by the law, usually with the purpose of ensuring tax and social security collection, having priority over common (senior) and subordinated claims. They include creditors such as the state, local councils, the institution's employees, the Deposit Guarantee Fund in relation to the amount of covered deposits in which it became subrogated after repayment, and the overwhelming majority of deposits not covered by the Deposit Guarantee Fund.

The law provides for specific safeguards in insolvency in respect of depositors. When deposits become unavailable (e.g. when a credit institution's authorisation is withdrawn), eligible depositors should be repaid by the Deposit Guarantee Fund up to the legally provided amount – €100,000. The Deposit Guarantee Fund is then subrogated to the rights of depositors for an amount equal to its payment to depositors. This means that the Deposit Guarantee Fund is a preferred creditor of the insolvent estate in the judicial liquidation procedure of a credit institution.

The part of eligible deposits from natural persons and micro, small and medium-sized enterprises which exceeds the coverage level provided for in the law is also a preferred claim, though its ranking is lower than the priority ranking of covered deposits mentioned in the previous paragraph.

The claims emerging from non-covered deposits and eligible deposits of large companies enjoy a preferred claim status, ranking lower than the claims referred to in the previous paragraph, but higher than common claims.

Common claims correspond to unsecured, un-preferred and unsubordinated credits, which are satisfied on a pro rata basis once those referred to above have been paid.

However, Law 23/2019, of March 13, introduced, by means of an amendment to Decree-Law N° 199/2006, of October 25, a new category of "non-preferred" senior debt, which has a higher priority position than subordinated liabilities, but lower than other senior liabilities. In practical terms, the credits of this (sub)class are paid in liquidation after the other common credits are fully paid and before subordinated credits are paid.

Non-preferred senior debt instruments are debt instruments issued by credit institutions and some investment firms that fulfil the following conditions: (i) the initial maturity of the debt instruments is equal to or more than one year; (ii) the instruments do not contain embedded derivatives and are not derivatives themselves and (iii) the contractual provisions applicable to debt instruments and, where applicable, their prospectus expressly state that, in the event of insolvency, debt instruments are those provided for in the new instrument.

Subordinated claims include the following:

(1) credits held by persons specially related to the institution, as well as claims that have been transferred by them, namely by succession due to death or assignment of receivables, subrogation or assignment of the contractual position. However, it is required that the special relationship already existed at the time of the acquisition of the credit and, in the case of transmission to a third party, that it occurred within the two years preceding the commencement of the insolvency proceedings. The concept of persons specially related to the institution includes: (i) shareholders, associates or members who are legally liable for its debts, as well as persons who have held that status within the two years preceding the commencement of the liquidation; (ii) legal persons who were in a controlling or group relationship as provided in Article 21 of the Portuguese Securities Code up until two years before liquidation; (iii) *de jure* or *de facto* managers up until two years before liquidation; and (iv) any persons that are specially related to the aforementioned, namely family members;

(2) the interest of non-subordinated credits constituted after the judgment of declaration of insolvency;

(3) credits whose subordination has been contractually agreed by the parties. This subordination agreement is legally admissible based on private autonomy, despite the enshrinement of the principle of equality of creditors or *par conditio creditorum*;

(4) claims provided by the institution free of charge and therefore without any co-responsibility on the part of the creditor. In this case, since the free



acquisition is a minor cause of acquisition, it is understandable that it cannot occur to the detriment of the remaining creditors;

(5) claims over the insolvency arising to a third party in bad faith as a result of the resolution to the benefit of the insolvent estate;

(6) the interest of subordinated credits constituted after the judgment of declaration of insolvency; and

(7) shareholder loans, i.e. loan agreements, considered to be permanent, through which the shareholder lends money to the institution on a permanent basis, e.g. when its maturity is above 12 months.

Subordinated claims can only be repaid when all remaining credit claims have been satisfied in full. Within the creditor class, the order of repayment is the one mentioned above. However, in what concerns credit claims that are contractually subordinated (mentioned in point (3) above), the parties can agree for those claims to have a lower repayment position than that which would arise from that order (this possibility is typically used in the contractual agreements governing own funds instruments).

### **3.8 Tools available to manage a bank's failure**

The judge's decision ordering the continuation of the judicial liquidation proceedings determines the immediate delivery to the liquidator or liquidation committee of the elements of the accounts of the institution under liquidation and of all its movable and immovable property. The powers of management and disposal of the assets comprised in the insolvency estate can no longer be exercised by the bank's management bodies and are given to the liquidator or liquidation committee. The seizure of these elements and assets is to be carried out by the liquidator or liquidation committee, with the assistance of the creditors' committee if necessary. Afterwards, the liquidator or liquidation committee is required to draft a report on the assets and elements seized, which is then discussed by the creditors' committee. Subsequently, the liquidator or liquidation committee commences the sale of the assets; any actions deemed to have special relevance are subject to prior consent of the creditors' committee.

Article 162 (1) of the Insolvency and Recovery Code provides that the company comprised in the insolvent estate is preferably to be sold as a whole, unless there is no satisfactory offer, or an advantage is recognised in liquidating and disposing the assets separately. This is a general provision arising from the general insolvency framework applicable to all persons and entities subject to a liquidation procedure. While its application to banks is not explicitly excluded by Decree-Law N.º 199/2006, of October 25, in the case of a bank that is no longer able to resume business, the sale of the goods is usually made in parts; it is also questionable whether a bank without a banking license could be sold as a whole.

The liquidator or the liquidation committee disposes of the assets preferably through sale by electronic auction, and it may justifiably opt for any of the modalities admitted in an executive process or any other deemed convenient (Article 164 (1) of the Insolvency and Recovery Code). Creditors with an *in rem* security on the assets to be disposed of are always heard about the modality of disposal (Article 164 (2) of the Insolvency and Recovery Code).

The liquidator or the liquidation committee also has the power to resolve any acts harmful to the insolvency estate that took place within two years prior of the date on which the insolvency proceedings commenced (Article 120 of the Insolvency and Recovery Code).

#### **4. Available means to challenge an insolvency proceeding**

The initiation of the judicial liquidation proceedings, ordered by the judge after the withdrawal of the bank's authorisation and the request by Bank of Portugal to initiate those proceedings, cannot be challenged on the basis of the legality of the decision to withdraw the authorisation. Interested parties are required to challenge the legality of withdrawal decision outside of the liquidation proceedings, before the Administrative Courts. The suspension of the effects of the withdrawal decision can be requested, leading to suspension of the liquidation of assets and repayment of creditors. However, Bank of Portugal is allowed to argue that such a suspension would be severely detrimental to the public interest.

Article 130 (1) of the Insolvency and Recovery Code confers the right to all interested party to, within 10 days of being notified of the list of recognised and unrecognised credit claims drawn up by the liquidator or the liquidation committee, challenge said list by means of a request to the judge, based on the undue inclusion or exclusion of claims, or on the incorrectness of the amount or of the qualification of the claims recognised.

Payment to recognised creditors can only be made after the court has issued a sentence of graduation of credits which lists the recognised credit claims and defines their hierarchy.

#### **5. Conclusions**

In Portugal, the insolvency of credit institutions is regulated essentially and jointly by three statutes: (i) the Banking Law; (ii) Decree-Law N.º 199/2006, of October 25; and (iii) the Insolvency and Recovery Code.

Despite being a court-based procedure, the beginning of the liquidation of credit institutions is characterised by the important role played by the Bank of Portugal.

The liquidation of a bank can only start with the withdrawal of its authorisation to carry out its activity. This decision is taken by the ECB, generally under a proposal by the Bank of Portugal. The Bank of Portugal is then required to request the court for the beginning of the liquidation procedures; the court then orders the continuation of the proceedings and appoints a liquidator or a liquidation committee. In some instances, when a situation of urgency is assessed, a pre-judicial liquidation may be performed.

## ANNEX 1: Interaction between national bank insolvency regimes and resolution regime – triggers for initiating insolvency procedures

BRRD Art 32 BRRD	TRIGGERS UNDER NORMAL NATIONAL INSOLVENCY	EXPLANATION OF DIFFERENCES
<p>1. a) the institution is failing or is likely to fail (FOLF)</p> <p>For the purposes of point (a) of paragraph 1, an institution shall be deemed to be failing or likely to fail in one or more of the following circumstances:</p>	<p>Pursuant to Article 5 of Decree-Law N.º 199/2006, of October 25, institutions are subject to liquidation following a withdrawal of their authorisation by the competent supervisory authority.</p>	<p>Portuguese law has no legal provision explicitly determining that an institution that is FOLF but whose resolution does not meet the public interest assessment criteria goes to liquidation, even though that is what stems, in our opinion, from the BRRD and the European resolution framework.</p> <p>According to the Portuguese legal framework, liquidation is dependent on the withdrawal of authorisation which, for credit institutions, is an exclusive competence of the ECB. The triggers for liquidation are thus, indirectly, the triggers for the withdrawal of the authorisation to carry out its activity.</p> <p>The connection between the FOLF triggers and the grounds for the withdrawal of authorisation can be seen most clearly in subparagraphs f), h) and l) of Article 22(1) of the Banking Law.</p>

<p>4. (a) the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;</p> <p>(b) the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities;</p> <p>(c) the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its debts or other liabilities as they fall due;</p> <p>(d) extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a</p>	<p>Article 22 of the Banking Law lists the grounds for an <i>ex officio</i> withdrawal of an institution's authorisation:</p> <ul style="list-style-type: none"> <li>a) The authorisation was obtained through false statements or any other irregular means, regardless of the applicable criminal penalties;</li> <li>b) Any of the requirements for banking activity ceases to be met;</li> <li>c) The activity of the credit institution does not correspond to the authorised statutory purpose;</li> <li>d) The credit institution ceases or reduces its activity to a negligible level for a period of six months;</li> <li>e) Serious irregularities are committed in the management, accounting procedures, or internal control of the credit institution;</li> <li>f) The credit institution is unable to comply with its commitments, in particular, where it no longer provides security for the assets entrusted to it;</li> <li>g) The credit institution fails to fulfil the obligations arising out of its participation in the Deposit Guarantee Fund or in the Investor Compensation Scheme;</li> </ul>	<p>-</p>
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Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:

(i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions;

(ii) a State guarantee of newly issued liabilities; or

(iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Article 59(3) are present at the time the public support is granted.

h) The credit institution fails to comply with the laws and regulations governing its activity, or fails to observe the determinations of the Bank of Portugal, in such a way as to jeopardise the interests of the depositors and other creditors or the smooth operation of the money, financial or foreign exchange market;

i) The credit institution expressly gives up the authorisation, except in the case of voluntary winding up;

j) The members of the management and supervisory bodies, as a whole, do not give guarantees of sound and prudent management of the credit institution;

k) The credit institution seriously or repeatedly fails to comply with the laws and regulations preventing money laundering and terrorist financing;

l) The credit institution ceases to comply with prudential own funds requirements, rules on large exposures or liquidity rules; and

m) The credit institution commits a "particularly serious breach", as

	<p>foreseen in Article 211 of the Banking Law, such as unauthorised transactions, fraudulent paying up of share capital, introduction of changes in bylaws not authorised by the Bank of Portugal, fraudulent accounting, failure to comply with prudential ratios and limits, breach of conflict of interest provisions, fraudulent mismanagement, unlawful non-compliance with instructions of the Bank of Portugal, refusal to carry out or obstruction of inspections by the Bank of Portugal, failure to report some information or provision of false information or failure to comply with obligations to contribute to the Deposit Guarantee Fund or the Resolution Fund.</p>	
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<p>b) there is <b>no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure</b> of the institution within a reasonable timeframe</p>	<p>No explicit requirement of a lack of alternative private sector measures as a trigger for liquidation, even though the withdrawal of authorisation, being an administrative act, has to comply with a general proportionality principle and, thus, needs to be adequate and necessary.</p>	
<p>c) a resolution action is necessary in the <b>public interest</b></p>	<p>No public interest is required.</p>	



## ANNEX 2: Interaction between national bank insolvency regimes and resolution regime – tools available

TYPE OF INSTRUMENT TO BE LOOKED FOR IN NATIONAL REGIME	BRRD TOOLS Art 37(3) BRRD	TOOLS GIVEN UNDER NORMAL NATIONAL INSOLVENCY	EXPLANATION OF DIFFERENCES
<p>Instruments whereby shareholdings, assets, rights or liabilities of the bank to be resolved are transferred (in whole or in part) to a certain buyer</p> <p>Instruments to transfer a shareholding or assets and liabilities to a bridge institution</p> <p>Instruments to separate assets until subsequent sale or liquidation</p> <p>Write-down (reduction in the value of assets) of financial instruments issued by the bank or claims against the bank</p> <p>Others</p>	<p>a) Sale of business tool</p> <p>b) Bridge institution tool</p> <p>c) Asset separation tool</p> <p>d) Bail-in tool</p> <p>N/A</p>	<p>Decree-Law N.º 199/2006 foresees no special powers akin to resolution powers bestowed upon the liquidator or liquidation committee. However, through the indirect application of general insolvency law, various acts of asset disposal are possible.</p> <p>Pursuant to such general rules, it is necessary, during the liquidation proceedings, to convert the remaining assets of the insolvent estate into money in order to distribute among creditors, such conversion and distribution being the competence of the liquidator in the case of banks.</p> <p>Some acts, such as the sale of certain assets, might need explicit consent from the creditors, pursuant to Article 161 of the Insolvency and Recovery Code.</p> <p>Furthermore, it is our understanding that though liquidators can sell assets, they cannot sell liabilities, as that would be incompatible with the ranking of creditors as established by law. Liabilities are not to be sold, but instead repaid.</p>	<p>There is significant difference in the range of powers attributed to the competent resolution authority <i>vis-à-vis</i> the liquidators, as the only common power is the ability to sell parts of a business that constitute assets.</p>

## ANNEX 3: CASE STUDIES

INSOLVENCY CASE # 1	DETAILED INFORMATION
<b>Name of the bank</b>	Banco Privado Português, S.A. (BPP)
<b>Relevant Liquidation Date</b>	15/04/2010
<p><b>Description of the case</b></p> <p><i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i></p>	<p>In November 2008, the rating agency Moody's aggravated the credit risk assessment of BPP, cutting not only the credit rating but the BSFR indicator of financial soundness, which measures the likelihood that a bank will require the assistance of third parties (shareholders or official institutions).</p> <p>In December 2008, the Bank of Portugal decided to intervene in BPP and appointed a provisional administration to accompany a rescue plan of the institution, which included a loan negotiated with six other Portuguese banks, worth €450 million, backed by a state guarantee.</p> <p>An audit was requested that revealed a chaotic reality with criminal outlines, such as: open accounts without titleholders, despite receiving orders to move; extracts that did not exist; information contained in extracts intentionally adulterated; lack of documentation to open accounts.</p> <p>In April 2010 Bank of Portugal withdrew the license granted to BPP and the Bank entered judicial liquidation proceedings. As a consequence, the Portuguese Deposit Guarantee Fund (FGD) was activated for the first time in its history and covered deposits were repaid.</p>
<p><b>Total assets in last balance sheet before failure</b></p> <p><i>(if available)</i></p>	
<b>Recovery rates</b>	The sale of BPP's assets quite possibly will only be enough to pay off the state guarantee loan made in December 2008 that was activated with the liquidation

<p><i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i></p>	<p>of the bank as the €450 million state credit claim is a preferred credit. Several actions and appeals are pending in relation to the award decision.</p>
<p><b>Length of the proceedings</b></p>	<p>2010 - ongoing</p> <p>In 2010, after the withdrew of the license granted to BPP the DGF was activated and, in that year, the amount of €89,200.00 was paid.</p> <p>According to its annual reports, in the following years (until 2015), the DGF proceeded with payments of €8,200,000 (2011), €1,900,000 (2012), €286,000 (2013), €736,200 (2014), €884,800.00 (2015).</p>
<p><b>Costs</b></p>	<p>Unknown</p>

INSOLVENCY CASE # 2	DETAILED INFORMATION
<b>Name of the bank</b>	Banco Espírito Santo, S.A. (BES)
<b>Date of resolution</b>  <b>Date of withdrawal of authorisation</b>  <b>Beginning of liquidation proceedings</b>	03-08-2014  14-07-2016  21-07-2016
<b>Description of the case</b>  <i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i>	<p>At the end of July 2014, BES publicly announced losses of around €3.6 billion for the first half of the year. These losses largely exceeded the previously estimated amounts and were not able to be accommodated by the bank's capital buffer, leading to a breach of the applicable capital requirements.</p> <p>Shortly after, BES informed Bank of Portugal that it would not be possible to submit a private capitalisation plan, as had previously been requested by the supervisor.</p> <p>This was accompanied by a sharp pressure in the liquidity of BES. On August 1, 2014, the ECB suspended BES's Eurosystem monetary policy counterparty status and requested BES to repay to the Eurosystem its outstanding credit of around €10 billion in three days.</p> <p>The overall situation meant that BES was in serious risk of not meeting its commitments in the short term and consequently of breaching the requirements for continuing authorisation.</p> <p>In August 3, 2014, the Bank of Portugal applied a resolution measure to BES, transferring most of its assets and liabilities to Novo Banco, a bridge bank established by the Bank of Portugal for this purpose.</p> <p>The ECB revoked, in July 2016, BES's authorisation to engage in banking activity. BES then entered into liquidation proceedings and a liquidation committee was appointed on that date.</p>

	<p>In January 2019, BES's Liquidation Committee announced that the deadline for filing credit claims was March 8, 2019 (<a href="http://www.bes.pt/Comunicados/BES%2020190108.pdf">http://www.bes.pt/Comunicados/BES%2020190108.pdf</a>).</p> <p>On May 31, 2019, BES's Liquidation Committee submitted to the court's secretariat a list of all recognised and unrecognised creditors (<a href="http://www.bes.pt/Comunicados/BES%2020190531.pdf">http://www.bes.pt/Comunicados/BES%2020190531.pdf</a>).</p>
<p><b>Total assets in last balance sheet before failure</b></p> <p><i>(if available)</i></p>	<p>According to the Report published by BES, at the time of the withdrawal of the authorisation the assets of BES were valued at €152,465,000.</p>
<p><b>Recovery rates</b></p> <p><i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i></p>	<p>About 32,500 claims were submitted from 23,960 individuals and public and private entities to the BES liquidation committee.</p> <p>The list of recognised creditors included 4,955 creditors, of which 2,707 correspond to creditors who have filed claims and 2,288 correspond to creditors who have not filed claims, but whose credits have been recognised on the basis of accounting records or were otherwise known to the liquidation committee.</p> <p>Total credits recognised, including capital and interest on arrears, amount to a total of €5,056,814,588.00, of which €2,221,549,499.00 are common credits and €2,835,265,089.00 are subordinated credits. No secured nor preferred credit claims were recognised.</p> <p>The list of unrecognised creditors includes 21,253 non-recognised claimants, which have been advised of the respective terms of non-recognition by the liquidation committee by registered letter or email, in case where the complaint were submitted this way.</p> <p>The Liquidation Committee, under the court order, determined that the deadline to contest the list of recognised and unrecognised creditors would be September 2, 2019.</p>

	<p>According to recent news reports, around 2500 challenges to the list of recognised and unrecognised creditors have been submitted before the court.</p> <p>As the list of recognised creditors has not yet been subject to a final decision by the court, the repayment of creditors has not started.</p>
<b>Length of the proceedings</b>	2016 - ongoing
<b>Costs</b>	Unknown



# **Study on the differences between bank insolvency laws and on their potential harmonisation**

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**Country report**

**Spain**



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## 1. Introduction

In Spain, the bank insolvency proceeding is regulated by Law 22/2003<sup>1</sup>, (hereinafter the Insolvency Law), which provides for a single legal procedure for situations of crisis caused by the insolvency of a common debtor whose centre of main interest is in the Spanish territory.

Law 22/2003 applies to the Spanish credit institutions. Notwithstanding this general rule, Second Additional Provision of Law 22/2003 sets forth that, in the insolvency proceedings adopted, *inter alia*, with respect to credit institutions, the specific terms provided in their special legislation shall also apply and will be considered *lex specialis* applicable to insolvency situations.

Within this special legislation, Second Additional Provision specifically mentions (i) Law 6/2005<sup>2</sup> (which implements into the Spanish legislation the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions) and (ii) Law 11/2015 (which transposes into the Spanish legislation part of the Directive 2014/59/EU<sup>3</sup>).

The Law 22/2003 establishes two options designed to bring a solution to the debtor's insolvency: 1) either to enter into a legal transaction with the creditors in which the free will of the parties is evidenced (this is known as composition of creditors or creditor's agreement) or; 2) to commence the liquidation of the company. The last legislative amendments have enhanced the first phase, i.e. the refinancing of the debts and the composition of creditors. However, this solution does not seem very appropriate in case of banks' insolvency, since it would require creditors to accept a reduction of their claims or a postponement of payments, as well as the continuation of the bank's activity. In case of a credit institution, the opening of the liquidation phase implies the withdrawal of the licence (Article 8(h) of the Law 10/2014)<sup>4</sup>.

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<sup>1</sup> Law 22/2003 of 9 July, Insolvency, in Spanish Official Journal of 10 July 2003 No 164.

<sup>2</sup> Law 6/2005 of 22 April on the restructuring and liquidation of credit institutions, in Spanish Official Journal of 23 April 2005 No 97.

<sup>3</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

<sup>4</sup> Law 10/2014, of 26 June, on the organization, supervision and solvency of credit institutions, in Spanish Official Journal of 27 June 2014.

The Directive 2014/59/EU was implemented through Law 11/2015<sup>5</sup> and Royal Decree 1012/2015<sup>6</sup>. The law sets out the responsibilities, instruments and powers that enable Spanish resolution authorities, the Bank of Spain and FROB to resolve failing banks in an orderly manner. Law 11/2015 integrated and modified the former Spanish resolution framework, replacing almost entirely Law 9/2012<sup>7</sup>.

## 2. Key findings

- Banks' insolvency and liquidation in Spain follows the general corporate insolvency procedure.
- Under Article 2 of Law 22/2003, the insolvency test is mainly a liquidity test. The debtor is in a state of insolvency when he/she is unable (currently or imminently) to fulfil his/her obligations in a continuous and reliable manner.
- The competent court cannot declare the insolvency of the bank if the request for the declaration of insolvency is not accompanied by the notification to the competent authorities and to the Fondo de Reestructuración Ordenada Bancaria (FROB) of the current or imminent inability to fulfil its obligations, in order for them to decide whether they intend to initiate an early intervention or resolution process or not.
- In case of declaration of insolvency, the court shall appoint the liquidator among those proposed by FROB. Nevertheless, this provision (introduced in the Law 22/2003 by Law 17/2014) has not yet entered into force. Until then, the previous regime remains in force, and the court shall appoint the liquidator among those proposed by the Deposit Guarantee Fund.
- The hierarchy of creditors in insolvency proceedings has been aligned to the hierarchy under BRRD, but certain relevant differences remain concerning subordinated creditors, including AT1 and T2 ranking, which are paid before other subordinated liabilities including intra-group loans and related persons.
- The sale of business or sale of business units is the main tool under Law 22/2003 to liquidate a company and to pay creditors. However, since the liquidation would very likely be the sole option for an insolvency scenario of a bank, it will not be possible a sale of the business as a going concern but rather the orderly realization of assets according to the liquidation plan.

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<sup>5</sup> Law 11/2015 of 18 June on recovery and resolution of credit institutions and investment services companies, Spanish Official Journal 19 May 2015 No 146.

<sup>6</sup> Royal Decree 1012/2015 of 6 November, implementing Law 11/2015 of 18 June on recovery and resolution of credit institutions and investment services companies, Spanish Official Journal 7 November 2015 No 267

<sup>7</sup> Law 9/2012 on the restructuring and resolution of credit institutions, of 14 November 2012, in Spanish Official Journal of 15 November 2012 No 275.

## **3. National insolvency proceedings applicable to banks**

### **3.1 Objective of the insolvency procedure**

Banks' insolvency follows the general rules of corporate insolvency, with certain specificities; therefore, the main objective of the insolvency and liquidation proceedings is the right of creditors to maximize the recovery of their debt.

Law 22/2003 does not contain a specific article dealing with its objectives. According to common understanding among scholars, the main objective of the national insolvency procedure could be described as protecting and maximizing the value of the debtor's total assets to cover the claims of creditors, trying to achieve an efficient administration of the debtor's insolvency estate or to the effective realization of the debtor's total assets, for the benefit of all interested parties. To achieve this objective, the national insolvency procedures allocate the risk among participants in an equitable and transparent manner, providing sufficient information to the creditors to exercise their rights under the proceedings and providing an equitable treatment of similarly situated creditors.

In the context of the banks' normal insolvency proceedings, the protection of depositors is of the utmost importance, even if not mentioned by the Law 22/2003. The rules on hierarchy of claims provided by Law 11/2015 for covered deposits are of application. Furthermore, Article 8 of Royal Decree Law 16/2011<sup>8</sup>, which introduced the Deposit Guarantee Fund, provides that, in case of declaration of insolvency of a bank, the Fund shall satisfy the depositors for the sums entrusted to a credit institution up to the coverage amount. By the mere fact of payment, the Fund will be subrogated to the rights of the creditor corresponding to the amount paid, the document certifying the payment being a sufficient title.

### **3.2 Pre-insolvency/restructuring**

According to Article 70 of Law 10/2014<sup>9</sup>, Bank of Spain can take over the institution (i.e., intervene in the entity) or appoint a special manager to replace its management body if, among other circumstances: (i) it is stipulated under Law 11/2015, concerning the resolution framework; (ii) there are well-founded indications that the institution is in a situation of extreme severity that could

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<sup>8</sup> Royal Decree 16/2011 of 14 October which created the Deposit Guarantee Fund for Credit Institutions, in Spanish Official Journal of 15 October 2011 No 249.

<sup>9</sup> Law 10/2014 of 26 June on the organization, supervision and solvency of credit institutions Spanish Official Journal of 27 June 2014 No 156.

endanger its stability, liquidity or solvency, even though that situation does not fall within the scope of application of Law 11/2015.

The intervention or replacement measures may be adopted in the context of a sanction process against the credit institution or independently from such sanctions. The intervention or replacement measures will be decided by the Bank of Spain, giving a reasoned account of their adoption to the Minister of Economy and Competitiveness and to the FROB.

The measure is adopted ex officio or based on a well-founded request of the entity itself, in particular: (i) by the administrators of the credit institution; (ii) by its internal auditing body; or, (iii) where appropriate, by the minority shareholders which are equal to the percentage required by the legislation for calling an extraordinary general meeting or ordinary meeting.

The intervention or replacement measure will be adopted after hearing the interested credit institution during the period granted for this purpose, which may not be less than five days. The hearing is not necessary when the measure is requested by the credit institution or when the procedure seriously compromises the effectiveness of the measure or the economic interests affected (Article 72).

The decision will designate the person or persons who shall perform the intervention functions or act as temporary administrators, and indicate whether such persons should act jointly or severally.

The decision is of executive nature from the moment it is issued. It shall be immediately published in the "Official State Gazette" and registered in the corresponding public records. The publication in the "Official State Gazette" will determine the effectiveness of the decision against third parties (Article 73).

When this is necessary for the execution of the decision of intervention or replacement of the administrators, it will be possible to take over offices, books and documents for their examination, without prejudice to the rules provided for by Article 96(3) of Law 30/1992 on the Legal Regime of Public Administrations and of the Common Administrative Procedure (Article 74).

In case of intervention, the acts and agreements of the credit institution that will be adopted from the publication of the decision in the "Official State Gazette" will require, for their validity and legal effects, the explicit approval of the appointed administrator, except for the actions and appeals of the credit institution against the intervention or against the replacement decision.

The appointed administrator shall be entitled to revoke powers or delegations which the board of directors of the credit institution or its proxies had delegated prior the publication of the decision. Once this measure is adopted, the administrators will proceed to demand the return of the documents in which the powers are recorded,

and they will proceed to register the revocation in the competent public records (Article 74).

In the case of replacement of the board of directors, the appointed temporary administrators shall have the power to intervene with respect to the acts or agreements of the general meeting of the credit institution.

The obligations of the submission of periodic public information, preparation of the annual accounts of the entity and their approval and governance rules shall be suspended, for a period not exceeding one year, as from the expiration of the statutory timeline provided by the legislation, if the temporary administrators reasonably estimates that there are no reliable and complete data or documents for their preparation (Article 75).

When the Bank of Spain decides to terminate the intervention or replacement measures, the temporary administrators shall immediately convene the general meeting of the credit institution, in which a new administrative body will be appointed. Until the new administrators take office, the temporary administrators will continue to exercise their functions (Article 76).

In the event that the credit institution decides its dissolution followed by the voluntary liquidation, it must notify the decision to the Bank of Spain, which may set the conditions for the dissolution and liquidation within three months from the submission of the notification (Article 77).

When the dissolution of a credit institution occurs, the Minister of Economy and Competitiveness may decide to order the liquidation of the credit institution if such measure is advisable based on the number of people affected or the financial situation of the entity. In that case, the provisions of Article 74 will be of application and all the acts adopted after the publication of the liquidation order in the Official State Gazette will require the explicit approval of the appointed liquidators. Provisions of Article 75 on temporary administration are of application.

The Bank of Spain will send an Annual Report to the Parliament (Cortes Generales) of the proceedings that have resulted in intervention or replacement measures.

The taking over of a credit institution by the Bank of Spain does not preclude the declaration of insolvency, if necessary and justified given the situation of the entity.

In addition to the specific administrative measures available to the Bank of Spain provided in Law 10/2014, Law 22/2003 regulates some pre-insolvency proceedings which can be used in respect to all entities within the scope of application of Law 22/2003, including banks. The two main pre-insolvency and restructuring proceedings, the refinancing and restructuring schemes, aim to develop a creditors' composition agreement and refinancing and to enhance restructurings that secure the viability of the distressed debtor through an expedited proceeding with judicial homologation (Spanish Scheme). However, while its application is not excluded *ex lege* for credit entities, it seems unlikely that a credit institution may resort to these

pre-insolvency procedures, given the specificities of their business and the fact that they are mainly creditors' workouts homologated by the courts.

### **3.3 Insolvency test (triggers of insolvency procedures)**

Article 2 of Law 22/2003 provides that insolvency shall be initiated by a judicial declaration of insolvency, which shall be pronounced when the debtor is unable to continuously and regularly fulfil his/her obligations.

Concerning the liquidation of the credit institutions, Article 6 of the Law 6/2005 provides that the Spanish judicial authorities are the only authorities competent to decide on the application of the reorganisation measures mentioned in Section 3.2, or of a liquidation procedure vis-à-vis a credit institution authorized in Spain. This also applies to branches in other Member States of the European Union<sup>10</sup>.

Reorganisation measures covered by the Law 11/2015 and mentioned in Article 3(7) Law 6/2005 are of competence of the FROB.

The insolvency proceeding is voluntary or compulsory. Insolvency will be considered voluntary if it is the debtor who, through his prudence and good will, files an application for insolvency before the competent courts, when he/she cannot meet his/her liabilities, currently or imminently. The applying debtor has to provide evidence of its situation of insolvency.

Insolvency proceedings can also be commenced before the courts by any of the creditors of the debtor (or by third parties specifically entitled to it), thus leading to compulsory insolvency proceedings.

If a request for declaration of insolvency is submitted by the debtor, he/she must justify his/her state of insolvency, which may be current (*concurso necesario*) or imminent (*concurso voluntario*). When the state of insolvency is current, it is mandatory for the debtor, or its legal representative in case of a legal entity, to file a request for the insolvency declaration.

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<sup>10</sup> Law 6/2005 applies to credit entities authorized in Spain operating in another European Member State by way of the provisions of services or through the establishment at least of a branch in that Member State; to credit entities authorised in another Member State operating in Spain by way of the provisions of services or through the establishment at least of a branch in Spain, as well as to the branches in Spain of non-EU entities with at least another branch in another EU Member State.

As clarified by the case law, this inability to regularly fulfil the obligations is the only condition for insolvency under Law 22/2003. The insolvency situation is compatible with the existence of a balance sheet that contains sufficient equity, but insufficient liquidity to regularly meet the company's obligations. The reason for its inability to meet the obligations is irrelevant: either the company lacks equity in order to guarantee the payments or, despite having equity, lacks liquidity and is not able to obtain financing from the market<sup>11</sup>.

In addition, the court clarified that the debtor's petition does not constitute evidence of insolvency, but the court ruling must be based on the documental evidence submitted together with the petition<sup>12</sup>.

Creditors' request for a declaration of insolvency must be founded upon the fact that the debtor was notified of the execution or seizure of goods, and that the debtor does not have the means to pay its obligations, or on any of the following facts:

1. The general suspension of the payment of the debtor's outstanding obligations.
2. The existence of seizures for pending executions that affect, in general terms, the estate of the debtor.
3. A general disorder or a hasty or ruinous liquidation of the assets by the debtor.
4. The general breach of obligations of any of the following classes: payment of tax obligations levied during the three months preceding the request of declaration of insolvency; payment of social security contributions, and other concepts of joint collection during the same period; the payment of wages and indemnities and other remunerations arising from the working relationships corresponding to the last three-month instalments.

In the case of Banco Madrid, the most recent process of bank liquidation in Spain, the request for a declaration of insolvency was filed by the entity itself, represented by the temporary administrators appointed by the Bank of Spain replacing the board of directors, for the imminent risk of lack of liquidity. The lack of liquidity was due to a massive withdrawal of deposits (*concurso voluntario*)<sup>13</sup>.

The Court affirmed that a declaration of insolvency based on such factual circumstances had to be evaluated carefully, due to its impact on financial stability.

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<sup>11</sup> Section 28 of the Specialized Commercial Court of the Provincial Court of Madrid, 18 November 2008.

<sup>12</sup> Madrid Commercial Court, 25 March 2015 n. 203/2015.

<sup>13</sup> Madrid Commercial Court, 25 March 2015 n. 203/2015.

The Court also considered the fact that the bank was in a situation of imminent insolvency at the time it filed for the declaration of insolvency<sup>14</sup>.

### **3.4 Standing to file for insolvency**

According to Article 3 of Law 22/2003, a request for a declaration of insolvency may be filed by the debtor, any of its creditors and, in the case of a composition of creditors regulated by Title X of Law 22/2003, by the insolvency mediator.

The legislation does not expressly provide for the possibility of the resolution and competent authorities to file for insolvency. However, the Bank of Spain can use its supervisory powers to ensure that the request is filed.

If the debtor is a legal person, the board of directors or the administrator in charge of the restructuring is competent to decide on the filing. Creditors who purchased outstanding liabilities in the six months preceding the payment date are not entitled to file a request for a declaration of insolvency.

As a general principle, shareholders are additionally entitled to file for insolvency when they are personally liable for the debts of the entity.

Under Article 4 of Law 22/2003, the public prosecutor has legal standing to file for insolvency when evidence has emerged on the insolvency status of any presumed party who is criminally liable and the existence of a plurality of creditors, during investigation for financial crimes or other crimes which attempt to disrupt the socio-economic order.

The debtor has the obligation to file for insolvency within the two months following the date on which he/she knew or should have known about his insolvency status (Article 5 of Law 22/2003). There is a presumption that the debtor became aware

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<sup>14</sup> Such objective information was found existing in the declaration of insolvency of the Banco Madrid. *In the case of Banco Madrid, the investigation of US and Spanish authorities caused, between 10 and 13 March 2015, a cumulative withdrawal of deposits of 124 million euros. To the closing of the day of 13 Friday 2015, there were additional withdrawal registered for other 52.3 million euros in deposits and there was a certain risk that the fund managers could send orders to withdraw more cash by transferring it to accounts other entities, which would imply the immediate exit of an amount close to about 150 million euros in total. It would have placed the entity in a negative liquidity situation of more than 100 million euros.*



of its situation of insolvency when any of the situations described under Article 2.4 of Law 22/2003 has arisen<sup>15</sup>.

It is important to clarify that the legislation “protects” the creditor who files the request for insolvency. According to Article 91 (7) of the Insolvency Law, half of the value of his/her credits is covered by a privilege, except for subordinated credits which are not covered by such privilege.

Article 5 of Law 6/2005<sup>16</sup> provides that the opening of the insolvency procedure in the terms set forth in Law 22/2003 shall be considered as a reorganisation measure in Spain. However, if, subsequently, the opening of the liquidation phase is agreed upon, Law 6/2005 provides that the rules corresponding to the liquidation procedures shall be applied from that moment on.

With specific reference to credit institutions, Article 6 of Law 6/2005 regulates the competences and the duties of information with which the Spanish judicial authorities are tasked in case of a credit institution’s declaration of insolvency. Pursuant to this provision, the relevant Spanish judicial authorities shall alone be empowered to decide on the opening of insolvency proceedings concerning a credit institution authorised in Spain, including branches established in other Member States. The Spanish judicial authorities shall, without delay, inform through the Bank of Spain, the competent supervisory authorities of another EU Member State of their decision to open insolvency proceedings, including the practical effects which such proceedings may have, if possible before they open or, otherwise, immediately thereafter.

A decision to open an insolvency proceeding with respect to a credit institution authorised in another EU Member operating in Spain by way of the provisions of services or through the establishment of at least one branch taken by a judicial authority of such Member State shall be recognised, without further formality, and shall be effective in Spain, including against third parties, when the decision is effective in the EU Member State in which the proceedings are opened.

However, insolvency proceedings affecting branches in Spain of non-EU entities with at least another branch in another EU Member State do not benefit from

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<sup>15</sup> The generalized breach of obligations of any of the following classes: payment of tax obligations due during the three months prior to the application for insolvency; payment of Social Security fees, and other joint collection during the same period; payment of salaries and compensation and other remuneration derived from the labour relations corresponding to the last three monthly payments.

<sup>16</sup> Law 6/2005 applies to credit institutions authorized in Spain operating in another European Member State by way of the provisions of services or through the establishment of at least one branch in that Member State; to credit entities authorised in another Member State operating in Spain by way of the provisions of services or through the establishment of at least one branch in Spain, as well as to the branches in Spain of non-EU entities with at least another branch in another EU Member State.

mutual recognition or direct effectiveness in Spain, but rather they require a court order to be effective.

The judicial declaration of insolvency (*auto de declaración de concurso*) includes the following information:

- the necessary or voluntary nature of the liquidation;
- the appointment of the insolvency liquidators and the effects of the declaration on the directors and the disposition of the debtor with respect to its asset;
- in case of compulsory insolvency, the demand for the debtor to submit the documents listed in Article 6 within the term of ten days;
- When applicable, the precautionary measures that the judge considers necessary to ensure the integrity, conservation or administration of the debtor's assets until the insolvency liquidator accepts the office;
- The information to creditors to allow them to submit their claims to the liquidators in a one-month period through publication in the "Official State Gazette" of the declaration of liquidation. The liquidator will inform, without delay, through individualized communication, each creditor whose identity and domicile are included in the debtor's official files, informing them of the declaration of insolvency and of their obligation to communicate their credits according the bankruptcy declaration and in the manner established by law. The communication will be made by telematic or electronic means when the creditor's electronic address is recorded. The communication will be sent by electronic means to the State Agency of the Tax Administration and to the General Treasury of Social Security through the means that these have activated in their respective electronic offices, whether or not they are creditors. Likewise, the representatives of the workers, if any, shall be informed of their right to appear in the proceeding as a party;
- The publicity that is required for the declaration of opening the insolvency proceedings;
- If the insolvent entity is a credit institution or an investment services company participating in a system of payment and settlement of securities or derivative financial instruments, the court clerk will notify the order, on the same date, to the Bank of Spain, to the National Securities Market Commission and to the management systems to which the affected entity belongs. This includes the stock exchange when the company is admitted to trading on an official market.

Credit institutions may not submit a voluntary declaration of insolvency without having made the notifications provided for in Articles 9.1 and 21.4 of Law 11/2015 to the competent authorities and to the FROB and without the competent supervisor and the FROB deciding whether to open a process of early intervention or resolution of the entity. The period of two months provided for in Article 5 of Law 22/2003 will be suspended until this decision is adopted.

Third paragraph of the 15th Additional provision of Law 11/2015, establishes that, in compulsory insolvency proceedings, the court must send any request for insolvency that has been filed by a person other than the debtor to the competent supervisor and FROB, who have a maximum period of seven days to adopt a decision as to whether they intend to initiate an early intervention or resolution procedure.

### **3.5 Appointment of liquidators or administrators and their powers**

Article 27(6) of Law 22/2003 provides that in the event of a credit institution's insolvency, the judge shall appoint the insolvency liquidator among those proposed by the FROB. This provision (introduced in the Law 22/2003 by Law 17/2014<sup>17</sup>) has not yet entered into force. Until then, the previous regime remains in force and the court shall appoint the liquidator among those proposed by the Deposit Guarantee Fund.

In proceedings where there is a relevant public interest, the judge of the proceeding, *ex officio* or at the request of a creditor that is a public entity, may appoint a second insolvency liquidator. The second liquidator may be a Public Administration body or a public law entity dependent or bound to a public entity that is a creditor of the insolvent debtor.

Article 12 of Law 6/2005 provides the discipline of the appointment of the insolvency liquidator in cross-border proceedings among EU Member States:

- The appointment of the insolvency liquidator shall be accredited by authenticated copy of the original decision under which it is designated, or by a certificate issued by the judge of the proceeding. The translation of these certifications into the official language or the languages of the Member States in the territory where the insolvency administration has to be exercised may be required.
- The insolvency liquidator may designate persons to assist him or, where appropriate, represent him in the course of an insolvency procedure. The liquidator may also designate an assistant during the winding-up procedure in the other Member States in which the insolvent institution has its branches, in order to easily find a solution to the difficulties that the creditors of such States might encounter.

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<sup>17</sup> Law 17/2014, of 30 September which adopts urgent measures regarding refinancing and restructuring of corporate debt, in Spanish Official Journal of 1st October 2014 No 238.

The insolvency liquidator has the obligation to prepare, among other things, a report on the causes of the insolvency, a list of creditors and a list of assets and the rights over the debtor's estate (Article 75 of Law 22/2003). Under Article 74 of the Law 22/2003, the term for submission of the insolvency report by the liquidators is two months, which may be extended by the court at the request of the liquidators if, among other circumstances, the notification of the claims has not been concluded on expiry of the term of two months. If the number of creditors exceeds 2.000, the liquidators may apply for an extension for a term not exceeding four months.

The insolvency liquidator must also draft a report on the liquidation plan and the settlement (creditors' composition) proposal.

### **3.6 Admission of creditors/debtors to insolvency estate**

According to Article 21.1 (5) of the Law 22/2003, creditors shall inform the liquidator on the amount of their credits within one month from the date of the publication of the declaration of insolvency in the Official State Gazette. Article 85(2) of the Law 22/2003 requires creditors to provide the liquidator with information on their identification and domicile, as well as on the origin, amount, maturity, characteristics and ranking of their credit claim.

As mentioned in Section 3.4, liquidators have the duty to individually inform the creditors whose names and addresses are reported in the company registry. When insolvency concerns a credit institution, such information is held within the bank; therefore, liquidators shall inform each creditor individually about their rights and of the procedures to submit their claims.

Furthermore, Article 13 of Law 6/2005 provides that, in case of the insolvency declaration affecting a credit entity authorized in Spain operating in another EU Member State by way of the provisions of services or through the establishment of at least one branch in that Member State, the liquidator shall inform the creditors residing in other Member States identified through the records and documents of the credit institution or known for any other reason. The information shall include the identification of the procedure, the date of the declaration of insolvency, the personal circumstances of the debtor, the agreed effects about the powers of the debtor on the management and disposal of the assets, the invitation to creditors to communicate their credits to the insolvency liquidators, including secured credits, the term for such communication and the postal address of the court. The credit claims of these creditors shall be granted the same treatment and priority as the credit claims with equivalent ranking of the creditors with habitual residence, domicile or registration in Spain.

Article 86 of the Law 22/2003 then requires the liquidator to include or exclude each credit claim from the list of creditors. This decision is adopted with respect to each of the claims, both those that have been expressly communicated and those resulting from the books and documents of the debtor, or from any other source.

All questions that arise on the inclusion or exclusion of credits will be processed and solved by means of an incidental insolvency proceeding.

Claims necessarily included in the list of creditors are:

- those that have been acknowledged with a judicial decision, even if the decision is not final;
- those that are in a document with executive force;
- those acknowledged by an administrative certificate;
- the secured claims with an *in rem* security entered in a public registry; and
- those of workers whose existence and amount result from the books and documents of the debtor or by any other document included in the insolvency.

However, the insolvency liquidator may challenge the existence and validity of the claims arising from an arbitral agreement or proceeding in case of fraud, the claims arising from a document with executive force, secured claims and administrative acts, in accordance with the respective specific requirements.

If there is no declaration of claims concerning public administration and workers, the debtor or the liquidator must provide the relevant information. Where, due to lack of information, it is not possible to determine the amount of these claims, they should be recognized as a contingent claims.

The claims subject to a resolute condition will be recognized as conditional and will enjoy the insolvency rights that correspond to their amount and ranking while the condition is not met. If the condition is met, the actions and decisions of conditional creditor which were decisive may be annulled at the request of a party. All other actions will be maintained, without prejudice to the duty of reimbursement to the estate, if any, of the amounts collected by the conditional creditor, and of the responsibility that said creditor may have incurred before the estate or the creditors.

Disputed claims and claims subject to conditions precedent will be recognized in the insolvency proceedings as contingent claims without an amount and with the corresponding ranking. Additionally, their holders are admitted as legitimized creditors in the proceedings without any limitation other than the suspension of the rights of adhesion, vote and collection. The confirmation of the contingent claims or its recognition in a final judgment or a judgment allowing its provisional execution shall grant the holder all the insolvency rights corresponding to their amount and ranking.

In general, set-off is not permitted in an insolvency proceeding unless the requirements for set-off have been met prior to the insolvency declaration. As an exception to the general regime, set-off provisions that comply with the requirements set out in Royal Decree-Law 5/2005 (which implements EU Directive 2002/47 on financial collateral) are enforceable in an insolvency scenario.

Article 94 of the Law 22/2003 requires the attachment of the list of creditors to the report of the liquidators submitted to the court. It must list all creditors, whether included and excluded, both in alphabetical order. The list of included creditors must specify the identity of the creditors, the cause of the credit, the amount of the principal and the interest, dates of origin and maturity of the recognized credits personal or real guarantees and indicating the disputed, conditional or pending execution of the debtor's assets.

### **3.7 Hierarchy of claims**

Taking into consideration the principle of *par conditio creditorum*, Law 22/2003 establishes a ranking of credits, which is paramount to creditors since it will provide them with higher or lower expectations of recovering the whole amount of their claims. Those credits are fully integrated in the insolvency proceedings, thus called "within-the-proceedings" (*concursoales*), and they are to be paid according to their legal ranking through the proceeds of the orderly liquidation of the insolvency estate.

However, some credits will be drawn directly and immediately from the estate (*créditos contra la masa*) and thus are not fully integrated in the insolvency proceedings, as they are "super senior" (except from those specially privileged credits that will seize their security exclusively, as a rule).

Furthermore, when the debtor is a credit institution, Law 11/2015 also includes provisions on the ranking in insolvency of specific types of liabilities.

The Law 22/2003, with the specificities of the Fourteenth Additional Provision of Law 11/2015 (as amended by Royal Decree Law 11/2017), provides the following rules on the payment of debts when the proceedings end with the liquidation of the debtor's assets:

#### **I. Credits against the insolvency estate (*créditos contra la masa*)**

Credits against the insolvency estate (*créditos contra la masa*) will be paid upon their respective maturity dates out of the debtor's assets (other than those assets attached to the specially privileged credits), with preference in respect of any other debts. These include, among others, credits for salaries for the 30 days before the declaration of insolvency, the legal costs and necessary expenses for the application and declaration of insolvency and the assistance and representation of the insolvent and the administrator throughout the proceeding.

#### **II. Credits with special privilege**

Credits with special privilege are listed in Article 91 of Law 22/2003 and are the following:

I. Credits secured with a voluntary or legal mortgage, either on moveable or immovable assets, or with a lien on mortgaged or pledged assets, based on registry instead of possession (privilege of seizure of the secured registered asset);

II. Credits secured with antichresis (privilege of seizure of the yield of encumbered assets);

III. Credits for manufacturing purposes on the manufactured goods, including those of employees (privilege on objects manufactured by employees while those assets stay in property or in possession of the debtor);

IV. Credits for financial lease or installment purchase of moveable or immovable assets, in favour of the lessors or sellers and, when appropriate, the financiers (privilege on assets leased with reservation of ownership, with prohibition on disposal or with a termination condition in the event of failure to pay);

V. Credits guaranteed by securities represented by book entries (privilege of seizure of the encumbered securities);

VI. Credits secured by notarial pledge (pledge constituted in a public document), based on possession instead of registry (privilege on assets as long as their possession remains). In case of pledge over credits, the possession is replaced by notarized documents with a reliable date of issuance.

These credits are paid with the proceeds resulting from the enforcement of the underlying security. According to Article 90 of Law 22/2003, the special privilege shall only affect the part of the claim that does not exceed the value of the respective security recorded on the list of creditors, calculated according to the terms set forth in Article 94(5) of Law 22/2003. The amount of the credit that exceeds that recognized as a specially privileged credit shall be classified according to its nature.

### **III. Credits with general privilege**

Credits with general privilege are paid with preference over the remaining credits through the liquidation of the debtor's estate (after deducting the assets necessary to repay the credits against the insolvency estate as well as the assets affected to the special privileges).

Claims with a general privilege are the following and are paid in the order as presented (within the same category, payments are made on a *pro rata* basis):

- labour claims, including salaries, compensations and severance payments up to certain limits;
- claims relating to tax and Social Security withholdings owed by the debtor in fulfilment of a legal obligation;
- claims by individuals arising from contracted works and those of authors for the exploitation of works protected by intellectual property, if accrued in the six months before declaration of insolvency;
- up to 50% of the amounts of tax and social security claims as well as any other public debts, if they do not enjoy any other privileged treatment;
- tortious (non-contractual) civil liability claims;

- deposits covered by the Deposit Guarantee Fund and the rights in which the Fund has been subrogated in case the guarantee has been made effective;
- eligible deposits of individuals and micro, small and medium-sized enterprises exceeding the coverage level also have a general privilege, as well as deposits from natural persons and micro, small and medium-sized enterprises which would have been classified as covered deposits if they had not been constituted through branches located outside the EU of parent undertakings located in the EU;
- Up to 50% of the claims of the creditor who filed for insolvency, provided they are not subordinated.

#### **IV. Ordinary credits**

According to Article 89(3) of Law 22/2003, ordinary unsecured credits (known in EU terminology as senior credits) are those which are not classified as privileged or subordinated.

Ordinary debts will generally be paid on a *pro rata* basis after the debts against the insolvency estate, the specially privileged debts and the generally privileged debts have been satisfied.

In the case of credit institutions, Fourteenth Additional Provision of Law 11/2015 (as amended by Royal Decree Law 11/2017) created a new type of debt instrument known as "non-preferred senior debt". The claims arising from this instrument are classified as ordinary unsecured credits but can only be paid after the remaining ordinary credits (though before subordinated claims).

In order to enjoy the "intermediate" ranking between the remaining ordinary unsecured claims and subordinated claims, the non-preferred senior debt instruments must have an initial maturity of at least one year, not being derivative instruments and not have implicit derivative. The terms and conditions and, if applicable, the prospectus, must include a clause establishing that they have a lower priority in insolvency compared to the rest of the ordinary credits and, therefore, they will be paid after the corresponding ordinary credits.

#### **V. Subordinated credits**

According to Article 92 of Law 22/2003, the following are classified as subordinated credits:

1. Claims that, not having been duly communicated by the creditor, are included at a later stage in the list of creditors by the insolvency liquidator or by the Court on settling a challenge of that list (with exceptions).
2. Claims that, under a contractual arrangement, are subordinated with regard to all the other claims filed against the debtor. When the debtor is a credit institution, Fourteenth Additional Provision of Law 11/2015 provides that contractually subordinated credits are to be repaid in the following order:
  - a) The principal amount of the subordinated debt that does not qualify as Additional Tier 1 or Tier 2 instruments;



- b) The principal amount of Tier 2 instruments;
  - c) The principal amount of Additional Tier 1 instruments.
3. Claims for interests of any kind, including those interests or any other form of extra charges for late payment, except for those claims with a security *in rem*, up to the limit stated in the respective guarantee.
  4. Claims for fines and other monetary penalties.
  5. Claims held by persons especially related to the debtor (see below);
  6. Claims of persons who, after an insolvency revocation, were ruled as having acted in bad faith, arising from that revocation;
  7. Claims arising from contracts with reciprocal obligations referred to in Articles 61, 61, 68 and 69 of Law 22/2003, when the court finds, following the report by the insolvency liquidator, that the creditor has repeatedly hindered fulfilment of the contract to the detriment of the insolvency interests.

Article 158 of the Law 22/2003 states that the payment of the subordinated credits shall not take place until the ordinary credits have been fully settled (including non-preferred senior claims). The payment takes place in the order presented above; within the same category, payments are made on a *pro rata* basis.

## **VI. Claims held by persons especially related to the debtor**

According to Article 93 of the Law 22/2003, a specific category of subordinated creditors is the "Related parties" claims. The definition of related party covers entities or individuals with a privileged position in terms of information about the debtor or of influence on the decisions made by the debtor. If the insolvent debtor is a company, the following will be considered a 'related party':

- Shareholders that are personally liable for the debts of the entity and that, when the relevant debt arose, directly or indirectly owned at least 10% of the shares of the insolvent company (5% when the insolvent company is a listed company or a company with listed debt). When shareholders are natural persons, the persons that are specially related to them as per Article 93(1) of Law 22/2003 are also deemed to be a related party. However, according to Article 71bis, a creditor who becomes a shareholder of the debtor by means of a capitalization of its claims in the context of refinancing or a homologated refinancing agreement, shall not be regarded as a 'specially related person' to the debtor and shall not lose their right to vote on a composition agreement nor their security;
- The insolvent company's directors and *de facto* directors, the insolvent company's liquidators and the attorneys with general powers to run the insolvent company, as well as those who have acted as such during the two years prior to the insolvency declaration;
- Companies in the same group as the insolvent company and their common shareholders, provided that they meet the requirements set out in the first point.

In addition, assignees or awardees of credits held by persons or entities that are considered related according to the above rules are presumed to also be specially related to the debtor if the acquisition of the credit took place within the two-year period prior to the declaration of insolvency. In other words, the acquisition of credits from a related party will imply subordination even if the new creditor does not fall within the circumstances contemplated above.

According to the Law 22/2003, if the directors (legally appointed or *de facto*) are liable for the insolvency, the judgement imposed on such directors (either individuals or corporations) can include total or partial coverage of the deficit of the insolvency (assets vs. debts). This implies that subordinated creditors could eventually benefit from such judgement if it includes the liability of directors for the deficit required to cover subordinated debts. Therefore, in those cases where the directors have acted negligently, subordinated creditors have important incentives to obtain such judgement in the insolvency procedure<sup>18</sup>.

### **3.8 Tools available to manage a bank's failure**

According to Article 148 of the Law 22/2003, liquidators shall submit, within 15 days from the opening of the liquidation phase, a liquidation plan to the court.

The plan, whenever feasible, must contemplate the unitary sale of the business or business units.

Except for public creditors, the settlement plan may provide for the transfer of assets or rights in payment or for payment in kind, with the limitations concerning credits with special privilege. These credits must be paid the proceeds of the forced sale of the security, except when the creditors accept to be paid in full, releasing the security.

If a liquidation plan is not approved, or certain tools are not included in the liquidation plan, Article 149 provides the legal rules for the liquidation operation. According to the provision, the sale of a business's units requires an auction; however, the judge may agree to direct transfer or a transfer through a person or specialized entity. This may occur when the auction is deserted or when, after having received the report of the insolvency liquidator, the judge considers an alternative method as the most suitable way to safeguard the interests of creditors, workers and other contractual parties.

When sale of a business or business units has an impact on workers, a hearing with the workers' representatives and trade union shall be held within 15 days. In the event that the liquidation operations involve the substantial modification of

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<sup>18</sup> Subordinated Credits under the Spanish Insolvency Act, <https://www.ga-p.com/wp-content/uploads/2018/07/subordinated-credits-under-the-spanish-insolvency-act.pdf>.

collective work conditions, including collective transfers and the collective suspension or termination of labour relations, a hearing and court decision according Article 64 of the Law 22/2003 is required.

Under Article 146bis of Law 22/2003, the sale of business units is subject to the following rules:

- the sale of a business unit shall imply the transfer (without requiring the consent of the counterparty) of the rights and obligations arising from any agreements that are attached to the continuity of the relevant professional or business activity (unless their termination has been requested in the framework of the insolvency proceedings);
- the sale of a business unit shall also imply the transfer of any administrative licences or authorisations that are attached to the continuity of the relevant professional or business activity, to the extent that the purchaser carries on the relevant activity in the same premises<sup>19</sup>; and
- the sale of a business unit shall not imply that the purchaser assumes any debt of the insolvent company that remains outstanding at the time of the sale, subject to certain exceptions, and unless the purchaser is a related party to the insolvent company.

In the case of liquidation, the following rules apply with respect to assets that were attached to a specially privileged claim pertaining to a business unit, depending on whether they are transferred unencumbered or if they remain attached to the relevant claim:

- when the asset continues to be attached to the specially privileged claim and the purchaser is subrogated in the relevant claim of the debtor, no consent of the creditor is required;
- when the asset is transferred unencumbered, the specially privileged creditor is entitled to a portion of the purchase price equal to the proportion that the value of the relevant secured asset represents in respect of the total value of the relevant business unit; if the purchase price to be received is lower than the value of the asset, the sale shall require the support of 75 per cent of the privileged creditors pertaining to the same class that is affected by the sale.

In addition, where offers do not differ by more than 15 percent, the judge may award the business unit to a lower offer, should that lower offer secure, to a

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<sup>19</sup> A specific issue relates to bank authorisation. In the Banco Madrid liquidation, the liquidation plan reported that the sale of business was not possible due to the withdrawal of the banks' authorisation from the ECB following the declaration of insolvency. Therefore, only the sale of business unit could be performed.

greater extent, the continuity of the relevant business and employment, and also a better satisfaction of the creditors.

#### **4. Available means to challenge an insolvency proceeding**

The legislation only regulates the procedure for challenging the list of creditors and insolvency inventory. In addition, according to Article 148 of the Law 22/2003, creditors may submit observations on the liquidation plan and they are entitled to appeal against the court decision of approval of the liquidation plan.

As mentioned in Article 94, the list of creditors shall be attached to the report submitted to the court by the insolvency liquidator. This list shall be communicated to creditors, both those included and excluded from the list, who will have the right to challenge the inventory of the assets and the list of creditors within a period of ten days from the notification (Article 96). Legal entities may challenge it within 10 days from its publication in the court registry.

The challenge to the list of creditors may refer to the inclusion or exclusion of credits, as well as to the amount and to the classification of recognized credits.

Any challenge will be determined in the context of the incidental proceeding of the insolvency, and the judge can decide *ex officio* to reunite all proceedings and to treat them jointly. Within five days following the notification of the final decision on the challenges, the insolvency liquidator will incorporate the judicial decisions in the revised inventory, in the list of creditors and in the motivated statement on the modification of the list that, when appropriate, will be presented to the judge in the form of the corresponding final texts.

When the objections affect less than twenty percent of the assets or liabilities of the insolvent debtor, the judge may order the conclusion of the common phase and the opening of the composition or liquidation phase. This may be done without prejudice to the impact that the objections may have in the final texts and the precautionary measures that may be adopted for their effectiveness.

The differences between the inventory, the list of creditors initially presented and the final texts, as well as the list of the subsequent communications filed and the amendments included and an updated list of the credits against the estate accrued, paid and pending payment with the indication of the respective maturities, shall be expressly stated. At the time of the presentation of the modified report and list of credits against the estate to the judge, the insolvency liquidator will electronically communicate these documents to the creditors whose electronic address is known.

All objections must be recorded, immediately after their presentation, with the Public Insolvency Registry. Within five days following the end of the challenge

period, a list of the objections presented and the claims deduced will be published in the abovementioned Registry.

## **5. Conclusions**

The Spanish banking insolvency proceedings follow the rules of the general insolvency procedure, with the exception, among others, of the appointment of the liquidators as well as specific provisions for the hierarchy of creditors.

Covered depositors are granted a general privilege in the hierarchy of creditors, as well as deposits of individual and of SMEs exceeding the guaranteed part. A specific subordination is provided for holders of banks' capital instruments, related parties, such as shareholders of the parent company, the common shareholders of companies forming part of the same group, and shareholders who are responsible for granting credits to the insolvent company.

## ANNEX 1: Interaction between national bank insolvency regimes and resolution regime – triggers for initiating insolvency procedures

BRRD Art 32 BRRD	TRIGGERS UNDER NORMAL NATIONAL INSOLVENCY	EXPLANATION OF DIFFERENCES
<p>1. (a) the institution is failing or is likely to fail (FOLF)</p> <p>For the purposes of point (a) of paragraph 1, an institution shall be deemed to be failing or likely to fail in one or more of the following circumstances:</p>	<p>The debtor is unable to fulfil its obligations on a regular basis.</p>	<p>Definitions in Article 2 of the Law 22/2003 mainly focus on the liquidity test, i.e., the continuous inability of the bank to meet its obligations when they fall due. The courts clarified that this is the only requirement for insolvency and the reasons for the inability can be either the lack of liquidity or lack of equity. This must be evaluated based on the evidence submitted by the debtor or by the creditors.</p>
<p>4. (a) the institution infringes or there are objective elements upholding the fact that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including , but not limited to, because the institution has incurred or is likely to incur losses that will deplete</p>	<p>Not provided for in insolvency.</p>	

<p>all or a significant amount of its own funds;</p>		
<p>(b) the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities;</p>		<p>While the liquidity test is the main trigger for insolvency, the courts clarified that the inability to pay outstanding liabilities can be either due to the lack of liquidity or lack of equity. This must be evaluated based on the evidence submitted by the debtor or by the creditors.</p>
<p>(c) the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its debts or other liabilities as they fall due;</p>		<p>Liquidity test is the main trigger of declaration of insolvency.</p>
<p>(d) extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:</p> <p>(i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions;</p>	<p>Not provided for in insolvency.</p>	

<p>(ii) a State guarantee of newly issued liabilities; or</p> <p>(iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Article 59(3) are present at the time the public support is granted.</p>		
<p>b) there is <b>no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure</b> of the institution within a reasonable timeframe.</p>	<p>Not provided for in insolvency.</p>	
<p>c) a resolution action is necessary in the <b>public interest</b>.</p>	<p>Not provided for in insolvency.</p>	



## ANNEX 2: Interaction between national bank insolvency regimes and resolution regime – tools available

TYPE OF INSTRUMENT TO BE LOOKED FOR IN NATIONAL REGIME	BRRD TOOLS Art 37(3) BRRD	TOOLS GIVEN UNDER NORMAL NATIONAL INSOLVENCY	EXPLANATION OF DIFFERENCES
Instruments whereby shareholdings, assets, rights or liabilities of the bank to be resolved are transferred (in whole or in part) to a certain buyer	a) Sale of business tool	The liquidation plan prepared according to Article 148 of Law 22/2003 shall contain the tools to manage the liquidation, including the sale of assets and of business units. Article 149 provides that the sale of business of its units requires an auction, however, the judge may agree that the sale takes place through direct transfer or through a person or specialized entity when the auction is deserted or when, in view of the report of the insolvency liquidator, they consider that to be the most suitable way to safeguard the interests at stake.	In general, in order to preserve the business, the liquidation plan should attempt to find a buyer for the whole business. In any case, as indicated above, since liquidation would very likely be the sole option for an insolvency scenario of a bank, which forces an immediate cessation of its operations, a sale of the business as a going concern would not be possible, but rather an orderly realization of assets according to the liquidation plan and payments to creditors in accordance with the hierarchy established by the Law 22/2003. This is consistent with previous insolvency cases of Spanish banks (Eurobank del

			Mediterráneo, S.A. and Banco Madrid).
Instruments to transfer a shareholding or assets and liabilities to a bridge institution	b) Bridge institution tool		
Instruments to separate assets until subsequent sale or liquidation	c) Asset separation tool		<p>Royal Decree-law 24/2012 provided for the creation of an Assets Management Company (SAREB), which received impaired assets from certain banks which were subject to State control or that received State aid with a view to divesting them, maximising value, over a period of 15 years.</p> <p>SAREB was part of the aid programme aimed at recapitalising the Spanish financial sector, formalised via a Memorandum of Understanding (MoU) on Financial Sector Policy Conditionality, signed on 23 July 2012 by the European Commission and Spain. This</p>

			MoU provided for the possibility of establishing a company responsible for the management of distressed assets transferred by the banks that received financial aid. As intended, it's mission is to divest such assets and thus it is not foreseen as a general tool to address failing banks.
Write-down (reduction in the value of assets) of financial instruments issued by the bank or claims against the bank	d) Bail-in tool		
Others	N/A		

## ANNEX 3: CASE STUDIES

INSOLVENCY CASE # 1	DETAILED INFORMATION
<b>Name of the bank</b>	Banco Madrid
<b>Date of failure</b>	25/03/2015
<p><b>Description of the case</b></p> <p><i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i></p>	<p>At the beginning of 2015, the Antifraud Department of the US Treasury considered that Banca Privada de Andorra (BPA), parent company of Banco Madrid, was a primary concern for the prevention of money laundering. This fact, together with the immediate actions taken by several international banks, aimed at freezing all assets of the entity. The operations related to BPA led the Andorran National Institute of Finance (INAF) to make the decision to intervene vis-à-vis the entity.</p> <p>The above was decisive for the Bank of Spain to intervene on 10 March 2015 vis-à-vis Banco Madrid, appointing new administrators, on the assumption that the bank would be able to guarantee the continuity of its operations.</p> <p>When Banco Madrid received such intervention, the entity was not in a state of insolvency. The imminent insolvency of Banco Madrid was triggered as a result of the concern of depositors and the banking market on the fact that the BPA event was linked to money laundering.</p> <p>These two situations triggered panic that caused the depositors of the entity to withdraw in a massive way 124 million euros in the course of three days; furthermore, the pending orders of execution totaled 52.3 millions of euros and there was a possibility that clients could execute withdrawal orders for an amount of almost 150 million euros.</p> <p>In view of the insolvency situation, on 16 March 2015 the directors of Banco Madrid decided to proceed with the request for voluntary bankruptcy. However, on 17 March 2015, the Commercial Court decided to suspend the process and to report the facts to FROB, so that it would be able to decide if Banco Madrid had to be subject to resolution rather than an insolvency proceeding.</p> <p>On 18 March 2015, the FROB ruled on the possibility of opening a process of restructuring or resolution of Banco Madrid, stating that its intervention in the proceeding was not appropriate, considering both the profile of its clients and the type of business and that it was reduced in size, and thus it did not pose a significant risk to the Spanish financial system and therefore did not comply with the legal requirements to carry out a restructuring or resolution process. This allowed</p>

	<p>the judicial authorities to carry out the liquidation of the entity through insolvency proceedings.</p> <p>Following the statements of FROB and the proceeding of the liquidation of Banco Madrid, on March 25 (2015), the Commercial Court 1 of Madrid declared the insolvency of the entity and decided to start the liquidation of the entity. The temporary administrators who had been appointed by the Bank of Spain were replaced by with insolvency liquidators in charge of valuing the entity's assets and deciding on the procedure to be followed for the payment of outstanding debts.</p> <p>After analyzing the case, the Spanish Deposit Guarantee Fund (FDG) stated that Banco Madrid was definitely unable to reimburse the depositors' savings and therefore proceeded with the payment of the guaranteed deposits, up to the sum of EUR 100,000 per client, with the maximum speed.</p> <p>On the other hand, it should be noted that because the main activity of Banco Madrid consisted in collective investment, the CNMV had to intervene in relation to the management company and the intermediary, since the CNMV is in charge of replacing the directors of the entities that operate in the securities market.</p> <p>The banking authorization of Banco Madrid was withdrawn by the European Central Bank on 26 July 2016.</p> <p>The liquidation procedure is still on-going and the liquidators have started the sale of the assets, including immovable assets with auction in lots; the last one will start at the end of 2019.</p> <p>The last information report of the liquidators of Banco Madrid was issued in March 2019 contains information on the liquidation process, legal actions (both as applicant and defendant), contracts and operation still on-going. 17 people were still employed by the Banco Madrid to assist in liquidation process.</p>
<p><b>Total assets in last balance sheet before failure</b></p> <p><i>(if available)</i></p>	<p>The asset held at the time of the declaration of insolvency (1,220 million euros) exceeded its liabilities (1,090 million euros) by 130 million euros. With regard to its solvency level, the entity had a solvency ratio of 38.4%, a very high ratio compared to the average for the banking sector.</p>
<p><b>Recovery rates</b></p> <p><i>(The recovery rate measures the extent to which creditors recover the principal and</i></p>	<p>It should be noted that after the declaration of insolvency, the two existing guarantee funds had to intervene: the FGD to cover the guaranteed deposits and the FOGAIN to cover the investors.</p>

<i>accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i>	<p>Creditors (privileged and ordinary) were admitted to insolvency for 340 millions of euros.</p> <p>In 2018, the insolvency liquidator had settled 75% of Banco Madrid's debts. 50% was paid to the creditors in June 2016 and another 25% was paid in March 2018<sup>20</sup>.</p> <p>In March 2019 the liquidators reported that creditors had recovered around 280 million of euros, representing 82,7% of the outstanding claims of both privileged and unsecured creditors. According to the last information report of March 2019, the liquidators expected to pay, before end of 2019, 100% of privileged creditors and 75% of the unsecured claims<sup>21</sup>.</p>
<b>Length of the proceedings</b>	March 2015-ongoing.
<b>Costs</b>	NA

INSOLVENCY CASE # 2	DETAILED INFORMATION
<b>Name of the bank</b>	Eurobank del Mediterráneo, SA,
<b>Date of failure</b>	2003
<b>Description of the case</b> <i>(General information, including from local media and official sources. Provide reference to sources in native language.)</i>	<p>In 2003, Eurobank asked the Bank of Spain to intervene and liquidate it.</p> <p>Since 1996, Eurobank presented regulatory difficulties despite being closely supervised. From 2002 the bank had difficulties in maintaining the regulatory prudential capital and embarked on the realization of a series of activities that increased its risk profile.</p> <p>The situation of insufficient own funds was not remedied by</p>

<sup>20</sup> [https://cincodias.elpais.com/cincodias/2018/03/21/companias/1521661127\\_736603.html](https://cincodias.elpais.com/cincodias/2018/03/21/companias/1521661127_736603.html)

<sup>21</sup> Ninth information report from liquidators, 3 March 2019 pages 32-33. [https://www.concursobancomadrid.info/wp-content/uploads/2019/07/9ITL\\_BM.pdf](https://www.concursobancomadrid.info/wp-content/uploads/2019/07/9ITL_BM.pdf)

	<p>the entity.</p> <p>As a result of an inspection, the Bank of Spain agreed to initiate disciplinary proceedings against the entity, its administrators and the general director in May 2003. At the same time, the entity's board of directors, responsible for its management, was asked to adopt a series of measures aimed at:</p> <ul style="list-style-type: none"> <li>a) modifying the income statement (recording a series of unposted adjustments);</li> <li>b) capitalizing the entity, with own funds not less than 18 million requested by the regulations in force (Royal Decree 1245/1995, of July 14) and</li> <li>c) providing certain information, repeatedly requested by the inspection services.</li> </ul> <p>In 2004, the Bank of Spain decided to intervene the Eurobank of the Mediterranean at the request of the entity itself. The president and maximum shareholder of the entity informed the Bank of Spain and the Generalitat of Catalonia on the decision to waive the bank license, prepare for an orderly liquidation of the bank and request the appointment of State auditors.</p> <p>The Bank of Spain appointed six auditors responsible for assessing the state of the bank. Of these six, one was appointed at the proposal of the Generalitat, since the Autonomous Administration has competences in insurance and mutual matters.</p> <p>Eurobank had maintained its full functioning as a banking entity and, according to the Bank of Spain, the entity was 'in a situation of high liquidity'. This fact had not prevented the orderly liquidation process of the entity that had already received five sanctions from the supervisory authority for lack of discipline.</p> <p>In November 2004, the withdrawal of the banking authorization of «Eurobank del Mediterráneo, SA, in liquidation» was registered in the Registry of Banks and Bankers, as a result of the agreement of the Council of Ministers dated 30 April 2004 withdrawing the authorization to operate as a credit institution<sup>22</sup>.</p>
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<sup>22</sup> [https://www.boe.es/diario\\_boe/txt.php?id=BOE-A-2004-4009](https://www.boe.es/diario_boe/txt.php?id=BOE-A-2004-4009)

<b>Total assets in last balance sheet before failure</b> <i>(if available)</i>	<p>At the date of the intervention, Eurobank del Mediterráneo, S.A., had total assets of 240 million euros and customer deposits of 209 million, liquid assets of 128 million, 4 offices, 55 employees. It had adjusted own accounting resources, as of 31 December 2002, of 12 million euros.</p>
<b>Recovery rates</b> <i>(The recovery rate measures the extent to which creditors recover the principal and accrued interest due on a defaulted debt. Information regarding recovery rates may or may not be publicly available for specific insolvency cases; in case it is available, please provide details here.)</i>	<p>On 20 August 2003, after two days from non-payment of monetary deposits, the Executive Commission of the Bank of Spain adopted the agreement provided for in article 8.1.c. of Royal Decree 2606/1996, of 20 December in order for the Deposit Guarantee Fund for Credit Establishments to pay the amounts guaranteed by it, 20,000 euros per cash depositor, since Eurobank was in the impossibility to return the monetary deposits to their holders in the immediate future.</p> <p>According to the estimates, of the 12,800 customers who had deposits with the bank, 85% of them were covered by this guarantee<sup>23</sup>.</p>
<b>Length of the proceedings</b>	<p>On-going</p>
<b>Costs</b>	<p>NA</p>

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[https://elpais.com/diario/2003/07/29/economia/1059429611\\_850215.html](https://elpais.com/diario/2003/07/29/economia/1059429611_850215.html)

<sup>23</sup> Source: COMPARECENCIA DEL GOBERNADOR DEL BANCO DE ESPAÑA EN LA COMISIÓN DE ECONOMÍA Y HACIENDA DEL CONGRESO DE LOS DIPUTADOS Madrid, 17 de septiembre de 2003





# **Study on the differences between bank insolvency laws and on their potential harmonisation**

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**Elements of the legislative framework**  
**applicable in the U.S.A.**



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## 1. Introduction and key findings

The purpose of the present document is to provide a general overview of some important characteristics of the US insolvency regime for banks, particularly to highlight elements which may be relevant in connection with the analysis carried out in the main report with respect to a potential reform of the current EU regime.

The analysis provided in this document is therefore focussed on certain aspects of the US framework, and particularly on certain functions and powers assigned to the Federal deposit Insurance corporation (FDIC) in its role of receiver or liquidator of certain banks.

The document is therefore not meant to provide a comprehensive analysis of all the aspects of the applicable legislative regime in the United States. Also, certain concepts and elements of the legal framework may be summarised in non-technical terminology in the following, also to account for the differences in terms of structure and legal concepts between the US legal system and the EU framework.

For context, below some key elements of the legislative framework in place in the US with respect to the management of bank failures, as well as the focus of the present document, are outlined:

- US law establishes a specific legislative framework for the management of the failure of “insured depository institutions” or IDIs. These include all bank and savings associations that hold deposits insured by the FDIC.<sup>1</sup>
- For IDIs, the FDIC operates as supervisor, receiver/liquidator and deposit insurer by protecting deposits held at banks or savings associations up to 250 000 Dollars.
- The focus of this document will be only on the regime for the management of the failure of IDIs, which is regulated mainly by the FDI Act.<sup>2</sup> Therefore in the following the term “banks” can be used as (non-technical) synonym for IDIs
- In case of failure of an IDI, the FDIC is appointed as receiver by a federal or state chartering authority in order to liquidate or wind up its affairs. In principle the FDIC can also operate as conservator of the bank to preserve the going concern value of the institution returning it to health or ultimately

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<sup>1</sup> These de facto include all deposits held at commercial institutions, including checking accounts and savings accounts. For a specific definition of insured deposits please see USC 1813(l) at <https://www.fdic.gov/regulations/laws/rules/1000-400.html>

<sup>2</sup> Other legislative regimes available under US law, such as the Orderly Liquidation Authority established by Title II of the Dodd-Frank Act, are not examined for the purposes of this document.

resulting in a receivership, but this function will not be explored in more detail in the present document.

- When appointed as receiver for an IDI, the FDIC has several measures available to manage the bank's liquidation. In particular, the FDIC assesses the possibility to use a purchase and assumption (P&A) transaction, under which deposits (and possibly also other liabilities) of the bank can be transferred, together with part of its assets, to a purchaser. This measure can be employed (and it is indeed in most cases used) in the context of a bank's liquidation as an alternative to the sale of the assets in a piecemeal fashion. The decision with respect to the most adequate tool is based on the so called "least cost test". The FDIC can also create a bridge bank to manage certain assets and liabilities of the failing IDI, but this tool has been used less frequently so far.
- The FDIC manages the Deposit Insurance Fund (DIF), which is used for the purpose of reimbursing insured depositors as well as a means of financing in case options other than the pay-out of depositors (e.g. P&A transaction) are chosen
- Finally, the FDIC is required to take certain pre-emptive measures (prompt corrective action or PCA), when certain triggers are met, to address a bank that is facing increasing financial distress.

## **2. FDIC receivership – elements of procedure**

The FDI Act provides the following grounds for appointing a receiver for an IDI.

*(A) Assets insufficient for obligations - The institution's assets are less than the institution's obligations to its creditors and others, including members of the institution.*

*(B) Substantial dissipation.—Substantial dissipation of assets or earnings due to—(i) any violation of any statute or regulation; or (ii) any unsafe or unsound practice.*

*(C) Unsafe or unsound conditions. — An unsafe or unsound condition to transact business.*

*(D) Cease and desist orders.— Any wilful violation of a cease-and-desist order which has become final.*

*(E) Concealment.— Any concealment of the institution's books, papers, records, or assets, or any refusal to submit the institution's books, papers, records, or affairs for inspection to any examiner or to any lawful agent of the appropriate Federal banking agency or State bank or supervisor.*

*(F) Inability to meet obligations—The institution is likely to be unable to pay its obligations or meet its depositors' demands in the normal course of business.*

*(G) Losses.— The institution has incurred or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the institution to become adequately capitalized (as defined in section 1831o(b) of this title) without Federal assistance.*

*(H) Violations of law.—Any violation of any law or regulation, or any unsafe or unsound practice or condition that is likely to— (i) cause insolvency or substantial dissipation of assets or earnings; (ii) weaken the institution’s condition; or (iii) otherwise seriously prejudice the interests of the institution’s depositors or the Deposit Insurance Fund.*

*(I) Consent.— The institution, by resolution of its board of directors or its shareholders or members, consents to the appointment.*

*(J) Cessation of insured status.— The institution ceases to be an insured institution.*

*(K) Undercapitalization.—The institution is undercapitalized (as defined in section 1831o(b) of this title), and— (i) has no reasonable prospect of becoming adequately capitalized (as defined in that section); (ii) fails to become adequately capitalized when required to do so under section 1831o(f)(2)(A) of this title; (iii) fails to submit a capital restoration plan acceptable to that agency within the time prescribed under section 1831o(e)(2)(D) of this title; or (iv) materially fails to implement a capital restoration plan submitted and accepted under section 1831o(e)(2) of this title.*

*(L) The institution— (i) is critically undercapitalized, as defined in section 1831o(b) of this title; or (ii) otherwise has substantially insufficient capital<sup>3</sup>.*

According to the above-mentioned rules, the federal bank regulatory agencies are required to appoint a receiver or conservator for the bank within 90 days of the time the bank’s capital-to-assets ratio falls below two percent [12 U.S. Code 1831o(h)]. In other words, if a bank becomes insolvent, or close to it, a receiver must be appointed. The period can be extended until a maximum of 270 days but only with the consent of the FDIC.

A banking agency may appoint a receiver even though the bank may not currently have weak capital if the agency determines that the bank is likely to incur losses that will deplete substantially all of its capital. Outside of capital considerations, a

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<sup>3</sup> 12 U.S.C. 1821 (c)(5) (“FDI Act”).

receiver may be appointed if the bank has wilfully violated a cease and desist order [12 U.S. Code 1821(c)]

In practical terms, the FDIC's role to prepare to place a bank in resolution begins when a bank chartering agency determines that the bank is no longer viable and notifies the FDIC. The FDIC then begins a multistep process generally lasting 90 to 100 days, but which can proceed much more quickly. While technically the FDIC is named receiver at the end of the process<sup>4</sup>—on the day the bank is closed—it begins performing many of the activities one expects of a receiver long before this date.

Before being formally appointed receiver of a troubled bank, the FDIC normally performs an evaluation to establish the value of its assets and liabilities (including the total amount of its insured deposits), determines appropriate options to manage the bank's failure, solicits bids and ultimately determines the strategy it will use to provide the least cost solution. The entire FDIC evaluation process can take up to 60 days. The evaluation typically begins by an FDIC planning team contacting the bank's directors and gathering preliminary information. FDIC specialists then visit the bank to examine the bank's books and records and more carefully determine its condition.

FDIC utilizes valuation models and statistical sampling procedures to estimate the liquidation value of a failing bank's assets. Loans are divided into categories based on the type of loan and further identified as either performing or nonperforming. Each subcategory of loans is given an estimated liquidation value. The estimated value of the bank's assets is used in calculating the loss factor FDIC expects the receivership to incur. FDIC creates a secure website or extranet to which asset and operating information about the failing bank is posted.

Based upon the information gathered, FDIC determines the appropriate resolution structures to offer to potential bidders. An "information package" containing a detailed description of the bank's assets and liabilities is compiled for bidders.

Once the strategy for the FDIC actions has been determined, FDIC begins the process of finding buyers to purchase the failing bank. This part of the process normally takes about 30 days

When a chartering authority closes a bank or thrift and appoints the FDIC as receiver, the first task for the FDIC is to take custody of the failed institution's premises and all its records, loans, and other assets. After taking possession of the premises, the FDIC posts notices to explain the action to the public. It then notifies correspondent banks and other appropriate parties of the closing.

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<sup>4</sup> It should be mentioned that, in certain circumstances, the FDIC can also appoint itself as receiver, when the bank chartering agency failed in doing so.

The FDIC closing staff, working in conjunction with employees of the failed institution, bring all accounts forward to the closing date and post all applicable entries to the general ledger, making sure everything is in balance.

When appointed as receiver, FDIC is considered the legal successor of the insured bank and it has both general and incidental powers. As successor to the institution, the FDIC is authorized to operate the institution and endowed with "*all the powers of the members or shareholders, the directors, and the officers of the institution*"<sup>5</sup> and may collect all the obligations due to the institution, perform its duties, and preserve and conserve its assets. Once the receiver is appointed, there is no mechanism for creditors, management, or shareholders to participate in the decision-making process beyond the filing of claims and the provision of requested information.

In addition to the explicit powers granted to the FDIC as conservator or receiver, the FDI Act contains a provision delegating to FDIC "*such incidental powers as shall be necessary to carry out such [explicit] powers*"<sup>6</sup>.

The legislation allows the depository institution to challenge the FDIC appointment. When the FDIC is appointed as receiver of a depository institution, the depository institution may, not later than 30 days thereafter, bring an action under the applicable procedure for an order requiring the FDIC to be removed as the conservator or receiver, regardless of how such appointment was made.

### **3. Hierarchy of claim**

The FDIA, as amended by the National Depositor Preference Amendment establishes the hierarchy of claims in receivership (12 USC 1821(d)(11)(A)).

This statute establishes the following order of priority, after payment of secured claims (to the extent of the value of the collateral pursuant to an enforceable lien), in an FDIC failed bank receivership:

- The FDIC's administrative expenses as receiver;
- All deposit liabilities (both insured and uninsured);
- Other general unsecured creditors including contract claims;
- Subordinated obligations; and
- Shareholder claims.

The National Depositor Preference Amendment gives a statutory priority to

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<sup>5</sup> 12 USC 1821 (d)(2)

<sup>6</sup> 12 USC 1821 (d)(2)(J).

depositors over other unsecured creditors. Insured depositors are paid in full by the FDIC, which subrogates to their claims<sup>7</sup>. Uninsured depositors and the FDIC share equally (on a pro rata basis) in any recoveries up to the amount of the deposit liabilities.

Excess recoveries are then distributed to general creditors, followed by subordinated claims, and then shareholders (including parent company equity interests).

FDIC has the discretionary authority to treat as “priority claims” certain pre-receivership obligations of the failed bank. These may include certain administrative expenses of the failed bank incurred during the 30 days period prior to the receivership (i.e., fees of attorneys, accountants, property managers providing valuable asset preservation or recovery functions), and certain claims for wages and employee benefits if FDIC finds that they are “*necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the [failed bank]*”.

#### **4. Tools and powers available to the FDIC in receivership**

The FDIC as receiver closes the bank, which effectively terminates the powers of members, shareholders, directors and officers of the failed institution and takes over the assets for liquidation and settles claims through a claims process.

Examples of some of the FDIC powers as receiver include:

- collecting all obligations and money due the failed institution;
- performing all functions of the failed institution to the extent the FDIC considers necessary to exercise its functions as receiver or to maximise value at the least cost for the DIF;
- Liquidating the assets of the failed bank
- Pursuing claims against directors, officers and other parties responsible for the failure of the bank

In carrying out its responsibilities in the management and disposition of assets from insured depository institutions, the FDIC may use the services of private persons, including real estate and loan portfolio asset

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<sup>7</sup> FDIC has a new rule that requires insured deposit institutions with large numbers of deposit accounts to implement information technology and recordkeeping enhancements to improve the FDIC’s ability to pay deposit insurance rapidly and resolve such institutions at the least cost to the Deposit Institutions’ Fund.



management, property management, auction marketing, legal, and brokerage services, only if such services are available in the private sector and the FDIC determines utilization of such services is the most practicable, efficient, and cost effective.

In receivership, the FDIC has the power to assign assets and liabilities (purchase and assumption or P&A), including any contract or lease, to an existing as well as a newly created bank, a bridge bank, or itself, in its corporate capacity. When exercising this power, the FDIC is not required to seek any approval or consent with respect to the assignment or transfer. The FDIC may make the transfer regardless of any state law or contractual limitation that would otherwise prevent the transfer.

The FDCI can structure P&A transactions depending on a number of factors, such as the amount of time available to arrange the transaction, the location and size of the financial institution, the nature of its deposits, and the assets available for sale.

Common types of transactions used in the past include “basic P&As”, where assets that pass to acquirers generally are limited to cash, cash equivalents, and marketable securities with optionally also loan pools offered. The premises of failed institutions (including furniture, fixtures, and equipment) often are offered to acquirers on an optional basis. As for liabilities, the acquirer will usually purchase the portion of the deposit liabilities covered by FDIC insurance, but the scope can extend to all deposits.

Alternatively, the FDIC has in certain occasions opted for a “whole bank P&A”, where all the assets and liabilities are transferred. According to the FDIC,<sup>8</sup> this type of sale is beneficial to the FDIC for three reasons. First, it ensures that the local institution continues serving its existing customers. Second, it minimizes the one-time FDIC cash outlay by having the acquiring institution purchase all assets, with the FDIC having no further financial obligation to it (as these transactions are usually concluded without guarantees). Finally, a whole bank transaction reduces the amount of assets held by the FDIC for liquidation.

As mentioned, the FDIC is also empowered to create bridge banks, which are chartered by the Office of the Controller of the Currency (OCC) and controlled by the FDIC. These act as temporary institutions to which assets and liabilities of the failed institutions are transferred through a P&A. It should be mentioned that this structure of transaction has not been used in many occasions so far, given, among other elements, the potential administrative cost entailed for the FDIC in managing the bridge institution.

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<sup>8</sup> See FDCI resolution handbook at <https://www.fdic.gov/bank/historical/reshandbook/resolutions-handbook.pdf>, page 17

The FDIC action as a receiver also allows for substantial flexibility with respect to the allocation of losses deriving from a P&A transaction. In this respect, the option to structure a transaction with the option of a loss-sharing agreement, whereby the FDIC agrees to cover part of the losses stemming from the transaction, is an important measure to incentivise potential buyers, and can be effectively employed to widen the scope of the transaction.

In choosing the most appropriate type of measure or transaction to manage the bank's resolution, the FDIC must abide to the so-called principle of the "least cost". This entails that, in order to limit the impact on the deposit insurance fund (DIF), the FDIC chooses the measure that is considered least costly to manage the bank's failure.

In carrying out this assessment, the potential available P&A transactions are weighed against each other and against the alternative of a deposit pay-out, which entails that the FDIC repays directly all the insured depositors and assumes the responsibility for the liquidation of all the assets and the repayment of all liabilities of the failed bank. In this context, the FDIC subrogates in the rights of the insured creditors for the amounts disbursed and recovers them from the proceeds of the sale of the assets. As mentioned above, given the general depositor preference in the hierarchy of creditors under US law, the FDIC ranks at same level as other deposit in recovering the amounts paid. The pay-out is chosen if no P&A transaction is feasible (e.g. for absence of interested buyers) or there is no possibility to structure the P&A transaction in a way that makes it economically preferable (i.e. less costly than the pay-out in terms of impact on the DIF).

In order to estimate the loss in receivership, the assets available for distribution are calculated by deducting estimated asset losses and adding any bids received for the failed bank. The FDIC's internal receivership expenses are also deducted from total assets. Total liabilities (claims) of the receivership are then deducted to determine the total loss to the receivership.<sup>9</sup>

While the assessment of the least cost is carried out on a case-by-case basis and must take into account the specific situation of the bank and the potential buyers available, it is safe to say that, in recent practice (particularly in the last few years) the FDIC has consistently chosen P&A transactions as least costly option. For example, out of 489 bank failures managed over the period 2008-2013, 462 were managed with a P&A transaction and only 26 with pay out.<sup>10</sup>

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<sup>9</sup> See the FDIC resolution handbook, page 18

<sup>10</sup> See the FDIC publication "Crisis and Response, 2008 – 2013", at: <https://www.fdic.gov/bank/historical/crisis>. Also, for a comprehensive list of recent cases of bank failure managed by the FDIC, see <https://www.fdic.gov/Bank/individual/failed/banklist.html>.

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