Recognition of foreign bank resolution actions

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8 Creditors' Position

8.1 Introduction

This chapter examines the creditors' position in recognition of foreign resolution actions. The last sentence of Financial Stability Board (FSB) Key Attribute 7.5 states: '[r]ecognition or support of foreign measures should be provisional on the equitable treatment of creditors in the foreign resolution proceedings'.[1] The FSB further explains: '[a]ny perception that creditors may be discriminated against, whether based on their nationality, residence, or the location of their claim or other factors (and whether de facto or de jure) may affect authorities' incentives to cooperate in the implementation of an agreed resolution strategy and give rise to risk of litigation'.[2] This Chapter therefore investigates the non-discrimination treatment principle between domestic and foreign creditors in cross-border bank resolution. The analysis is conducted based on the doctrines of traditional insolvency law.

This chapter first lays out the theoretical framework (§8.2) under international insolvency law, particularly the trade-off between protection of local interest and equal treatment of foreign creditors. §8.3 compares the creditors' position in the selected jurisdictions. Next, §8.4 examines three questions: (i) How circumstances should be interpreted as discriminatory against local creditors? (§8.4.1) (ii) Should the difference in laws be a reason to refuse to recognise or support foreign resolution actions? (§8.4.2) (iii) Should governing law provisions be the reason to refuse to recognise or support foreign resolution actions? (§8.4.3) The final section, §8.5, concludes. The discussion in this chapter applies to all scenarios listed in Figure 2.1.

1 FSB KA 7.5.
2 FSB Principles, 13.

8.2 Theoretical framework

8.2.1 Creditors in recognition of foreign corporate insolvency proceedings

8.2.1.1 Creditors in domestic corporate insolvency proceedings

Creditors are significant participants in normal corporate insolvency proceedings.[3] Insolvency proceedings have a collective nature, namely, 'the interests of individual creditors, and in particular their rights to collect in the debts due to them by one or other of the methods of enforcing payment of judgment debts, must give way to the collective interest of the general body of creditors'.[4] Creditors are protected as a group instead of as individuals. Within the group of creditors, it is required that similarly situated creditors are treated equally.[5] This basic rule is commonly referred to as equal treatment of creditors or equitable treatment of creditors, which, as Bork pointed out, is 'the first and most important principle of insolvency law'.[6]

This principle encompasses two dimensions: substantive dimension and procedural dimension. The substantive aspect of the equal treatment principle is reflected in the well-known *pari passu* principle, a fundamental rule in the insolvency law.[7] The World Bank (WB) specifically regulates the *pari passu* rule in the 'Principles for Effective Insolvency and Creditor/Debtor Regimes':

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3 Bob Wessels, Hon Bruce A Markell and Jason Kilborn, 'Prominent Principles of Domestic Law' in *International Cooperation in Bankruptcy and Insolvency Matters* (OUP 2009) 14-16. See also generally, e.g. Philip Wood, *Principles of International Insolvency* (Sweet & Maxwell 2007); Roy M Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell 2011); Reinhard Bork, *Principles of Cross-border Insolvency Law* (Intersentia 2017).

4 Goode (n 3) para 2-04. See also Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986); Michael Bridge, 'Collectivity, Management of Estates and the *Pari Passu* Rule in Winding-up' in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Hart Publishing 2003).

5 See generally, e.g. UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law (2004), Recommendation 1(d) and (f); WB, World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (2015), Principle No.12.3; Rizwaan J Mokal, 'The *Pari Passu* Principle and its Relationship with Other Methods of Insolvency Distribution' in *Corporate Insolvency Law: Theory and Application* (OUP 2005) 92-132; Wessels, Markell and Kilborn (n 3) 16-17; Goode (n 3) para 3-07.

6 Bork (n 3) para 4.6. See also Andrew Keay and Peter Walton, 'The Preferential Debts Regime in Liquidation Law: In the Public Interest?' (1999) 3 Company Financial and Insolvency Law Review 84, 85.

7 Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles* (2nd edn, CUP 2009) 599. Almost any discussion on the principles of insolvency law and international insolvency law would list the *pari passu* principle as a basic principle. See, e.g. Ian F Fletcher, *Insolvency in Private International Law* (OUP 2005) para 1.08; Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005) 92ff; Wessels, Markell and Kilborn (n 3) 16-17; Goode (n 3) para 3-07. Criticism see, e.g. Rizwaan J Mokal, 'Priority as Pathology: The Pari Passu Myth' (2001) 60 The Cambridge Law Journal 581; Mokal (n 5); David Skeel, 'The Empty Idea of 'Equality of Creditors'' (2017) 166 University of Pennsylvania Law Review 699.

> Following distributions to secured creditors from their collateral and the payment of claims related to the costs and expenses of administration, proceeds available for distribution should be distributed *pari passu* to the remaining general unsecured creditors.[8]

The *pari passu* principle originated from the notion of equal distribution of the debtor's assets in the liquidation proceedings, which dates back to a Henry VIII Statute in 1542 in the English common law history.[9] The *pari passu* principle refers to the *pro rata* distribution of debtors' assets in the liquidation/winding-up proceedings. To be understood more accurately, the *pari passu* principle only applies to 'similarly situated creditors', who should be treated equally. For example, secured creditors have priority of repayment from value of the assets secured.[10] For other unsecured creditors' claims, some claims are supposed to be treated as priority claims, such as administrative costs and expenses, and employee and tax claims. [11] Other exceptions include set-off [12] and netting,[13] which put some creditors in an advantageous position. These exceptions are allowed under the *pari passu* principle with 'compelling reasons to justify giving priority status to a particular class of claims',[14]

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8 WB, World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, Principle No.12.3.

9 Statute of Bankrupts 1542 (34 & 35 Hen. VIII, c.4). See Goode (n 3) para 7-03.

10 Regarding the priority for secured creditors, see, e.g. Thomas H Jackson and Anthony T Kronman, 'Secured Financing and Priorities Among Creditors' (1979) 88 Yale Law Journal 1143; Alan Schwartz, 'Security Interests and Bankruptcy Priorities: A review of Current Theories' (1981) 10 The Journal of Legal Studies 1; Roy M Goode, 'Is the Law Too Favourable to Secured Creditors' (1983) 8 Can Bus LJ 53; Vanessa Finch, 'Security, Insolvency and Risk: Who Pays the Price?' (1999) 62 The Modern Law Review 633.

11 UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law, 269-274. See also Mokal (n 5) 96-98; Finch (n 7) 599-674; Goode (n 3) para 8-05 ff; Dennis Faber and others, *Ranking and Priority of Creditors* (Dennis Faber and others eds, OUP 2016).

12 UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law, 155-156. (The enforcement under insolvency law of rights of set-off of mutual obligations arising out of pre-commencement transactions or activities of the debtor is important not only to commercial predictability and the availability of credit, but also because it avoids the strategic misuse of insolvency proceedings. For these reasons, it is highly desirable that an insolvency law afford protection to such set-off rights.)

13 UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law, 156-159. (Permitting "close-out netting" after the commencement of insolvency proceedings is an important factor in mitigating systemic risks that could threaten the stability of financial markets. The value of or exposure under a financial contract may vary significantly from day to day (and sometimes from hour to hour) depending on conditions in the financial markets. Accordingly, the value of these contracts can be highly volatile. Counterparties typically mitigate or hedge the risks associated with these contracts by entering into one or more "matching" or "hedge" contracts with third parties, the value of which fluctuates inversely with the value of the debtor's contract.)

14 WB, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' (2015), C12.13. See, e.g. Keay and Walton (n 6); Andrew Keay, Andre Boraine and David Burdette, 'Preferential Debts in Corporate Insolvency: A Comparative Study' (2001) 10 International Insolvency Review 167.

which reflects the legislators' intention to classify different sub-groups of similarly situated creditors.

With the development of the rescue culture and the later statutory reorganisation scheme or out-of-court restructuring process, the *pari passu* principle extended to non-liquidation insolvency proceedings like reorganisation and restructuring proceedings. However, the function of the *pari passu* principle is limited in those reorganisation proceedings since the final reorganisation decision is reached through the negotiation of the debtor and creditors rather than following the statutory liquidation rules.[15]

Apart from the distribution equality, equal treatment of creditors principle exists in almost every aspect of insolvency law, including 'the application of the stay or suspension, provisions to set aside acts and transactions and recapture value for the insolvency estate, classification of claims, voting procedures in reorganisation and distribution mechanism'.[16] These requirements reflect procedural equality, namely, similarly situated creditors should be able to participate in the insolvency proceedings on an equal basis. A manifestation of procedural equality is the 'equality of arms' rule, which requires that (i) '[e]ach party in interest in an insolvency proceeding case shall be given a full and fair opportunity to present both the facts and the laws on its side'; and (ii) '[e]ach party shall be given a full and fair opportunity to comment on the evidence and legal arguments of an opponent'.[17] In other words, this includes 'the rights to be notified of procedural documents and, more generally, the right to be heard, with adequate time and opportunity to arrange for representation at any hearing'.[18] The equality of arms principle also reflects the need for unprejudiced usage of language[19] and sufficient notice to foreign creditors.[20]

8.2.1.2 Creditors in cross-border corporate insolvency proceedings

In cross-border corporate insolvency cases, equal treatment of creditors is also a leading rule.[21] Regardless of their location, creditors are supposed to be treated equally on a global basis. In other words, foreign creditors should not be discriminated against merely because of their nationalities.

15 Goode (n 3) 238.
16 UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law, Recommendation 1(d).
17 Principle 5.1 (Equality of Arms) ALI-III Global Principles and Guidelines 2012; Principle 6.1 (Equality of Arms) JudgeCo Principles and Guidelines. See also, e.g. Bork (n 3) para 3.55.
18 Comment to Global Principle 5.
19 Principle 21 (Language) ALI-III Global Principles and Guidelines 2012.
20 Principle 25 (Notice) ALI-III Global Principles and Guidelines 2012.
21 Bork (n 3) para 2.62; Goode (n 3) para 16-09.

This position evolved over time. Before the 1900s, national authorities preferred to protect their local creditors. [22] Usually, domestic creditors were in an advantageous position.[23] The practice, however, was criticised by judges and academics. For example, Jabez Henry, a 19th-century British judge, pointed out that 'the principle of equality of distribution among the general creditors who have no special lien' is 'the essence of all bankrupt laws'.[24] Also, as Lord Hoffmann explained in his often-cited *Cambridge Gas* case,

> fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated.[25]

Several international organisations also advocate for such an equal treatment principle. The Model Law on Cross-border Insolvency (MLCBI) requires that 'foreign creditors have the same rights regarding the commencement of, and participation in, a proceeding … as creditors in this State'.[26] The MLCBI Guide also emphasises that this Article 'embodies the principle that foreign creditors, when they apply to commence an insolvency proceeding in the enacting State or file claims in such a proceeding, should not be treated worse than local creditors'.[27]

It is also confirmed in the ALI-III Global Principles for Cooperation in International Insolvency Cases (ALI-III Global Principles and Guidelines 2012) that 'due regard should be given to the interests of creditors, including the need to ensure similarly ranked creditors are treated equally',[28] and '[e]

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22 See Kurt H Nadelmann, 'Foreign and Domestic Creditors in Bankruptcy Proceedings. Remnants of Discrimination?' (1943) 91 University of Pennsylvania Law Review and American Law Register 601; Kurt H Nadelmann, 'Revision of Conflicts Provisions in the American Bankruptcy Act' (1952) 1 The International and Comparative Law Quarterly 484; Kurt H Nadelmann, 'Bankruptcy Reform Act and Conflict of Laws: Trial-and-Error' (1988) 29 Harv Int'l LJ 27; John Honsberger, 'Conflict of laws and the Bankruptcy Reform Act of 1978' (1980) 30 Case Western Reserve Law Review 631; Stephen B James, 'International Bankruptcy: Limited Recognition in the New U.S. Bankruptcy Code' (1980) 3 Hous J Int'l L 241; Donald Trautman, 'Foreign Creditors in American Bankruptcy Proceedings' (1988) 29 Harvard International Law Journal 49.

23 For the history of the (in)equality of foreign and domestic creditors, see Kurt H Nadelmann, 'Legal Treatment of Foreign and Domestic Creditors' (1946) 11 Law and Contemporary Problems 696.

24 Regarding the work and opinions of Jabez Henry, see Kurt H Nadelmann, 'An International Bankruptcy Code: New Thoughts on an Old Idea' (1961) 10 The International and Comparative Law Quarterly 70.

25 *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2006] UKPC 26; [2007] 1 AC 508 (PC, IoM), para 16.

26 Article 13(1) MLCBI; 11 US Code §1513(1).

27 MLCBI Guide, para 118.

28 Principle 1 (Overriding objective) ALI-III Global Principles and Guidelines 2012.

nsuring that creditors' interests are respected and that creditors are treated equally' is one of the aims.[29] The European Union (EU) Cross-Border Insolvency Court-to-Court Cooperation Principles (JudgeCo Principles and Guidelines) also contain similar provisions.[30] The ALI-III Global Principles and Guidelines Comment[31] further explains that equal treatment is interpreted as 'treatment of the same class of creditors in a similar way and without discrimination as worded in Principle 11'.[32] Principle 11 states the non-discriminatory treatment: 'a court should not discriminate against creditors or claimants based on nationality, residence, registered seat or domicile of the claimant, or the nature of the claim'.[33]

As mentioned above, equal treatment only applies to similarly situated creditors. Classification of different sub-groups of differently situated creditors can be regulated in the national laws. However, based on the opinions expressed by the above judges and international standards, different nationalities should not be treated as differently situated creditors. In other words, domestic and foreign creditors cannot be treated in different situations merely because of their nationalities.

Similar to the principle in the domestic context, equal treatment of creditors encompasses both substantive and procedural dimensions. Regarding the substantive dimension, the *pari passu* principle applies, and the insolvency law should be applied equally to all the domestic and foreign creditors.[34] An explicit example is the hotchpot rule, which aims to ensure that domestic and foreign creditors should receive repayment on a *pro rata* basis.[35] The MLCBI requires that

> Without prejudice to secured claims or rights *in rem*, a creditor who has received part payment in respect of its claim in a proceeding pursuant to a law relating to insolvency in a foreign State may not receive a payment for the same claim in a

29 Principle 2 (Aim) ALI-III Global Principles and Guidelines 2012.

30 Principles 3 and 4 JudgeCo Principles and Guidelines.

31 Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases, Report to ALI (30 March 2012).

32 Comment to Global Principle 1.

33 Principle 11 (Nondiscriminatory Treatment) ALI-III Global Principles and Guidelines 2012. See also Principle 10 (Nondiscriminatory Treatment) JudgeCo Principles and Guidelines.

34 Comment to Global Principle 11. Recital (63) EIR 2015 Recast. See also, e.g. Bork (n 3) para 2.62ff.

35 See, e.g. H Hanisch, 'Crediting a Creditor with Proceeds Recovered Abroad out of the Debtor's Assets Recovered Abroad in Domestic Insolvency Proceedings' in Ian F Fletcher (ed), *Cross-border Insolvency: Comparative Dimensions, The Aberystwyth Insolvency Papers*, vol 12 (United Kingdom National Committee of Comparative Law 1990); Look Chan Ho, 'On Pari Passu, Equality and Hotchpot in Cross-Border Insolvency' (2003) Lloyd's Maritime and Commercial Law Quarterly 95.

> proceeding under [*identify laws of the enacting State relating to insolvency*] regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received.[36]

The hotchpot rule is intended to 'avoid situations in which a creditor might obtain more favourable treatment than the other creditors of the same class by obtaining payment of the same claim in insolvency proceedings in different jurisdictions';[37] the rule's sole purpose is to 'establish the equal treatment of creditors of the same class'.[38] The United States (US) Bankruptcy Code Chapter 15 mirrors the MLCBI and adopts this rule.[39] This rule is also referred to as 'Adjustment of Distributions' in the ALI-III Global Principles.[40] The European Insolvency Regulation (EIR) 2015 Recast also contains the same rule. Article 23(2) EIR prescribes that '[i]n order to ensure the equal treatment of creditors, a creditor which has, in the course of insolvency proceedings, obtained a dividend on its claim shall share in distributions made in other proceedings only where creditors of the same ranking or category have, in those other proceedings, obtained an equivalent dividend'.[41]

The procedural dimension of the equal treatment ensures the procedural rights of the creditors in different jurisdictions. As mentioned in the domestic context, a manifestation is the 'equality of arms' rule. This principle is also confirmed in the *Eurofood* judgment, a landmarking case that deals with international insolvency disputes:

> Concerning more particularly the right to be notified of procedural documents and, more generally, the right to be heard, …., these rights occupy an eminent position in the organisation and conduct of a fair legal process. In the context of insolvency proceedings, the rights of creditors or their representatives to participate in accordance with the equality of arms principle is of particular importance.[42]

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36 Article 32 MLCBI; 11 US Code §1532.

37 MLCBI Guide, para 239.

38 MLCBI Guide, para 240.

39 11 US Code §1532.

40 Principle 12 (Adjustment of Distribution) ALI-III Global Principles and Guidelines 2012. See, e.g, Bork (n 3) para 2.65.

41 Article 23(2) EIR. See also, e.g. Virgós-Schmit Report, para 117; Gabriel Moss, Daniel Bayfield and Georgina Peters, 'Recognition and Enforcement' in Gabriel Moss, Ian F Fletcher and Stuart Isaacs (eds), *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings* (3rd edn, OUP 2016) para 5.161ff; Bob Wessels, *International Insolvency Law Part I: Global Perspectives on Cross-Border Insolvency Law* (4th edn, Kluwer 2015) para 10348ff; Bork (n 3) para 4.9.

42 Judgment of 2 May 2006, *Eurofood IFSC Ltd*, C-341/04 EU:C:2006:281, para.66. See also Samuel L Bufford, 'Center of Main Interests, International Insolvency Case Venue, and Equality of Arms: The Eurofood Decision of the European Court of Justice' (2007) 27 Northwestern Journal of International Law & Business 351.

In reality, complete equality is difficult to reach across different jurisdictions. This is not because laws explicitly discriminate against foreign creditors. Instead, the unequal outcome usually comes from different laws that are also applicable. A distinct manifestation is the possibility of opening secondary proceedings, which is the main feature of the current modified universalism principle.[43] For example, in the EIR, the jurisdictions where the centre of main interest (COMI) of a debtor is situated can open main insolvency proceedings, while the jurisdictions where a debtor has an establishment can open secondary proceedings.[44] Due to the application of the law of the 'State of the opening of proceedings' (*lex concursus*),[45] which 'should be valid both for the main insolvency proceedings and for local proceedings',[46] the creditors in the COMI jurisdiction and establishment jurisdiction might be treated differently because of the different applicable laws.

A likely result is that creditors from establishment jurisdictions or third jurisdictions are treated advantageously. The intention of having secondary proceedings is to protect creditors from discriminatory main proceedings. However, this is hardly the case in the modern world since almost every insolvency law *de jure* ensures that domestic and foreign creditors should have equal rights when they participate in insolvency proceedings.[47] More commonly, local courts, where secondary proceedings are commenced and foreign main proceedings are sought to be recognised, would prefer to apply the local laws, for the purpose of protecting local interests.[48] Such 'local interests' include local creditors' expectation of applying a law they are familiar with or the interests of local policies.

In extreme cases, foreign creditors may leverage their position as foreigners to obtain more repayment in a main proceeding, especially in reorganisation proceedings where negotiations could happen. For example, in the 2006 *Collins & Aikman* case, the administrator in the debtor's COMI jurisdiction

43 See Chapter 6, §6.2.2.1.1. See also, e.g. Jay L Westbrook, 'A Global Solution to Multinational Default' (2000) 98 Michigan Law Review 2276, 299ff; Miguel Virgós and Francisco J Garcimartín, *The European Insolvency Regulation: Law and Practice* (Kluwer Law International 2004) 17; Westbrook (n 41) para 10025; Bork (n 3) para 2.11.

44 Article 3 EIR 2015 Recast. See, e.g. Fletcher (n 7) para 7.39ff; Gabriel Moss, Ian F Fletcher and Stuart Isaacs, *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings* (Gabriel Moss, Ian F Fletcher and Stuart Isaacs eds, 3rd edn, OUP 2016) para 3.09ff, 08.60ff, 08.555ff; Bob Wessels, *International Insolvency Law Part II: European Insolvency Law* (4th edn, Kluwer 2017) para 10540ff.

45 Article 7 EIR 2015 Recast.

46 Recital (66) EIR.

47 See, e.g. Article 13(1) MLCBI; Recital (63) EIR.

48 Recital (40) EIR 2015 Recast. See also the *Notel* case, Judgment of 11 June 2015, *Comité d'entreprise de Nortel Networks SA and Others v Cosme Rogeau liquidator of Nortel Networks SA and Cosme Rogeau liquidator of Nortel Networks SA v Alan Robert Bloom and Others*, C-649/13 EU:C:2015:384, para 36.

(UK) promised to provide foreign creditors from Spain and Germany better treatment than they would receive under the UK law, with the aim of avoiding secondary proceedings.[49] It is confirmed in the EIR 2015 Recast that 'this Regulation confers on the insolvency practitioner in main insolvency proceedings the possibility of giving an undertaking to local creditors that they will be treated as if secondary insolvency proceedings had been opened'.[50] With or without the opening of secondary proceedings, there is a possibility that domestic and foreign creditors are treated differently.

8.2.1.3 Creditors in recognition proceedings

8.2.1.3.1 Recognition v relief

A distinction is made between recognition and 'relief', in the words of the MLCBI,[51] or 'enforcement', in the EIR.[52] This distinction parallels judgment recognition and enforcement under the framework of private international law. Recognition refers to the action that the recognising jurisdiction accepts the validity of foreign insolvency proceedings or foreign representatives, without additional assistance. In contrast, relief and enforcement may need local courts' assistance to achieve specific objectives. Recognition is the precondition for relief or enforcement.

In the MLCBI context, courts can grant automatic reliefs after recognising a foreign main proceeding,[53] and discretionary reliefs upon receiving a recognition request[54] and after recognising a foreign main/non main proceeding,[55] as well as additional assistance.[56] As explained in Chapter 4 of this dissertation, which discussed Chapter 15 of US Bankruptcy Code that incorporated the MLCBI, automatic relief generally restricts the actions against assets within the receiving jurisdictions' territory, such as automatic stay; and discretionary relief is in the sole power of courts and can be granted in cases of, for instance, 'entrust[ing] the distribution of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court', which is the turnover power.[57]

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49 *Re Collins & Aikman Europe SA*, [2006] EWCH 1343 (Ch); [2006] B.C.C. 861. See the comments from the administrator of this case, Gabriel Moss, 'Group Insolvency - Choice of Forum and Law: the European Experience under the Influence of English Pragmatism' (2007) 32 Brooklyn Journal of International Law 1005.

50 Recital (42) EIR 2015 Recast.

51 Articles 19 to 21 MLCBI; 11 US Code §§1519 to 1521.

52 Articles 19-33 EIR 2015 Recast.

53 Article 20 MLCBI; 11 US Code §1520.

54 Article 19 MLCBI; 11 US Code §1519.

55 Article 21 MLCBI; 11 US Code §1521.

56 Article 7 MLCBI; 11 US Code §1507.

57 See Chapter 4, §4.3.1.2.1. See also Article 21(2) MLCBI; 11 US Code §1521(2); MLCBI Guide, para 192.

The EIR establishes an automatic recognition mechanism within the EU,[58] giving immediate effect to insolvency proceedings across the Member States.[59] The Virgós-Schmit Report explains:

> The divestment of the debtor, the appointment of the liquidator, the prohibition on individual executions, the inclusion of the debtor's assets in the estate regardless of the State in which they are situated, the obligation to return what has been obtained by individual creditors after opening, etc., are all effects laid down by the law of the State of the opening which are simultaneously applicable in all [Member] States.[60]

Insolvency practitioners as qualified foreign representatives can act accordingly without the need to obtain additional reliefs.[61] Following the automatic recognition, enforcement procedures are governed by Regulation (EU) No 1215/2012 (Brussels I Recast).[62] Both recognition and enforcement are subject to public policy exceptions.[63] Similarly, the EU Directive on Reorganisation and Winding-up of Credit Institutions (CIWUD) also contains such an automatic recognition mechanism.[64] The CIWUD, different from the EIR and the Brussels I Recast, does not allow public policy exceptions. It is because, as explained in Chapter 3 of this dissertation, the EU financial regulation adopted the home-country control principle, and the reorganisation and liquidation proceedings are required to take effect within the EU without further obstacles.[65] The EIR and CIWUD are special arrangements within the EU, based on the foundation of strong political and economic ties.

Recognition of foreign insolvency proceedings does not necessarily ensure that subsequent relief requests would be granted. Empirical research on US Chapter 15 cases between 17 October 2005 and 8 June 2009 shows that

> while U.S. Courts recognised foreign proceedings in almost every Chapter 15 case, courts entrusted U.S assets to foreign proceedings for distribution in only 45.5 percent of cases where foreign proceedings were recognized. When such entrustment was granted, 31.8 percent of cases were accompanied by qualifying

58 Article 19 EIR 2015 Recast.
59 Article 20 EIR 2015 Recast.
60 Virgós-Schmit Report, para 154.
61 Article 20 EIR 2015 Recast.
62 Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast). Article 32 EIR 2015 Recast.
63 Article 33 EIR 2015 Recast.
64 Articles 3(2) and 9(1) CIWUD.
65 See Chapter 3, §3.3.2. See also, e.g. Gabriel Moss, Bob Wessels and Matthias Haentjens, 'Principles for Cross-border Financial Institution Insolvencies' in Gabriel S. Moss, Bob Wessels and Matthias Haentjens (eds), *EU Banking and Insurance Insolvency* (OUP 2017) para.2.26.

> factors including orders that protected U.S. creditors by allowing them to be paid according to the priority scheme under U.S. bankruptcy law or assurances that certain U.S. creditors would be paid in full or in priority.[66]

These findings show that recognition is the premise for enforcement, but not vice versa, similar to the doctrines of private international law.

8.2.1.3.2 Public policy exception

Public policies can be invoked as reasons to refuse to recognise foreign insolvency proceedings. There are several public policies that may be relevant for creditors. First, any insolvency proceedings should respect the *pari passu* rule, which ensures similarly situated creditors receive the same treatment.[67] In a cross-border context, foreign creditors cannot be treated in a discriminatory fashion that is different from the treatment of domestic creditors.[68] Second, creditors are protected through various fundamental procedural rights, such as the right to be notified, or more generally, the right to be heard.[69] Infringing creditors' rights may be considered as violation of these principles of public policy and result in refusual of recognition.

Interpretation of public policies should follow a narrow interpretation method, as explained in Chapter 7 at §7.4.2. As the MLCBI Guide explicitly states, 'the public policy exception is construed as being restricted to fundamental principles of law, in particular, constitutional guarantees', and it 'should be interpreted restrictively and that [public policy] is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting State'.[70]

8.2.1.3.3 Other safeguard measures

Creditors are protected by other safeguard measures. A receiving jurisdiction may decide to refuse to grant reliefs because creditors' rights are infringed, even after the receiving jurisdiction has decided to recognise a foreign insolvency proceeding. This is the mechanism of the MLCBI, which has been adopted by the US. As a general rule, in order to protect the host creditors,[71]

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66 Jeremy Leong, 'Is Chapter 15 Universalist or Territorialist-Empirical Evidence from United States Bankruptcy Court Cases' (2011) 29 Wis Int'l LJ 110.

67 See, e.g. *Re HIH Casualty & General Insurance Ltd* [2008] UKHL 21; Richard Sheldon, *Cross-border Insolvency* (Bloomsbury 2015) para 3.70; Neil Hannan, *Cross-border Insolvency: The Enactment and Interpretation of the UNCITRAL Model Law* (Springer 2017) 86.

68 Moss, Bayfield and Peters (n 41) para 5.72.

69 See, e.g. Judgment of 2 May 2006, *Eurofood IFSC Ltd* C-341/04 EU:C:2006:281, paras 65-66; *In re* Sivec SRL, 2011 WL 3651250, 3 (Bankr. E. D. Okla. 2011); *In re* Ashapura Minechem Ltd., 480 B.R. 129, 139 (S.D.N.Y. 2012).

70 MLCBI Guide, paras 102 and 104.

71 MLCBI Guide, para 192. See e.g. *In re* Tri-Cont'l Exch. Ltd., 349 B.R. 627 (Bankr.E.D.Cal. 2006); *In re* Atlas Shipping A/S, 404 B.R. 726 (Bankr.S.D.N.Y. 2009); *In re* International Banking Corp. B.S.C., 439 B.R.614 (Bankr.S.D.N.Y. 2010).

'[t]he court may grant relief under §1519 or §1521, or may modify or terminate relief under subsection (c), only if the interests of the creditors and other interest entities, including the debtor, are sufficiently protected'.[72] In addition, 'the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in the United States to the foreign representative or another person designated, including an examiner, authorized by the court, provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected'.[73] In determining the 'sufficient protection' criterion, the *Artimm* case confirmed that three factors listed in the previous §304 Bankruptcy Code can still apply: (i) 'the just treatment of all holders of claims against the bankruptcy estate'; (ii) 'the protection of U.S. claimants against prejudice and inconvenience in the processing of claims in the [foreign] proceeding'; and (iii) 'the distribution of proceeds of the [foreign] estate substantially in accordance with the order prescribed by U.S. law'.[74] One judge even concluded that 'before assets are transferred out of the United States for distribution in a foreign case, priority claims will likely have to be paid or satisfied, or at least provision will have to be made for their payment in the foreign proceeding.'[75] Empirical research also showed that courts often hold the view that US secured and priority creditors should be satisfied first.[76]

This chapter brings attention to a discrepancy in the texts of Chapter 15. §1522(a) Bankruptcy Code requires the protection of the interests of the creditors and other interested persons. The US *SPhinX* case confirmed that the intention of §1522(a) is to protect all creditors, not just US parties.[77] However, §1521 (b) only emphasises the interests of creditors in 'this State'. Judges might invoke §1521(b) to protect US creditors' rights only, instead of considering the balance of interests of all the creditors in different jurisdictions.

72 Article 22 MLCBI; 11 US Code §1522.

73 Article 21(2) MLCBI; 11 US Code §1521(b).

74 *In re* Artimm, S.R.L, 335 B.R. 149, 160 (Bankr.C.D.Cal.2005). See also *In re* Atlas Shipping A/S, 404 B.R. 726, 740 (Bankr.S.D.N.Y. 2009).

75 Allan L Gropper, 'The Payment of Priority Claims in Cross-Border Insolvency Cases' (2010) 46 Tex Int'l L J 559, 568.

76 Leong (n 66) 123-125.

77 *In re* SPhinX, Ltd., 351 B.R. 103, 113 (Bankr.S.D.N.Y.2006). However, the *Lida* case might mistakenly expand this equal protection notion to the foreign creditors under §1521 (b). See *In re Lida*, 377 B.R. 243, 259 (9th Cir.BAP 2007).

The EIR established a set of private international law rules, covering jurisdiction and applicable laws,[78] to protect the interests of the receiving jurisdictions.[79] A particular example is, after recognition of a foreign insolvency practitioner (IP), the IP 'shall comply with the law of the Member State within the territory of which it intends to take action, in particular with regard to procedures for the realisation of assets'.[80] There are different understandings of this clause. It is acknowledged that the manner in which an IP can exercise power should comply with local law, while it is unclear whether the nature, content or extent of an IP's powers are determined by the law of the State where the main proceedings are opened or the local law.[81] The *Aria* case interprets that local law only refers to procedural issues.[82] This rule helps ensure that the host procedural rights are guaranteed even after receiving courts recognise home proceedings.

In China, the legal text of Article 5 of the Enterprise Bankruptcy Law (EBL), as well as the case law, does not provide enough guidance on interpreting local creditors' interests. As implicitly indicated by the Lehman Brothers' case discussed in Chapter 5, in which the court refused to recognise the UK insolvency proceeding and required that local creditors' claims should be satisfied first, it is assumed that local Chinese creditors' claims are treated in an advantageous position.[83]

In sum, other safeguard measures may help to ensure that receiving jurisdictions' creditors' claims are satisfied first before the receiving jurisdictions turn over remaining assets to a foreign representative, or the receiving jurisdictions' law applies so that creditors are protected according to their own laws.

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78 Articles 8(third parties' rights *in rem*), 9 (set-off), 10 (reservation of title), 11 (contracts relating to immoveable property), 12 (payment system and financial markets), 13 (contracts of employment), 14 (effects on rights subject to registration), 15 (European patents with unitary effect and Community trade marks), 16 (detrimental acts), 17 (protection of third-party purchasers), 18 (effects of insolvency proceedings on pending lawsuits or arbitral proceedings) EIR 2015 Recast.

79 Gabriel Moss and Tom Smith, 'Commentary on Regulation 1346/2000 and Recast Regulation 2015/848 on Insolvency Proceedings' in Gabriel Moss, Ian F Fletcher and Stuart Isaacs (eds), *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings* (3rd edn, OUP 2016) para 8.303.

80 Article 21(3) EIR 2015 Recast.

81 Moss and Smith (n 79) paras 8.316-8.318.

82 Aria Inc v Credit Agricole Corporate and Investment Bank [2014] EWHC 872, para 60.

83 Since the Conciliation Statement is confidential, the opinion stated here is a reflection of a judge from the Shanghai High People's Court, who heard the Lehman Brothers case. See F Zhang, 'The Needs for Improvement of Relevant Laws Arising from the Financial Derivative Products Cooperative Disputes between Hua An Funds and Lehman Brothers International Europe' (2012) <http://old.ccmt.org.cn/showexplore.php?id=4148> accessed 25 February 2020. See also, e.g. X Gong, 'To Recognise or Not to Recognise? Comparative Study of Lehman Brothers Cases in Mainland China and Taiwan' (2013) 10 International Corporate Rescue 240; X Gong, 'A Balanced Way for China's Inter-Regional Cross-Border Insolvency Cooperation' (Leiden University 2016) para 3.55.

8.2.1.4 Local interest v equal treatment

Receiving jurisdictions might refuse to recognise foreign insolvency proceedings when the foreign insolvency proceedings discriminate against receiving jurisdictions' creditors. This refusal would be for the purpose of protecting the local creditors. However, probably more commonly, receiving jurisdictions may refuse to recognise foreign insolvency proceedings or refuse to grant reliefs because the laws of the receiving jurisdictions were not applied in foreign insolvency proceedings. Subsequently, receiving jurisdictions would apply their local laws, which might result in a different treatment of domestic and foreign creditors.

One example is the different priority rules in distribution, which 'leaves open the question of discrimination'.[84] The different priority rules stem from the national legislators' different perceptions towards the classification of sub-groups within the general body of creditors, that is, how to define 'similarly situated creditors'. If priority rules are applied in each different jurisdiction, similarly situated creditors in these different jurisdictions might be subject to different distribution rules. Therefore, some creditors might be in a better position while some others might be worse off, thus infringing the general fairness rule in international insolvency.[85]

To address this, Lord Hoffman, as an advocate of universalism, emphasised the non-discrimination rule in the *HIH* case and argued for a universal application of one priority rule across borders:

> Almost all countries have their own lists of preferential creditors. These lists reflect legislative decisions for the protection of local interest, which is why the usual English practice is, when remittal to a foreign liquidator is ordered, to make provision for the retention of funds to pay English preferential creditors. But the existence of foreign preferential creditors who would have no preference in an English distribution has never inhibited the courts from ordering remittal. I think that the judge was inclined to regard these differences as de minimis variations which did not prevent the foreign rules from being in substantial compliance with the pari passu principle. But they are nevertheless foreign rules. The fact that the differences were minor might be relevant to the question of whether a court should exercise its discretion to order remittal. But any differences in the English and foreign systems of distribution must destroy the argument that an English court has absolutely no jurisdiction to order remittal because it cannot give effect to anything other than the English statutory scheme.[86]

84 Jay L Westbrook, 'Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation' (2002) 76 American Bankruptcy Law Journal 1, 16. See also Jay L Westbrook, 'Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies' (2009) 27 Penn St Int'l L Rev 869.

85 *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2006] UKPC 26; [2007] 1 AC 508 (PC, IoM), para 16.

86 *In re HIH Casualty and General Insurance Ltd* [2008] UKHL 21; [2008] 1 W.L.R. 852 (HL), para 21.

Another example is the set-off rule. As Lord Scott repeatedly emphasised, '[t]he English courts have a statutory obligation in an English winding up to apply the English statutory scheme and have … no inherent jurisdiction to deprive creditors proving in an English liquidation of their statutory rights under that scheme'.[87] Notably, in the often-cited *Bank of Credit and Commerce International* (BCCI) case, he considered set-off as a public policy and refused to transmit the entire English assets to the Luxembourg main proceeding on the basis that Luxembourg does not have statutory set-off in insolvency proceedings, and he further directed the English liquidators to 'retain sufficient funds to make provision for the dividend that net creditors entitled to take advantage of the English insolvency rules of set-off would receive in the English liquidation'.[88] Sticking to the set-off rule puts English creditors in a better position than non-English creditors, because English creditors would *de facto* have priority access to debtors' assets, limited to the amount of claims that can be set-off.

Lord Hoffmann disapproved of Lord Scott's position: '[i]f the country of principal liquidation does not recognise bankruptcy set off and the mutual debts arise out of transactions in that country, it is hard to see why an English court should insist on rights of set off being preserved in respect of claims by the foreign creditors against assets which happen to be in England'.[89] Rather, in most civil law jurisdictions, set-off is regarded as a violation of the *pari passu* principle.[90]

The EIR does not harmonise national policies towards set-off; instead, it regulates the applicable laws and stipulates, for set-off, that 'the conditions under which set-offs may be invoked' are determined by the law of the State of the opening of proceedings,[91] and '[t]he opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of a debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim'.[92] Receiving Member States cannot refuse to recognise or to grant reliefs to home main proceed-

87 Ibid para 59.

88 *In re Bank of Credit and Commerce International S.A. (No.10)* [1997] Ch. 213. See also *Stein v Blake* [1996] A.C. 243 (HL); *Secretary of State for Trade and Industry v Frid* [2004] 2 A.C. 506 (HL). For literature, see, e.g. Sandy Shandro, 'Judicial Co-operation in Cross-border Insolvency - The English Court Takes a Step Backwards in BCCI (No. 10)' (1998) 7 International Insolvency Review 63.

89 *In re HIH Casualty and General Insurance Ltd* [2008] UKHL 21; [2008] 1 W.L.R. 852 (HL), para.25.

90 See Ian F Fletcher, 'Choice of Law Rules' in Gabriel Moss, Ian F Fletcher and Stuart Isaacs (eds), *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings* (3rd edn, OUP 2016) para 4.22.For more analysis on the set-off vis-à-vis *pari passu*, see In re Bank of Credit and Commerce International S.A. (No.10) [1997] Ch. 213, 252.

91 Article 7(2)(d) EIR 2015 Recast.

92 Article 9(1) EIR 2015 Recast.

ings on the basis of different rules towards set-off. However, outside the EU where no applicable laws are widely accepted, receiving courts have the power not to grant reliefs on the basis that the local law, such as the set-off rule, is not respected.

The above two examples show differences in laws. Another example is about the *Gibbs* rule mentioned in Chapter 3 at §3.3.1.2.4. This rule originates from the English common law tradition and ensures that any debt governed by English law cannot be discharged by foreign insolvency proceedings.[93] Apart from the analysis listed in Chapter 6 at §6.4.4.1.2, this Chapter 8 provides additional insights from the view of creditors' position: applying the *Gibbs* rule would lead to different treatment between creditors in different jurisdictions. The receiving jurisdiction (in this circumstance, the UK) would not accept foreign debt alteration or discharge, thus creditors governed by English law would be treated differently from other creditors. To address this, Bork assumes a hierarchy of principles of international insolvency law and holds that equal treatment of creditors is among the highest-ranking principles.[94] He further maintains that 'the idea of protecting "local creditors" must be rejected as displaying a confusing and erroneous emphasis on domestic creditors, where what is actually required is the equal treatment of local and foreign creditors'.[95] A simple direct application of national statutory rules might be questionable on the basis of possible unequal treatment outcomes between domestic and foreign creditors. It can be seen that the legal community has debated about the competing principles, that is, pure and complete equal treatment across the world and the application of national laws.

8.2.2 Creditors in recognition of foreign resolution measures

8.2.2.1 Creditors in resolution

Unlike the traditional insolvency regime in which creditors are major stakeholders and have deciding powers in pursuing insolvency procedures, one of the most distinctive features of bank resolution is the shift from individual to public interest,[96] where creditors are subject to the concept of greater good, such as financial stability. In resolution, the creditors' position is subordinated to public policy considerations, and creditors are supposed to absorb the losses after the shareholders during resolution proceedings.[97]

93 Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux (1890) 25 Q.B.D. 399 (CA).
94 Bork (n 3) para 5.4.
95 Ibid para 6.9.
96 Matthias Haentjens and Bob Wessels, 'Three Paradigm Shifts in Recent Bank Insolvency Law' (2016) 31 Journal of International Banking Law and Regulation 396.
97 See FSB Key Attributes, Preamble.

As explained in Chapter 2 at §2.1.4, one of the most representative resolution tools is the bail-in tool, which would substantively alter creditors' positions by either writing down their claims or converting their claims into equity.[98] Another common resolution tool is the transfer tool, which collectively refers to those measures transferring assets and liabilities of the debtor to other entities, including to a solvent third party, a bridge institution, or a separate asset management vehicle, without the need of obtaining any consent from the shareholders or creditors.[99] A full transfer of liabilities to a third institution might not materially affect the creditors' rights; however, the transfer tool is usually implemented through a partial transfer of assets and liabilities, in which circumstance some creditors' claims are transferred to a new solvent institution and are not affected, while some other remaining liabilities would enter liquidation proceedings and those creditors left behind might suffer losses.[100] These two major resolution powers largely affect the creditors' rights in the way that they are statutory powers and can be exercised without obtaining the creditors' consent.[101]

Another resolution tool is restriction on early termination rights. Upon entering into resolution, a temporary stay on early termination rights is exercised, 'to allow a short period of time for the resolution authority to make a determination on the treatment of the contracts'.[102] After the temporary stay time, some contracts may remain in the bad bank and be subject to loss absorption. The counterparties can still exercise the early termination rights, however, due to the volatility of these instruments, the value of these

98 See, e.g. Chris Bates and Simon Gleeson, 'Legal Aspects of Bank Bail-ins' (2011) 5 Law and Financial Markets Review 264; Victor de Serière, 'Bail-in: Some Fundamental Questions' in Matthias Haentjens and Bob Wessels (eds), *Bank Recovery and Resolution: A Conference Book* (Eleven International Publishing 2014); Joseph H Sommer, 'Why Bail-in? And How?' (2014) December Federal Reserve Bank of New York Economic Policy Review 207; Bart PM Joosen, 'Regulatory Capital Requirements and Bail in Mechanisms' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015); Michael Schillig, *Resolution and Insolvency of Banks and Financial Institutions* (OUP 2016) 279-310.

99 KAs 3.2 (vi)-(viii), 3.3 and 3.4. See literature, e.g. Stephan Madaus, 'Bank Failure and Pre-emptive Planning' in Matthias Haentjens and Bob Wessels (eds), *Bank Recovery and Resolution: A Conference Book* (Eleven International Publishing 2014); Michael Schillig, 'The EU Resolution Toolbox' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar Publishing 2015); Michael Schillig, 'Private Sector Transfer, Bridge Bank, and Asset Separation' in *Resolution and Insolvency of Banks and Financial Institutions* (OUP 2016).

100 See, e.g. Jens-Hinrich Binder, 'The Position of Creditors under the BRRD' (2015) Commemorative Volume in memory of Professor Dr Leonidas Georgakopoulos, Bank of Greece's Center for Culture, Research and Documentation 37; Geoff Davies and Marc Dobler, 'Bank Resolution and Safeguarding the Creditors Left Behind' (2011) 2011 Bank of England Quarterly Bulletin 213.

101 FSB KA 3.3.

102 FSB KA EN 4(a).

financial instruments may be affected.[103] Other contracts transferred to a solvent bank or exempted from bail-in cannot exercise the early termination rights only because of entry into resolution.[104]

Several safeguard measures are available for creditor protection. First, the losses suffered by creditors should respect the hierarchy of liquidation in national insolvency laws, which means the loss-absorption sequence should follow the ranking of claims in the liquidation proceedings – shareholders absorb losses first, followed by unsecured subordinated creditors and then senior creditors.[105] This mechanism reflects the *pari passu* rule. However, resolution powers shall also provide 'flexibility to depart from the general principle of equal treatment of creditors of the same class, with transparency about the reasons for such departures'.[106] In fact, in a partial transfer, the claims left behind might be treated in a less favourable situation than those transferred to a solvent third entity or bridge institution, and thus would be a violation of the *pari passu* rule.[107]

Second, creditors cannot suffer losses greater than the losses would have been in liquidation proceedings, and if there are any differences, creditors should be entitled to compensation.[108] This is the no creditor worse off than in liquidation principle (NCWO).[109] Although 'creditors have far less procedural rights in bank resolution than they would have under general insolvency law', with the implementation of the NCWO principle, they are 'guaranteed at least an economic outcome that would not be worse than that they would have to expect in ordinary winding-up'.[110] However, a concern is raised about the NCWO principle, that is, in practice, it would be difficult to conduct an *ex-post* fair valuation about what the position would be in an alternative liquidation that did not happen, and thus it would be difficult to determine the real losses.[111]

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103 UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law, 156-159. See also, e.g. Edward Janger and John AE Pottow, 'Implementing Symmetric Treatment of Financial Contracts in Bankruptcy and Bank Resolution' (2015) 10 Brooklyn Journal of Corporate, Financial & Commercial Law 155, 164-168; Mark J Roe and Stephens D Adams, 'Restructuring Failed Financial Firms in Bankruptcy: Selling Lehman's Derivatives Portfolio' (2015) 32 Yale J on Reg 363, 373-377.

104 FSB KA EN 4(a).

105 FSB KAs 3.5(i) and 5.1.

106 See the FSB Key Attribute 5.1. It is proposed by the FSB that equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt (including all regulatory capital instruments) has been written-off entirely (whether or not that loss-absorption through write-down is accompanied by conversion to equity).

107 Binder (n 100) 48-51. See also Davies and Dobler (n 100).

108 FSB KA 5.2.

109 FSB KA 5.2.

110 Binder (n 100) 45.

111 Ibid 47.

Third, there are safeguard measures specifically set for the temporary stay tool, including: (i) 'be strictly limited in time'; (ii) 'be subject to adequate safeguards that protect the integrity of financial contracts and provide certainty to counterparties'; and (iii) 'not affect the exercise of early termination rights of a counterparty against the firm being resolved in the case of any event of default not related to entry into resolution or the exercise of the relevant resolution power occurring before, during or after the period of stay'.[112]

Fourth, legal remedies and judicial action is another safeguard measure. The resolution authorities exercising resolution measures shall be 'subject to constitutionally protected legal remedies and due process'.[113] To reach the goal of a fast and efficient resolution, the FSB advised establishing an *ex-post* compensation mechanism.[114] The intention is that such resolution would ensure a timely resolution to achieve the objectives of financial stability within a short period of time so that the involvement of judicial bodies is minimised unless the judicial proceedings are expedited.[115] The court proceedings are, therefore, more necessary when resolution actions 'are unlawful because they have been taken in bad faith or are otherwise outside its legal powers, and does not constrain the general or inherent powers of the court to award remedies'.[116]

8.2.2.2 Creditors in cross-border resolution

In a cross-border context, the non-discriminatory treatment of domestic and foreign creditors is still a general principle of cross-border bank resolution. From the home jurisdiction's perspective, home authorities cannot adopt resolution measures discriminating against foreign creditors. The FSB confirms that

> National laws and regulations should not discriminate against creditors on the basis of their nationality, the location of their claim or the jurisdiction where it is payable.[117]

To simplify the illustration, all these 'nationality', 'location' and 'jurisdiction' factors are collectively referred to as 'nationality'. In reality, such equality might be a theoretical illusion, and it is not unusual for (home) resolution authorities to favour their national creditors, whether intentionally or unintentionally. There are two cases often mentioned by scholars that demon-

112 FSB KA 4.3. See also FSB KA Appendix I - Annex 5, para 2.1.
113 FSB KA 5.4.
114 FSB KA 5.5.
115 FSB KAAM EN 5(d).
116 FSB KAAM EN 5(e).
117 FSB KA 7.4.

strate a biased treatment by home authorities. The first case happened in the above-mentioned Icelandic financial crisis, in which only the local Icelandic depositors of those insolvent banks were transferred to a new bank and covered in its national deposit insurance scheme, while depositors in the UK and the Netherlands were not.[118] The second case happened during the Cyprus financial crisis in the process of exercising a bail-in tool.[119] To resolve the crisis, deposits over €100, 000 in two Cypriot banks were bailed-in, partly converted into equity and partly liquidated.[120] However, among the depositors, many were Russians, who, in the Cypriot media, were portrayed as 'rich, unscrupulous profiteers'.[121] And some authors even made the comment that an alternative bail-out measure would mainly benefit 'rich Russians who have invested illegal money there'.[122] In the authors' inflammatory words, 'the beneficiaries of the help won't be ordinary workers or farmers but a caste of nouveau-riche immigrants that shamelessly boast their wealth while making virtually no contribution to solving the country's problems'.[123] The case raised suspicion of Cypriot discriminatory treatment against Russian creditors. These two cases are further analysed in §8.4.1.

Despite the intention of establishing an international rule that no discrimination should be allowed against foreign persons, in reality, the home authorities may favour their own citizens. In such circumstances, a foreign creditor from the host jurisdiction may have no adequate remedy in the home jurisdiction, and it is up to host authority to provide a legal remedy against the assets of the debtor located in the host jurisdiction. One particular solution is to ring-fence the host assets and realise the assets to satisfy the host creditors with priority. This is the practice in the US, as mentioned in Chapter 4. The US authority would ring-fence the local branches, regardless of the foreign

118 Regarding the Icelandic financial crisis, see, e.g. BCBS, 'Report and Recommendations of the Cross-border Bank Resolution Group' (March 2010) 12-14; Stijn Claessens and others, *A Safer World Financial System: Improving the Resolution of Systemic Institutions* (International Center for Monetary and Banking Studies 2010) 51-53; IMF, 'Cross-border Bank Resolution: Recent Developments' (June 2014) 30-31.

119 Regarding the Cyprus financial crisis, see, e.g. IMF (n 118) 34-35; World Bank, 'Bank Resolution and "Bail-in" in the EU: Selected Case Studies Pre and Post BRRD' (2016) 18-23. For literature see, e.g. John Theodore and Jonathan Theodore, *Cyprus and the Financial Crisis: The Controversial Bailout and What It Means for the Eurozone* (Palgrave Macmillan 2015).

120 Regarding the resolution measures, see Central Bank of Cyprus, Clarification for the Better Understanding of the Resolution Measures Implemented under the Resolution of Credit and Other Institutions Law, 2013 at the Bank of Cyprus and Laiki Bank, 30 March 2013 <https://www.centralbank.cy/en/announcements/30032013-1> accessed 25 February 2020.

121 Theodore and Theodore (n 119) 71.

122 M Dettmer & C Reiermann, EU Aid for Cyprus A Political Minefiled for Merkel, Spiegel Online <http://www.spiegel.de/international/europe/german-intelligence-report-warns-cyprus-not-combating-money-laundering-a-865451.html> accessed 25 February 2020.

123 Ibid.

proceeding. Of course, this practice can protect the host creditors from a possible discriminatory resolution. However, it also impedes effective global resolution.

The ring-fencing approach is usually accompanied by the refusal of recognition of foreign resolution actions.[124] Apart from the potential discriminatory treatment from home jurisdictions, another common reason for a host authority not to recognise home resolution actions is to protect the interests of local creditors, particularly, in accordance with host laws. Under the current legal framework, there is no legal obligation for the home authority to take actions according to the host law unless it is within the EU where the Article 117 of the Bank Recovery and Resolution Directive (BRRD) applies. At the global level, there are no rules. In this sense, the conflict between equal treatment of creditors and protection of local creditors' rights in cross-border bank resolution cases resembles the conflict in corporate insolvency cases. In the recognition proceedings, these two competing principles need a delicate balance.

On the one hand, it is indisputable that a discriminatory treatment by foreign home authorities is a justifiable reason for host authorities to refuse to recognise foreign resolution measures. As mentioned at the beginning of this chapter, the FSB proposed that '[r]ecognition or support of foreign measures should be provisional on the equitable treatment of creditors in the foreign resolution proceeding'.[125] It is the leading rule guiding cross-border cases, including recognition proceedings. The FSB explained that '[i]n the context of recognition where the creditor hierarchy of the foreign jurisdiction may apply, it would be consistent with the standard to condition recognition on, at minimum, creditors in the host jurisdiction receiving treatment equal to that of home-country creditors with similar legal rights (i.e. a non-discrimination requirement).'[126]

On the other hand, yet more complex, the over-protection of 'local interest' may result in a different form of unequal treatment of creditors from different jurisdictions. The previous section in this chapter shows that in traditional cross-border corporate insolvency cases, national authorities might not refuse to recognise foreign insolvency proceedings on the basis of the mere difference of national insolvency laws, but it is a common practice for national authorities to refuse to grant additional reliefs before the local rules are satisfied. In some jurisdictions such as the US and China, where the cross-border corporate insolvency laws still apply in cross-border resolution cases, this practice will remain unless the national insolvency

124 Binder (n 100) 59-60.
125 FSB KA 7.5. See also FSB Principles, 13.
126 FSB KA EN 7(g).

law is amended. However, this dissertation argued that local obstacles for impeding a global resolution strategy should be minimised. The following sections further investigate specific rules that should be applied.

8.3 Creditors' positions in the selected jurisdictions

This section examines two general issues in the selected jurisdictions: equal treatment of creditors and special treatment for host creditors. As shown below, all the selected jurisdictions acknowledge both principles, yet there is an inherent conflict between the two.

8.3.1 Equal treatment of creditors

As summarised above, equal treatment of creditors is a principle generally applied to the whole cross-border proceedings, not only limited to the recognition proceedings. In fact, the equal treatment of creditors obligation is more often imposed on the home authorities when actively taking resolution measures.

In the EU, equal treatment of creditors is one of the general principles governing bank resolution. The BRRD confirms that 'when applying the resolution tools and exercising the resolution powers, … creditors of the same class are treated in an equitable manner'.[127] In other words, 'where creditors within the same class are treated differently in the context of resolution action, such distinction should be justified in the public interest and should be neither directly nor indirectly discriminatory on the grounds of nationality'.[128] In particular, special attention is paid to the bail-in tool and the transfer tool. When applying the bail-in tool, including write-down and conversion powers, it is required that the losses should be allocated equally between liabilities of the same rank.[129] With regard to the transfer tool, 'the power to decide which liabilities to transfer out of a failing institution based upon the objectives of ensuring the continuity of services and avoiding adverse effects on financial stability may affect the equal treatment of creditors', but it is also emphasised 'where creditors within the same class are treated differently in the context of resolution action, such distinctions should be justified in the public interest and proportionate to the risks being addressed and should be neither directly nor indirectly discriminatory on the grounds of nationality.'[130] The home resolution authority does have

127 Article 34(1)(f) BRRD; Article 15(1)(f) SRMR. Recital (47) BRRD also reaffirms that 'resolution authorities should take all appropriate measures to ensure that resolution action is taken in accordance with principles including that … creditors of the same class are treated in an equitable manner'.

128 Recital (47) BRRD. See also Recital (60) SRMR.

129 Article 48(2) BRRD.

130 Recital (13) BRRD.

the discretion to treat similarly situated creditors differently; however, the threshold cannot be nationality. A thorough examination of the legal texts in the BRRD does not reveal any exception for nationality non-discrimination.

In the US, the Dodd-Frank Act confirms that '[a]ll claimants of a covered financial company that are similarly situated … shall be treated in a similar manner'.[131] The Federal Deposit Insurance Corporation (FDIC) may decide to depart from such requirement only if it is necessary (i) 'to maximize the value of the assets'; (ii) 'to initiate and continue operations essential to implementation of the receivership or any bridge financial company'; (iii) 'to maximize the present value return from the sale or other disposition of the assets'; and (iv) 'to minimize the amount of any loss realized upon the sale or other disposition of the assets'.[132] It thus could be inferred that nationality cannot be a justifiable reason to not comply with the equal treatment of creditors principle.

In China, although currently there is no particular bank resolution law, the general corporate insolvency law prescribes that creditors similarly situated should be repaid *pro rata*.[133] There is no distinction between Chinese and foreign creditors, and therefore it is assumed that foreign and domestic creditors should be treated in the same way.

In other words, the selected jurisdictions do not intentionally discriminate against foreign creditors, at least not explicitly in the written law. There is special situation, though, regarding depositors. The US has a long-standing 1993 'national depositor preference' rule, which requires that any 'deposit liability of the institution' should rank higher than other 'general or senior liability'.[134] In particular, this provision sets a preferential treatment for deposits at domestic institutions over deposits at foreign institutions, namely, the national depositor preference rule does not apply to 'any obligation of a depository institution which is carried on the books and records of an office of such bank or savings association located outside of any State' or 'any international banking facility deposit'.[135] In other words, deposits

131 12 US Code §5390(b)(4).

132 12 US Code §5390(b)(4)(A).

133 Article 113 EBL.

134 12 US Code §1821(d)(11) 'depositor preference', established by the Omnibus Budget Reconciliation Act. See, e.g James Thomson, 'The National Depositor Preference Law' (1994) Federal Reserve Bank of Cleveland, Economic Commentary (15 February 1994); Simon Gleeson and Randall D. Guynn, *Bank Resolution and Crisis Management: Law and Practice* (OUP 2016) para 2.36ff; Schillig (n 98) para 13.46ff.

135 12 US Code §1813(l)(5). See James A Marino and Rosaline L Bennett, 'The Consequences of National Depositor Preference' (FDIC Banking Review) <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.190.8222&rep=rep1&type=pdf> accessed 25 February 2020; FDIC, '"Deposit Liability" for Purposes of National Depositor Preference Includes Only Deposits Pyable in U.S.' (28 February 1994) <https://www.fdic.gov/regulations/laws/rules/4000-8720.html> accessed 25 February 2020.

at branches of foreign banks cannot enjoy such preferential treatment. By contrast, US authorities still have interests in resolving failing branches of foreign banks, which, as explained in Chapter 4, are resolved by a separate entity approach subject to only US authorities.[136] In 2013, the FDIC also clarified that foreign branches of US banks are not insured by the FDIC.[137]

It should be noted that such a national depositor preference rule developed over the past decades. At the earliest, the International Banking Act (IBA) allowed branches of foreign banks to take retail deposits and they can be insured by the FDIC, in order to ensure 'parity of treatment between foreign and domestic banks in like circumstances', namely, a policy of national treatment.[138] However, this position was opposed by the FDIC at the beginning, which arised from the concern that 'insufficient legal and regulatory controls could be placed on branch operation that are not legally separate from those of the parent bank'.[139] However, failures of two foreign banks in the 1990s, namely, Banca Nazionale del Lavoro and Bank of Credit and Commerce International (BCCI), strengthened the concern of the FDIC, and the Foreign Bank Supervision Enhancement Act of 1991 reversed the provisions in the IBA and required that most branches of foreign banks cannot take deposits and cannot be insured by the FDIC.[140] For those grandfathered institutions insured by the FDIC before 1991, they are subject to the FDIC resolution, without the need to discuss (home) entities outside the US.[141] In short, the exclusion of branches of foreign banks from eligible FDIC-insured institutions is because insuring branches of foreign banks 'would expose the insurance fund to unacceptable risks of loss from events beyond the FDIC's control because of limited ability to supervise direct offices of foreign banks'.[142]

A similar situation exists in China. The Commercial Bank Law (CBL) does not provide for a different treatment of foreign and domestic depositors.[143]

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136 See Chapter 4, §4.3.1.2.2.

137 FDIC, 12 CFR Part 330, RIN 3064-AE00, Deposit Insurance Regulations; Definition of Insured Deposit, 78 Fed Reg 56583. See, e.g. Bradley K Sabel, 'Preferring Foreign Depositors - The Final Rule' (*Harvard Law School Forum on Corporate Governance and Financial Regulation* 28 September 2013) <https://corpgov.law.harvard.edu/2013/09/28/preferring-foreign-depositors-the-final-rule/> accessed 25 February 2020.

138 S. Rep. No.95-1073, 2 (1978), reprinted in 1978 USCCAN 1421, 1422.

139 International Banking Act of 1978: Hearings on H.R. 10899 Before the Subcomm. on Financial Institutions of the Senate Committee on Banking, Housing & Urban Aairs, 95th Cong., 2d Sess. 93, 103-04 (1978) (statement of George A LeMaistre, Chairman, Federal Deposit Insurance Corporation).

140 12 US Code §3104(d).

141 Chapter 4, at Section 4.3.1.2.2.

142 John C Dugan and others, 'FDIC Insurance and Regulation of U.S. Branches of Foreign Banks' in Guynn R (ed), Regulation of Foreign Banks and Affiliates in the United States (9th edn, Thomson Reuters 2016), 611-612.

143 Article 71 CBL.

As a general rule, all individual deposits also enjoy preference priority, without additional sub-classes or the mentioning of corporate deposits.[144] It is still up to the new Bank Insolvency Risk Resolution Regulation to determine whether there would be any amendments to the current ranking of claims. However, the Deposit Insurance Regulation (DIR) excludes foreign branches of Chinese banks and Chinese branches of foreign banks from the list of eligible covered institutions, except for situations where China and another jurisdiction have an arrangement for the deposit insurance.[145] It is possible that foreign depositors can be left uninsured.

The EU takes an opposite stand. In the EU, the ranking of claims in liquidation is in the competence of national legislators. It is admitted that the Member States in the EU 'have divergent approaches to the subordination of creditor claim'.[146] However, the EU has attempted in Article 108 BRRD to harmonise to a certain level the ranking of claims. Implementing this Article requires that uncovered deposits from natural persons and SMEs rank higher than ordinary unsecured, non-preferred creditors, and covered deposits as well as deposit guarantee schemes subrogating to the rights and obligations of covered depositors in insolvency rank even higher than uncovered deposits. Different from the US, the BRRD does not make a distinction for foreign branches in non-EU countries. In relation to DGSs, within the EU, 'DGSs shall cover the depositors at branches set up by their member credit institutions in other Member States',[147] and '[d]epositors at branches set up by credit institutions in another Member State shall be repaid by a DGS in the host Member State on behalf of the DGS in the home Member State'.[148] In other words, depositors at home and host Member States should be treated equally.

In terms of third-countries, the EU adopts an 'equivalency' test. It is required that 'Member States shall check that branches established in their territory by a credit institution which has its head office outside the Union

144 Article 71 CBL.
145 Article 2 DIR.
146 COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT Accompanying the document Proposal amending: - Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms; - Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms; - Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms; - Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, COM(2016) 850 final, COM(2016) 851 final, COM(2016) 852 final, COM(2016) 853 final, COM(2016) 858 final, Brussels, 24.11.2016, SWD(2016) 377 final/2, 74.
147 Article 14(1) DSG Directive 2014.
148 Article 14(2) DSG Directive 2014.

have protection equivalent to that prescribe in [DGS Directive]'.[149] And '[i]f protection is not equivalent, Member State may … stipulate that branches established by a credit institution which has its head office outside the Union may join a DSG [deposit guarantee scheme] operation within their territories'.[150] Based on these provisions, a branch of a US or Chinese bank within the territory of the EU may join a DSG of the Member State where the branch is located.

8.3.2 Host creditors' interest in the recognition proceedings

As seen below, all the selected jurisdictions guarantee that the interest of host creditors is protected, and the host authorities would refuse to recognise foreign home proceedings on the condition that host creditors' interest is compromised. In one scenario, if host creditors were treated less favourably in the home proceeding, a host authority would refuse to recognise. In another, if host and home creditors are treated the same way, but in accordance with the home law, a host authority may also refuse to recognise or recognise subject to the condition that the host law should apply to host creditors.

In the EU, resolution actions taken within the EU are automatically recognised across the EU Member States. With regard to the recognition request from third jurisdictions outside the EU, Article 95 BRRD lists five circumstances as reasons to refuse to recognise or enforce third-country resolution actions. Those related to the creditors' position are

> …
> (c) creditors, including in particular depositors located or payable in a Member State, would not receive the same treatment as third-country creditors and depositors with similar legal rights under the third-country home resolution proceedings;
> …
> (e) that the effects of such recognition or enforcement would be contrary to the national law.[151]

It is clear that unequal treatment (point (c)) is a legitimate reason to refuse to recognise foreign resolution actions. Point (e) is more complex to interpret as to what constitutes as 'contrary to the national law'. A relevant question is raised and analysed in §8.4.2: Should the difference in laws be as the reason to refuse to recognise or support foreign resolution measures?

149 Article 15(1) para 1 DGS Directive 2014.
150 Article 15(1) para 2 DGS Directive 2014.
151 Article 95 BRRD.

In the US, the Bankruptcy Code Chapter 15 applies to recognition of foreign resolution actions. Accordingly, there are two primary mechanisms to protect host interest: first, public policy exception regulated in §1506, and second, other safeguard measures regulated in §1521(b) and §1522(a), with §1521(b) putting special emphasis on the protection of the interests of US creditors. Drawn from the previous cases, the mere fact of the difference of laws cannot trigger the public policy exception to refuse to recognise. Most foreign insolvency proceedings were recognised, unless US creditors were treated less favourably than foreign creditors. However, US courts may rely on other safeguard measures to ensure local rules are obeyed.

In China, Article 5 EBL prescribes the circumstances for refusal to recognise or enforce foreign insolvency judgments, and failure to protect the legitimate interests of local creditors is one of the grounds.[152] Although no court has invoked this exception, China does have the intention to protect Chinese local creditors.

8.4 Comparison and evaluation

8.4.1 How should circumstances be interpreted as discriminatory?

As concluded in the previous sections, any discriminatory actions against host creditors can be a reason not to recognise foreign resolution actions. But what circumstances should be interpreted as discriminatory? This question relies on a case-by-case analysis. This section analyses two real cases mentioned in §8.2.2.2 above.

The first case regards the difference in treatment of Icelandic depositors and English and Dutch depositors during the failure of Icelandic banks. In the dispute *The European Free Trade Area (EFTA) Surveillance Authority v Iceland*,[153] the court ruled that there was no legal obligation for Iceland to ensure payment to foreign depositors,[154] because the non-discrimination rule embedded in the European Economic Area (EEA) Agreement did not apply in this case on the basis that domestic deposits were transferred to a

152 Article 5 EBL.

153 Judgment of EFTA Court, *EFTA Surveillance Authority v Iceland*, E-16/11, 28 January 2013. See comments, e.g. Valia Babis, 'Abandoning Foreign Depositors in a Bank Failure? The EFTA Court Judgment in EFTA Surveillance Authority v. Iceland' (2013) 2 Global Markets Law Journal 1; M Elvira Méndez-Pinedo, 'The Icesave Saga: Iceland Wins Battle Before the EFTA Court' (2013) 1 MJIL Emerging Scholarship Project 101; Federico Lupo-Pasini, 'The Perils of Home-Country Control' in *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (CUP 2017); Federico Lupo-Pasini, 'Financial Stability in International Law' (2017) 18 Melbourne Journal of International Law 45.

154 Judgment of EFTA Court, *EFTA Surveillance Authority v Iceland*, E-16/11, 28 January 2013, paras 117-185.

third institution, which is not governed by the Deposit Guarantee Scheme Directive, nor within the scope of the plea made by the plaintiffs.[155] The court may have been correct in cautiously limiting its discretion to the extent of the law and the plaintiffs' plea; however, it overlooked the nature of non-discrimination as a general public policy. By following the court's decision, it would be possible to reach the absurd conclusion that any discrimination is acceptable when there is no explicit law forbidding such action.

A second argument the court made is that 'the EEA States enjoy a wide margin of discretion in making fundamental choices of economic policy in the specific event of a systemic crisis provided that certain circumstances are duly proven'.[156] The argument implies that the 'right to regulate', especially with the aim of maintaining financial stability, overrides the non-discrimination rule. This dissertation does not challenge the right to regulate but disagrees with the court's opinion on its hierarchy vis-à-vis non-discrimination rule, namely, the right to regulate is not a justifiable reason to deviate from the non-discrimination principle.[157] As mentioned above, Bork assumes a hierarchy of principles of international insolvency law and holds that equal treatment of creditors is among the highest-ranking.[158] In the present case, at least one alternative solution would be repaying *pro rata* both Icelandic and foreign creditors, thereby respecting the *pari passu* principle.[159] There seems to be no risk of major instability because of paying foreign creditors. In addition, allowing national interest as an arbitrary reason to deviate from non-discrimination principle would encourage home banks to take risky behaviours abroad or home authorities to take less prudential supervision, given that they are aware that they will not be responsible for foreign interests.[160]

This case also relates to the national depositor preference rule in the US. Excluding foreign branches of US banks from preferential treatment would result in a discriminatory treatment of host depositors, which is a justifiable reason for host authorities to refuse to recognise US resolution actions. In addition, foreign branches in the US and China cannot participate in the home jurisdictions' deposit guarantee schemes, which is another potential

155 Ibid paras 186-228.
156 Ibid para 227.
157 See similarly, Babis (n 153) 9-10. See also the discussion of domestic financial stability vis-à-vis international financial stability, Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (CUP 2017) 84-89.
158 Text to n 94.
159 Martin Wolf, 'How the Icelandic Sage Should End' (Financial Times, 14 January 2010) (presenting the data that the assets of the failed bank were sufficient to compensate depositors and over 100 percent of 4 billion euros in liabilities).
160 Lupo-Pasini (n 157) 88.

discriminatory scenario. In these circumstances, it is also possible for host jurisdictions not to recognise home resolution actions. Apart from invoking the non-discrimination rule, refusal of recognition could also be on the basis of material fiscal policies, because the host jurisdiction may need additional funding to save host branches, which gives justification for the host jurisdiction not to cooperate with home jurisdictions.[161]

The second case relates to the alleged sacrifice of Russian depositors in the resolution of the Cyprus crisis. However, unlike the above-mentioned Iceland case, this dissertation holds the view that the exercise of bail-in, in the Cyprus case, does not violate the *pari passu* rule. A report showed that among the €37.6 bn deposits that were exposed to haircut, only €25.5 billion belonged to foreigners,[162] which meant not only Russian depositors suffered losses, but also domestic depositors.[163] Although it put many rich Russians in disadvantageous positions, the Cyprus case differs from the Icelandic case, in the way that Cyprus set the threshold at a certain amount of money (€100, 000), rather than nationalities (Icelandic v British and Dutch). Despite the suspicion that the decision unfavourable to many Russians might have an implicit political incentive behind,[164] there was no manifest discrimination against Russians.

A relevant question is raised: If unequal treatment is not found in relation to host creditors but in relation to third countries, can a host authority refuse to recognise home resolution actions? At present, the EU law only lists discriminatory treatment of domestic creditors as the legitimate reason to refuse to recognise foreign resolution actions.[165] So does the FSB.[166] However, this dissertation suggests that equal treatment of creditors is a general rule applicable universally.

A relevant case is *Bayern LB v Hypo Alpe Adria (HETA)* mentioned in Chapter 3 at §3.3.1.1.1. In this case, a court in Munich refused to recognise an Austria resolution action because the action fell outside the scope of 'resolution'. Yet, the appeal court decided to set aside the first instance judgment because the Austrian Constitutional Court later ruled the Austrian resolution invalid because of the violation of the *pari passu* rule:

161 Chapter 7, at §7.4.3.

162 Kate Mackenzie (Financial Times, 18 March 2013) <https://ftalphaville.ft.com/2013/03/18/1426012/the-cyprus-depositor-pain-distribution-ratio/> accessed 25 February 2020.

163 Ian Jack and Tom Cassels, 'Cyprus: An Analysis of the Impact of the Resolution Methodology on Stakeholders' Claims Including the Emergency Liquidity Assistance' (2013) 8 Capital Markets Law Journal 450, 455.

164 See, e.g. Emilios Avgouleas and Charles Goodhart, 'Critical Reflections on Bank Bail-ins' (2015) 1 Journal of Financial Regulation 3, 16.

165 Article 95(c) BRRD; Article 33(3)(b) SRMR.

166 FSB Principles, 12.

> However, the Court found that the right to property was nonetheless violated because the HaaSanG differentiated within the group of subordinate creditors by declaring only those claims that mature before 30 June 2019 as expired. Subordinate creditors with such claims were discriminated further as the securities and guarantees on their claims expired together with the claim. Meanwhile, the other equally subordinate creditors were not affected at all and even kept their interest claims. Since it turned out that the cut-off date could not prevent HETA from failing before the end of restructuring period (measures under the Bank Restructuring and Resolution Act had been taken with regard to the remaining creditors after the entry into force of the Hypo Reorganisation Act), it could not ensure an orderly restructuring and resolution.[167]

Normally, a host authority would have no incentive to hamper cross-border bank resolution if no host creditors are discriminated against, namely, no host interests are harmed. However, as is the consistent viewpoint made in this chapter, equal treatment of creditors ranks highest among all the general principles.[168] Therefore, when making decisions to recognise a foreign resolution action, any discriminatory consequences should be considered. This is also the result of saving judicial resources. In the *HETA* case, the differentiated treatment of creditors was later ruled invalid and thus did not need to be recognised anymore. If the host authority had recognised and enforced the original Austrian action, there would have been a reverse verdict, which would have been a waste of resources. The receiving jurisdiction can set the request in pending until the home authority makes the decision.[169]

8.4.2 Should the difference in laws be as a reason to refuse to recognise or support foreign resolution measures?

Based on the previous summary on cross-border corporate insolvency cases, a conclusion is drawn that the differences of lawa are not necessarily as a reason to refuse to recognise foreign insolvency proceedings. However, when it comes to relief measures, for instance, turning over the domestic assets to a foreign representative, the difference of laws between the relevant countries might be a reason to refuse such a relief request. This

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167 Austrian Constitutional Court, decision of 3 July 2015, ECLI:AT:VFGH:2015:G239.2014 <https://www.vfgh.gv.at/downloads/Bulletin_2015-1_G_239-2014_03.07.2015.pdf> accessed 25 February 2020.

168 Text to n 94.

169 This is also the case in *Goldman Sachs v Novo Banco*, in which the English court decided that the effectiveness of the resolution action, which was under review in Portugal, should be in the hands of the home court. See *Goldman Sachs International v Novo Banco SA, Guardians of New Zealand Superannuation Fund & Ors v Novo Banco SA* [2015] EWHC 2371 (Comm), [2015] 2 CLC 475; *Guardians of New Zealand Superannuation Fund & Ors v Novo Banco SA, Goldman Sachs International v Novo Banco SA* [2016] EWCA Civ 1092, [2016] 2 CLC 690; *Goldman Sachs International v Novo Banco SA, Guardians of New Zealand Superannuation Fund & Ors v Novo Banco SA* [2018] UKSC 34, [2018] 1 WLR 3683.

section argues that any difference of law should not be the reason to refuse to recognise or enforce foreign resolution actions, subject to the condition that the host jurisdiction has the basic framework of resolution in place. In fact, as shown in the following comparison, there are not many substantive differences between each jurisdiction's resolution regimes, at least in the EU and the US where both jurisdictions have resolution laws in line with the FSB Key Attributes.

8.4.2.1 Bail-in

8.4.2.1.1 Bail-in in the selected jurisdictions

The first comparison is in relation to the bail-in tool. Among the selected jurisdictions, the EU has the most systemic legal regime for bail-in as prescribed in the BRRD and Single Resolution Mechanism (SRMR).[170] It regulates various aspects of how bail-in should be implemented, including 'objective and scope', 'minimum requirement for own funds and eligible liabilities', 'implementation of the bail-in tool', and other 'ancillary provisions'. The purpose of the bail-in tool is either to 'recapitalise an institution or an entity' or 'to convert to equity or reduce the principal amount of claims or debt instruments that are transferred (i) to a bridge institution with a view to providing capital for that bridge institution; or (ii) under the sale of business tool or the assets separation tool'.[171] The bail-in tool can be exercised individually or in combination with other resolution tools.[172] However, it should be noted that the bail-in tool in the EU context is different from the FSB KAs in that the bail-in in the BRRD and SRMR only applies to 'liability' rather than 'equity'.[173]

In the US, there is no clear mention of the phrase 'bail-in' in the Federal Deposit Insurance Act (FDIA), the Dodd-Frank Act or the Bankruptcy Code, nor in the newly proposed amendments including the Financial Choice Act, the Financial Institution Bankruptcy Act, and a Chapter 14 proposed by the Hoover Institute. The most recent policy recommendation made by the Treasury entitled 'Orderly Liquidation Authority and Bankruptcy Reform' states that 'the FDIC has taken several critical steps to address these concerns, including through the development of [the single point of entry (SPE)] strategy that would involve "bail-in" of long-term creditors of the holding company'. [174] The bail-in mechanism is believed to be carried out by implementing the SPE strategy, as shown in a document entitled 'Resolution of Systemically Important Financial Institutions: The Single

170 Articles 43-58 BRRD; Article 27 SRMR.
171 Article 43(2) BRRD.
172 Article 37(4) BRRD.
173 Article 2(1)(57) BRRD.
174 Treasury, Orderly Liquidation Authority and Bankruptcy Reform, February 21, 2018.

Point of Entry Strategy',[175] which contains no explicit mention of the term 'bail-in'. Simply put, the holding company of the financial group in distress would be put into resolution with the aim of absorbing the losses, while the operating subsidiaries, including the deposit-taking subsidiaries, would continue their normal businesses.[176] The bail-in is exercised together with the transfer tools as those discussed in §8.4.2.2. Under the SPE strategy, assets of the holding company, mainly the investments and loans to the subsidiaries, would be transferred to a 'bridge financial company',[177] and the remaining liabilities, including equity, subordinated debt and senior unsecured debt of the holding company, would be either partly repaid or, worse, not repaid at all.[178] The FDIC can also apply a 'securities-for-claims exchange' tool, by which the claims of creditors could be converted to the new debt, equity or contingent securities of the 'new holding company or new holding companies (NewCo or NewCos)', based on the bridge financial company.[179]

China, on the other hand, represents the third type of model which completely lacks a statutory bail-in tool. The Capital Rules acknowledge that write-down and conversion powers are in place for the financial authority,[180] previously the China Banking Regulatory Commission (CBRC) and currently, the China Banking and Insurance Regulatory Commission (CBIRC). However, the liabilities that could be written down or converted are only limited to the Additional Tier 1 (AT1) and Tier 2 (T2) instruments, and only for banks failing to meet the minimum capital requirements.[181] Although the legal texts explicitly contain the explicit wording 'write-down' (减记) and 'conversion into equity' (转为普通股), the two manifestations of the bail-in tool under resolution laws, the legislation itself – the Capital Rules – is supervisory guidance but not for resolution purposes. These measures are for the sole purpose of implementing Basel III reforms. Nevertheless, the SIFI Guiding Opinions confirm that bail-in will be adopted in China,[182] although the detailed implementation rules are not in place.

The following part therefore mainly compares the bail-in mechanisms in the EU and the US. The most obvious difference is the procedural aspect. The exercise of bail-in in the EU and the US differs in that bail-in is a statu-

175 FDIC, 'Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy' (2013) 78 Fed. Reg. 76614. See, e.g., Thomas Jackson and David Skeel, 'Dynamic Resolution of Large Financial Institutions' (2012) 2 Harv Bus L Rev 435; Schillig (n 98) para 11.49ff.

176 78 Fed. Reg. 76614, 77616.

177 12 US Code §5381 (a)(3).

178 78 Fed. Reg. 76614, 77616.

179 78 Fed. Reg. 76614, 77616.

180 Article 157 Capital Rules.

181 Articles 153 and 157 Capital Rules.

182 Article 29 SIFI Guiding Opinions.

tory tool in the EU which can be exercised independently, while in the US the bail-in effect is achieved through the bridge institution tool. However, these different approaches can lead to the same result that shareholders and subordinated creditors absorb the losses first.

Regarding the substantive aspect of bail-in, the *pari passu* principle still exists.[183] In the liquidation proceedings, similarly situated creditors are supposed to be repaid *pro rata*. In principle, the sequence of repayment is prescribed in the relevant law, and the insolvency practitioner or the court cannot amend it. In contrast, similarly situated creditors in the bail-in process are supposed to absorb the losses *pro rata* unless the resolution authority discretionarily determines to treat certain liabilities within a sub-group differently from the other liabilities within the same sub-group. In addition, the loss absorption should respect a certain hierarchy and bail-in can be imposed on higher rank liabilities only after the lower ranking liabilities have fully been written down or converted into equity. Regarding the ranking of claims, an established rule is that shareholders and subordinated unsecured creditors should bear the losses first.[184] In the EU, the sequence of write down and conversion is: (i) Common Equity Tier 1 (CET1); (ii) AT1; (iii) T2; (iv) subordinated debt; (v) the rest of eligible liabilities.[185] In the US, the FDIC also confirmed that '[l]osses would be apportioned according to the order of statutory priority among the claims of the former equity holders and unsecured creditors, whose equity, subordinated debt and senior unsecured debt would remain in the receivership'.[186] In short, subordinated debt is supposed to absorb the losses before other senior unsecured debt.

One closely related principle is the respect of national insolvency hierarchy and the NCWO rule, which is prescribed in both the EU[187] and the US.[188] As explained in §8.2.2.1, the NCWO rule ensures that no creditors should receive less than what they would have been received in liquidation. Although this rule is criticised as a result of its practicability or lack thereof, the purpose is to ensure that creditors who suffered losses greater than liquidation would receive further compensation. Regardless of the valuation issues, the NCWO rule also relates to the hierarchy of liquidation, which means that the general insolvency law hierarchy may affect the actual implementation of the bail-in.

183 Recital (77) BRRD; 12 US Code §5390 (b)(4).

184 KA 5.1; Recital (5) and Article 34(a)-(b) BRRD, Article 15(1)(a)-(b) SRMR; 12 US Code §5384(a)(1) and §5390(a)(1)(M).

185 Article 48(1) BRRD.

186 78 Fed. Reg. 76614, 77616.

187 Recitals (5) and (73) BRRD; Article 34(1)(g) BRRD.

188 12 US CODE §5390(a)(7).

Regarding the sequence of liquidation, the EU has not harmonised the ranking of claims in national insolvency laws, although Article 108 BRRD harmonises to a certain level the ranking of claims. In particular, uncovered deposits from natural persons and SMEs rank higher than ordinary unsecured, non-preferred creditors, and covered deposits as well as deposit guarantee schemes subrogating to the rights and obligations of covered depositors in insolvency rank even higher than uncovered deposits. In addition, according to the new amendment to Article 108 BRRD,[189] a new class of non-preferred senior debt is created, subordinated to other ordinary unsecured claims, on the conditions that (i) 'the original contractual maturity … is of at least one year'; (ii) 'the debt instruments contain no embedded derivatives and are not derivatives themselves'; and (iii) 'the relevant contractual documentation and, where applicable, the prospectus related to the issuance explicitly refer to the lower ranking'.[190] Simply put, short-term debts or derivatives and derivative-related instruments (such as structured notes) are favoured in the EU.

In contrast, the priority of claims prescribed in the Dodd-Frank Act is: (i) administrative expenses; (ii) any amounts owed to the US; (iii) employee salaries; (iv) employee benefits; (v) senior debt; (vi) subordinated debt; (vii) senior officer salaries; and (viii) equity.[191] As can be seen, there are no additional sub-classes within the senior debt category and no special treatment for short-term debts or derivatives.

In addition, as mentioned above, both the EU and the US now adopt the depositor preference rule. Both of them give special protection to deposits of natural persons and SMEs. However, one difference is that deposits of large corporates are also covered in the US national depositor preference rule, but not in the BRRD. EU resolution authorities can bail-in deposits of large corporates subsequent to other senior liabilities, yet prior to uncovered deposits of natural persons and SMEs. These are the differences between the EU and the US. It is worth mentioning that, in China, all individual deposits also enjoy preference priority, without additional sub-classes or the mention of corporate deposits.[192]

Another difference is about liabilities excluded from bail-in. The BRRD clearly states that certain liabilities are excluded from the coverage of the bail-inable liabilities, including (a) 'covered deposits'; (b) 'secured liabilities'; (c) 'client assets or client money'; (d) 'any liability that arises by virtue

189 DIRECTIVE (EU) 2017/2399 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 December 2017 amending Directive 2014/49/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy, OJ L 345/96.

190 Article 108 (2) BRRD (revised).

191 12 US Code §5390 (b)(1).

192 Article 71 CBL.

of a fiduciary relationship'; (e) 'liabilities to institutions … with an original maturity of less than seven days'; (f) 'liabilities with a remaining maturity of less than seven days, owed to systems or operators of systems … or their participants and arising from the participation in such a system' and (g) 'a liability to … an employee…, a commercial or trade creditor ..., tax and social security authorities … and deposit guarantee schemes'. [193] Also, there are exceptional circumstances in which the resolution authority can exclude certain liabilities from bail-in.[194] In contrast, the US legal framework does not provide for such a specific exclusion of bail-inable liabilities. However, the FDIC indicated that liabilities to vendors and secured creditors should be transferred to the bridge financial company and thus avoid bail-in.[195] Also, deposits, employees' claims, tax claims are preferred claims in the Dodd-Frank Act, while client assets and liabilities arising out of fiduciary relationships do not, in essence, belong to the debtor. Exclusion of short-term debt may also be in line with the US policy choice as mentioned in the Total Loss-absorbing Capacity (TLAC) rule. Although there is no clear indication that the maturity date should be within seven days, the underlying rationale might be accepted.

8.4.2.1.2 Analysis

Based on the above analysis, in short, all jurisdictions generally accept the legitimacy of bail-in, although China does not have a detailed rule. Nonetheless, when comparing the bail-in implementation requirements in the EU and the US, the difference is also obvious: most distinctly, the EU has direct rules on bail-in in the BRRD, while the US only provides an SPE strategy without a further indication on the coverage of bail-inable liabilities and the legal process of executing the bail-in tool. In addition, the EU and US differ in the aspects of coverage of bail-inable liabilities and the ranking of claims.

In cross-border cases, usually, active recognition would not be requested in the case of bail-in. A more likely case is a host creditor brings about litigation against the home debtor in the host court and seeks full repayment of the claims. The court thus needs to decide on the validity of the bail-in procedure. Based on the present laws, it is not clear whether China would recognise foreign bail-in measures. Given that the law has not officially prescribed a statutory bail-in power in China, Article 5 EBL, especially the public policy exceptions specified therein, can be a reason to refuse to recog-

193 Article 44(2) BRRD.

194 Article 44(3) BRRD; Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstance where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, OJ L 144/11.

195 78 Fed. Reg. 76614, 77618. Here, vendors share a similar meaning of the commercial or trade creditors in the EU, who provide daily operation services.

nise foreign bail-in. In the circumstances of pursuing recognition in the EU or US, there is no explicit law on this issue. According to Article 95 BRRD, EU resolution authorities are empowered to refuse to recognise third-country resolution actions if 'the effects of such recognition or enforcement would be contrary to the national law'.[196] However, based on the above comparison, does it mean that the US resolution procedure is contrary to EU law?

In cross-border corporate insolvency, the mere difference of laws, including both procedural and substantive differences, does not form a sufficient reason to refuse foreign insolvency proceedings. This general principle may also be extended to this special insolvency proceeding – resolution. As shown above, the most outstanding difference between the EU and the US is the procedural difference in the sense that the EU can directly apply the bail-in tool, while the US exercises the bail-in tool through the transfer tool. The different approaches are with the same purpose of resolution and can lead to the same result: shareholders and subordinated creditors absorb the losses. Despite the differences, both jurisdictions incorporate the FSB Key Attributes with the same purpose of making shareholders and subordinated creditors absorb the losses. It is difficult to reach the simple conclusion that US law is *contrary* to EU law.

A relevant case – the *Irish Bank* case – confirms that the winding-up measures taken by the Irish Finance Minister, although administrative in nature and different than the general judicial corporate insolvency proceedings, 'parallel provisions in laws adopted by the United States in response to the global financial crisis'.[197] This case demonstrates that the US accepts the validity of foreign resolution proceedings, without the need for them to be identical to US resolution proceedings. It should be acknowledged that identical resolution regimes are nearly impossible to achieve, but the administrative nature with the aim of orderly resolution should be the common cornerstone of the modern resolution regimes in different jurisdictions. Any invocation of public policy exceptions should be interpreted with a narrow approach, and the differences between bail-in procedures are not sufficient enough to refuse recognition.

8.4.2.2 Transfer tools

8.4.2.2.1 Transfer in the selected jurisdictions

In the EU, the transfer tool encompasses three resolution tools: the sale of business tool, the bridge institution tool and the asset separation tool. The sale of business tool is to effect a sale of the institution or part thereof

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196 Article 95(e) BRRD; Article 33(3)(d) SRMR.

197 *In re* Irish Bank Resolution Corporation Ltd., 538 B.R. 692 (D. Del. 2015), 698.

to one or more private sector purchasers, by transferring shares or other instruments of ownership issued by the institution under resolution or all or any of its assets, rights, or liabilities. [198] The sale of business tool does not need the consent of the shareholders or any third party 'other than the purchaser'.[199] The bridge institution tool will be applied when no private buyer is quickly available, or the failing institution is too big to merge with another institution, which enables the resolution authorities to transfer all or a part of the business of the institution under resolution to a temporary bridge institution. [200] The asset separation tool authorises the resolution authorities to transfer certain assets, rights and liabilities of the institution under resolution or a bridge institution to an asset management vehicle.[201] The asset separation tool has to be applied together with another resolution tool.[202] The exercise of bridge institution tool and asset separation tool also may take place without the consent of the shareholders or any third party 'other than the bridge institution'.[203]

In the US, the Dodd-Frank Act empowers the FDIC to 'merge the covered financial company with another company', or 'transfer any asset or liability of the covered financial company … without obtaining any approval, assignment, or consent with respect to such transfer', [204] including to a 'bridge financial company',[205] also without consent.[206] Similarly, the FDIC can also act as the receiver of the insured deposit institutions (IDIs) and exercise transfer powers including 'purchase and assumption transaction' (P&A)[207] and 'bridge bank'.[208] These transfer powers may also be exercised without the consent of the shareholders or creditors. [209]

In China, the authorities can assume control over a failing institution and exercise the operation and management powers.[210] There might be cases where the authorities decide to sell the business or transfer assets and liabilities to another institution, but the decision needs to comply with

198 Articles 2(1)(58) and 38-39 BRRD; Articles 3(1)(30) and 24 SRMR. See Madaus (n 99) 61; Schillig, 'The EU Resolution Toolbox' (n 99) 91-93.
199 Article 38(1) BRRD.
200 Articles 2(1)(60) and 40-41 BRRD; Articles 3(1)(31) and 25 SRMR. See Madaus (n 99) 61-62; Schillig, 'The EU Resolution Toolbox' (n 99) 93-94.
201 Article 42(1) BRRD; Article 26 SRMR. See Madaus (n 99) 61-62; Schillig, 'The EU Resolution Toolbox' (n 99) 94-95.
202 Article 37(5) BRRD; Article 22(4) SRMR.
203 Article 40(1) BRRD; Article 42(1) BRRD.
204 12 US Code §5390 (a)(1)(G)(i).
205 12 US Code §5390 (a)(F) and (h).
206 12 US Code §5390 (O)(iii), (h)(2)(E)(ii) and (5)(D).
207 12 US Code §1821 (d)(2)(G); §1823 (c)(2)(A) and (4)(E)(iii).
208 12 US Code §1821 (d)(2)(F); 12 US Code §1821 (m)(new depository institutions) and (n) (bridge depository institutions). See FDIC, Resolution Handbook, 18.
209 12 US Code §1821(d)(2)(G)(i)(II) and (n)(3)(A)(iv).
210 Article 66 CBL.

Chinese company law or contract law, including the statutory requirement of shareholders' or creditors' consent. In other words, the authorities do not have an explicit power to override shareholders' rights, thus assumption of control is not considered as a transfer tool here. The following part again only compares the EU and US transfer tools.

A substantive concern is about the partial transfer in which creditors similarly situated might be treated differently. As explained above, bail-in is exercised in the US through the transfer tool. [211] A similar situation might happen in the EU as well. In a partial transfer, certain liabilities might be transferred to another entity, thus unaffected, but the remaining liabilities entering into liquidation would suffer losses. Creditors left behind might be treated in a less favourable situation than those whose claims are transferred. The authorities do have discretionary power to determine which liabilities are transferred to a solvent institution and which liabilities are left behind for loss-absorbing, but they cannot discriminate against foreign creditors and only put foreign claims in the bad bank. The difference is that the US resolution authorities would follow a loss-absorption rule that the statutory priority should be respected in the sequence of equity, subordinated debt and senior unsecured debt.[212] The EU does not have a similar explicit provision. The reason is that the US treats the transfer tool as a mechanism for loss-absorption and thus respects the insolvency hierarchy similar to the bail-in tool; while in the EU, the bail-in tool and the transfer tool are separate tools and the transfer tool does not serve the function of bail-in.

The second point is about the safeguard measures in a partial transfer, which are similar in the EU and the US. In the EU, special safeguard measures are provided for liabilities include security arrangement, title transfer financial collateral arrangements, set-off arrangements, netting arrangements, covered bonds, and structured finance arrangements.[213] The BRRD regulates that '[w]hen the safeguard applies, resolution authorities should be bound to transfer all linked contracts within a protected arrangement, or leave them all with the residual failing institution', in order to 'preserve legitimate capital market arrangements' and to 'prevent the splitting of linked liabilities, rights and contracts'.[214] Similarly, the US also regulates similar protection for 'qualified financial contracts' (QFCs), requiring

211 78 Fed. Reg. 76614.
212 78 Fed. Reg. 76614, 76616.
213 Article 76 BRRD. Also Commission Delegated Regulation (EU) 2017/867 of 7 February 2017 on classes of arrangements to be protected in a partial property transfer under Article 76 of Directive 2014/59/EU of the European Parliament and of the Council, OJ L 131/15.
214 Recital (95) BRRD.

these QFCs should be transferred either all together or not at all.[215] A QFC means 'any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the [FDIC] determines by regulation, resolution, or order to be a qualified financial contract'.[216] Despite the different wording, both the EU and the US confirm that liabilities attached to each other cannot be separated.

Procedurally, both the EU and the US authorities can exercise these transfer tools overriding the shareholders' and creditors' rights, removing the most difficult obstacle in implementing such resolution powers. However, the transfer tools are subject to different national laws and regulations. For instance, the EU sale of business tool needs to comply with Article 39 BRRD procedural requirements, while the US P&A power needs the approval of federal agency.[217] In addition, the operation of the bridge institution also needs to comply with local rules covering authorisation, management and other supervision standards.[218]

8.4.2.2.2 Analysis

Transfer tools, unlike the bail-in tool, not only require recognition but, under most circumstances, require enforcement in host jurisdictions. It would be difficult for China to directly recognise foreign resolution transfer measures, because China does not have a resolution law, and a transfer tool may be deemed as contrary to Chinese laws or in violation of creditors' rights, given that a transfer action does not need the consent of creditors.

With regard to the interaction between the EU and the US, in the recognition process, non-recognition should be restricted to a violation of fundamental national public policies. Based on the above comparison, both the EU and the US have incorporated transfer tools, and it is unlikely that the exercise of transfer tools would be deemed as a violation of public policies. In the process of granting support, host authorities might be requested to take certain actions. The above comparison shows that the EU and the US have comparable transfer tools but distinct implementation rules. These detailed differences, however, should not be a reason to refuse to grant reliefs. However, host authorities may require local laws to apply, such as registration rule concerning the establishment of a bridge institution, or approval procedures from local authorities. To implement foreign resolution actions, host authorities may need to take domestic support actions in order to achieve the goals set by foreign resolution actions.

215 12 US Code §5390 (c)(9).
216 12 US Code §5390 (c)(8)(D)(i).
217 12 US Code §5390 (a)(1)(G)(ii); 12 US Code §1821(d)(2)(G)(ii).
218 Article 41 BRRD; 12 US Code §5390 (h); 12 US Code §1821 (n).

8.4.2.3 Restrictions on early termination rights

8.4.2.3.1 Restrictions on early termination rights in the selected jurisdictions

In the EU, Article 68 BRRD prescribes that resolution measures 'shall not, per se, under a contract entered into by the entity, be deemed to be an enforcement event, … or as insolvency proceedings … provided that the substantive obligations under the contract, including payment and delivery obligations and the provision of collateral, continue to be performed'.[219] In addition, resolution measures shall not 'be deemed to be an enforcement event or insolvency proceedings under a contract entered into by: (a) a subsidiary, the obligations under which are guaranteed or otherwise supported by the parent undertaking or by any group entity; or (b) any entity of a group which includes cross-default provisions.'[220] Consequently, entering into resolution does not constitute a default right.[221] Therefore, it shall not 'make it possible for anyone to (a) exercise any termination, suspension, modification, netting or set-off rights…; (b) obtain possession, exercise control or enforce any security over any property of the institution or entity…; (c) affect any contractual rights of the institution'.[222] Directly related to this dissertation's topic on cross-border issues, the BRRD explicitly states that '[w]here third country resolution proceedings are recognised pursuant to Article 94, or otherwise where a resolution authority so decides, such proceedings shall for the purposes of this Article constitutes a [resolution] measure'.[223]

In addition, the BRRD prescribes the 'power to temporarily suspend termination rights', empowering the authorities to 'suspend the termination rights of any party to a contract with an institution under resolution from the publication of the notice … until midnight in the Member State of the resolution authority of the institution under resolution at the end of the business day following that publication'.[224] The temporary stay also applies to other payment and delivery obligations,[225] as well as enforcement of security interests,[226] which, as the FSB advocates, gives the resolution authority some breathing time to decide how to dispose of these liabilities.[227]

219 Article 68(1) BRRD.
220 Article 68(1) BRRD.
221 See, e.g. Francisco Garcimartín and Maria Isabel Saez, 'Set-off, Netting and Close-out Netting' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015) 342
222 Article 68(3) BRRD.
223 Article 68(2) BRRD.
224 Article 71(1) BRRD.
225 Article 69 BRRD.
226 Article 70 BRRD.
227 KA EN 4(a). See also Recital (94) BRRD. For literature, see, e.g. Garcimartín and Saez (n 221) 342-343; Philipp Paech, 'The Value of Financial Market Insolvency Safe Harbours' (2016) 36 Oxford Journal of Legal Studies 855, 880-881.

Similarly, the US also has such restrictions on early termination rights.[228] 'A person who is a party to a qualified financial contract with a covered financial company may not exercise any right that such person has to terminate, liquidate, or net such contract … solely by reason of or incidental to the appointment under this section of the Corporation as receiver for the covered financial company'.[229] The Federal Reserve System (Fed) explains in its policy document that this rule is 'intended to facilitate the orderly resolution of the most systemically important banking firms – the GSIBs – by limiting the ability of the firm's counterparties to terminate QFCs upon the entry of the GSIB or one or more of its affiliates into resolution'.[230] There are two types of restrictions: first, a stay shall only be 'until 5:00 p.m. (eastern time) on the business day following the date of the appointment',[231] which is the temporary stay. Second, a stay could also be imposed 'after the person has received notice that the contract has been transferred',[232] then the temporary stay becomes a permanent prohibition. Similarly, a temporary stay can also be imposed on payment obligations.[233]

China, on the other hand, does not provide for a statutory rule on restrictions on early termination rights. The EBL does not even make an explicit reference to the effectiveness of *ipso facto* clauses. Yet, in practice, Chinese financial institutions may enter into agreements containing such clauses. An outstanding example is the close-out netting provision. For instance, the National Association of Financial Market Institutional Investors (NAFMII) put forward a standardised set of documents for derivatives, including the Master Agreement, the Supplement (or Schedule), the Security Agreement, and the Definitions, collectively referred to as the 'NAFMII Documents', which in the 2009 version adopted the close-out netting mechanism for onshore derivatives transactions.[234] Also, the NAFMII Bond Repurchase Master Agreement (2013 version) recognised the application of close-out

228 See, e.g. Douglas G Baird, 'Dodd-Frank for Bankruptcy Lawyers' (2011) 19 American Bankruptcy Institute Law Review 287; Roe and Adams (n 103).

229 12 US Code §5390(c)(10)(B)(i). See also 12 US Code §1821(e)(10)(B)(i).

230 Fed, 'Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions' (2017), 82 Fed. Reg. 42882, 42899. See also 12 CFR §252.81.

231 12 US Code §5390(c)(10)(B)(i)(I). See also 12 US Code §1821(e)(10)(B)(i)(I).

232 12 US Code §5390(c)(10)(B)(i)(II). See also 12 US Code §1821(e)(10)(B)(i)(II).

233 12 US Code §5390(c)(8)(F). See also 12 US Code §1821(e)(8)(G).

234 NAFMII Master Agreement (2009 version), section 9. See also Qingjiang Kong, *New Bank Insolvency Law for China and Europe Volume 1: China* (M. Haentjens, Qingjiang Kong and B. Wessels eds, Eleven International Publishing 2017) 73.

netting in Outright Transfer Repos.[235] In addition, the CBRC, in its response to the National People's Congress (NPC), explicitly stated that there is no legal conflict between the bankruptcy law and the close-out netting provision.[236] The International Swaps and Derivatives Association (ISDA) is also heavily involved in developing close-out netting in China.[237] According to the ISDA 2017 Memorandum on Enforceability of Close-out Netting in China, in general, close-out netting is not prohibited.[238] Both the ISDA and Chinese authorities seem to overlook the possibility that close-out netting, alongside other early termination rights, may result in negative effects on the market. There is little discussion on restricting the early termination rights in China. Given the fact that the Chinese legal framework lacks a comprehensive resolution regime, the current law does not delegate any authority the statutory power to disapply contractual terms in relation to early termination rights.

8.4.2.3.2 Analysis

Both the EU and the US contain almost identical rules on prohibition and temporary stay on early termination rights. The only difference is about the time of the end of temporary stay: midnight in the EU, and 5 p.m. in the US. The difference might not be relevant since it may not be possible to exercise the early termination powers other than during working hours. The stay power is expected to be effective across the EU and the US. Immediately after the entry into resolution, the home authority could impose a temporary stay for a limited period of time. After the period, such a temporary stay does not need to be recognised in the host jurisdictions. If the liabilities are transferred to a solvent institution, home authorities would disapply early termination rights to these liabilities, host authorities would also acknowledge that there is no need to apply termination rights since those claims are not affected.

235 NAFMII Bond Repurchase Master Agreement (2013 version), Special Provisions of Outright Transfer Repo, Section 3(V). Outright Transfer Repo or Title Transfer Repo is defined as 'the transaction where one Party (the "Repo Party") sells the Purchased Bonds to the other party (the "Reverse Repo Party") and the Reverse Repo Party pays the Purchase Amount on the Purchase Date to the Repo Party simultaneously, and the Parties agree to a certain date (Repurchase date) on which the Repo Party will purchase the Repurchase Bonds from the Reverse Repo Party at an agreed price ("Repurchase Amount")'. There is another type of repo, i.e. Pledged Repo, which refers to 'the transaction where one Party (the "Repo Party") pledges the Repurchased Bond to the other party (the "Reverse Repo Party") and the Reverse Repo Party Pays the Purchase Amount on the Purchase Date to the Repo Party simultaneously, and the Parties agree to a certain date (the "Repurchase Date") on which the Repo Party pays the Repurchase Amount to the Reverse Repo Party and the Reverse Repo Party releases the pledge over the Repurchased Bonds'. There is no close-out netting provision in Pledged Repo agreements. NAFMII Bond Repurchase Master Agreement, Section 24(53).

236 CBRC, Responses to the Fifth Meeting of the Twelfth NPC Recommendation No 2691 (《对十二届全国人大五次会议第2691号建议答复的函》), Yin Jian Shen Han [2017] No 105.

237 Ibid.

238 ISDA, Memorandum on Enforceability of Close-out Netting in China (2017).

There is little guidance on how the Chinese authorities would respond in these circumstances. The lack of statutory rule might be a problem for such a cross-border issue. There is currently no resolution law in China, and any resolution action imposed by foreign authorities may be deemed as a default event under Chinese law and thus subject to early termination rights.

8.4.3 Should governing law provisions be the reason to refuse to recognise or support foreign resolution actions?

This is the scenario discussed in the previous Chapter 2 at §2.2.1 and Chapter 6 at §6.4.4.1.2.[239] Simply put, the question is whether the choice of a governing law rather than the law where a resolution action is taken can be the reason to refuse to recognise or support foreign resolution actions. The discussion revolves around the *Gibbs* rule, which established an English law tradition that an English-law-governed contract cannot be discharged by a foreign insolvency proceeding. Despite being criticised by many, the *Gibbs* rule is still in effect under the English common law. In the case of bank resolution, it is possible that a resolution measure imposed on an English-law-governed contract may not be recognised in the UK.

Other jurisdictions showed a similar concern. In the EU, the Impact Assessment 2016 questioned the validity of bail-in abroad.[240] A bail-in tool exercised by a European resolution authority on a third-country-law-governed contract may not be effective under the law of that third-country. In the US, the Dodd-Frank Act raised the concern that a transfer of foreign-law-governed contract may not be effective either. It is regulated that a transfer to a foreign institution is not allowed except for certain circumstances:

> In transferring any qualified financial contracts and related claims and property …, the [FDIC] as receiver for the covered financial company shall not make such transfer to a foreign bank, financial institution organized under the laws of a foreign country, or a branch or agency of a foreign bank or financial institution, unless, under the law applicable to such bank, financial institution, branch or agency, to the qualified financial contracts, and to any netting contract, any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts, the contractual rights of the parties to such qualified financial contracts, netting contracts, security agreements or arrangements, or other credit enhancements are enforceable substantially to the same extent as permitted under this Section.[241]

239 Paul Davies raised the same question, see, Paul Davies, 'Resolution of Cross-border Groups' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015) 269.

240 Commission Impact Assessment 2016, 143.

241 12 US Code §5390 (c)(9)(B).

The previous §6.4.4.1.2 in Chapter 6 supports the repeal of the outdated *Gibbs* rule, from the standpoint of making insolvency proceedings effective across borders. This section continues the discussion from a creditor's point of view. It might be understandable that the English court would protect English creditors from discriminatory and unjustifiable debt discharge arrangments. However, such protection is not necessarily to be performed through the *Gibbs* rule. As confirmed in §8.4.1, any discriminatory act can be invoked as a public policy exception to refuse to recognise foreign resolution actions. Also, as explained in §8.2.1.3.3, the law provides for various additional safeguard measures to protect the interests of creditors. A simple recourse to the *Gibbs* rule on the mere basis of choice-of-law provision is not sufficient to refuse to recognise foreign resolution actions.[242] In addition, not recognising foreign resolution actions would result in different treatments of home and host creditors, which is contradictory to the general non-discrimination principle.

The contractual approaches discussed in Chapter 6 at §6.2.3.2 are another argument for recognition. The FSB and other institutions have proposed a 'contractual recognition approach', which requires that the contracting parties agree to be bound by the resolution actions.[243] This approach, however, is questioned on the enforceability issues.[244] The EU and the US have incorporated the contractual approaches, such as contractual bail-in,[245] contractual stay,[246] and contractual transfer tools.[247]

These contractual provisions require any creditor who chooses to be governed by the host law agree to be subject to the home resolution measures. Such mutual contractual agreement discredits the rationale of the *Gibbs* rule. The *Gibbs* rule builds on the party autonomy principle and refuses non-English insolvency proceedings because parties did not choose non-English law. However, applying the same logic to the contractual resolution provisions, it should be accepted that the counterparties agree to be subject to the home resolution proceedings, and there is no contract law basis to deny such consensus. Conversely, with the existence of such contractual provisions, it will enhance cross-border effectiveness.

242 See §8.2.1.4.

243 FSB Principles, 6-7.

244 See FSB, 'Public responses to the September 2015 consultative document "Cross-border Recognition of Resolution Actions"' (12 December 2014) <http://www.fsb.org/2014/12/public-responses-to-the-september-2014-consultative-document-cross-border-recognition-of-resolution-actions/> accessed 25 February 2020.

245 Article 55 BRRD.

246 Amended Article 71a BRRD; Article 1(33) BRRD II. See also 12 CFR §252.83(b)(1).

247 12 CFR §252.83(b)(1).

8.5 Concluding remarks

To conclude, a premise and leading rule is established in this chapter that cross-border resolution, from both the home and host authorities' perspectives, should ensure equal treatment of creditors and avoid discrimination on the basis of nationality. Following this rule, any discriminatory actions against host creditors can be a legitimate and reasonable basis for refusing to recognise home resolution actions.

Host authorities may have additional incentives to protect host creditors in accordance with host laws and to refuse to recognise or enforce foreign resolution actions made by home laws. This chapter supports the opinion that resolution actions should be made effective across borders and holds that protection of host creditors should not impede recognition of foreign resolution actions. It is acknowledged that different jurisdictions have different implementing resolution rules; however, these differences should not constitute barriers to recognition. As a matter of fact, the comparison made in the previous sections shows that the resolution laws in the EU and US share major similarities despite different details. This finding, in turn, supports the argument that recognition should not be refused because of different laws. One exception, however, is China. Given that China does not have a comprehensive resolution law at the moment, it is unpredictable how China would treat foreign resolution actions, and it is likely that China would refuse recognition on the basis of recognition being contrary to national laws. This example demonstrates that the FSB's endeavour to harmonise resolution laws at the global level would facilitate cross-border bank resolution.

Another point raised in this chapter is that governing law provisions should not be the reason to refuse to recognise foreign resolution actions. This is in response to the *Gibbs* rule. From the point of view of the creditors' position, applying different laws would result in different treatment of home and host creditors. Therefore, the *Gibbs* rule should be abolished to avoid different treatment of home and host creditors. The protection of creditors does not need to be guaranteed by the *Gibbs* rule; instead, such protection can be achieved by invoking public policy exceptions or additional safeguard measures.