Recognition of foreign bank resolution actions

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10 Conclusions

This dissertation addresses the question of what the legal framework for recognition of foreign resolution actions should be. Chapter 1 lays out the general background. Chapter 2 defines resolution as actions taken by resolution authorities to resolve banks that are failing or likely to fail. The first two introductory chapters emphasise the importance of cross-border bank resolution to preserve global financial stability and the current lack of comprehensive regimes for recognition of foreign resolution actions. Two policy goals are identified for establishing a recognition framework: to facilitate cross-border bank resolution and make home resolution actions effective in foreign jurisdictions, and to protect the interest of host jurisdictions. This dissertation argues that foreign resolution actions should be, in principle, effective, subject to certain limited exceptions. This is in line with the recommendations of the Financial Stability Board (FSB) and other international organisations.

For a recognition regime for foreign resolution actions, Chapters 6, 7 and 8 identified ten questions, from the perspectives of private international law, financial law and insolvency law. Analysis was conducted on the basis of traditional legal doctrines and the special characteristics of resolution. The answers to these ten questions formulate ten principles, as guidance for host jurisdictions to use when formulating a legal framework on recognition of foreign resolution actions:

Principle (i): There should be no reciprocity request for recognition of foreign home resolution actions. In the selected jurisdictions, only China adopts a strict reciprocity test, which requires that a recognition decision can only be made when a foreign jurisdiction has previously recognised a Chinese judgment. However, reciprocity is an unnecessary pre-condition for recognition, as it would severely impede cross-border bank resolution. (Chapter 6, §6.4.1)

Principle (ii): Jurisdictions in cross-border bank resolution cases are distinguished as home and host jurisdictions. The distinction is made because cross-border bank resolution relies on the system of cross-border bank supervision in which home supervisory authorities of multinational banks conduct consolidated supervision on a global basis. Home resolution authorities are in a leading position to take global resolution actions for the whole group. (Chapter 6, §6.4.2)

Principle (iii): An ongoing foreign resolution proceeding should be recognised, with the effects of recognising the authority of foreign representatives and relevant reliefs such as moratorium. Recognition of home representatives allows these foreign representatives to take actions within the host territory. Putting moratorium measures in place facilitates the implementation of resolution actions taken in the home jurisdictions and maintains international financial stability. It is further advised that national laws should clearly prescribe the formal requirements, such as documents to be submitted for recognition. This proposal does not make a recommendation for either administrative recognition or judicial recognition, and national legislative bodies have the discretion to make an option. (Chapter 6, §6.4.3)

Principle (iv): A foreign resolution measure with immediate effect should be recognised. The potential judicial review process for the acts of resolution authorities in a home jurisdiction should not be the reason to refuse to recognise home resolution actions, because making resolution effective serves the public interest, which outweighs private rights in this situation. Affected creditors can still seek remedies in home jurisdictions. A debt discharge under home resolution actions can also be recognised, because a counterparty in the host jurisdiction should have foreseen this situation when it entered into a contract with a party that is subject to home resolution actions; entering into resolution alters the normal contractual relationships governed by the choice of law provision. Upon recognition, some foreign resolution actions need to be enforced, either through direct enforcement or by taking domestic supportive measures. This proposal recommends that jurisdictions should put enforcement proceedings in place, with clear procedures and guidance. (Chapter 6, §6.4.4)

Principle (v): Financial stability in the host jurisdictions should be able to be invoked as a public policy exception to refuse to recognise foreign resolution actions. This is because, in general, home jurisdictions have no incentive or legal obligation to take care of host interests, and it is justifiable for host jurisdictions to take this defensive legal mechanism to protect host interests. (Chapter 7, §7.4.1)

Principle (vi): There should be a narrow interpretation of financial stability in the host jurisdictions. This is because, first, financial stability is a public policy exception, and public policy exceptions must be interpreted narrowly; second, invoking the host financial stability exception might impede global resolution and undermine the financial stability of home jurisdictions, which in turn may affect host stability; third, the financial stability test also exists in domestic resolution decision-making, which only concerns severe situations which are rare and exceptional. (Chapter 7, §7.4.2)

Principle (vii): A recognition request may be rejected if it is accompanied with the need for massive public funds from host jurisdictions, that is, if it would have an adverse impact on host jurisdictions' fiscal policies. However, this public policy exception should also be interpreted narrowly. Furthermore, this dissertation holds the opinion that home jurisdictions' resolution actions may have unintended external stability effects on host jurisdictions, therefore, host jurisdictions might be free from the need to supply additional funds. (Chapter 7, §7.4.3)

Principle (viii): Any discriminatory actions should be the cause for refusal of recognition. Taking resolution actions does not necessarily require discriminatory treatment against foreign creditors; resolution objectives can be achieved by *pro rata* loss-absorption among domestic and foreign creditors. (Chapter 8, §8.4.1)

Principle (ix): Different national laws should no longer be reasons for refusal of recognition. After examining the present resolution laws in the selected jurisdictions, it can be seen that resolution laws have been largely harmonised between the European Union (EU) and the United States (US), though not in China. The different implementation details do not constitute a strong reason to refuse foreign resolution actions. (Chapter 8, §8.4.2)

Principle (x): A choice of governing law other than the home law should not be the reason to refuse to recognise foreign resolution actions. Protection of host creditors' rights does not necessarily need to be achieved through the choice-of-law provisions; rather, public policy exceptions and additional creditors' safeguard measures can be invoked to protect host creditors' rights. Also, not recognising foreign resolution actions simply because of the choice of law would result in a different treatment of home and host creditors. When a contractual provision is added in the contract for creditors to recognise home resolution actions, such a provision can be the supporting argument that host creditors' expectations are protected, thus undermining the reason to refuse to recognise foreign resolution actions. (Chapter 8, §8.4.3)

These principles reflect both the policy goals stated in Chapter 1. Principles (i) to (iv) deal with grounds for recognition and making resolution actions effective across borders, while principles (v) to (x) address reasons to refuse recognition, with the aim of protecting host local interests. This dissertation attempted to keep a dedicated balance between the two policy goals. On the one hand, this dissertation holds the view that foreign home resolution actions should be recognised so that a cross-border resolution decision can take effect. On the other hand, this dissertation acknowledges that host authorities should have public policy exception tools to refuse to recognise home actions, in order to protect host interests. However, it is highlighted that such public policy exceptions can only be invoked when fundamental

interests of host jurisdictions are at stake, with the aim of least undermining a global resolution strategy. In other words, public policies should be interpreted narrowly.

All three jurisdictions compared in this dissertation currently have both mechanisms for recognition and reasons for the refusal of recognition. However, as illustrated in Part II, it is questionable whether the current regimes can address all important issues that may arise from the recognition of foreign resolution actions. For example, the EU adopted the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR) and created a special regime for cross-border bank resolution. As explained in Chapter 3, for Banking Union Member States, the Single Resolution Board (SRB) is the resolution authority for cross-border banks. Outside the Banking Union, resolution actions on a branch in another Member States are automatically recognised. In addition, it is a requirement that resolution colleges are established to address the resolution of banking groups. These are special intra-EU arrangements. For resolution actions taken by third country authorities with regard to third country banks with entities in the EU, Articles 94 to 96 BRRD lists the conditions for recognition and grounds for refusal of recognition. These provisions make it explicit that EU resolution authorities are empowered to recognise and enforce third-country resolution actions. Although there is no clear identification of the jurisdiction rule (principle (ii)), it is inferred that EU authorities accept the jurisdiction of home countries; this is required in Article 96 BRRD where EU branches of third country institutions are generally subject to third country resolution authorities, unless an EU branch is not subject to third country resolution actions or recognition of third country resolution actions would violate EU public policies. Article 94 BRRD specifies that, after recognition, EU resolution authorities have the power to enforce third country resolution actions with regards to subsidiaries (equity or other ownership instruments), branches, assets of third country banks located in the EU and rights and liabilities governed by the law of one of the EU Member States. However, these rules are overly simple, without distinguishing recognition of foreign resolution proceedings (principle (iii)) and foreign resolution measures (principles (iv)), let alone subsequent effects upon recognition. It is not clear how EU authorities would deal with different types of recognition requests. On the other hand, the EU values local interests. Article 95 BRRD numerates five public policies based on which EU authorities can refuse to recognise and enforce third country resolution actions, namely, financial stability, resolution objectives, equal treatment of creditors, material fiscal policies, and national laws. These public policy exceptions are in line with the FSB Principles. Given the lack of cases, for the time being, it is difficult to predict how EU authorities would apply these exceptions. It is proposed that the interpretation of these public policy exceptions should be in line with principles (v) to (x).

The US is a leading jurisdiction in formulating bank resolution rules. As early as the 1950 Federal Deposit Insurance Act (FDIA), the Federal Deposit Insurance Corporation (FDIC) was equipped with administrative resolution powers to resolve failing depository institutions. The 2010 Dodd-Frank Act also extends such resolution powers to non-bank financial institutions and bank holding companies. However, despite the leading role of the US formulating domestic rules, the US pays little attention to cross-border bank resolution issues. One of the reasons might be that the US incorporated the Model Law on Cross-border Insolvency (MLCBI) into Chapter 15 of its Bankruptcy Code, which is very effective in resolving cross-border corporate insolvency cases. Indeed, the FSB also identified the MLCBI as an instrument to resolve cross-border bank resolution cases.[1] Although being a cross-border insolvency instrument, which targets decisions of courts, Chapter 15 can apply to administrative resolution actions. However, as explained in Chapter 4, Chapter 15 is insufficient to address cross-border bank resolution cases. First, Chapter 15 explicitly excludes foreign banks (depository institutions) with branches or agencies in the US, and all branches or agencies of foreign banks are subject to US resolution authorities. It makes almost impossible to recognise or enforce foreign resolution actions imposed on US branches or agencies of foreign banks. Second, Chapter 15 adopts the distinction of centre of main interest (COMI)/establishment, which is the manifestation of modified universalism of the present international insolvency law. However, this identification may not be suitable for financial institutions that are subject to the home/host distinction (principle ii), although it is argued in Chapter 6 that home jurisdiction can be understood as COMI jurisdiction, and host jurisdiction can be understood as establishment jurisdiction. Third, the effects of recognition in Chapter 15 only extends to reliefs, including both automatic reliefs and discretionary reliefs. However, automatic reliefs are limited to certain restrictions on assets located in the US. It is uncertain how US courts would react to most discretionary reliefs related to foreign resolution actions. It is recommended that a recognition of foreign resolution proceedings (principle (iii)) and foreign resolution measures (principle (iv)) should be distinguished, with clear references to available subsequent reliefs. Fourth, Chapter 15 grants public policy exceptions for refusal of recognition and additional safeguard measures to refuse relief requests, with the effect of protecting US creditors' interests. While it may be justifiable to invoke public policy exceptions in cross-border bank resolution cases, a broad application of additional safeguard measures may impede cross-border resolution. It is recommended that public policies should be clearly listed, such as financial stability (principle (v)), fiscal policy (principle (vii)), and non-discriminatory treatment of creditors (principle (viii)).

1 FSB, 'Principles for Cross-border Effectiveness of Resolution Actions' (3 November 2015) 18.

Courts in previous Chapter 15 cases interpreted public policies narrowly, and it is suggested that for resolution cases, such an interpretation method should also apply, following the specific principles elaborated in above (v) to (x).

China, albeit the home jurisdiction to four global systemically important bank (G-SIBs) out of 30 as of 2019, is lagging behind in adopting the FSB Key Attributes. The most recent policy document is the 2018 SIFI Guiding Opinions, which only set out several general principles without concrete resolution rules that can be applicable to failing banks. In addition, little attention is paid to cross-border issues. For the time being, only Article 5 of the Enterprise Bankruptcy Law (EBL) prescribes the rules for cross-border insolvency, following the general principles of private international law. The application of Article 5 in cross-border bank resolution cases raises several concerns. First, although Chapter 5 of this dissertation explains that resolution under the Chinese law should also be understood under the general framework of insolvency, lack of additional legislative interpretation or case law questions the applicability of this Article 5 in resolution. Second, Article 5 adopts a strict reciprocity test, which makes recognition difficult. It is proposed that reciprocity should be abandoned (principle (i)). Third, the rules prescribed in Article 5 are overly vague, without clear guidance on the effects of foreign resolution actions in China, let alone foreign actions imposed on Chinese subsidiaries, branches, assets or Chinese law governed rights and liabilities. Therefore recognition of foreign resolution proceedings (principle (iii)) and foreign resolution measures (principle (iv)) should be distinguished, with clear references to subsequent effects. Fourth, China puts much stress on local interests, with Article 5 listing a variety of public policies that can be invoked in refusal of recognition, including the basic principles of Chinese laws, the State sovereignty, security or public interest, as well as the interest of Chinese creditors. It is not clear how Chinese courts would react to these public policies when deciding a resolution case, and it is recommended that interpretation of these public policies should follow principles (v) to (x).

In sum, all the selected jurisdictions have some tools to recognise foreign resolution actions and can invoke public policies to refuse to recognise. The tricky part is how to interpret and apply the rules when facing specific resolution requests. Authorities need to decide, on a case-by-case basis, whether a recognition request falls under the scope of resolution, whether all pre-requisites for recognition have been met, to what extent a relief can be granted, and whether recognition of foreign resolution actions would have material negative effects on host jurisdictions. It is hoped that the principles proposed in this dissertation can help host authorities deal with these issues.

This dissertation, furthermore, emphasises that cross-border bank resolution relies on the interaction between both home and host authorities. The decision of a host authority concerning whether or not to recognise a home resolution action depends not only on the host jurisdiction's legal system, but also, to a large extent, on the home authority's decision-making process, including whether or not host interests have been taken into account. Since this dissertation mainly focuses on the issue of recognition which is about the actions taken by host authorities, recommendations for home authorities are not included in the previous principles. Nevertheless, legal regimes for home resolution authorities should be a next-step research topic, which is put in a broader theme of global financial governance. Chapters 7 and 8 have slightly touched upon this issue. In particular, home authorities are encouraged to adopt actions that can maintain international financial stability but are not discriminatory against host creditors. However, it is acknowledged that the current prevailing global financial governance does not have a binding regime for home authorities. From an international law point of view, home jurisdictions have no hard-law international legal obligations to protect host interests. And from a domestic law perspective, home jurisdictions are only accountable to their national constituencies but not foreign actors and, therefore, have no incentives to consider foreign interests in resolution decision-making. This situation can be explained by the financial trilemma doctrine and financial nationalism doctrine mentioned in Chapter 7.[2] Although it is suggested in this dissertation that home authorities duly take into account host interests, how to incorporate this obligation into a (new) legal regime and make home authorities accountable to foreign actors may be a challenge from both theoretical and practical points of view.

As mentioned at the beginning of Chapter 1, apart from recognition of foreign resolution actions, there are additional approaches to address cross-border resolution issues, such as establishing a supranational authority at the global level, further harmonisation of national resolution rules and enhanced cooperation between home and host authorities.[3] The special intra-EU arrangements are examples. The BRRD harmonised bank resolution laws across the EU, which, to a large extent, mitigates legal conflicts among the Member States. The SRMR created the SRB as a supranational agency empowered to be in charge of resolving cross-border banks within the Banking Union. Article 117 BRRD follows the previous Directive on

2 See Chapter 7, §7.2.2.2. See literature, Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma* (OUP 2013); Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (CUP 2017).

3 See Matthias Haentjens, Bob Wessels and Shuai Guo, 'Conclusions' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Cross-Border Bank Resolution* (Edward Elgar 2019).

Reorganisation and Winding-up of Credit Institutions (CIWUD) and adopts an automatic recognition mechanism. Such regimes are based on the special political and economic relations of EU Member States, such as the founding treaties of the EU and internal market within the Union, and, particularly, the harmonization of financial regulation, *inter alia*, the EU passporting and home country control mechanism. It is doubtful that these special EU arrangements can be applied across the world. On the bright side, cross-border cooperation seems to be on the rise. The BRRD, for example, provides a legal basis for the establishment of resolution colleges as platforms for cross-border cooperation between EU Member States. Even outside the EU, national authorities have reached memorandums of understanding (MOUs)[4] or other cooperation agreements (CoAgs).[5] The concern for these international agreements, as explained in Chapter 9, is that they are not binding. It is uncertain if or how countries would act on these agreements. Other international instruments discussed in Chapter 9 such as model law or customary international law can also be utilised in cross-border bank resolution cases, although it is also not clear to what extent these international law instruments would be recognised and enforced by national authorities or courts. Cooperation is not simply a legal issue but involves additional political considerations.

A final thought touches upon internationalism vis-à-vis nationalism. This dissertation is imbued with a grand theme of globalisation.[6] In the banking sector, the former Governor of the Bank of England Mervyn King once put it that 'global banking institutions are global in life, but national in death'.[7] To phrase it another way, the businesses of banks are extending around the world, but banking regulations, including insolvency/resolution regimes for banks, are still in the hands of national authorities, even though international organisations such as the Basel Committee on Banking Supervision (BCBS) and the FSB have been promoting 'soft law' international standards

4 For example, Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Resolution of Insured Depository Institutions with Cross-border Operations in the United States and the United Kingdom, signed on 10 January 2010 (FDIC-BOE Resolution MOU).

5 For example, Cooperation Arrangement Concerning the Resolution of Insured Depository Institutions and Certain other Financial Companies with Cross-border Operations in the United Stated and the European Banking Union, singed in September 2017 (FDIC-SRB Resolution CA).

6 See, e.g. Jeffry A Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (WW Norton & Company 2007); Ronald Findlay and Kevin H O'Rourke, *Power and Plenty: Trade, War, and the World Economy in the Second Millennium* (Princeton University Press 2009); Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton University Press 2019).

7 Financial Services Authority, 'The Turner Review: A Regulatory Response to the Global Banking Crisis' (March 2009) 36.

to harmonise global banking regulations.[8] The incompatibility of global business vis-à-vis national legal systems makes cross-border issues an extreme challenge. One of the solutions, as Schoenmaker proposed in his 'financial trilemma' theory, is to uphold globalisation as usual and make national policies subordinate to international solutions.[9] This dissertation follows this strategy, arguing for making foreign resolution actions effective in domestic regimes and endeavouring to address potential legal barriers that may undermine a global resolution strategy.

On the other hand, there is an opposite opinion that international banks should be broken down and kept within national borders.[10] This reflects the anti-globalisation or reverse-globalisation view. As Dani Rodrik explains in his 'political trilemma' theory, national self-determination, political democracy and hyper-globalisation are three incompatible objectives that cannot be fulfilled simultaneously, and he stood by the view that hyper-globalisation should be given up, at least not be pushed forward in extreme forms.[11] Recent international events have demonstrated this trend. For instance, Brexit discussed in Chapter 3 at §3.3.1.1.3 is a form of anti-European sentiment.[12] The US President Donald Trump put forward the 'America First' slogan and started a round of trade wars with an increasing tendency

8 See Chapter 7, §7.2.1.2. See literature, e.g. Lawrence LC Lee, 'The Basle Accords as Soft Law: Strengthening International Banking Supervision' (1998) 39 Va J int'l L 1; Patrick Van Roy, 'The Impact of the 1988 Basel Accord on Banks' Capital Ratios and Credit Risk-taking: An International Study' (2005) EFMA 2004 Basel Meetings; Daniel K Tarullo, *Banking on Basel: The Future of International Financial Regulation* (Peterson Institute 2008); David S Bieri, 'Financial Stability, the Basel Process and the New Geography of Regulation' (2009) 2 Cambridge Journal of Regions, Economy and Society 303; Thomas Cottier and Rosa M Lastra, 'The Quest for International Law in Financial Regulation and Monetary Affairs' (2010) 13 Journal of International Economic Law 527; Thomas Cosimano and Dalia Hakura, 'Bank Behavior in Response to Basel III: A Cross-Country Analysis' (2011) IMF Working Papers 2011/119; Camilo Soto Crespo, 'Explaining the Financial Stability Board: Path Dependency and Zealous Regulatory Apprehension' (2017) 5 Penn St JL & Int'l Aff 302.

9 See Chapter 7 at §7.2.2.2. See Schoenmaker (n 2). Also, e.g., Dani Rodrik, 'How Far Will International Economic Integration Go?' (2000) 14 The Journal of Economic Perspectives 177; Dirk Schoenmaker, 'Is Burden Sharing Needed for International Financial Stability' in Philipp Hartmann, Haizhou Huang and Dirk Schoenmaker (eds), *The Changing Fortunes of Central Banking* (CUP 2018).

10 Schoenmaker (n 2) 90-114.

11 Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (WW Norton & Company 2011).

12 See, e.g. Dominic Cummings, 'On the referendum #21: Branching histories of the 2016 referendum and "the frogs before the storm"' (Dominic Cummings's Blog, 9 January 2017) <https://dominiccummings.com/2017/01/09/on-the-referendum-21-branching-histories-of-the-2016-referendum-and-the-frogs-before-the-storm-2/> accessed 25 February 2020; Harold D Clarke, Matthew Goodwin and Paul Whiteley, *Brexit: Why Britain Vote to Leave the European Union* (CUP 2017); Kevin O'Rourke, *A Short History of Brexit: From Brentry to Backstop* (Pelican 2019).

toward national protectionism.[13] The recent outbreak of coronavirus, on the one hand, upheld the populist view that international travel and immigration should be reduced out of the fear of swift spread of the virus across the globe, and on the other hand, strengthened the anti-globalisation opinion that cross-country interdependent economic relations are vulnerable especially when one of the supply chains is broken.[14]

Are we on the verge of the collapse of globalisation? In the banking sector, have international banks come to the end to their roles? It is hard to tell at this moment. And these questions leave room for future debate. What cannot be overlooked is the *status quo* of international banks predominately engaging in global markets. Global leaders are still in the process of continuously strengthening the global (financial) safety net. A failure of global solutions and a lack of international cooperation could lead to catastrophic consequences. As for lawyers, it is a sophisticated art to search for solutions in the midst of vast legal provisions and keep a delicate balance between global objectives (international cooperation) and each jurisdiction's own interest.

13 See, e.g. 'Trade wars, Trump tarrifs and protectionism explained' (BBC, 10 May 2019) <https://www.bbc.com/news/world-43512098> accessed 25 February 2020; Anne van Aaken and Jürgen Kurtz, 'Beyond Rational Choice: International Trade Law and The Behavioral Political Economy of Protectionism' (2019) 22 Journal of International Economic Law 601; Anthea Roberts, Henrique Choer Moraes and Victor Ferguson, 'Toward a Geoeconomic Order in International Trade and Investment' (2019) 22 Journal of International Economic Law 655.

14 See, e.g. Rana Foroohar, 'Coronavirus is speeding up the decoupling of global economies' (Financial Times, 23 February 2020) <https://www.ft.com/content/5cfea02e-549f-11ea-90ad-25e377c0ee1f> accessed 25 February 2020; Steven Erlanger, 'Spread of Virus Could Hasten the Great Coming Apart of Globalization' (The New York Times, 25 February 2020) <https://www.nytimes.com/2020/02/25/world/europe/coronavirus-globalization-backlash.html> accessed 25 February 2020.