International Banking, Finance and Economic Law Series

International Bank Insolvencies

A Central Bank Perspective

Editors
Mario Giovanoli and Gregor Heinrich

KLUWER LAW INTERNATIONAL

KLUWER LAW INTERNATIONAL

SMU Institute of International Banking and Finance Dallas Texas

Centre for Commercial Law Studies University of London

Institute of International Banking, Finance and Development Law, London

Asian Institute of International Financial Law, University of Hong Kong

International Bank Insolvencies: A Central Bank Perspective

Editors

Mario Giovanoli
General Counsel, BIS,
Professor, Law Faculty, University of Lausanne

Gregor Heinrich
Head of Secretariat,
Committee on Payment and Settlement Systems, BIS

Wolters Kluwer
Law & Business

AUSTIN BOSTON CHICAGO NEW YORK THE NETHERLANDS

Published by
Kluwer Law International Ltd
Sterling House
66 Wilton Road
London SW1V 1DE
United Kingdom

Sold and distributed in
the USA and Canada by
Kluwer Law International
675 Massachusetts Avenue
Cambridge MA 02139
USA

Kluwer Law International incorporates
the publishing programmes of
Graham & Trotman Ltd,
Kluwer Law & Taxation Publishers
and Martinus Nijhoff Publishers

In all other countries, sold and distributed by
Kluwer Law International
PO Box 322
3300 AH Dordrecht
The Netherlands

ISBN 90-411-9728-1
CIP 99-35059

First published 1999

British Library Cataloguing in Publication Data is available

Library of Congress Cataloging-in-Publication Data

International bank insolvencies : a central bank perspective /
editors, Mario Giovanoli, Gregor Heinrich.
p. cm. -- (International banking, finance and economic law :
v. 12)
Includes index.
ISBN 9041197281
1. Bank failures--Law and legislation. 2. Bankruptcy. 3. Banks
and banking. Central. 4. Banks and banking, International--Law and
legislation. I. Giovanoli, Mario. II. Heinrich, Gregor.
III. Series.
K1070.I58 1999
341.7'511--dc21 99-35059
CIP

Typeset in Palatino 10/11 pt by Photoprint Typesetters, Torquay, Devon

Printed and bound by CPI Antony Rowe, Eastbourne

Sponsoring Organisations

Centre for Commercial Law Studies
The Centre was established in 1980 as a distinct department within the Faculty of Laws of Queen Mary and Westfield College, University of London. The primary objectives of the Centre are to promote the systematic study and research of national and international commercial law and its social and economic implications and to develop a body of knowledge, information and skills that can be placed at the service of government, public bodies, overseas institutions, the legal profession, industry and commerce.

SMU Institute of International Banking and Finance
Established within Southern Methodist University, Dallas, Texas in 1982, the Institute serves as an interdisciplinary forum for research, publications, conferences and research seminars in the international finance area, with input from SMU's Law School, Political Science and Economic Departments, and the Edwin L. Cox School of Business. The Institute conducts several major international conferences and is actively involved in economic law reform projects in relation to emerging economies. Finally, the Institute regularly produces books and other scholarly articles and papers.

Asian Institute of International Financial Law
An Institute of the University of Hong Kong Law Faculty, in cooperation with UHK's School of Business and Management and Department of Economics, that is committed to postgraduate programmes, research publications, conferences, short courses, and seminars in the international financial law area, with an emphasis on the East Asian and Greater China areas.

London Institute of International Banking, Finance and Development Law
The London Institute is a privately incorporated educational institution. Among other related functions, the Institute assists the International Financial Tax Law Unit at the Centre for Commercial Law Studies at Queen Mary and Westfield College, University of London, in directing research seminars, professional conferences, executive training sessions, law reform and consulting projects, and major journals and book series. This legal think-tank is also responsible for conducting research and publishing articles and essays on an array of important legal issues concerning banking, finance and development.

1930s when it was thought that the division of risks was helpful, as the following examples illustrate:

(1) The classical concept of currency and money as embodied in banknotes and coins is increasingly questioned: indeed, coins and banknotes are now merely used as pocket money for the economy, while the bulk of monetary aggregates is made up of bank assets, which are subject to credit risk.
(2) Bank assets are often securitized, and the corresponding securities are traded on financial markets. At the same time, securities on the financial markets have been dematerialized, such that they are now mainly recorded as book-entry securities, which resemble bank deposits and notably do not have any tangible physical existence.
(3) Banking and insurance used to be considered as quite separate businesses. Nowadays, more and more banks are involved in the insurance business, sometimes even as the result of mergers with insurance companies, while the latter sometimes also apply for bank licences. This evolution favours the emergence of financial conglomerates devoted to 'all finance'.

A third, less often mentioned, aspect is 'operational or transactional globalization'. The use of financial engineering and of derivatives has made it possible to separate out certain risks which were inherent to classic banking operations, and to incorporate those risks into new financial instruments which are now traded separately. The use of these new instruments in turn fosters the integration and complete interpenetration of the various areas of the markets.

The various causes of this evolution are well documented and go far beyond financial issues. There is indeed an overall worldwide evolution: we are developing into one world and a number of divisions which previously hindered free and speedy communication have disappeared or are disappearing. From the regulatory side, the restrictions between markets (whether geographical or intersectoral) have been lowered, if not eliminated. Furthermore, modern telecommunications facilities, combined with computer technology specifically adapted to mastering complex processes, make it possible to communicate instantly, everywhere and at any time. In short, the frontiers of time and space have been largely surmounted.

What are the effects of these developments for lawyers?

Despite all efforts, there is still a huge discrepancy between this worldwide integration with instant communication 24 hours per day in a global market, on the one hand, and the continuing fragmentation into differing national legal orders, on the other hand. Law still remains nationally based, despite international approaches. If we include the US, there are at least 250 different jurisdictions in the world, that is 250 different, often conflicting, approaches with regard to the procedural and substantive issues which can arise in civil and commercial matters. There are still some 200 different

Preface

*Mario Giovanoli**

When, in 1997, the Legal Service of the Bank for International Settlements (BIS) invited senior central bank lawyers to contribute to a Workshop to be held in the summer of 1998 on international bank insolvencies, the 'Asian crisis' – not to mention the subsequent problems with regard to Latin America – were not yet on people's minds. These crises have shown dramatically how difficulties in the banking sector of some economies, including bank insolvencies, can have repercussions in the global financial world of today.

'Globalization' is not only a catchword, but the result of an evolution over the last two decades, which poses numerous challenges to policy makers, regulators, lawyers and to many others. The phenomenon has a variety of aspects.

First of all, globalization is geographical in nature. In short, markets have grown closer and, although barriers between markets have perhaps not been completely eliminated, they have certainly been significantly lowered. A number of initiatives fostering integration of financial markets have already had far-reaching effects. This has occurred most notably in the European Union and in connection with other regional efforts such as the North American Free Trade Agreement (NAFTA) and MERCOSUR.[1] Note also, at a more general level, the General Agreement on Trade in Services (GATS) under the World Trade Organization, as well as the evolution of domestic regulation with regard to access of foreign banking and financial institutions.

Secondly, barriers have been lowered not only among countries, but also among the various segments which existed in the financial sector. We were used to somewhat artificial distinctions being drawn among the areas, first, of money and currency, secondly, of banks, banking, and banking supervision, thirdly, of financial markets, and, finally, insurance and maybe even other specialized sectors which are related to financial transactions. These were, from a logical point of view, probably never entirely separate sectors, and, in recent years, the traditional divisions and boundaries among them have been progressively blurred, and the barriers have been significantly lowered if not completely removed. The legal delimitations between the segments of the banking system and financial markets have tended to fade; indeed, a number of countries have reversed policies implemented in the

* General Counsel, BIS, and Professor of Law, University of Lausanne, Switzerland.

[1] Mercado Comun del Sur, the Southern Latin America Free Trade Zone, covering Argentina, Brazil, Paraguay and Uruguay.

on insolvency. In the European Union there are ongoing efforts to harmonize banking and bankruptcy laws. Following the Lamfalussy Report (1990)[2] on netting, a number of specific changes were made to bankruptcy legislation, with a view to fostering the safety of financial contracts through specific rules. This raises the question of whether it is necessary and/or desirable for financial institutions and/or financial transactions to be subject to special rules; some would consider this as an undue privilege, while others would consider it indispensable to financial stability.

Furthermore, a number of other international initiatives are presently under way, which may have implications on international bank insolvencies. In particular, the 'G-30' is devoting attention to the regulatory and legal mechanisms needed to deal successfully with a cross-border financial insolvency. One G-22 working group is focusing on mechanisms for 'strengthening national financial systems', including supervision, deposit insurance and bank resolution mechanisms; a second G-22 working group is focusing on international financial crises, including bankruptcy and debt restructuring. The International Monetary Fund (IMF), in cooperation with the BIS and a number of central banks, is currently drafting a Code of Good Practices on Transparency in Monetary and Financial Policies. It should also be mentioned that the European Bank for Reconstruction and Development (EBRD) recently held a workshop on 'Bank failures and bank insolvency law in economies in transition', and that the contributions to that workshop have been published by Kluwer Law International.[3]

Why, therefore, is it also necessary specifically for central bank lawyers to address issues relating to international bank insolvencies? Limiting the study to banks, as opposed to insolvencies in general (as other groups and initiatives have done) is of course because central banks often have ultimate supervisory responsibility for banks. Even where they do not supervise, central banks are often the principal authority for safeguarding monetary stability by fulfilling the 'lender of last resort' function, and consequently have a paramount interest in ensuring the robustness of the banking and financial system as a whole.

This is the background for the Workshop for central bank lawyers organized by the BIS in the summer of 1998. In its capacity as the central banks' bank and as a forum for central bank cooperation, the BIS seemed to be particularly well suited to convene a Workshop on such a topic. This is all the more so as the BIS hosts the Basle Committee on Banking Supervision, which was also invited to contribute to the Workshop. Participants came from some 25 central banks, including the G-10 central banks, as well as a number of other European and overseas member central banks of the BIS and the European Central Bank, which had been inaugurated just a few days before the Workshop.

---

[2] Report of the Committee on Interbank Netting Schemes of the Central Bank of the Group of Ten Countries, Basel, November 1990.

[3] Rosa M. Lastra and Henry N. Schiffman (eds), *Bank Failures and Bank Insolvency Law in Economies in Transition* (Kluwer Law International, London, 1999).

currency zones, despite the recent European integration. Even more importantly, supervisory responsibilities are still entrusted to a plethora of national authorities. This division is not only geographic, but in many countries also sectoral, despite a few instances in which a country has introduced a single supervisor with responsibility for all financial activities. There is furthermore no uniformity in the field of criminal law, even though international criminal activity is increasing and becoming more sophisticated as criminals too use the facilities of the global financial market for their purposes. Finally, rates and methods of taxation, tax legislation and the related procedures vary considerably from country to country.

In short, lawyers are not at the forefront of this evolution, which is being led by economists, statisticians and computer and telecommunications technicians, as well as by other specialists. People seem to assume, sometimes erroneously, that an appropriate legal structure simply exists for the global market. Against this background, it is, however, evident that sound legal infrastructure for financial stability is more crucial than ever for a global market, and that the present gaps and shortcomings in this field must be remedied.

One of the most important issues to be considered in this connection is that of international bank insolvencies. This is of very great interest to bank supervisors, central banks and other financial authorities. International bank failures such as those of BCCI and Barings have shown that monetary and financial authorities, although they do not have direct responsibilities in respect of insolvency procedures, cannot ignore the effects of such procedures. The need for effective and non-conflicting international bankruptcy procedures (indeed, there are significant discrepancies between the approaches adopted in different countries) appears more frequently.

The relationship between the preventive action of supervisors, and the exit policy followed by liquidators, can also raise delicate issues. An illustration of this is provided by the city of Thun, the very place of the Workshop. It was in fact there that the last important Swiss bank failure occurred, and, although relatively small, it was nevertheless one in which depositors incurred losses. The sudden withdrawal of the banking licence for supervisory reasons triggered the liquidation of the bank. Some creditors claimed that the supervisors had acted prematurely and that, but for the supervisors' intervention, the bank could still have continued operating. On this basis, the creditors argued that the supervisors were liable for the losses suffered by the creditors. This example shows how the topics of prudential supervision, liquidation, the potential liability of financial authorities and deposit guarantee schemes are linked and form a vast cluster of interrelated topics which need to be addressed globally.

In addition to cooperation and coordination among the various domestic authorities involved, international cooperation too is extremely important. Indeed, as a result of the globalization of financial markets, most insolvencies now comprise international elements. At this level, there have been a number of international efforts to establish a degree of compatibility and harmonization. For instance, the United Nations Commission on International Trade Law (UNCITRAL) is promoting an international convention

In anticipation of the Workshop, the BIS had prepared a questionnaire which was sent to the prospective participants. The first part of the questionnaire was devoted to identifying the various authorities involved in monitoring the financial stability of banking institutions, and in coordinating among the various authorities potentially involved in a bank failure and bankruptcy procedures. The second part looked at the instruments used for crisis prevention and for crisis resolution. The third part dealt with issues arising after a bank failure has occurred. In response to the questionnaire, participants drafted country reports relating to the situation in their respective countries. The reports form Part I of this book.

A number of presentations were made at the Workshop, partly by external experts. In particular, Mr E. Patrikis gave the keynote presentation, for which he was particularly qualified as he had been involved – in his former capacity as General Counsel and Executive Vice-President of the Federal Reserve Bank of New York – in drafting the Lamfalussy report and in studying particularly the legal aspects of the BCCI failure, including the international aspects of insolvency law. The other external experts who made presentations were Mr Sekolec, Senior Legal Officer at the United Nations Commission on International Trade Law (UNCITRAL), who is responsible for UNCITRAL's work on the Convention for Cross-Border Insolvencies, Professor Kanda, a prominent Japanese academic in this field, and Ms Mills, who is a partner with Ernst & Young and who was one of the receivers in the Barings insolvency proceedings. These presentations are included in Part II of the book. Note that, in the country reports and in the papers presented at the Workshop, the authors express their personal views, which do not commit either the BIS, any committee of experts meeting at the BIS or the respective institutions of the authors.

Acknowledgements

We are grateful to the management of the BIS for supporting this Workshop. The success of this initiative nevertheless owes very much to the work carried out by all the participants in drafting the individual country reports, and by the very skilful lecturers who made presentations. Thanks also are due notably to Paul Skinner, a former translator of the BIS, for expert editorial assistance, to Shona Eggimann, a secretary in the BIS Legal Service, for invaluable assistance in organizing the Workshop, as well as to Kathie Jackson, a secretary in the BIS Legal Service, and to Corinne Poggioli and her staff at the Secretarial Services of the BIS, for formatting the texts and for the numerous hours spent incorporating last-minute changes to the manuscript.

PRIVY COUNCIL

UNITED KINGDOM

UNITED STATES

Table of Cases

AUSTRALIA

CANADA

EUROPEAN COURT OF JUSTICE

INDIA

JAPAN

NETHERLANDS

BRAZIL

CANADA

FRANCE

GERMANY

HONG KONG