Deposit Insurance and Bank Insolvency in a Changing World: Synergies and Challenges

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International Monetary Fund Conference
May 28, 2004

Today business and finance indisputably are global. The financial and capital markets are more globally integrated and move much more rapidly in response to events. As a result, many financial institutions and activities that once were local are now international. The changes in the international financial system have been driven by deregulation, by improvements in communications, by technological changes that have increased the speed and volume of transactions enormously, and by widespread innovation in markets, organizational structures, services and instruments.[2] Often overlooked in the debate over globalization, however, is that smaller businesses and financial institutions participate in global trade and finance on an unprecedented scale. The interactions of businesses at all levels of the markets for goods, services, and financial assets affect the prices for goods, cost of capital, availability of credit, value of businesses, and economic efficiency of all countries.

While business and finance are global most regulatory systems and laws are not. There are few international rules and norms to govern the linkages between financial institutions, payments systems, and markets. This is particularly true in banking and financial services. National laws define the relationships between domestic banks and between internationally-active banks and other financial institutions. One crucial process that is almost exclusively governed by national law is the resolution of insolvent banks.

Effective insolvency rules, and the commercial infrastructure which they presuppose, are central to developing and maintaining the confidence of domestic, as well as foreign, businesses and investors. In some cases, national insolvency laws may not provide certainty to creditors or investors even in local insolvencies. In other cases, the laws may not be up to the task of coping with instability in the most important financial institutions.[3] In systems with deposit insurance, an effective insolvency system is vital to control risk-taking and to ensure that financial assets remain productive. As a result, improving the effectiveness and efficiency of national insolvency systems is a crucial component of strengthening national and international financial systems. This paper will review some of the developing standards for effective insolvency systems and offer examples from the U.S. system of specific laws reflecting these standards.

In today's global economy, even effective national insolvency laws cannot fully address the failure of an internationally-active financial institution. Unfortunately, there are few internationally-recognized insolvency rules. The absence of international rules and norms would not be overly troublesome if national insolvency laws were not inconsistent between countries. Differences in the treatment of secured creditors, rights to set-off and net, finality of transactions, and philosophical approaches to debtor-creditor relationships all increase the difficulties of responding to instability in larger, more complex banks with international operations. These inconsistencies are most important when they create uncertainty among other market participants and impair the ability of regulators and insolvency authorities to limit disruptions in key linkages between international financial firms. In this context, national laws and the few international rules may not fulfill the insolvency goals of reducing uncertainty, promoting efficiency, or providing equitable treatment to creditors. The second part of this paper will review some of the current international rules and norms, and offer suggestions for future work.

These related issues suggest that efforts to strengthen insolvency laws and the international financial system should focus both on bolstering national insolvency laws and on enhancing the ability to respond to insolvencies affecting the cross-border linkages between financial institutions, payments systems, and markets. In recent years, regulators and bankers have undertaken significant steps to strengthen national regulatory and insolvency systems as well as these critical links. Many international groups – such as the Bank for International Settlements, the IMF, the Group of Thirty, the World Bank, the Financial Stability Forum, and others – have worked to improve cooperation and to better understand the processes through which crises arise and are resolved. Cooperation and coordination efforts by regulators have increased, both across sectors and across national boundaries. Further progress on these issues is fundamental to long-term economic stability.

I. Insolvency Principles

General Goals of Insolvency Laws. Recent analyses have identified a number of generally accepted principles for effective resolution of problem financial institutions. These principles are based on the normally complementary, but sometimes competing, goals of maximizing the value of the estate for the benefit of all creditors within an equitable, transparent, and predictable process while minimizing the cost of the resolution.[4] These goals follow from the function that insolvency rules fulfill in the national economic life – returning financial assets to productive uses by mediating claims against insolvent companies or individuals. More broadly, these goals can be divided into three complementary components: reduction of legal and financial uncertainty, promotion of efficiency, and provision of fair and equitable treatment.[5]

Achieving these goals requires an effective and efficient legal and institutional infrastructure. The ability of any nation to provide greater certainty, efficiency, and fairness in an insolvency depends upon the environment provided by its laws, culture, markets, the availability of trained professionals (such as bankers, supervisors, lawyers, accountants, and others), governmental competence, and economic depth. For example, a functioning insolvency system must have well-designed insolvency laws, but it also must have laws that provide a basis for commercial activity, grant creditor and debtor rights, and otherwise promote predictable commercial outcomes. Beyond legal issues, the maturity of market mechanisms in a country will determine whether certain insolvency processes, such as auctions, bulk asset sales or others, will be effective and maximize value by accessing a large enough pool of potential buyers. Such processes will also be affected by the reliability and transparency of prices and financial data, which themselves are dependent on the legal infrastructure and the presence of a trained cadre of financial and legal professionals. This does not mean, however, that all of these elements must, or should, exist to permit an effective insolvency system. It does indicate that the more a nation moves toward these mutually interdependent features, the more likely that its insolvency system will be successful in providing certainty, efficiency, and equitable resolutions.[6]

Banking Insolvencies. Insolvencies of banks and similar financial firms create additional problems. Due to the short-term liquidity of most banks' primary liabilities, banks are uniquely dependent on public trust for funding.[7] The largest banks have substituted the reliance on deposits for funding with market instruments. However, this simply has substituted reliance on depositor trust for reliance on market trust and, indeed, may have increased the risk of a liquidity collapse through a "market run." In short, a weakening large bank relying on the market for funding could find itself effectively excluded from the market by the increased costs of collateral and spreads. As commentators have noted, the resulting "market run" as counterparties liquidate contracts and impose additional costs on the weakening bank could increase the speed of its collapse.[8] It is a truism that the less time available for planning a resolution of a failing bank, the greater the potential losses and disruption. In such cases, the loss of confidence in one bank can have dire implications for confidence in the overall banking system.[9]

Another truism is that deposit insurance is designed, in part, to maintain public confidence in the banking system during times of institution-specific or broader systemic stress by reassuring depositors that their funds, or at least the insured maximum, will be protected even if their bank is closed. Deposit insurance thus exchanges the preexisting dynamic of depositor and market discipline, in part, for a regulatory buffer along with regulatory oversight. While insured banks remain reliant on public trust, that trust is supported, and perhaps supplanted to a degree, by public trust in the efficacy and reliability of the governmental promise of payment in an insolvency. Unless the supervisors are vigilant and disciplined this substitution can allow weak and even insolvent banks to remain active and drain economic capital from more productive uses. An effective and fair insolvency system that quickly returns funds to depositors and retains credit in the market can ameliorate this bank-specific and external consequence. Deposit insurance without an effective insolvency system – that the supervisors use – can enhance moral hazard and impair economic efficiency. On the other hand, if the deposit insurer does not or cannot, fulfill the promise of payment within an acceptable time the short-term liability problem inherent in deposit-based banking will create recurring crises as depositor confidence ebbs and flows. Ultimately, the breach of this promise of payment will drain liquidity and resources from the financial system and reduce economic activity. Once again, the reduction of uncertainty is as important to deposit-based institutions as it is to market-based institutions.[10]

Whether dealing with a smaller, deposit-based bank or a larger, more market-based bank, the goals of an insolvency process must focus on promptly returning insured funds to depositors, maintaining critical bank functions, and ensuring public confidence in the equity of the resolution process. Speed is a fundamental element in an effective bank insolvency process. Returning cash to insured depositors quickly is as important as assurance of payment. Speed in taking over and continuing failing bank functions – whether payments processing, credit, or capital markets settling – limits the loss of value in the bank's assets, halts a potentially dangerous spread of settlement failures, and reduces the contagious loss of confidence in other banks.[11] However, speed must be matched by equity. Predictability and reliability of the process are essential if public and business confidence is to be maintained in the banking system.

Components of Effective Bank Insolvency Laws. As noted by many international organizations and commentators, there are some common components of effective bank insolvency laws.[12] First, the overall legal infrastructure of the country must support the insolvency system. An important component of this legal infrastructure is effective and predictable commercial legal rules. A well-developed commercial law is a crucial prerequisite to functioning markets for goods, services and financial assets as well as a reliable business climate. An essential analog to the commercial law is an effective legal and institutional system for enforcing contracts and collateral foreclosure. Similarly, the legal infrastructure should support and enforce financial transparency, effective regulation, the rule of law, and provide independent courts and well-trained professionals. This legal infrastructure provides some of the preconditions for efficient markets and commercial stability – both of which are important if the society is to be successful in recycling financial assets from insolvent companies.

Second, the laws must have clear criteria for initiating insolvency proceedings. This is particularly crucial in banking insolvencies where otherwise insolvent banks may be able to continue indefinitely by raising funds from depositors and act as a drag or diversion of economic capital. Clear, mandatory criteria permit prompt and decisive action before the bank's equity is exhausted. The criteria should be mandatory to require supervisory action as capital or other indicia of institutional soundness erode. In effect, mandatory action requirements create the supervisory discipline that augments market discipline.

Third, the insolvency laws should provide that when a trustee or receiver is appointed it has immediate power to control, manage, marshal, and dispose of the bank's assets and liabilities. Many difficulties in resolving individual insolvencies, and in addressing broader instability, have been exacerbated by the inability of trustees or receivers to take prompt action while waiting for review or other preliminary action. If the public goal is preservation of funds and assets for repaying depositors, then a receiver needs flexibility and the ability to act quickly to maximize recoveries.

Next, the insolvency laws should confer adequate legal powers on the receiver that are sufficient to permit flexible and decisive action to maximize recoveries on assets and minimize delays in providing money back to depositors. These legal powers should include independence from undue interference by other governmental bodies, the ability to terminate contracts, the power to enforce contracts, the authority to sell assets, the right to avoid fraudulent or unauthorized transfers, and broad flexibility to design resolution and asset sales structures to achieve the goals of the resolution. A sometimes overlooked additional "power" that can be critical to encourage timely action to close a failing bank and to efficiently resolve it is immunity or indemnification for receivership or regulatory employees acting within the scope of their duties. Personal liability for lawsuits can bring regulatory and receivership action to a halt. Of course, the receivership or organizational entity should remain subject to suit to provide redress for real injuries.

Fifth, the insolvency laws should provide a transparent process for determination of claims against insolvent bank. This will enhance public confidence in the process as well as providing mechanisms for the bank receiver to define the universe of claims pending against the failed bank. While often overlooked, the power to gather and define the claims against the assets of an insolvent institution is as important as the power to exercise ownership over those assets. As a result, well-defined time frames for filing claims after notice to potential claimants and rules barring late claims are important to allow the receiver to assess the return available to creditors. Related to this element are provisions designed to enhance the overall equity of the resolution process. For example, if some creditors receive preferential protection – or if some institutions receive preferential protection that extends to their equity holders – while depositors or other creditors at other institutions incur greater losses, it will damage public confidence. The FDIC has, at times, been criticized for not providing equitable treatment across all receiverships – principally during the 1980s when some failing institutions received "open bank assistance" to avoid insolvency before enactment of the "least cost" requirement. An often cited example was Continental Illinois in 1984.[13]

Finally, this process should be designed to reimburse depositors up to the insured maximum as soon as possible, while minimizing the cost to the deposit insurance fund. While depositor confidence in the guarantee is based on the certainty of repayment, it is equally based on the speed of repayment. Unless depositors are confident that their funds will be available quickly, the risk of deposit runs on even solvent banks remains. A related part of the process must be an obligation to minimize the costs of the insolvency process. Even in a system without a deposit insurance fund, this requirement can be an important brake on the tendency to use an insolvency process to avoid recognition of losses through some broad or blanket guarantee. In some cases, the "easy" route of a blanket guarantee to mask infrastructural inadequacies and difficult policy choices has weakened the ability of the insolvency system to return assets to more productive uses and has undercut the credit culture of the financial system. A more limited guarantee, combined with explicit requirements to minimize losses in the resolution, promotes a well-funded insurance system as well as limiting the moral hazard that can be engendered in a deposit insurance system. A well-funded insurance system also provides the ready cash for quicker payment of insured deposits. Insolvencies and an equitable sharing of losses are valuable reminders that business, even banking, has risks and that creditors as well as supervisors must monitor the riskiness of the banks with which they do business.

While these insolvency principles are broadly applicable, the key elements of an effective insolvency system must be adjusted to conform to the existing financial, legal, institutional, and cultural conditions of the individual country. It would be the height of hubris, and folly, to suggest that the laws of one country should be rigidly applied in all other countries. While hopefully reflecting consistent and effective principles, laws must be adapted to respond to changed conditions or even the best legal rules will become ineffective. Moreover, even if the laws of one country could ever be said to have created a harmonious system of effective and complementary rules, those laws are inherently a product of that country's conditions. If those legal rules are inserted into another structural, financial and economic environment, it is very unlikely that the rules would continue to be effective.

This is not to undercut the importance of recommended principles and laws. However, in applying those principles it is essential that they be implemented in a way that achieves the desired results in <u>that</u> country's environment.[14] For example, the virtually immediate access to insured deposits available following insured bank or thrift failures in the United States is only possible within a context of specific laws, effective supervision, reliable asset values, standard accounting procedures, and other related conditions. While a country will benefit greatly from improved public confidence and a reduced likelihood of bank runs if it can achieve a similar quick return of cash to insured depositors, it is unlikely to meet this goal without an infrastructure – beyond the insolvency law – that provides the foundation for expeditious resolutions.

Under U.S. law, insured bank and thrift resolutions are handled through a separate body of law principally found in the Federal Deposit Insurance Act, 12 U.S.C. §§ 1821 – 1825. By contrast, non-bank corporate insolvencies are addressed by the U.S. Bankruptcy Code, 11 U.S.C. §§ 101 – 1338. These different insolvency systems have many common features designed to systematize the management of the insolvency process and achieve an equitable disposition of the proceeds from the assets of the insolvent entity to its creditors. However, these systems also have significant differences that reflect the divergent policies that each seeks to achieve and the different characteristics of the entities they are responsible for resolving.

Elements of the U.S. Bank Insolvency Laws. Some of the key elements of a national insolvency system of laws for banking insolvencies can be illustrated by the American laws governing failing banks and thrifts.

<u>Clear Criteria for Initiating Insolvency Proceedings.</u> The Federal Deposit Insurance Act contains a number of grounds for the closing of an insured bank or thrift. Those include capital-based as well as liquidity, illegality, and other soundness criteria.[15] The most explicit and most used basis for closing U.S. banks and thrifts is the capital-based grounds under "prompt corrective action" (PCA). Adopted in 1991 as part of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), PCA prescribes mandatory measures for undercapitalized institutions.[16] As an institution's capital declines additional supervisory controls may be imposed in an effort to stem the erosion of its capital position. However, once an institution's tangible capital is equal to or less than 2 percent of total assets, it is defined as "critically undercapitalized." Once the institution is defined as "critically undercapitalized, a conservator or receiver must be appointed within 90 days unless the institution can improve its capital ratio or the period

is extended. The appropriate federal regulatory authority can grant up to two 90-day extensions of the PCA period if it determines that those extensions would better protect the relevant insurance fund from long-term losses. A firm cut-off point, such as prompt corrective action, along with a role for the deposit insurer promotes effective resolutions and also provides a prod for enhanced efforts by management to recapitalize or correct problems to save a weakened bank.

A firm deadline for closing a failing institution also facilitates a critical element in the FDIC's ability to return funds to depositors virtually overnight in most cases. That element is the opportunity to develop detailed information about a failing bank or thrift during the 90-day period between a notice that the bank is critically undercapitalized and the PCA deadline. Through close cooperation with the primary chartering authority or regulator (such as the state banking authority, the Office of the Comptroller of the Currency (for national banks), the Office of Thrift Supervision (for federal thrifts) and the Federal Reserve) and the FDIC's own supervision department, the resolution staff can access financial information, share that information with potential bidding institutions under a confidentiality agreement, solicit bids, and select a successful bidder before the institution closes. U.S. regulators have learned that it is essential to have early access to reliable information. This allows the regulator to select and design more suitable failed bank resolution and asset disposition structures. Reliable information also serves to attract more potential purchasers and to reduce resolution costs by minimizing the "risk premium" required by potential investors.

<u>Immediate vesting of full control/ownership of assets and liabilities in the independent insolvency authority.</u> Under the FDI Act, the FDIC has complete power over the assets and liabilities of the failed bank or thrift as soon as the FDIC is appointed as receiver.[17] This power allows the receiver for a failed bank to arrange an immediate sale of assets and transfer of insured deposits to another bank. Such immediate sales limit the impact of the failure on depositors, borrowers, and economic activity. In addition, the FDIC has found the prompt resolution and sale of assets reduces the losses to the deposit insurance funds.[18]

Since the receiver for a failed bank is immediately vested with full ownership over the assets, it can complete a sale as part of the initial resolution or shortly afterward without awaiting court, creditor, or shareholder approval. This is an important power and facilitates greater reliance on market-based valuations and sales techniques. Today, the FDIC uses technology to make failing bank asset information available to potential purchasers through CDs and secure internet sites.

<u>Effective and Flexible Legal Powers.</u> The FDIC, when acting as conservator or receiver for a failing bank or thrift, has been granted broad legal powers that help achieve quick resolution of failures by limiting shareholder participation, controlling assets and claims, and promoting decisive action. The policy goal underlying these powers is to provide the bank receiver with flexibility in maximizing recoveries to the benefit of the bank's creditors and the deposit insurance funds. Statutory flexibility may be crucial to

adapt to changing circumstances in insolvencies. A brief discussion of these powers will highlight the policy choices that have been made in the United States.

The FDIC's receivership powers reflect a policy choice that limiting losses to the deposit insurance funds and depositors is more important than protecting equity holders or other creditors. First, the FDIC as receiver cannot be ordered to take or refrain from taking specific action by a court or any other governmental agency.[19] The receiver is not immune from court action, but any remedy is limited to money damages. An important component of the resulting freedom of action is that FDIC employees generally are not personally liable for the actions of the receiver. Any claims for damages normally are limited to actions against the receivership or the FDIC. This legal independence is crucial to allow quick sales of assets by preventing shareholders or other parties from halting receivership activities. Second, agreements with the failed bank are unenforceable unless they comply with statutory requirements mandating that written documentation be contained in the bank's records and approved by senior management of the bank.[20] Thus, any unwritten side agreements affecting the bank's assets are unenforceable. Third, claims against the bank are limited to those that existed at the time the bank failed. As a result, claims based on future events are barred.[21] Fourth, the receiver has the common law and statutory power to repudiate or disaffirm contracts that may be burdensome.[22] Finally, although in contrast to U.S. Bankruptcy Code proceedings, there is no automatic stay upon appointment of a receiver for a failed bank, some provisions, in effect, impose a moratorium on adverse action by creditors or debtors after appointment of the FDIC as a conservator or a receiver. For example, a contract party cannot terminate, accelerate, declare in default, or exercise any other contract rights based upon the insolvency or the appointment of a conservator or receiver.[23] This provision allows the receiver to enforce contracts that may be necessary or valuable to the receivership. However, termination and netting rights under certain types of financial contracts, such as swaps and similar agreements, can be exercised.[24] In addition, if a lawsuit is pending against the failing bank when a conservator or receiver is appointed, the other party cannot proceed with the lawsuit until after it exhausts a statutory receivership claims process.[25] This permits the receiver to stay lawsuits and bar new lawsuits until an administrative claims process is completed.

<u>Equitable Process for Determining Claims.</u> An essential part of effective government is maintenance of public confidence in the fairness of government. Effective insolvency laws must include a fair process to determine claims. In the U.S. system, the receivership claims process offers the receiver an opportunity to determine claims against the failed bank or thrift and, if dissatisfied with the result, it offers the claimant unfettered access to the courts. The receivership process includes well-defined time frames for notice to potential claimants and for filing claims (which if violated bar the claim), for decisions on claims, and for notification to claimants of a decision. The statutory procedures also specify the time period within which a claimant must file a court action to pursue the claim before an independent tribunal. As noted above, this also applies to claims pending in court before the bank or thrift was closed. Those pre-existing lawsuits must be stayed until the receivership process is completed.[26]

<u>Prompt Payment to Depositors While Minimizing Costs.</u> In addition to these statutory powers, several factors affect the ability of a deposit insurer to make prompt payment to depositors. These include adequate funding, the availability of accurate and complete information for pre-planning, and transparency of financial records.[27]

In the U.S., Funding for payment of depositors is provided through deposit insurance funds managed by the FDIC and maintained through risk-based assessments on open depository institutions.[28] The resilience of the deposit insurance funds is supported by a national statutory priority for depositors and by the "least costly" test. Once it provides protection for insured depositors in a failed institution, the deposit insurance funds become subrogated to claims of the insured depositors and recover along with uninsured depositors through depositor preference.[29] As noted above, a fundamental part of prompt payment of depositors is the ability offered by the PCA standards to obtain, use, and share confidential information about a failing bank or thrift in advance of its closure. Laws that too tightly restrict access to such information in some countries, under bank secrecy or privacy laws, can seriously impair the ability to quickly return funds to insured depositors. Financial transparency and the ability to rely on accounting and banking records are necessary for depositor protection. In the U.S., bank examinations and audit standards support oversight of bank accounting and help identify troubled institutions. It is no coincidence that the biggest proportionate losses to the deposit insurance funds have occurred when financial transparency did not exist. In its absence, depositor protection and the efficient sale of banking assets that supports it will be seriously compromised.

A final component of the American system for resolving failing banks and thrifts is the requirement that, absent a systemic crisis, the FDIC must choose the resolution structure that is "least costly" to the deposit insurance funds "of all possible methods."[30] U.S. law also prohibits using the insurance funds in a fashion that benefits shareholders. While this requirement clearly limits the flexibility accorded to the FDIC, it serves as a control on expenditure of deposit insurance funds and delays in recognition of losses on non-performing assets. This requirement also prevents reliance on blanket guarantees or other resolutions that protect uninsured depositors or other creditors. Prior to 1991, the U.S. used a less stringent control on losses which required only that the resolution method be "less costly" than a liquidation and direct payment of insured depositor claims. The "least costly" requirement reflects the U.S. policy choice to control costs and protect the viability of the pre-funded deposit insurance funds.

The U.S. system also includes a provision permitting an exception to the "least costly" requirement only if the "least costly" resolution "would have serious adverse effects on economic conditions or financial stability" and an alternative resolution "would avoid or mitigate such adverse effects." The determination that the "least costly" resolution would have such consequences must be made by the Secretary of the Treasury, in consultation with the President, upon the recommendation of two-thirds votes of the FDIC Board of Directors and the Board of Governors of the Federal Reserve System. This is commonly referred to as a systemic risk determination.[31] The restrictions on this exception to the "least costly" requirement highlight the American policy to avoid "moral hazard" and protect the deposit insurance funds against additional expenditures.

In the U.S., these laws were implemented over an extended period of time, but were responses to specific periods of banking crises – principally the Great Depression and the banking and thrift crisis of the late 1980s and early 1990s. Many of the most recent and important changes to bank insolvency laws have never been tested during a banking crisis because they were adopted as the last U.S. banking crisis began to ebb. For example, prompt corrective action and the "least costly" requirement were adopted in 1991 – after the frequency of failures had begun to decline. While these are undoubtedly important innovations that have worked well during the intervening years, they have not been tested during a crisis. National laws must adapt to changed circumstances and, it must be presumed, that U.S. laws may be modified in the future to further improve their effectiveness in achieving the goals of the bank insolvency system. Nonetheless, the current provisions incorporate key elements recommended for effective insolvency legal systems.

II. Current International Insolvency Structures

Effective national insolvency laws are a fundamental element in addressing cross-border insolvencies. Effective national laws are not enough. However, there are few standard international rules to govern the failure of financial firms and banks and current national rules create a significant potential for conflicts.[32] The few international rules that exist tend to address insolvency rules within defined geographical or economic relationships, such as the European Union's Insolvency Regulation.[33] Even these few rules address primarily judicial and regulatory cooperation and not the substance of the law governing an insolvency. While this state of international insolvency law is appropriate for addressing stable "hard" assets and enterprises, it may not provide the combination of certainty and flexibility necessary to avoid possible contagion effects in rapidly changing markets and payments processes.

One of the most vital issues in the insolvency of an internationally-active financial firm is to avoid disruption in key interbank linkages, such as the settlement of obligations, capital markets, clearing and settlement systems, and correspondent banking services.[34] A significant complicating factor is that the national legal rules and policy choices that govern the resolution of international financial institutions may conflict and, at a minimum, may preclude effective action at the time of insolvency. There are several interrelated issues. First, there is no international insolvency standard for banks or other financial institutions. While it may be appropriate that different nations – with different economic and cultural histories – have adopted varying laws and policy choices to govern domestic financial insolvencies, it is essential that the basic legal mechanisms applicable to key international linkages permit effective action to mitigate contagion effects around the globe. Second, current laws around the globe do not adequately address the complexities created by international holding company structures. These complex structures certainly create difficulties in regulatory coordination under normal conditions. During a period of financial instability, the differing regulatory jurisdictions within a nation and between nations create even more difficult challenges in pre-failure coordination. International supervisors are taking steps to improve understanding and coordination before insolvency. However, if insolvency occurs, the different legal rules and policies that apply to banking, insurance, and securities components of a holding company structure could impair the ability to respond effectively to prevent cross-border crises. Current insolvency laws may not provide the level of flexibility available to regulators once the actual insolvency occurs. Third, in a world of 24/7 financial operations and markets, the many legal rules that are based on the pace of the 19th or even 20th century may not be up to the task. It is essential that insolvency rules give decision-makers the flexibility and authority to take action in "real time" to avoid compounding the effect of a single large insolvency through the linkages between markets and payments systems.

What sources exist today for rules to govern a cross-border insolvency? These can be grouped into 1) national law, 2) multinational agreements to facilitate international cooperation, 3) private international norms, 4) the UNCITRAL Model Law, and 5) the European Union approach. All of these initiatives seek to provide a basis for cooperation in legal insolvency proceedings. These initiatives enhance the ability of insolvency authorities to cooperate and coordinate their actions.[35] This cooperation and coordination may be vital to limit disruption in a crisis. However, most do not address the substantive rules that govern the payments systems and other key links.

National Law. The foundation of international insolvency law remains national law. Each country has developed general insolvency laws to deal with the failure of most enterprises. Countries also have developed either special provisions within the general insolvency law to deal with special types of debtors, such as banks, or special insolvency legal systems to deal with those special debtors. In all of these cases, however, the operative substantive and, for most issues, procedural law is the law within one country.

To the extent that national laws address how to deal with debtors, creditors, assets and liabilities outside the national boundaries, these laws adopt one of two basic positions: territorialism or universalism. Different laws, of course, may adopt any number of permutations of these positions, but the basic premises of those laws remains either focused on resolving the insolvency within a single nation or on resolving the entirety of the insolvency on an international basis. Under a territorial approach each country adjudicates claims against the assets within its borders for the benefit of creditors of the insolvent local firm with little or no regard for foreign proceedings. This approach focuses on the primacy of national law within the territory of the country. The law where the assets are found thus controls their distribution. A universal approach, on the other hand, allows a single jurisdiction to adjudicate the worldwide claims against the debtor and its worldwide assets with the cooperation of courts or other authorities in each affected country. This approach effectively applies national law to all worldwide assets and claims. Typically the claim to jurisdiction is based on the focus or center of the firm's operations residing in that jurisdiction and acquiescence in the fairness of the proceedings by other courts.[36] The universal approach can achieve an equitable distribution of the proceeds from the failed firm's assets to all worldwide creditors.

Most nations currently apply a territorial approach to cross-border insolvencies. This simply is a consequence of the domestic focus of most insolvency laws. To the extent that national insolvency laws address cross-border issues, most nations permit cooperation with foreign insolvency authorities within constraints imposed by the national insolvency policies. National insolvency laws typically address recognition of foreign proceedings, recognition of foreign representatives, and the participation of foreign creditors in domestic proceedings. National insolvency laws vary considerably in how they deal with these "relationship" issues, and equally in how they treat different classes of creditors.[37]

Cooperation between national insolvency authorities under national law typically works reasonably well. To the extent that the separate national substantive provisions create inequities, those normally have limited effects on other businesses. However, if those separate substantive rules prevent settlements or impair market functioning for a major internationally-active financial firm, these statutory inconsistencies could increase the risks of transnational contagion. Harmonization of national insolvency laws may not be required to avoid this risk. Indeed, both territoriality and universality are based on sound policy grounds. However, it may be vital in a crisis for nations and the international community to have the statutory and structural infrastructure to permit flexible and timely action to prevent or ameliorate disruption in the key linkages between markets and transnational financial institutions.

What, then, are some of the current multinational avenues to limit disruption?

Multinational Agreements. Some older efforts to address cross-border insolvency issues within treaties or multinational conventions represented advances in cooperation, but were limited in their geographic and substantive scope. The Convention on Private International Law, more commonly referred to as the Havana Convention, is a 1928 agreement between a number of Central and South American nations to deal with the cross-border effects of insolvencies. The Havana Convention provides for separate and parallel insolvency proceedings where the debtor has more than one business location. On the other hand, where the debtor is located in a single nation the Convention authorizes broad powers for that nation's authorities to collect assets, manage operations, and enforce judgments in the territories of the other signatory countries. While the Havana Convention still leaves many judicial cooperation and substantive law issues unresolved, it was a major change from the pure territoriality of national laws. Another example is the Convention Regarding Bankruptcy, commonly known as the Nordic Convention. In this 1933 agreement, the five Nordic countries focused on the principle of providing extraterritorial effect to judgments by the home country court. As a result, the judgment of a Norwegian home country court on assets in Iceland must be given effect in Iceland on key issues, such as the priorities for distribution of assets. However, there are limits to the extraterritorial effect of the home country courts. For example, collection on claims in other countries under the Nordic Convention is based on the law where the asset is located, not the home country's law. Both the Havana Convention and the Nordic Convention represent one option for addressing the conflict between national laws within geographic limitations.[38]

Private International Norms. Recently, there have been several private efforts to improve cooperation in cross-border insolvencies. First, private groups have developed non-statutory principles to govern international insolvency issues. The two principal examples are the Cross-Border Insolvency Concordat, which was approved by the Council of the Section on Business Law of the International Bar Association (IBA) in September 1995 (the Cross-Border Insolvency Concordat) and the American Law Institute's Principles of Cooperation in Transnational Insolvency Cases Among the Members of the North American Free Trade Agreement ("ALI Principles"). Both the IBA's Cross-Border Insolvency Concordat and the ALI Principles seek to establish norms to harmonize separate national insolvency proceedings involving an internationally-active debtor. These norms do not propose changes to national laws.

The IBA's Cross-Border Insolvency Concordat includes general principles to define the interaction between lawyers and national authorities. The principles, rather than defining the parameters of the insolvency, seek to serve as a road map for insolvency attorneys and courts that could be implemented by judicial decision or the agreement of creditors' groups.[39] The principles include coordination of all insolvency proceedings for a cross-border insolvency in a single forum, the right of creditors and administrators in other forums to appear in any relevant forum, distribution of assets in all forums pro rata among creditors of the same class, and substantive rules should be applied based on the applicability of that substantive law to the parties or assets involved.[40] The principles attempt to ease the effects of the inconsistencies between national laws through comity between authorities while recognizing the continued application of national law.

Like the Cross-Border Insolvency Concordat, the ALI Principles are a private-sector initiative to develop principles and mechanisms to enhance cooperation for multinational bankruptcy cases. The ALI Principles focus specifically on cross-border insolvencies within the area subject to the North American Free Trade Agreement ("NAFTA"). This initiative created an accepted statement of the insolvency laws of the three NAFTA countries, Canada, Mexico, and the United States and, using this as a basis, developed seven principles – to be implemented by the parties to insolvency cases, courts, and trustees – to achieve timely communication and cooperation.[41] Those principles are 1) cooperation; 2) recognition of proceedings and administrators in other NAFTA countries; 3) implementation of a stay in each country where the debtor has assets; 4) free exchanges of information among proceedings; 5) after recognition, distribution of assets on a transnational basis; 6) rejection of discrimination based on nationality, domicile, or residence; and 7) distributions in multiple countries should not permit creditors to recover more than received by creditors of same class in that country. These principles are accompanied by "procedural principles" to facilitate parties and courts in applying the basic principles and "guidelines" for court-to-court communications. For example, the principle on stays is accompanied by procedural principles to guide courts in reconciling stays in different countries and in applying stays. As a result, the ALI Principles seek to create a common language of insolvency among the NAFTA practitioners and to establish guidelines within this common language to promote cross-border cooperation and predictability.

A second effort has again been one by the private sector, supported by statutory changes under national laws, to develop private contractual solutions to potential transnational insolvency disputes. One of the most significant efforts has involved the development of standardized documents to permit termination and close-out netting of certain financial contracts, such as swaps and repurchase agreements, and crucially the extension of this effort to achieve statutory changes to permit enforcement of those contractual rights in insolvency proceedings. Initially as a reaction to the uncertainty created by settlement mismatches and potential delays in market sensitive financial contracts, financial firms and their lawyers developed master agreements under which individual transactions can be regulated by identical contract terms. To be effective, however, these agreements must be enforceable under national insolvency laws, which typically bar termination, netting, and set-off of claims after initiation of the insolvency proceedings. Through international lobbying efforts and with the active support of financial regulators, the securities and derivatives industry has been successful in gaining legal protection for these contractual provisions in virtually all nations with active participation in the financial markets.[42] Financial regulators have been active participants in this endeavor because of the concern that settlement mismatches or stays of contract termination and netting could create a domino effect in other financial firms and in markets throughout the world. Standardized agreements now exist for several types of transactions. Two important examples are the International Foreign Exchange Master Agreement and the International Swaps and Derivatives Association Master Agreement.

The UNCITRAL Model Law. In 1997, the United Nations Commission on International Trade Law (UNCITRAL) issued its Model Law on Cross-Border Insolvency. As its name suggests, the UNCITRAL Model Law is a model law for adoption by individual countries that specifies mechanisms for coordination between courts in cross-border insolvency cases in order to reduce the potential for competing and inconsistent decisions on the assets and liabilities of the debtor. The UNCITRAL Model Law applies to all insolvent firms, but it does include optional provisions to allow a country to exclude certain companies, such as banks and insurers, from its coverage.

The Model Law does not address the substantive law applicable to key transactions or assets, but leaves those issues to individual national laws. The UNCITRAL Model Law focuses on 1) access to courts by foreign country insolvency administrators, 2) defining when a foreign country insolvency proceeding will be "recognized" and the benefits of "recognition," 3) clarifying the rules for cooperation by national courts with foreign insolvency proceedings and administrators, 4) specifying procedures for coordination between concurrent insolvency proceedings, and 5) providing rules to coordinate the relief available to creditors by providing foreign creditors with notice and access to local insolvency proceedings. The Model Law includes a process for obtaining recognition of a foreign proceeding. If a foreign proceeding is recognized as a "main" proceeding a stay is imposed on actions against the assets of the debtor, the transfer of such assets, and execution against the debtor's assets.

These rules help support the coordination goals of the Model Law by focusing resolution efforts into the "main" proceeding. The Model Law additionally provides for coordination of concurrent insolvency proceedings in multiple jurisdictions.[43]

In short, the Model Law is an important step to developing a common legal infrastructure for close cooperation between judicial authorities and recognition of the enforceability of foreign court rulings. At this date, it has not been adopted by most developed countries, although it has been adopted by Japan, Mexico, Poland, Romania, and South Africa.

The European Union Approach.

The European Union's recent insolvency regulations represent new, statutory efforts to create a common "universal" approach to cross-border insolvencies within a unifying political entity. The resolution of failed banks is addressed by EC Directive 2001/24/EC of April 4, 2001 on the reorganization and winding up of credit institutions. In short, the EU's Insolvency Regulation seeks to establish a EU-wide insolvency process providing for non-discrimination and equal treatment of creditors, recognition of other EU insolvency proceedings, and cooperation between insolvency authorities as an overlay on national insolvency law. The Insolvency Regulation does not displace substantive law, but provides an infrastructure for mediating potential conflicts among jurisdictions that could assert primary control by conferring plenary authority on the "home Member state." The "home Member state" is the original chartering or incorporating authority for the insolvency firm. This state has exclusive jurisdiction to decide to open "reorganization measures" and "winding-up proceedings" and its substantive law governs critical legal issues, such as determination of claims, assets covered by the proceedings, conditions for set-off, and effects of the proceedings on current contracts. The decisions of the "home Member state" on these and other issues are recognized and fully effective in other EU states.[44]

The Insolvency Regulation includes provisions to address cases where a blanket application of the "home Member state" may be inappropriate, such as netting agreements which are governed by the law specified in the netting contract.[45] A separate directive, EU Directive 98/26/EC of May 19, 1998 on settlement finality in payment and securities settlement systems, also accommodates netting contracts by allowing the contracting parties to determine which law will apply and by ensuring that netting is enforceable despite an event of insolvency. These provisions offer additional certainty for critical linkages between markets and internationally-active firms. Similarly, this "Settlement Directive" provides that insolvency proceedings will not have retroactive effect to impair settlement of obligations in a payment system.[46] This addresses the so-called "zero hour" issue for settlement finality in an insolvency.

For insolvencies among EU members, the Insolvency Regulation embodies the universal approach by treating the entire bank and its branches as a single entity subject to resolution under the law of the "home Member state." Even within the EU there remains the possibility for conflict because countries can, and have, exercised the option to opt out of the Insolvency Regulation. However, if the insolvency involves a debtor, creditors and assets located outside the EU, the territoriality approach typically used under members' national laws will be applied because the Insolvency Regulation confines its scope to insolvencies within the EU. Article 1(2) of the Insolvency Regulation specifies that it will apply to a non-EU credit institution only if the institution has branches in at least two EU member states. Even in those cases, separate substantive law will apply in separate insolvency proceedings administered by the EU host countries. As a result, universality will apply between the EU member states, but not for the resolution of the foreign bank as a whole.[47]

The Insolvency Regulation certainly goes beyond the UNCITRAL Model Law because the Insolvency Regulation identifies the governing substantive law and provides for greater enforceable decisions by the "home Member state." As such the Insolvency Regulation and other EU Directives provide a more complete harmony of substantive law.

This survey of current international insolvency rules reveals the limitations and strengths of a reliance on national law with coordinating international conventions. The question remains whether the current international rules are adequate to provide certainty while offering insolvency authorities the flexibility to respond to an emerging crisis.

III. Conclusions and Next Steps

Deposit insurance can be a significant part of a stable, efficient national financial system. An equal partner in such a financial system is an effective system to deal with the inevitable insolvencies in a free market economy. An effective insolvency system can be judged by its ability to reduce uncertainty, promote economic efficiency, and provide fair and equitable treatment to creditors. National insolvency systems are making great strides in meeting these goals. International organizations, such as the International Monetary Fund, private groups and governmental agencies are assisting nations in their efforts to reform insolvency and related infrastructures to allow full participation in the international marketplace.

With increasing integration of all nations into the global economy, the national and international insolvency rules have become central to risk management and stability. Unfortunately, as the foregoing survey of international insolvency approaches and insolvency structures demonstrates, the current international rules for insolvency probably do not satisfy the developing international standards for an effective system. The current approach to cross-border insolvencies is typified by procedural mechanisms to encourage international cooperation within a controlling framework of national law. While recent efforts have achieved substantial improvements in the ability of regulators and insolvency tribunals and authorities to coordinate their efforts, further steps are necessary.

Those steps probably should not include substantive uniformity among national laws. National laws are based on philosophical and policy choices that each nation has made about the goals and outcomes appropriate in an insolvency. Similarly, those steps also probably should not include a global adoption of a universal approach to cross-border insolvencies. Territoriality and universality each proceed from sound principles and policy choices. Any solution to this challenge must proceed from practical and not from theoretical or political positions.

What could those practical steps include? Policy makers and astute observers of the past and potential future problems in cross-border insolvencies surely will have many specific recommendations. One important next step may be to identify and focus on the critical linkages through which financial instability could spread to other markets or institutions. Some of those key linkages are the payments systems, certain capital markets, individual clearing systems and financial firms who fulfill critical clearing and settlement functions, and some correspondent banking relationships. All of these critical linkages are interrelated, and in many instances it is difficult to differentiate the processes and links forged between financial institutions in these areas. Nonetheless, it is useful to distinguish between these linkages because this focuses attention on how different elements of the interwoven fabric of interfirm ties each could give rise to contagion. For example, while correspondent banking services are part of the payments systems, the importance of those services to smaller firms that could result in a spread of large bank risk throughout the economy can be submerged in analyses focusing on the causes and spread of instability solely among larger banks.

While much progress has been made, specific, additional steps to improve harmonization of the contractual infrastructure underlying these linkages should remain a focus to ensure that they remain functional in an insolvency of a key member. An example of ongoing work is insuring that key contracts for customers, vendors, and participants are enforceable in all relevant jurisdictions irrespective of the insolvency of any one of those parties. As noted above, one success story in the development of such contractual rules, and supporting statutes, is the netting provisions common in many financial contracts today. It was only a few years ago, that close-out netting of financial contracts was ill-protected and even broadly viewed as a breach of the theoretical underpinnings of insolvency law. Nonetheless, the logic of preventing contagion effects from the insolvency of a single market participant and the importance of maintaining liquidity in rapidly moving markets led to the relatively quick adoption of insolvency laws that protected contractual netting after a declaration of insolvency.

Statutory rules also must ensure that regulators and insolvency authorities can cooperate to control risks. While insolvency laws inherently control risks and allocate losses, normal insolvency laws may not do so as quickly as is necessary. Most critically, the legal rules governing how we restructure a financial organization and continue to complete payments and other critical functions must occur in "real time" if the critical linkages are to be maintained and systemic effects avoided. A likely prerequisite for "real time" legal rules is greater harmonization in the cross-border and cross-industry rules that determine what business processes can continue, settle, and be completed despite the declaration of insolvency. Similarly, the differing treatments of banks compared to other corporate debtors and the "first-to-file" effects of initiating an insolvency in one jurisdiction over others can create potential disruptions in operations and inconsistencies in the impact on creditors.[48] Initiatives such as the UNICITRAL Model Law and others will help resolve some of the cooperation issues. While national rules should continue to govern most substantive areas in an insolvency, it may be necessary to look to an international standard, enacted in national laws as was done with netting protections, to ensure continuation of key functions and greater flexibility for regulators and insolvency authorities. Some nations have a great deal of flexibility in some areas, while remaining limited in others.

The future of deposit insurance and the public confidence and stability it was designed to achieve may rest on our ability to adapt to a globalized world of finance. A key step is continuing improvements in national bank insolvency laws. The most difficult steps may be in adapting national laws to the global scope of enterprise.

Endnotes and References:

[1] Mr. Krimminger is Manager for Policy Analysis in Federal Deposit Insurance Corporation's Division of Resolutions and Receiverships. The views expressed in this paper are solely those of the author and do not necessarily represent the policies or views of the FDIC.

[2] Lawrence J. White, "Technological Change, Financial Innovation, and Financial Regulation in the U.S.: The Challenges for Public Policy", Stern School of Business, New York University; "Banking is Becoming a Less Local Business", The Economist (April 17, 2004).

[3] The discretion conferred on many central banks to provide liquidity to systemically significant banks generally does not extend to systemically significant non-banking institutions. Nor is there a mechanism for coordinated assistance of this kind for a global institution with sizeable operations in a number of jurisdictions. Non-banks may pose as great a threat to the global financial system as our largest banks, yet the mechanisms under insolvency law to permit a system-focused resolution rather than a creditor-focused resolution may not exist. See Michael Krimminger, "Insolvency in the Financial Markets: Banks, Hedge Funds, and Other Complications", Banking Policy Report, Vol. 18, No. 4 at 4 (Jan. 18, 1999).

[4] See John F. Bovenzi, "Resolving Large Complex Financial Organizations", comments delivered at the 38th Annual Conference on Bank Structure & Competition, Federal Reserve Bank of Chicago (May 10, 2002); G-10 Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" (Sept. 2002); Bethany Blowers, "The Economics of Insolvency Law: Conference Summary," Bank of England Financial Stability Review 153, 154 (Dec. 2002); IMF Legal Dept., "Orderly & Effective Insolvency Procedures" (1999); Stijn Claessens, "Experiences of Resolution of Banking Crises," Prepared for joint PBOC/BIS Seminar on Strengthening the Banking System in China, February 28-March 2, 1990, at 280-283 (1990) ; see also "Report of the Working Group on International Financial Crises", Appendix A (Oct. 1998) (defined as applying solely to commercial firms).

[5] See Rosalind L. Bennett, "Failure Resolution and Asset Liquidation: Results of an International Survey of Deposit Insurers," FDIC Banking Review, Vol. 14, No. 1 at 3-7 (Fall 2001); Group of Ten, Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" at i (Sept. 2002).

[6] See, e.g. Group of Ten, Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" at Appendix A (Sept. 2002); Global Bank Insolvency Initiative, "Legal, Institutional, and Regulatory Framework to Deal with Insolvent Banks"; Financial Stability Forum, "Guidance for Developing Effective Deposit Insurance Systems" at 12 (Sept. 2001); Subhrendu Chatterji, "Bank Restructuring and Recapitalization: the Key Issues" at 3, Financial Sector Chapter of the U.K. Department for International Development's Guide for Economists (Jan. 1999).

[7] See Speech by David Clementi, Deputy Governor of the Bank of England, London, July 19, 2001 at 3, available at www.bis.org.

[8] Group of Ten, "Report on Consolidation in the Financial Sector" at 15 (Jan. 2001).

[9] See Aristobulo de Juan, "Does Bank Insolvency Matter? And What to Do About It?" in P. Collier (eds.) Financial Systems & Development in Africa, EDI Seminar Series, The World Bank (1991).

[10] See Andrea Maechler & Kathleen McDill, "Dynamic Depositor Discipline in U.S. Banks", FDIC Working Paper 2003-7 (Nov. 2003); Global Bank Insolvency Initiative, "Legal, Institutional, and Regulatory Framework to Deal with Insolvent Banks"; Financial Stability Forum, "Guidance for Developing Effective Deposit Insurance Systems" at 8-11 (Sept. 2001).

[11] See Subhrendu Chatterji, "Bank Restructuring and Recapitalization: the Key Issues" at 5, Financial Sector Chapter of the U.K. Department for International Development's Guide for Economists (Jan. 1999).

[12] See Group of Ten, Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" (Sept. 2002); Global Bank Insolvency Initiative, "Legal, Institutional, and Regulatory Framework to Deal with Insolvent Banks"; Financial Stability Forum, "Guidance for Developing Effective Deposit Insurance Systems" at 8-11 (Sept. 2001); IMF Legal Dept., "Orderly & Effective Insolvency Procedures" (1999).

[13] See FDIC, Managing the Crisis: The FDIC and RTC Experience 1980-1994 at 545- 565 (August 1998).

[14] See Aristobulo de Juan, "Does Bank Insolvency Matter? And What to Do About It?" in P. Collier (eds.) Financial Systems & Development in Africa, EDI Seminar Series, The World Bank (1991).

[15] 12 U.S.C. § 1821(c)(5).

[16] FDICIA required federal regulators to establish 5 capital levels ranging from "well-capitalized" to "critically undercapitalized." These levels serve as the basis for PCA and, as the capital level declines, the regulators can impose increasingly stringent controls on the institution. Those controls may include limits on deposit taking and other business restrictions. 12 U.S.C. § 1831o(b)(1).

[17] 12 U.S.C. § 1821(d)(2).

[18] Unnecessary delays only serve to reduce asset values and to increase resolution costs. Reasons for this loss in value (called the "liquidation value") include 1) information costs incurred by prospective purchasers; 2) disruption in financing for partially completed projects; 3) reluctance of receivers to grant additional financing; 4) borrower's incentives to negotiate reduced payments with receivers; and 5) the administrative costs of the receivership. See FDIC, "Resolutions Handbook: Methods for Resolving Troubled Financial Institutions n the United States" at 21-22 (1998).

[19] 12 U.S.C. § 1821(j).

[20] 12 U.S.C. § 1823(e); see Langley v. FDIC, 484 U.S. 86 (1987).

[21] 12 U.S.C. § 1821(e)(3)(A).

[22] See 12 U.S.C. § 1821(e)(1).

[23] 12 U.S.C. § 1821(e)(12).

[24] 12 U.S.C. § 1821(e)(8).

[25] 12 U.S.C. §§ 1821(d)(12) and 1821(d)(13)(D).

[26] 12 U.S.C. §§ 1821(d)(3) – (10), (12) – (13).

[27] Financial Stability Forum, "Guidance for Developing Effective Deposit Insurance Systems" at 34-36 (Sept. 2001).

[28] 12 U.S.C. § 1821(a).

[29] 12 U.S.C. § 1821(d)(11).

[30] 12 U.S.C. § 1823(c)(4).

[31] 12 U.S.C. § 1823(c)(4)(G).

[32] See e.g., Group of Ten, Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" at Appendix A (Sept. 2002); Richard Herring, "International Financial Conglomerates: Implications for Insolvency Regimes" at 19-22 (July 2002).

[33] EU Insolvency Regulation (EC) No. 1346/2000 of May 29, 2000; the Winding Up Directive for insurance undertakings 2001/17/EC of Mar. 19, 2001; and the Winding Up Directive for credit institutions 2001/24/EC of April 4, 2001; see Group of Ten, Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" at Appendix A, A16-17 (Sept. 2002).

[34] See Board of Governors of the Federal Reserve System, Dept. of the Treasury, & SEC, "Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System" (April 7, 2003); Erwin Nierop & Mikael Stenstrom, "Cross-Border Aspects of Insolvency Proceedings for Credit Institutions – A Legal Perspective", Paper delivered at the International Seminar on Legal & Regulatory Aspects of Financial Stability, Basel, Switzerland, Jan. 21-23, 2002; Kai Barvell, "Risks and Developments in Payment Systems" (IMF Aug. 28, 2002); Richard Herring, "International Financial Conglomerates: Implications for Insolvency Regimes" (July 2002); Bank for International Settlements, Report of the Committee on Interbank Netting Schemes (Lamfalussy Report) (Nov. 1990)..

[35] For a valuable discussion of growing cooperation and the application of international precedents in cross-border litigation, see Anne-Marie Slaughter, "A Global Community of Courts", 44 Harv. Int. L. J. 191 (Winter 2003).

[36] An example of this approach is the EU Directive 2001/24/EC of April 4, 2001 on the reorganization and winding up of credit institutions. The Directive confers on the "administrative or judicial authorities of the home Member state" the authority to decide and implement "reorganization measures" or "winding up (liquidation) proceedings." Article 3 & Article 9. The "home Member state" is defined, in short, as the original chartering authority for the bank. Article 2. See Antonio Sainz de Vicuna, General Counssel, European Central Bank, "Cross-border aspects of insolvency and the principles of universality and

territoriality", comments delivered at the Insolvency Symposium 2003, Sept. 30-Oct. 1, 2003, European Central Bank, Frankfurt, Germany.

[37] See Note, Roland Lechner, "Waking from the Jurisdictional Nightmare of Multinational Default: The European Council Regulation on Insolvency Proceedings", 19 Ariz. J. Int. & Comp. L. 975, 886-1000 (Fall 2002).

[38] See Group of Ten, Contact Group on the Legal and Institutional Underpinnings of the International Financial System, "Insolvency Arrangements & Contract Enforceability" at Appendix A, A13 (Sept. 2002); Note, Roland Lechner, "Waking from the Jurisdictional Nightmare of Multinational Default: The European Council Regulation on Insolvency Proceedings", 19 Ariz. J. Int. & Comp. L. 975, 886-1000 (Fall 2002). .

[39] See Nielsen, Sigal, & Wagner, "The Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies", 70 Am. Bkry. L.J. 533, 537-38 (Fall 1996).

[40] See Cross-Border Insolvency Concordat at Principles 1-4, 8 (1996).

[41] See Jay L. Westbrook, "Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation", 76 Am. Bkry. L.J. 1, 4 (Winter 2002); Peter J. Murphy, "Why Won't the Leaders Lead? The Need for National Governments to Replace Academics and Practitioners in the Effort to Reform the Muddled World of International Insolvency", 34 U. Miami Inter-Am L. Rev. 121, 130-31 (Winter 2002).

[42] See list of nations with close-out netting laws in effect is available at www.isda.org under "Opinions", "Status of Netting Legislation"; see also Richard Herring, "International Financial Conglomerates: Implications for Insolvency Regimes" at 29-30 (July 2002).

[43] See UNCITRAL Model Law available at www.uncitral.org; Simeon Sahaydachny, "The UNCITRAL Model Law on Cross-Border Insolvency", Presentation at the International Conference on Deposit Insurance, September 9-11, 1998, FDIC, Washington, D.C.; Erwin Nierop & Mikael Stenstrom, "Cross-Border Aspects of Insolvency Proceedings for Credit Institutions – A Legal Perspective" at 6-8, Paper delivered at the International Seminar on Legal & Regulatory Aspects of Financial Stability, Basel, Switzerland, Jan. 21-23, 2002.

[44] EU Directive 2001/24/EC of April 4, 2001, Articles 3, 9, 10, and 21.

[45] EU Directive 2001/24/EC of April 4, 2001, Articles 25 and 26; see also Articles 21, 23, and 27.

[46] EU Directive 98/26/EC of May 19, 1998 on settlement finality in payment and securities settlement systems, Article 3; Erwin Nierop & Mikael Stenstrom, "Cross-Border Aspects of Insolvency Proceedings for Credit Institutions – A Legal Perspective" at 16, Paper delivered at the International Seminar on Legal & Regulatory Aspects of Financial Stability, Basel, Switzerland, Jan. 21-23, 2002.

[47] See Andrew Campbell, "Issues in Cross-Border Bank Insolvency: The European Community Directive on the Reorganization and Winding-Up of Credit Institutions", presentation at the IMF's Seminar on Current Developments in Monetary and Financial Law, Washington, D.C., May 7-17, 2002; See Jay L. Westbrook, "Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation", 76 Am. Bkry. L.J. 1, 34-35 (Winter 2002).

[48] See The President's Working Group on Financial Markets, "Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management" at 27 and Appendix E (April 1999); Kai Barvell, "Risks and Developments in Payment Systems" at 15-20 (IMF Aug. 28, 2002).