Recognition of foreign bank resolution actions

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Summary

This dissertation studies the question what the legal framework for recognition of foreign resolution actions should be. Chapter 1 lays out the general background, namely, the need for a regime to give effect to foreign bank resolution actions. This dissertation builds on both a normative analysis and positive analysis and compares three jurisdictions: the European Union (EU), the United States (US) and mainland China.

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 in Part I 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.

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 during the process of recognising foreign resolution actions. Chapter 3 introduces the EU regime. 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. For Banking Union Member States, the Single Resolution Board (SRB) is the resolution authority for cross-border banks. Outside the Banking Union, resolution actions imposed on an EU bank with one or more branches in other Member States are automatically recognised in those other Member States. In addition, resolution colleges must be established to resolve banking groups consisting of entities in different Member States. These are special intra-EU arrangements. On the other hand, for resolution actions taken by third country authorities with regard to third country banks with entities in the EU, Articles 94 to 96 BRRD list 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. Article 94 BRRD specifies that, after recognition, EU resolution authorities have the power to enforce third country resolution actions with regard to subsidiaries (equity or other ownership instruments), branches, and assets of third country banks located in the EU, and rights and liabilities governed by the law of one of the EU Member States. In particular, Article 96 accepts the jurisdiction of third country resolution authorities, and 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 95 BRRD numerates five public policies, based on which EU authorities may refuse to recognise and enforce third country resolution actions, namely, financial stability, resolution objectives, equal treatment of creditors, material fiscal policies, and national laws. Given the lack of cases, for the time being, it is difficult to predict how EU authorities would apply these exceptions. In general, these rules are overly simple, without a comprehensive list of conditions for recognition or distinguishing recognition of foreign resolution proceedings with ongoing effects and foreign resolution measures with immediate effects, let alone subsequent consequences after recognition.

Chapter 4 turns to the US, which 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 extends FDIC's resolution powers to non-bank financial institutions and bank holding companies. However, in spite of 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 UNCITRAL 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. Chapter 15 mainly targets the decisions of judges, but it can also apply to administrative resolution actions. However, Chapter 15 is inadequate 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 US branches or agencies of foreign banks are subject to US resolution authorities. It makes it almost impossible for US authorities 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 as currently adopted in international insolvency law. However, this may not be suitable for financial institutions that are subject to the supervisory home/host distinction, although it is argued in Chapter 6 of this dissertation that home jurisdiction can be understood as COMI jurisdiction, and host jurisdiction can be understood as establishment jurisdiction. Third, the effects of recogni-

tion in Chapter 15 only mention reliefs, including both automatic reliefs and discretionary reliefs. However, it is uncertain how US judges would react to relief requests related to foreign resolution actions. Fourth, Chapter 15 grants public policy exceptions for refusal of recognition and additional safeguard measures to refuse relief requests, with the purpose 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. Judges in previous Chapter 15 cases interpreted public policies narrowly, and it is suggested that for resolution cases, such an interpretation method should also apply. And for cross-border bank resolution cases, it is recommended that specific public policies should be clearly listed, just as the EU does.

China, albeit the home jurisdiction to four global systemically important banks (G-SIBs) out of 30 as of 2019, is lagging behind in adopting the FSB Key Attributes. As illustrated in Chapter 5, the most recent policy document on bank resolution 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 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, the current Chinese legal regime lacks clear legislative guidance or case law on the applicability of Article 5 in resolution, although this dissertation argues that resolution should also be understood under the general framework of insolvency. Second, Article 5 adopts a strict reciprocity test, which makes recognition difficult. It is proposed that reciprocity should be abandoned. Third, the rules prescribed in Article 5 are overly vague, without clear guidance on the effects of foreign resolution actions in China, in particular, foreign actions imposed on Chinese subsidiaries, branches, assets of foreign banks, or Chinese law governed rights and liabilities. 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 judges would interpret and apply these public policies when deciding a resolution case.

Based on the comparative studies in Part II, Part III conducts normative analysis and further investigates the application of traditional legal doctrines in cross-border bank resolution. Chapter 6 examines the grounds for recognition. This chapter builds on the doctrines in private international law, namely, comity and reciprocity, the obligation doctrine and res judicata, as well as modified universalism principle in international insolvency law, which all form the basis for recognition of foreign bank resolution actions.

Chapter 6 also points out that specific rules should be formulated to address cross-border bank resolution. In particular, four principles are proposed:

Principle (i): There should be no reciprocity requirement 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 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 should have 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)

Chapter 7 builds on the doctrines of financial law and identifies the dilemma of national financial policy and international financial stability. This chapter finds that international financial stability is a desired outcome but without binding international legal rules. International financial regulation is soft law in nature and does not have mandatory effect on national policy makers. Therefore, Chapter 7 proposes another three principles:

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 obligations 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 broadly 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 by 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)

Chapter 8 studies the position of creditors and maintains the basic rules that foreign creditors should not be discriminated against. In addition, the interests of home and host creditors should be balanced. Chapter 8 also propose three other principles:

Principle (viii): Any discriminatory actions should be the cause for refusal of recognition. Taking resolution actions however 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 not be a reason for refusal of recognition. After examining the present resolution laws in the selected jurisdictions, it can be seen that resolution laws have been largely harmon-

ised between the EU and the 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 a 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)

Chapter 9 discusses several other international legal instruments that may be additional tools to facilitate recognition of foreign resolution actions. These include international agreements, model law and customary international law. These international instruments can be used in parallel to enhance certainty for recognition of foreign resolution actions and are recommended to follow the ten principles mentioned above. Chapter 10 contains the concluding remarks of the whole dissertation.