EU bank resolution framework: A comparative study on the relation with national private law

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EU bank resolution framework

A comparative study on the relation with national private law

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L.G.A. Janssen, 'Bail-in from an insolvency law perspective', *Norton Journal of Bankruptcy Law and Practice* 2017, no. 5, p. 457-505.

M. Haentjens, L.G.A. Janssen & B. Wessels, *New Bank Insolvency Law for China and Europe. Volume 2: European Union*, The Hague: Eleven International Publishing 2017.

L.G.A. Janssen, 'Bail-in from an insolvency law perspective', *Journal of International Banking Law and Regulation* 2018, no. 1, p. 1-23.

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Table of abbreviations

AktG	Aktiengesetz
AT1	Additional Tier 1
BA 2009	Banking Act 2009
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
BGB	Bürgerliches Gesetzbuch
BW	Burgerlijk Wetboek
KAKred	Bundesaufsichtamt für das Kreditwesen
BCCI	Bank of Credit and Commerce International
FMStFG	Finanzmarktstabilisierungsfondsgesetz
BoE	Bank of England
BRRD	Bank Recovery and Resolution Directive
CA 2006	Companies Act 2006
CET1	Common Equity Tier 1
CJEU	Court of Justice of the European Union
CoCos	Contingent Convertible bonds
CRR	Capital Requirements Regulation
CVA	Company voluntary arrangement
DNB	De Nederlandsche Bank
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
EEC	European Economic Community
EU	European Union
G30	Group of Thirty
G20	Group of Twenty
FCA	Financial Conduct Authority
FMSA	Bundesanstalt für Finanzmarktstabilisierung
FSA	Financial Services Authority
FSA 2012	Financial Services Act 2012
FSA 2013	Financial Services (Banking Reform) Act 2013
FSMA 2000	Financial Services and Markets Act 2000
Fw	Faillissementswet
HRE	Hypo Real Estate
IA 1986	Insolvency Act 1986
ING	Internationale Nederlanden Groep
InsO	Insolvenzordnung
IR 2016	Insolvency Rules 2016
KWG	Kreditwesengesetz
MREL	Minimum Requirement for own funds and Eligible Liabilities
PRA	Prudential Regulatory Authority

Repo	Repurchase agreement
SAG	Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen
SoFFin	Sonderfonds Finanzmarktstabilisierung
SPV	Special Purpose Vehicle
SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SRR	Special Resolution Regime
SSM	Single Supervisory Mechanism
T2	Tier 2
TFEU	Treaty on the Functioning of the European Union
TLAC	Total Loss-Absorbing Capacity
UK	United Kingdom
UmwG	Umwandlungsgesetz
Wft	Wet op het financieel toezicht
Wtk	Wet toezicht kredietwezen

Part I

Introductory chapters

1 Introduction[1]

1 European convergence of national bank resolution frameworks

Over the last decades, financial globalization has led to the emergence of banks that operate through a multinational network of numerous entities and provide a full range of financial services.[2] Because of the interconnected structures of these banks, also the systemic risks associated with their failure transcend national boundaries. In 1998, after an examination of the 'issues surrounding the insolvency of a global financial institution',[3] the Group of Thirty (G30) concluded that 'supervisors, legislators, the financial services industry and insolvency and legal professionals have a great deal of work to do.' Its study was triggered by the failure of the bank Barings in the United Kingdom (UK) in 1995 and published during a widespread banking crisis in Asia. The G30 continued that '[t]here is no international framework for dealing with the supervisory, legal and financial problems that would arise in a cross-border insolvency of any kind, and a major cross-border insolvency in the financial sector could therefore pose a substantial risk to the international financial system.'[4]

Twenty years later, indeed, the global financial crisis tested the bank insolvency frameworks around the world and the lack of adequate tools to deal with bank failures forced many authorities to rescue banks with public funds. The European Commission, for instance, approved EUR 4.38 trillion of state aid measures to banks in the European Union (EU) over the period 2008-2010.[5] In response to these developments, the leaders of the Group of Twenty (G20) countries called for compatible national bank resolution

1 This chapter contains and builds on the following work previously published by the author: Janssen 2018.

2 *See* Claessens, Herring & Schoenmaker 2010, p. 7, noting that 'the structure of the world's financial services industry has been transformed by two trends. One is the marked rise in the importance of large financial institutions and the consolidation of national financial markets, so that in most countries the financial system is now dominated by a small number of large institutions. The second is the internationalization of these institutions – many of the largest institutions in the world today operate across multiple borders.'

3 Group of Thirty 1998, p. 1.

4 Group of Thirty 1998, p. 3.

5 European Commission's 'State Aid Scoreboard', available at http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html.

regimes and cross-border coordination amongst authorities to resolve cross-border operating banks in financial distress. They endorsed a set of global standards to which all national bank resolution frameworks should adhere.[6]

In the EU, the Bank Recovery and Resolution Directive[7] (BRRD) transposed these global standards into EU law and required the legislatures of all Member States to implement its rules into their national laws by 1 January 2015. It aimed to both strengthen and harmonize the existing national bank resolution frameworks. Each Member State designated a resolution authority that is empowered to intervene in a failing bank in an administrative, non-judicial procedure to mitigate risks to financial stability and ensure continued access to the critical functions of the bank. Other primary policy goals of the BRRD are reducing the costs of bank failures for taxpayers and minimizing moral hazard, i.e., excessive risk-taking by banks, confident that they will be bailed-out in the event of default. Under the Single Resolution Mechanism (SRM) Regulation[8] the decision on the resolution of significant and cross-border operating banks in the Euro Area is since 1 January 2016 taken by a resolution authority at the EU level, in cooperation with the resolution authorities of the Member States.

The BRRD provides for a bank resolution procedure as an alternative to an insolvency procedure under national insolvency law. Nonetheless, private law of the Member States plays an essential role in the EU bank resolution framework. Many rules in the BRRD and SRM Regulation only require specific results in national law and refer to national private law for their application and interpretation, such as to substantive insolvency law, property law, and company law.[9] For example, the BRRD and SRM Regula-

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6 In 2009, the G20 leaders called for a review of bank resolution and insolvency laws. In 2011, they endorsed the 'Key Attributes of Effective Resolution Regimes for Financial Institutions' of the Financial Stability Board. *See* Explanatory Memorandum of the Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012, 2012/0150 (COD)), p. 4.

7 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

8 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 and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

9 *See* Haentjens 2014b, p. 73.

tion provide that the resolution measures taken by the resolution authorities have to respect the priority amongst shareholders and creditors under the applicable insolvency law.[10] Resolution authorities may not exercise their statutory power to write-down a liability or convert debt into equity if the claim of the creditor is secured *in rem* under national property law.[11] Moreover, in a resolution procedure, the shareholders and creditors of the bank may not incur greater losses than they would have incurred if the bank had been liquidated under national insolvency law. This so-called no creditor worse off-principle requires resolution authorities to compare the actual treatment of shareholders and creditors in the resolution procedure with the position of these stakeholders in a hypothetical insolvency procedure. If the shareholders and creditors have incurred greater losses in resolution, they are entitled to payment of the difference.[12]

In contrast to the global and European origin of the rules in the BRRD and SRM Regulation, the regulation of private law areas such as substantive insolvency law and property law has always been largely left in the hands of the legislatures of the EU Member States. Therefore, the national bank resolution frameworks are currently based on a body of rules with mixed origin. Also, one has to interpret and apply the bank resolution rules in a way that is consistent with national private law. The European Commission acknowledged this in the legislative process for the BRRD. It noted that

> '[b]ecause the crisis management tools and powers are used at the point when an institution is failing or has failed, they inevitably interact with national insolvency regimes. Substantive insolvency law is not harmonised, and the measures proposed in the bank resolution framework need to be implemented in a way that is consistent with that national law. Furthermore, the application of the tools and exercise of the powers will almost certainly affect contractual and property rights, that are also rooted in national law.'[13]

According to the Commission, a directive was the appropriate legal instrument for the EU bank resolution framework to allow the national legislatures to transpose the bank resolution rules into the existing national legal orders. As a general rule, a directive requires the Member States to achieve a particular result and leaves to them the choice of form and methods.[14]

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10 Articles 34(1)(a)-(b) and 48(1) BRRD; Articles 15(1)(a)-(b) and 17 SRM Regulation.

11 Article 44(2) BRRD; Article 27(3) SRM Regulation.

12 Articles 34(1)(g) and 73-75 BRRD; Article 15(1)(g) and 20(16)-(18) SRM Regulation.

13 Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 79.

14 Article 288(3) Treaty on the Functioning of the European Union (TFEU).

The BRRD established a minimum harmonized framework with bank resolution tools and powers.[15] The SRM Regulation, by contrast, is binding in its entirety and directly applicable in the EU Member States.[16] Under the Regulation, resolution decisions are taken in a centralized decision-making procedure and then implemented by the national authorities on the basis of national law transposing the BRRD.[17]

It is not exceptional that national private law plays an essential role in an EU harmonized legal framework. Not only the BRRD and SRM Regulation but also other EU legislation affecting traditional areas of national private law, such as the Financial Collateral Directive[18] and the Settlement Finality Directive,[19] introduce rules that operate at the intersection of the harmonized legal framework and existing areas of national private law, and do not fully replace the latter. Other examples of such EU legislation that the literature has discussed include directives in the field of contract law.[20]

As regards the EU bank resolution framework, however, various studies have advocated further streamlining of the framework by introducing more uniform substantive rules, including by closer harmonizing specific areas of national private law for bank resolution. An important part of the recent academic and policy discussions has focused on the harmonization of substantive insolvency law in the EU. For example, much attention has been paid so far to (1) the further alignment of the national bank creditor hierarchies in resolution and insolvency,[21] (2) the introduction of harmonized collateral enforcement procedures that allow banks to recover value from secured non-performing loans,[22] and (3) the creation of a harmonized bank

15 Recital 44 BRRD.

16 *Cf.* Article 288 TFEU.

17 Articles 18, 23 and 29 SRM Regulation.

18 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002, p. 43), which was amended by Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 (OJ L 146, 10.6.2009, p. 37) and by article 118 BRRD.

19 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166, 11.6.1998, p. 45), which was amended by Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 (OJ L 146, 10.6.2009, p. 37).

20 E.g., Hartkamp 2012, p. 191-248; Loos 2007, p. 524-531; Teubner 1998.

21 An EU directive that aims to harmonize a small part of the national creditor hierarchies in resolution and insolvency was adopted in December 2017 and has to be transposed into national law by 29 December 2018. *See* paragraph 5.3.4 of chapter 5.

22 Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral (14.3.2018, COM(2018) 135 final). The proposal is part of a package of measures to reduce the level of non-preforming loans of banks in the EU.

insolvency chapter within all national insolvency laws.[23] Some scholars even call for a single bank insolvency regime.[24] Proponents of harmonization say that the differences in specific areas of national private law and the discretion left for resolution authorities and legislatures create legal uncertainty for banks and investors and are likely to complicate the application of the bank resolution tools to cross-border operating banks.[25] Arguably, seeking greater convergence of bank resolution frameworks by harmonizing, for instance, specific aspects of substantive insolvency law for bank resolution, could help to enhance predictability and consistency of the treatment of creditors and other participants in bank resolution procedures.[26]

At the same time, it has been concluded that removing all disparities in specific parts of national private law is politically not feasible in the short term. Substantive insolvency laws and laws on security rights, for instance, are strongly intertwined with other areas of national legislation and are deeply rooted in domestic legal traditions. For that reason, many scholars consider the creation of EU legislative instruments to change these areas of law complicated.[27]

The goal of this book is to assist in the further development of the EU bank resolution regime by asking the question of how the harmonized bank resolution frameworks currently relate to national private law. It starts from the premise that academic and policy discussions on the further develop-

23 E.g., International Monetary Fund, 'Euro Area Policies. Financial sector assessment program. Technical note – bank resolution and crisis management', IMF Country Report No. 18/232, p. 22-23 and 25-27; Merler 2018; Lehmann 2018; Philippon & Salord 2017, p. 44-46; Valiante 2016, p. 31-32. For a discussion of these proposals, *see* paragraph 3.2 of chapter 7.

24 Véron 2018, p. 9; Bénassy-Quéré at al. 2018, p. 6.

25 E.g., Merler 2018; Philippon & Salord 2017, p. 44-46; European Banking Authority, Final Report on MREL. Report on the implementation and design of the MREL framework (EBA-Op-2016-21, 14 December 2016), p. 119; Council of the European Union, 'Council Conclusions on a roadmap to complete the Banking Union', 17 June 2016, para.7; Wojcik 2016, p. 124-126. *See also* Recital 7 Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy (OJ L 345, 27.12.2017, p. 96–101).

26 Hüpkes 2011, para. 5.58.

27 On the harmonization of insolvency law in the EU in general, *see* e.g., Eidenmüller 2017, p. 275; Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (SWD (2016) 357 final, 22.11.2016), p. 23-25; Mucciarelli 2013, p. 196-199; Laukemann 2013, p. 385-386. *See also* Fletcher & Wessels 2012, p. 107-135. For a discussion of the harmonization of property law in the EU, *see* e.g., Akkermans 2016; Van Erp & Akkermans 2012, chapter 10; Drobnig, Snijders & Zippro 2006.

ment of the bank resolution frameworks call for the closer harmonization of national private law for bank resolution. The chapters, therefore, analyze how the resolution rules, principles, and objectives of the BRRD and SRM Regulation currently interact with and how they have been embedded into existing areas of private law at the national levels. On that basis, they examine which possible differences in interpretation and application of the bank resolution rules are created by the differences in areas of national private law that interact with the bank resolution rules.

The results of the research indicate that Member States are currently indeed left discretion in the field of substantive insolvency law. At the same time, the present study ascertains that differences in bank resolution procedures may not only stem from the diverging insolvency legislation to which the literature and policymakers have paid much attention. Divergent national approaches and procedures to apply the harmonized bank resolution rules may also lead to a different application and interpretation of the bank resolution rules. Therefore, in the debate on the further development of the EU bank insolvency framework, we may also need to consider the current implementations of the bank resolution framework and their effect on supranational coherence in the bank resolution procedures.

Furthermore, the examination mentioned above of how the resolution rules, principles, and objectives currently interact with and how they have been embedded into existing areas of national private law signals that inconsistencies in legislation may not only arise at the supranational level. The developments in EU bank insolvency law entail that the national bank insolvency regimes have been and will be increasingly governed by EU legislation. The EU legislation deals with specific topics and objectives and contains rules and terminology that are entirely different from that in the existing national law. The legislatures of the Member States are faced at the moment and will also be charged in the future with the difficult task of aligning their national legal orders with the EU legislation. This book analyzes coherence of the resolution rules, principles, and objectives with private law of the national legal orders. It maintains that the national legislatures should carefully examine coherence in the domestic legal orders in the further development of the national bank insolvency laws.

2 Theoretical framework

The present study investigates several examples of relations between the current bank resolution frameworks and national private law. The investigated relations are selected because of their relevance to legal practice or the literature has paid much attention to them. This analysis also requires an examination of the resolution rules as established at the EU level. Nonetheless, the focus of the assessment is on the bank resolution rules,

principles, and objectives provided by the SRM Regulation, which is by its nature directly applicable at the national level, and the national legislation transposing the BRRD.

Based on the analysis of the selected relations, the final chapter of this dissertation, which is chapter 7, uses two notions of coherence, namely national coherence and supranational coherence, as tools to determine how the bank resolution frameworks created by the BRRD and SRM Regulation relate to existing areas of national private law. Both supranational coherence and national coherence are in the book regarded to contribute to important goals such as transparency in rights of parties and predictability of the application and interpretation of the law.

Although the literature assigns a variety of meanings to the concept of coherence in the law, here coherence in the national legal orders is considered to focus on the elements that form a system of law. At the surface level of the national legal system, coherence requires that the legal components such as statutes and case law allow non-contradictory interpretations and definitions, and that they are logically connected with each other. Hence, a study of the coherence at this level is intended to identify, for instance, a contradictory meaning of a rule, leading to potential uncertainty. Furthermore, at a deeper level of the national legal system, coherence requires a set with some shared policy goals, principles, and objectives. The analysis at this deeper level is intended to identify, for example, joint objectives of areas of law, without disputing the fact that the relevant areas of law have potentially distinct fields of applicability. If full coherence cannot be reached because, for instance, a different meaning of one term in two different areas of law is preferable to a uniform definition, for the sake of legal certainty it may be preferable to at least explicitly provide how the conflicting legal components relate to each other.

Coherence in the national legal orders is to be distinguished from a coherent interpretation and application of the bank resolution rules across jurisdictions. An analysis of the latter, supranational type of coherence requires an investigation of whether the results of the interpretation and application of the harmonized bank resolution rules are likely to be different in different jurisdictions because of the transpositions into the national legal orders. For example, inconsistent implementations of the harmonized rules in the EU or heterogenous private laws with which the harmonized rules interact may cause divergent outcomes.

3 Research questions and structure of the dissertation

This book asks the question of how the bank resolution frameworks created by the BRRD and SRM Regulation currently relate to national private law.

Chapters 2-4 introduce bank insolvency law and define the notions of coherence that the present study uses. In particular, chapter 2 examines why many scholars and policymakers consider bank-specific insolvency rules crucial and which developments have taken place in the field of bank insolvency law at the EU level over the last decades. Chapter 3 focuses on developments in the field of banking supervision and bank insolvency law from a historical perspective. It investigates which bank-specific supervisory and insolvency tasks were granted to authorities in the Netherlands, Germany, and the UK before the introduction of the BRRD. It also makes some introductory remarks about the implementation of the BRRD in the three jurisdictions. Chapter 4 introduces the normative legal framework by discussing the notions of national and supranational coherence and why the coherence analysis is relevant in the context of the harmonization efforts in the field of bank resolution law.

Chapters 5 and 6 then analyze key relations between the objectives, principles, and rules of the bank resolution framework and several areas of private law in the selected jurisdictions – in particular, national substantive insolvency law. The first question in both chapters focuses on the deeper levels of the domestic legal orders, namely the principles or objectives. The next three questions in each chapter focus on the relation of the bank resolution rules with rules of national private law. Chapter 5 is devoted to bail-in, i.e., the write-down and conversion into equity of capital instruments and liabilities of a bank. Chapter 6 discusses the other three bank resolution tools, i.e., the tools to transfer a part of or the whole business of a failing bank to a third-party bank, a temporary bridge institution or an asset management vehicle. One can also say that chapter 5 focuses on restructuring measures that mainly take place on the liabilities side of the balance sheet of a bank and chapter 6 on the measures on the assets side of the bank balance sheet.

Chapter 5 discusses the following questions:
1. Do the national legal frameworks on bail-in and the national company and insolvency laws share some important principles, especially from the perspective of the trend in the EU to introduce corporate restructuring procedures as an alternative to traditional court-centered procedures?
2. What is the effect of a reduction of liabilities of a bank by a resolution authority on the liabilities themselves and related guarantees under national law?
3. Does conversion of debt into equity under the bank resolution rules follow the formalities and practice for such conversion normally followed in a financial restructuring under national law?
4. How does the hierarchy of claims in bail-in relate to the insolvency ranking of claims under national law?

Chapter 6 addresses these questions:
1. Do the resolution rules on the transfer tools and national insolvency law share objectives?
2. How did the national legislatures ensure that the transfers ordered by a resolution authority have an immediate effect? How do the effect and scope of the application of the transfer tools relate to other types of acquisition of assets, rights, and liabilities or shares under national private law?
3. In case of a partial transfer of assets, rights, and liabilities, how do the resolution rules protect security rights under a security arrangement and set-off or netting rights under a set-off or netting arrangement, respectively? Would creditors also benefit from these rights if an insolvency procedure is opened under national insolvency law? Do other areas of national private law also offer protection against a loss of these rights in case of a partial transfer in a resolution procedure?
4. What is considered a 'normal insolvency proceeding' for a bank under national insolvency law? Which role does the national resolution authority play in the opening of such a procedure?

As noted above, chapter 7 is the final chapter that applies the coherence theory that was developed in chapter 4 to the results of the analysis in chapters 5 and 6 to identify how the bank resolution frameworks relate to national private law.

4 Scope of the study

The analysis focuses on the bank resolution frameworks in three jurisdictions: the Netherlands, Germany, and England. The three jurisdictions have large national financial sectors. Financial institutions such as ING Bank, Deutsche Bank, and Barclays are considered 'global systemically important banks'. In addition, the Netherlands has 4, Germany 15, and the UK 12 so-called 'other systemically important institutions'.[28]

The three jurisdictions also introduced domestic bank resolution frameworks already before the introduction of the BRRD at the EU level. These national regimes then formed the legal basis for interventions in several failing banks. The interventions in the failing Dutch financial conglomerate SNS Reaal, German bank Hypo Real Estate (HRE), and UK bank Northern Rock are often selected as case studies to illustrate how EU Member

28 Financial Stability Board, '2017 list of global systemically important banks (G-SIBs)', 21 November 2017; Basel Committee on Banking Supervision, 'Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III G-SIB framework and review of D-SIB frameworks – European Union', June 2016, p. 11.

States dealt with failures of financial institutions before the entry into force of the BRRD and SRM Regulation. Moreover, the Dutch, German, and English bank resolution frameworks that existed before implementation of the BRRD have all influenced the current design of the bank resolution framework at the EU level, although the national regimes differed amongst themselves. In its Impact Assessment accompanying the proposal for the BRRD of 2012, the European Commission refers several times to Germany and the UK as examples of Member States that had recently introduced a national bank resolution framework and to the Netherlands as an example of a country that was in the process of introducing such a framework at that time.[29] Thus, the three jurisdictions are important players in the EU bank resolution framework.

Besides, the Dutch Bankruptcy Act (*Faillissementswet*, Fw), German Insolvency Act (*Insolvenzordnung*, InsO), and English Insolvency Act 1986 (IA 1986) represent diverse legal traditions. The three national insolvency acts are used as examples in the discussions about the harmonization of general insolvency law at the EU level. A study of the Dutch legal system was also chosen because the author is familiar with this system and has good access to Dutch legal resources. An examination of English law is relevant because the common law tradition differs highly from the civil law tradition and in practice, a large number of financial contracts is concluded under English law. Furthermore, the selection of Dutch and German law, on the one hand, and English law, on the other hand, is relevant because it illustrates the distinction that can be made in the EU between the SRM participating Member States and the Member States which only transposed the BRRD.

Although the UK soon leaves the EU and the effects of the Brexit on banking legislation are uncertain at the moment of finalizing this dissertation (August 2018), a study of the English bank resolution framework is of significant relevance. Firstly, as indicated above, the UK approach to bank resolution served as a model for the BRRD.[30] Secondly, according to the present author, the UK resolution framework is likely to influence the EU approach to resolution in the future, and vice versa. Bank resolution cases that extend to both the UK and the EU force authorities on both sides of the Channel to find some means to cooperate and coordinate the procedures.

29 Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 61, 72, 79 and 101-102.

30 *See* Brierley 2017, p. 460-461.

The study is both descriptive and normative. For the examination in the selected jurisdictions, several questions have been phrased which all have a functional perspective. Following the in-depth analysis of the current national bank resolution rules and their relations with national private law in the selected jurisdictions, the bank resolution frameworks can be measured against the coherence standards.

Inevitably, the scope of the study had to be limited in some respects. The bank resolution framework interacts with many areas of national law. The areas of law that are studied include bank resolution law, insolvency law, company law, property law, and contract law. The primary focus of the present study is bank resolution law and substantive insolvency law. This angle was chosen because in the current policy and academic discussions on the further development of bank resolution law pay much attention to the interaction of the bank resolution rules with substantive insolvency law. A comprehensive analysis of conflict of laws rules falls outside the scope of the dissertation.

The book focuses on banks (credit institutions), even though the scope of the resolution framework under the BRRD and SRM Regulation is broader.[31] Notwithstanding the fact that not all banks that are established in the Netherlands, Germany, and England are organized as public limited companies, the present study focuses on public limited companies while addressing other legal forms when considered relevant. Furthermore, the following chapters do not contain an extensive discussion of legal practice and recent case law in the field of bank resolution. They rather focus on the positive law in three jurisdictions and on the systemization of the national legal orders in these jurisdictions. Hence, the dissertation does not thoroughly discuss questions such as whether the existing resolution measures are in practice appropriate for both an idiosyncratic bank failure and the failure of a systemically important bank, and which conclusions about the application of the bank resolution rules can be drawn from recent bank resolution cases in the EU. Also, it does not include an in-depth analysis of whether different structures of large financial conglomerates influence the resolution strategies chosen by authorities.

5 Terminology

The dissertation uses, in principle, the terminology used in the BRRD and SRM Regulation, such as the terms 'resolution tools' and 'resolution powers'. In some cases, different terminology is preferred. The bail-in tool and the write-down or conversion of capital instruments and eligible liabilities

31 *Cf.* Article 1 BRRD; Article 2 SRM Regulation.

tool are together called the 'bail-in mechanism'. The sale of business tool, bridge institution tool, and asset separation tool are together called the 'transfer tools'. The meaning of these terms is discussed in chapters 5 and 6, respectively. For the sake of simplification, this book uses the term 'bank' to refer to a credit institution, which is the term used in the BRRD and SRM Regulation and many other EU legislative instruments.[32] Moreover, for the sake of clarity, the term 'competent supervisory authority' or 'supervisory authority' is used rather than the term 'competent authority', as employed in EU legislative instruments.[33] The study uses the term 'bank insolvency law' as an umbrella term for both bank resolution law and the more traditional bank insolvency law. Chapter 2 discusses this term. The term 'general insolvency law' or 'insolvency law', in turn, is used for the field of law related to the insolvency of a corporate debtor.[34] Finally, the present study uses the term 'private law' for the area of law that, as opposed to public law, is traditionally concerned with 'the rights which, against another, people are able to realize in courts'.[35] It includes, for instance, property law, contract law, insolvency law, and company law.[36]

The book takes into account developments until August 2018.

32 Article 4(1)(1) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1) (Capital Requirements Regulation, CRR) defines the term 'credit institution' as 'an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.'

33 *Cf.* Article 2(1)(21) BRRD; Article 4(1)(40) CRR.

34 *Cf.* Goode 2011, para. 1.01. English lawyers distinghuish between 'bankruptcy', which applies to individuals, and 'insolvency', which applies to companies. The German legal literature generally only uses the term 'insolvency law' (*Insolvenzrecht*). Dutch lawyers seem to use the terms 'bankruptcy law' (*faillissementsrecht*) and 'insolvency law' (*insolventierecht*) often interchangeably. *See* Wessels 2016, para. 1001-1002.

35 Burrows 2013, p. ix. *See also* Hesselink 2002a, p. 8.

36 It is not always possible, however, to make a sharp distinction between private law and public law. EU legislative instruments, for instance, often contain both public and private law aspects. *See* Hesselink 2002a, p. 8-10.

2 European bank insolvency rules[1]

1 Introduction

This chapter discusses the questions of why most policymakers and scholars consider a special legal framework to deal with banks failures crucial and which rules for bank insolvencies exist at the EU level. To answer these questions, paragraph 2 examines the primary policy goals of general insolvency law, why a corporate insolvency procedure may not work for a failing bank, and which policy goals an ideal bank resolution framework pursues. Paragraph 3 then explores the main developments in the field of EU bank insolvency law before the entry into force of the BRRD. The paragraph also introduces the bank resolution procedure created by the BRRD. The cross-border convergence and coordination sought by the BRRD and the unified decision-making procedure under the SRM Regulation are discussed in the last sections of the chapter.

The chapter shows that the EU bank resolution framework does not reject the more traditional insolvency framework, but it heavily relies on insolvency law. The resolution framework aims to replicate the economic outcome of an insolvency procedure for the shareholders and creditors of the failing bank and adheres to some fundamental principles of insolvency law. The deviations of the resolution rules from general insolvency law reflect the unique characteristics of a bank failure when compared to a more traditional business failure.[2]

2 Special legal framework for bank insolvencies

2.1 General framework of insolvency law

Insolvency scholars have described insolvency law as a set of rules which core is to be found in 'the prevention, regulation, or supervision of discontinuity in the legal relations of a legal subject that is in financial difficulties'.[3]

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1 This chapter contains and builds on the following work previously published by the author: Janssen 2018a; Janssen 2018b; Janssen 2017.

2 *Cf.* Massman 2015, p. 644.

3 Wessels 2016, para. 1001, who notes in Dutch that '[i]n het insolventierecht staat centraal het vermijden, reguleren of begeleiden van discontinuiteit in rechtsbetrekkingen van een rechtssubject dat in financiële moeilijkheden verkeert'. Wessels, Markell & Kilborn 2009, p. 2 provide almost the same definition.

The term 'insolvency' derives from the Latin verb 'solver', to pay, and is often used interchangeably with the term 'bankruptcy'. The latter term derives from the Italian term 'banca rotta', broken table. It appears to refer to the fact that the table of an early Italian money-changer in the market place was broken if he was no longer able to pay his debts.[4] A modern-day, widely-used definition of the term 'insolvency' is 'when a debtor is generally unable to pay its debt as they mature, or when its liabilities exceed the value of its assets.'[5] The literature describes it as a state of affairs in which the debtor is overwhelmed by debts and the creditors, therefore, can no longer expect that their debtor will be able to meet its financial commitments fully and in time.[6] When a debtor is insolvent for the purpose of the law, the creditors and debtor can typically initiate a legal process that requires a court judgment.[7]

The justification for the existence of insolvency law and the purpose of this area of law have been much debated amongst scholars, especially US scholars.[8] We consider two important camps in this debate in turn.

The scholars in one camp argue that the main function of insolvency law is to organize a collective procedure.[9] Their theory is called the 'creditors' bargain theory', which is the most influential theory of insolvency law and has been mainly developed by Jackson and Baird.[10] It is based on the idea that if insolvency law does not provide for a collective procedure, creditors would agree on a collective debt collection method themselves. Without such a procedure, it would be free for all and a chaotic race to the assets of the insolvent debtor would take place in which some creditors may be better off but which does not result in the most efficient outcome for the creditors as a whole.[11] Thus, a so-called 'common pool problem' exists.[12] Insolvency law seeks to overcome the coordination problems amongst creditors by providing a collective, compulsory insolvency procedure and respecting the pre-insolvency entitlements.[13] It imposes a moratorium or automatic stay on the actions of individual creditors.[14] The only objective of the collective procedure is to allocate the common pool of assets in such a

4 Wessels, Markell & Kilborn 2009, p. 2; Rajak 2008, p. 3-4; Hüpkes 2000, p. 12.
5 UNCITRAL, Legislative guide on insolvency law, New York: United Nations 2005, p. 5 (para. 12, under B, 'Glossary').
6 McBryde & Flessner 2003, p. 15.
7 *See* Rajak 2008, p. 4-5. *See also* Finch & Milman 2017, p. 119; Goode 2011, para. 4.01.
8 *See* Goode 2011, para. 2.15.
9 *See* Goode 2011, para. 2.15.
10 E.g., Jackson 1986; Baird & Jackson 1984; Jackson 1982.
11 Jackson 1986, p. 9-13.
12 Jackson 1986, p. 11.
13 *See* Jackson 1986, p. 13 and 21.
14 *See* Jackson 1986, p. 151-192.

way as to maximize the returns to the creditors. According to the creditors' bargain theory, insolvency law should not concern itself with societal aims such as keeping the corporate debtor in operation and protect community interests.[15]

By contrast, according to the scholars of another camp, insolvency law should play a wider role and consider a larger range of interests than the interests of the creditors.[16] Warren, for instance, distinguishes four principal goals of insolvency law. In her view, this field of law creates a system to (1) enhance the value of the failing firm, (2) distribute value according to multiple normative principles, (3) internalize the costs of business failure to the parties dealing with the debtor and minimize the losses to the general public, and (4) create reliance on private monitoring.[17] Thus, enhancing the collective returns to the creditors is not the only goal of insolvency law.[18] Furthermore, according to Warren, insolvency law does not only aim to create a system to distrubute value amongst the persons with formal legal rights to the assets. She advocates a regime that also takes into account the distributional implications of business failure on other parties. Insolvency law may, for example, indirectly protect the interests of employees in the preservation of their jobs and the community interests by facilitating going concern sales and reorganizations so that the business of a failing company can remain in operation.[19]

In actuality, as we will see in chapter 6, the primary objective of Dutch, Germany and English insolvency law is considered maximizing the returns to the creditors.[20] The insolvency laws offer multiple procedures. These procedures do not all offer an automatic stay on creditor action.[21] For example, there is no automatic stay in the company voluntary arrangement[22] (CVA) under the English IA 1986.[23] Moreover, besides providing for the possibility of a sale of the debtor's assets to one or more parties, the insolvency laws offer a debtor the possibility to restructure as a business in the hands of the original legal entity on the basis of an arrangement with the creditors and

15 Jackson 1986, p. 210 and *see* Finch & Milman 2017, p. 28-29; De Weijs 2012, p. 68-70; Goode 2011, para. 2.15
16 *See* Goode 2011, para. 2.15. *See also* Finch & Milman 2017, p. 35-41.
17 Warren 1993, p. 344.
18 *See* Warren 1987, p. 777.
19 Warren 1993, p. 354-356 and *see* Finch & Milman 2017, p. 35-37; Kirshner 2015, p. 799-800, who refer to several other scholars.
20 Paragraph 4 of chapter 6.
21 On English law, *see* Paterson 2016, p. 700.
22 Part I IA 1986; Schedule A1 to the IA 1986.
23 In the CVA, a statutory moratorium is only available for small, eligible companies under Schedule A1 to the IA 1986, para 7. *See* Finch & Milman 2017, p. 420-424; Paterson 2016, p. 700.

shareholders.[24] Also, as chapter 5 will show, they provide for a distributional order of priority amongst creditors. Dutch and English insolvency law has become infused with some societal interests as they give a few types of creditor claims, including claims of employees, a preferential status.[25]

In addition to the ex-post objective to maximize the returns to creditors when the debtor is insolvent, insolvency law is said to have an important effect on ex-ante incentives and behavior.[26] If certain parties do not consider insolvency a sufficient threat, the problem of moral hazard may arise in that these parties have no constraints to limit risk-taking.[27] Moral hazard is the concern that someone who is protected against the consequences of a risk because another party will incur the costs, is less inclined to take precautions but has an incentive to take the risk.[28] Insolvency law determines the consequences of business failure. A failing company may need to leave the market if it is no longer economically viable.[29] The shareholders may have to incur losses if the company enters an insolvency procedure because they do not receive any payments until the other claims are paid. Insolvency law also aims to create appropriate ex-ante incentives for managers by, for instance, presenting the threat that the management of the debtor may not keep its jobs in the event of insolvency.[30] Under English insolvency law a director can be held liable for wrongful trading in the period before the commencement of an insolvency procedure.[31] Under German insolvency law the directors are also obliged to file for an insolvency procedure within three weeks after a company has become insolvent.[32] This ex-ante perspective on insolvency law plays an important role in the bank resolution framework, as the next paragraphs will discuss.

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24 *Cf.* however Madaus 2018, who uses the term 'insolvency law' in a narrow sense. He argues that insolvency law only governs liquidation procedures to address a common pool problem, whereas restructuring law facilitates the conclusion of a restructuring agreement, including an insolvency plan in an insolvency plan procedure under the InsO. The present study uses the term 'insolvency law' in a broader sense.

25 Paragraph 5.3 of chapter 5.

26 E.g., Eidenmüller 2018, para. 3.3.1; Goode 2011, para. 2.01; Eidenmüller 1999, p. 27-30.

27 Krimminger 2011, para. 11.11.

28 *See* Ayotte & Skeel 2010, p. 485.

29 Eidenmüller 2017, p. 284-285. *See also* Goode 2011, para. 2.01.

30 Marinč & Vlahu 2011, p. 4-5; Davies 2006, p. 304; Hart 2000, p. 4-5. *See also* Acharya, Amihud & Litov 2011, whose empirical research suggests that providing strong rights to the creditors of a company which is in financial trouble leads the company to reduce risks. Such strong rights increase the likelihood of companies making diversifying acquisitions, in which case the managers may run the risk of being dismissed in the reorganization.

31 Section 214 IA 1986. *See* Finch & Milman 2017, p. 599-604; Eidenmüller 2006, p. 249; Davies 2006, p. 316-329.

32 Section 15a InsO. *See* Eidenmüller 2006, p. 250.

2.2 Banks subject to a special insolvency regime

2.2.1 Why a traditional, formal insolvency procedure may not be an appropriate option for a bank

Is a traditional, formal insolvency procedure also an appropriate option for a bank? It has been argued that

> '[a] priori there is no reason not to apply general insolvency rules to banks. In fact, many aspects of a bank liquidation, such as the calculation of the assets, the verification of claims, the adjudication of disputed claims, and the distribution of assets will need to be handled largely in the same manner as the liquidation of a commercial company.'[33]

Nevertheless, some scholars and standard setters advocated a specialist framework for bank failures several decades ago already.[34] Furthermore, as we will see in chapter 3, already before the start of the latest financial crisis specific rules for banks in financial distress existed in the Netherlands, Germany, and the UK. An example is the rule that the supervisory authority may file the petition addressed to the court for the initiation of an insolvency procedure for a bank.[35] Moreover, at that time, Dutch law provided for the emergency procedure (*noodregeling*) as a bank-specific suspension of payments procedure. Bank failures during the latest financial crisis underlined that there are strong arguments to give banks a more special treatment if they are in financial distress. These failures include the collapse of UK bank Northern Rock, which experienced a bank run and was subsequently taken into public ownership in 2008,[36] and the failure of the German bank HRE, which financial position significantly worsened following the insolvency of US investment bank Lehman Brothers in 2008.[37]

The reasons given by Hüpkes to view banks as 'special' when compared to most other companies are the following.[38]

First, traditionally banks have highly liquid liabilities in the form of demandable deposits and short-term funds. The deposits can be withdrawn at any time and much of the short-term debt is due in a few days or even

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33 Hüpkes 2005, p. 475.

34 E.g., Asser 2001, p. 8-11; Hüpkes 2000, p. 12-30; Basel Committee on Banking Supervision, 'The insolvency liquidation of a multinational bank', December 1992.

35 Paragraphs 2.1.2, 3.1.2 and 4.1.2 of chapter 3.

36 *See* paragraph 4.1.3 of chapter 3 and *see* Lastra 2008.

37 *See* paragraph 3.1 below and *see* Admati & Hellwig 2013, p. 11.

38 Hüpkes 2005, p. 472-473; Hüpkes 2000, p. 8. *See also* Cranston et al. 2017, p. 6-8; Bliss & Kaufman 2007, p. 147-149; Kelly 1997, p. 264-268.

overnight. By contrast, banks typically invest a large part of the money in long-term loans and other investments for longer periods that are often difficult to be converted into cash on short notice. Thus, a maturity mismatch exists between their short-term liabilities and long-term assets.[39] This maturity mismatch may not create any problems under normal circumstances. However, a sudden loss of confidence in the bank may result in a large number of deposit withdrawals and run on funds that threaten its liquidity position and may require it to sell assets at a loss.[40] As we will see below, these problems can also quickly affect other parts of the financial system. Second, banks offer financial services that are critical to the functioning of the economy. For instance, they lend funds to other companies and households and participate in payment systems. The literature considers this special role in our economy 'a sort of public service.'[41] A third characteristic function of banks is that they perform a crucial function in the transmission of the monetary policy of central banks.[42]

It is true that modern-day banks in the EU are much more complex than these characteristics may suggest. They have significantly expanded their activities beyond the traditional activities of taking deposits and making loans. Examples include the involvement in securitization and derivatives markets.[43] Furthermore, many non-bank financial companies now also carry out traditional banking functions, such as the credit-providing functions,[44] and it is argued that financial innovation will soon fundamen-

39 Allen, Carletti & Gu 2014, para. 2.4; Admati & Hellwig 2013, p. 39 and 51; Ayotte & Skeel 2010, p. 474-475; George 1997, p. 252. *Cf.* the definition of 'credit institution' in article 4(1)(1) CRR: 'an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.' This business model is of all times. *Cf.* e.g., *Foley v Hill* [1848] 2 HLC 28, in which case the House of Lords noted that '[m]oney, when paid into a bank, ceases altogether to be the money of the principal [...] it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's, is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers in some places, or the principal and a small rate of interest, according to the custom of bankers in other places. The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases.' *See also* Campbell 2008, p. 212-213.

40 Allen, Carletti & Gu 2014, para. 2.4; Admati & Hellwig 2013, p. 39; Ayotte & Skeel 2010, p. 474-475. *See also* Diamond & Dybvig 1983.

41 Hüpkes 2005, p. 472.

42 Hüpkes 2005, p. 473; Hüpkes 2000, p. 8. For a discussion of the role in the transmission of monetary policy, *see* Peek & Rosengren 2014.

43 Cranston et al. 2017, p. 15-17; Final report of the High-level expert group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen (Liikanen Report), October 2012, p. 13-14. *See also* Fonteyne et al. 2010, p. 10.

44 Krimminger 2011, para. 11.12-11.18.

tally change the current financial intermediation structures.[45] However, in the EU, the banking sector still has a significant share in financial intermediation.[46] The present study focuses on banking in the traditional sense and considers other types of financial institutions and activities if relevant for the analysis of bank insolvency. Further research might consider how the analysis of the present study maps into the insolvency regimes that apply to other parts of the financial sector.

The above-mentioned characteristics of a banking business lead to great public interest in protecting the banking functions in case of failure.[47] A general corporate insolvency procedure may not always be appropriate to do so. That analysis mainly applies to banks which are considered too important, connected and/or big to fail because of their size, complexity or interconnectedness with other market participants, or the insubstitutionability of some of their operations. The limitations of a general corporate insolvency procedure include that (1) it does not have as its primary objective to minimize the impact of the failure on the financial system as a whole,[48] (2) it traditionally involves a stay, (3) the trigger for the initiation of the procedure may be inadequate, (4) the procedure may require negotiations with shareholders and creditors, and (5) it may not sufficiently facilitate international coordination.

The first limitation of insolvency law is that it does not focus on the protection of the broader public interest.[49] Dutch, German, and English insolvency law has traditionally been directed towards the maximization of the value for the creditors and their equal treatment.[50] The principal players in an insolvency procedure, such as the debtor, creditors, administrator or trustee and court, may not consider or may not be able to take full control over the broader implications of a bank failure.[51]

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45 For an analysis of fintech and some issues policymakers might need to consider, *see* Demertzis, Merler & Wolff 2018.

46 *See* Final report of the High-level expert group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen (Liikanen Report), October 2012, p. 12; Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 7.

47 Attinger 2011, p. 7.

48 *See* Jackson & Skeel 2012, p. 448-449; Levitin 2011, p. 483-487.

49 Jackson & Skeel 2012, p. 448-449; Levitin 2011, p. 483-487.

50 *Cf.* Hüpkes 2005, p. 479-480.

51 Jackson & Skeel 2012, p. 449; Hüpkes 2005, p. 479-480.

What distinguishes the failure of a bank that is considered considered too important, connected and/or big to fail from, for example, the failure of a local bakery is often the systemic risk.[52] A single definition of the term 'systemic risk' does not exist. One definition provided in the literature on bank insolvency is that it is 'the risk that the failure of a market participant to meet its contractual obligations may, in turn, cause other participants to default, with a chain reaction to broader financial difficulties.'[53] Thus, it is about the risk to the entire financial system. One can argue that the fact that a bank failure may result in negative externalities beyond the private costs of the failure justifies a special legal framework for bank failures.[54]

The financial problems of a bank can quickly affect the rest of the financial system through three channels:[55] (1) through counterparty risk because the bank is a direct counterparty of many other market participants, such as through derivatives contracts and repurchase agreements (repos), so that its problems can easily be transmitted to the balance sheets of these other participants;[56] (2) through liquidity risks when the bank is forced to fire-sale its assets to obtain cash, which sales depress the value of the assets of other financial institutions;[57] and (3) through contagion risks because the problems of one bank cause a panic that spreads to other financial institutions.[58] The problems within the financial system can, in turn, affect the broader economy, for instance, because there is less funding available for companies to finance their activities.[59]

The third channel, i.e., contagion, entails run behavior.[60] Banks are especially vulnerable to such behavior because, as indicated above, a large part of their assets tends to be less liquid than their liabilities. Moreover, they are highly leveraged, that is, they rely heavily on debt to finance their

52 *See* Grünewald 2014, p. 11; Hüpkes 2005, p. 489.

53 Hüpkes 2005, p. 489 (footnote 118). For comparable definitions, *see* Schillig 2016, p. 46 ('the probability that the process of financial intermediation ceases, at least to a significant extent and in significant parts of the financial system.'); Schwarcz 2008, p. 204 ('the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a chain of markets or institutions or (Y) a chain of significant losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-market price volatility.'). *Cf.* Coffee 2010, p. 1, who notes about systemic risk that '2008 essentially witnessed a localized economic shock in the U.S. subprime mortgage market that nearly caused the meltdown of worldwide capital markets because that shock was transmitted rapidly through counterparties and global markets with the speed of a tsunami.'

54 Beck 2011, p. 56.

55 Tröger 2018, p. 39; Zhou et al. 2012, p. 4. *See also* Armour 2015, p. 457-458.

56 *See* Scott 2016, p. 3-4.

57 *See* Admati & Hellwig 2013, p. 63.

58 *See* Scott 2016, p. 5-14.

59 Tröger 2018, p. 39.

60 Scott 2016, p. 6.

investments.[61] A loss of confidence in the financial position of a bank may lead to the sudden withdrawal of their money by the creditors. Such a run may be targeted to one bank, but the suggestion that one bank is in default may also spread a panic and trigger creditors of multiple financial institutions to withdraw preemptively.[62] If these institutions then cannot obtain new funding, they may have to fire sale their assets and may experience liquidity problems within a short period. Hence, banks are confronted with a more dramatic form of common pool problem than most non-financial companies. They have a large number of creditors who have an incentive to immediately run to the firm to withdraw their money and liquidate their claims.[63]

In the past, banking crises were often limited in scope, such as the crisis in Finland and Sweden in 1992, which had limited effects outside the borders of those jurisdictions.[64] Also, the literature on contagion has traditionally focused on bank runs by retail depositors.[65] The latest financial crisis provided new insights into the contagion risks and run behavior. The contagion risks have increased over the last few decades, especially because of the greater (international) interconnectedness of and new types of players and transactions in the financial system.[66] Following the insolvency of Lehman Brothers in 2008, for example, a run by investors on money market funds ensued, even on funds that were themselves not directly affected by the failure of Lehman Brothers.[67] Furthermore, banks now rely heavily on the wholesale markets for their funding. During the crisis, many banks experienced financial difficulties as a result of wholesale market (rather than retail deposit) runs, including on the repo and interbank lending markets.[68] In 2007, Northern Rock experienced a classic retail deposit run, with many queuing depositors wishing to withdraw their money. The main run, however, took place on the wholesale market.[69] While, at least in theory, a deposit guarantee scheme may prevent a run by retail and some other types of depositors because it guarantees them that they will have continuous access to their deposits if their bank defaults, such a scheme may not mitigate the effects of other types of runs.[70]

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61 Admati & Hellwig 2013, p. 30; Fonteyne et al. 2010, p. 10.
62 Scott 2016, p. 5-14. *See also* Diamond & Dybvig 1983.
63 Schillig 2018, para. 2.2; Schillig 2016, p. 63-64; Swire 1992, p. 494-495.
64 Admati & Hellwig 2013, p. 65.
65 Scott 2016, p. 10 and 68.
66 Admati & Hellwig 2013, p. 65-69. *See also* Coffee 2010, p. 22.
67 Admati & Hellwig 2013, p. 62.
68 Leckow, Laryea & Kerr 2011, para. 12.22. *See also* Scott 2016, p. 67-78.
69 Final report of the High-level expert group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen (Liikanen Report), October 2012, p. 59 and *see* paragraph 4.1.3 of chapter 3.
70 Leckow, Laryea & Kerr 2011, para. 12.22.

A second and related limitation of a formal insolvency procedure is that, as indicated above and notwithstanding certain exceptions under EU law,[71] a moratorium may come into effect to block individual creditors to enforce their claims against the debtor. A comprehensive moratorium has been considered problematic in case of a bank failure.[72] The bank may need to continue some of its operations and transactions to avoid disruptions in the financial system, give depositors access to their funds, and bring down the potential for systemic risk.[73] However, preventing some of the contractual counterparties of the bank, such as investors in repos and derivatives transactions, from the immediate liquidation of their positions may at least give the bank a breathing space in which can be determined which measures need to be taken. This 'paradox'[74] requires, according to Schillig, 'a finely balanced system under which a moratorium cannot be automatic and comprehensive; it may be discretionary, temporary and limited, as the individual situation requires.'[75]

Thirdly, the classic trigger of 'insolvency' for the initiation of a procedure may not be appropriate if a bank fails. The definition of 'insolvency' under insolvency law traditionally encompasses cash flow insolvency (inability to pay debts as they fall due) and balance sheet insolvency (the liabilities exceed the assets).[76] As already indicated, banks do not have the money available to immediately pay all debts that must be repaid upon first demand.[77] Moreover, it is generally acknowledged that in relation to a bank an additional, regulatory threshold should exist so that authorities can take action when they consider the bank no longer viable even though it has not

71 Under the Settlement Finality Directive exceptions to the automatic stay under insolvency law apply to netting of claims resulting from transfer orders and the transfer orders themselves entered into payment and securities settlement systems. Insolvency procedures do not have a retroactive effect on the rights and obligations of a system participant arising from or in connection with the participation. Also, an insolvency procedure against the provider of collateral does not affect the right of a participant to realize the security. Under the Financial Collateral Directive, a close-out netting provision in a qualifying financial collateral arrangement can take effect regardless of the commencement of an insolvency procedure and such a qualifying financial collateral arrangement and the provision of collateral under it are not affected by the retroactive effects of an insolvency declaration.

72 Schillig 2016, p. 64-65; Hüpkes 2005, p. 484.

73 Hüpkes 2005, p. 484; Asser 2001, p. 95-96.

74 Asser 2001, p. 95-96.

75 Schillig 2016, p. 64-65. *See also* Bliss & Kaufmann 2007, p. 157-159.

76 Campbell & Lastra 2011, para. 2.10; Goode 2011, para. 4.01-4.39 and *see* paragraph 2.1 of this chapter, which referred to the definition of 'insolvency' provided by the UNCITRAL, Legislative guide on insolvency law, New York: United Nations 2005, p. 5 (para. 12, under B, 'Glossary'). *Cf*. Section 1 Fw (referring to the condition of 'stop of payments' as the condition for the opening of a bankruptcy procedure); sections 123(1)(e) IA 1986 (cash flow test) and 123(2) IA 1986 (balance sheet test); sections 17 InsO (cash flow test), 18 InsO (imminent insolvency) and 19 InsO (balance sheet test).

77 Schelo 2015, p. 25 and 96; Hüpkes 2000, p. 13.

yet reached the formal state of balance sheet insolvency under insolvency law.[78] Such a regulatory threshold should ensure timely intervention to at least reduce the potential for systemic impact.[79] Several authors call the regulatory threshold 'regulatory insolvency' since the bank is considered no longer viable for the purpose of banking law rather than insolvency law.[80] It should be noted, however, that there is a strong tendency in EU Member States to allow also the opening of a restructuring procedure under corporate restructuring and insolvency law before the corporate debtor becomes insolvent for the purpose of the law. As chapter 5 will discuss in more detail, one can argue that the triggers preferred for the intervention in a bank are not far removed from more recent developments in corporate restructuring and insolvency law to enable timely restructuring.[81]

Fourthly, insolvency law typically provides for procedures that allow a negotiation about a solution for the financial problems and give a powerful and active role to the creditors. While the theory of the common pool problem used by insolvency scholars helps to understand the problems with run behavior, if the authorities want to negotiate a solution with the creditors and shareholders of a bank on the basis of an arrangement, they may face anticommons problems.[82] As chapter 5 discusses,[83] insolvency scholars use the anticommons dilemma to describe the situation that not all creditors vote in favor of a proposed arrangement. They holdout because they expect to have a chance to become in a better individual position without the arrangement. Accordingly, lengthy negotiations may be needed to reach an agreement and the deal may even fall apart.[84] The solution to anticommons problems which many insolvency laws offer, such as the German InsO in the insolvency plan procedure (*Insolvenzplanverfahren*),[85] is that a majority vote rather than unanimity and a court confirmation is required for an arrangement between the debtor and the creditors and shareholders to become effective. As a result, a dissenting minority can be overruled.[86] In case of a bank failure, the anticommons problems may be more severe than

78 Schillig 2016, p. 65; Grünewald 2014, p. 88; Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions', October 2014, para. 3.1; Randell 2012, p. 116-117; Campbell & Lastra 2011, para. 2.12-2.13; International Monetary Fund & The World Bank, 'An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency', April 2009, p. 19; Hüpkes 2005, p. 477-478; Hüpkes 2000, p. 12-13.

79 Grünewald 2014, p. 88; Hüpkes 2000, p. 12-13.

80 Campbell & Lastra 2011, para. 2.14; Hüpkes 2000, p. 12.

81 Chapter 4.3 of chapter 5.

82 Schillig 2016, p. 65-66; De Weijs 2013. Anticommons problems in insolvency procedures were for the first time discussed by Baird & Rasmussen 2010, *see* especially p. 652-653. For the concept of anticommons in general, *see* Fennell 2011, p. 41-46; Heller 1998.

83 Paragraphs 2.2 and 4.3 of chapter 5.

84 Madaus 2018, para. 5.1; Schillig 2016, p. 65-66; De Weijs 2013; De Weijs 2012.

85 *See* paragraph 4.2.3 of chapter 5.

86 Madaus 2018, para. 5.1; De Weijs 2012, p. 74-78.

in corporate insolvency.[87] Time is usually of the essence to prevent further deterioration of the financial position of the bank and minimize the impact within the financial system, for instance, because of the dependence of the bank on short-term funding.[88] Thus, there may be no time for negotiations. Furthermore, the balance sheets of most banks are extremely complex with various types of financial counterparties, which may make the process at the negotiation table complicated.[89]

Finally, corporate insolvencies are typically resolved in court. A cross-border bank failure requires the coordination of an international procedure. An administrator or insolvency trustee and a judge may not be able to sufficiently coordinate with authorities and courts in the other countries in which the bank operates.[90] Moreover, because an insolvency court typically plays a reactive role, that is, a role at the outset of the case, it may have to take a decision in a short period, based on limited information. Accordingly, the court may find itself in a difficult position.[91]

2.2.2 Alternative: public financial support

The failures or near-failures of several banks in the EU during the latest financial crisis showed that governments are sensitive to such events and want to step in to prevent the default of banks which individual crisis threatens to have a substantial impact on the financial system. Because of the size, complexity, and/or interconnectedness of these banks or the insubstitutionability of some of their operations, they were considered of systemic importance and too important, connected and big to fail.[92] For example, as we will see in chapter 3,[93] when SNS Reaal and SNS Bank, which was the fourth largest bank in the Netherlands, experienced severe financial problems in 2013, the Dutch Minister of Finance did not consider the opening of an insolvency procedure an appropriate option. In his view, such a procedure would cause social unrest and pose risks to financial stability.[94]

87 Schillig 2018, para. 3.2; Schillig 2016, p. 65; De Weijs 2013, p. 215-221.
88 Schillig 2016, p. 65. *See also* Jackson & Skeel 2012, p. 447; Hüpkes 2005, p. 479.
89 Schillig 2016, p. 65.
90 Jackson & Skeel 2012, p. 445.
91 Jackson & Skeel 2012, p. 450.
92 Grünewald 2014, p. 13. *See also* Attinger 2011, p. 18-20. The term and doctrine of 'too-big-to-fail' is not new. For example, in 1984 it already attracted much public attention when the government of the United States intervened in Continental Illinois Bank to rescue it. *See* Gup 1998, p. 53-54 and 69-70.
93 Paragraph 2.2 of chapter 3.
94 Letter of the Dutch Minister of Finance to the Parliament of 1 February 2013 (*Kamerstukken II* 2012/13, 33532, no. 1), p. 6.

During the crisis, the alternative to the initiation of an insolvency procedure was in many cases a government intervention with public money to restore the balance sheets of the failing bank. According to a study by Stolz and Wedow, in the period 2008-2010 the public support measures of the EU governments for the financial sector took the form of guarantees for bank liabilities, recapitalization measures (such as the acquisition of preferred shares), and measures to provide relief from legacy assets.[95] An example forms the case of ING, which the Dutch government in 2008 and 2009 supported with a capital injection (the purchase of subordinated bonds), asset support measures, and guarantees for bonds issues.[96] A more dramatic example is the public intervention in Ireland, which government provided blanket guarantees for all liabilities of six large banks and took additional recapitalization and asset support measures.[97]

It is widely acknowledged that such government-funded rescues of banks can have several unintended consequences. The costly rescues can have a significant impact on public finances and sovereign debt.[98] Furthermore, they can be a source of moral hazard and distortion of competition in the banking sector.

The problem of moral hazard in the context of bank failures has been extensively discussed in the literature. The traditional corporate governance model encourages the management of a stock company to run the business in the interest of the shareholders. Such a focus on the shareholders' interests motivates the management to seek to maximize the overall value of the company and, thus, the share price.[99] As we saw in the previous sections, banks are different from most other types of companies in several regards, including because they are highly leveraged. Their ratio of debt funding to funding through equity is high.[100] As a result, the bank shareholders tend to favor an increase in leverage. The shareholders benefit from a potential upside of risky activities while the downside risk falls in an insolvency procedure on the unsecured creditors. The liability of the shareholders is limited to the value of their investments.[101] It is believed, however, that in an efficient market, investors monitor the financial condition of a company and set funding prices that reflect this condition.[102] Accordingly, if the bank pursues a risky business strategy, the risk-taking would normally increase the expected costs for its creditors because the probability of default grows.

95 Stolz & Wedow 2010.
96 Stolz & Wedow 2010, p. 10-11.
97 Allen et al. 2015, p. 33-35.
98 *See* Tröger 2018, p. 39; Avgouleas & Goodhart 2015, p. 4; Zhou et al. 2012, p. 4.
99 Armour et al. 2016, para. 17.2.1.
100 Armour et al. 2016, para. 14.1.1 and 17.2.2.
101 Armour et al. 2016, para. 17.2.2; Armour 2015, p. 458-459; Admati et al. 2013, p. 28-29. *Cf.* Davies 2006, p. 306-307.
102 Flannery 2010, p. 379.

The creditors are then likely to demand a higher risk premium, which makes an increase in leverage less attractive for the bank.[103]

If, however, this bank is a bank which the creditors expect to be rescued by the government in the case of failure because it is regarded 'too-big-to-fail', the market participants will underprice the bank capital. They have reduced incentives to monitor the bank and are willing to lend to the bank on more favorable conditions than without the implicit government guarantee. Thus, the bank capital prices do not reflect the true financial condition of the bank. The bank managers and shareholders, in turn, are expected to have less incentives to change their risk-taking behavior.[104] Hence, the expectation of public financial assistance could give them an incentive them to increase the risks and leverage to maximize shareholder returns.

In this context, scholars often use the term 'market discipline'. In the literature on financial regulation, effective market discipline is understood to involve a monitoring component (i.e., the ability of investors to timely and accurately assess the financial condition of a financial institution).[105] Moreover, it is considered to involve an influence component (i.e., the ability of the subsequent reactions by the investors to the institution's liability choices to influence the behavior of the institution, for instance, because the investors charges more for funding if the bank increases its risks).[106] The implicit public guarantees are argued to undermine the market discipline.[107]

Empirical research confirms that the relation between bond spreads and risks has been weaker for the largest financial institutions that investors most likely expect to be rescued by the government should they ultimately fail than for the other financial institutions. Thus, such a large financial institution could attract funding at lower prices.[108] The public guarantees create competitive distortions between banks that are regarded candidates

103 Armour 2015, p. 458-459; Flannery 2010, p. 379.

104 Armour 2015, p. 458-459; Admati & Hellwig 2013, p. 129-130 and 142. *See also* Ayotte & Skeel 2010, p. 486, who discuss that a government may try to addresses the moral hazard problem in relation to the shareholders of banks by, for instance, purchasing shares in the capital of a distressed bank in such a way that existing shareholders are diluted. However, such a measure may not solve the moral hazard problem in relation to creditors. The creditors may have no reason to stop lending money to banks at more favorable terms than they would otherwise require. And *see* Coffee 2010, p. 18, who claims that 'even if shareholders were not protected in these cases, creditors were, and as a result the implicit subsidy in interest rates may remain. If so, this should continue to motivate shareholders to pursue "cheap" sources of financing at the price of excessive leverage.'

105 Flannery 2010, p. 378-379; Bliss & Flannery 2002.

106 Flannery 2010, p. 378-379; Bliss & Flannery 2002.

107 E.g., Tröger 2018, p. 40-41; Acharya, Anginer & Warburton 2016.

108 Tröger 2018, p. 40, who refers to the studies by Acharya, Anginer & Warburton 2016; Morgan & Stiroh 2005. *See also* Avgouleas & Goodhart 2015, p. 19; Hüpkes 2011, para. 5.02.

for government rescues and those that are not. Moreover, empirical studies conclude that expected government support to banks has influenced the willingness of the banks to take on more risks.[109] Such studies also indicate that the banks that had a governance structure that made them accountable to their shareholders took large risks to pursue policies favored by these shareholders and ultimately performed poorly during the financial crisis because the risks led to significant losses.[110]

In sum, the 'too-big-to-fail' consideration has created a moral hazard problem. Moreover, the prospect of government support to a bank may encourage a potential purchaser of the failing bank or a part of its business to wait until the financial situation is so bad that it can claim public financial assistance as part of the deal.[111] Also, if insolvency is not a sufficient threat, the management of the bank may fail to take steps to prepare for and initiate an insolvency procedure.[112]

2.2.3 Compromise: a bank resolution framework

It follows from the analysis in the previous sections that for a failing bank for which the initiation of an insolvency procedure is not appropriate, an ideal bank resolution framework strives for some of the policy goals pursued by insolvency law. In particular, it should aim to address the moral hazard problem, for instance, by ensuring that in the event of a failure the shareholders and creditors bear the losses, as they would do in an insolvency procedure. Furthermore, we should add some of the objectives pursued if public financial support is provided to a bank, including ensuring financial stability and access to critical functions.[113]

According to Hüpkes, the objectives of a bank resolution framework should be six-fold.[114] Chapter 6 will show that the EU bank resolution framework includes these objectives.[115] First, the framework should create adequate ex-ante incentives to comply with contractual obligations and promote market discipline. Thus, it is not the function of the resolution framework

109 Tröger 2018, p. 40, who refers to the study by Brandao Marques, Correa & Sapriza 2013. *See also* Krimminger 2011, para. 11.11.

110 Armour 2015, p. 459, who refers to the study by Beltratti & Stulz 2012 and *see* Coffee 2010, p. 15-18.

111 Ayotte & Skeel 2010, p. 485.

112 Ayotte & Skeel 2010, p. 485-486.

113 *See* Schillig 2016, p. 54-55; Beck 2011, p. 58-64, who claim that a bank resolution framework provides a trade-off between objectives that have often been presented as being at different ends of the spectrum. These objectives are, on the one hand, minimizing external costs and, on the other hand, strengthening market discipline.

114 Hüpkes 2010, p. 219-220. *See also* Claessens, Herring & Schoenmaker 2010, p. 58-59.

115 Paragraph 4 of chapter 6.

to eliminate the risk of business failure.[116] Second, the regime should aim to maximize the value of the failing business that can be distributed to debtors, creditors, and possibly other parties. Third, it should allocate the assets amongst creditors by respecting the insolvency hierarchy of claims so that the pre-failure entitlements are respected in the resolution procedure.[117] These objectives derive from general insolvency law.

Three additional objectives come into play in a bank resolution procedure.[118] First, the resolution framework should enable the competent resolution authorities to intervene rapidly to attempt to limit contagion effects. Second, it should ensure the continuity of the critical functions of the bank for the financial system, such as payment services. Finally, the bank resolution framework should enable the continuity of access of depositors to their funds or prompt repayment of these funds.[119]

An example of a possible bank resolution measure is the isolation and transfer of a part of the business of the failing bank to a temporary bridge bank or a 'healthy' bank so that some functions are continued, such as the deposit-taking activities. When other parts of the business, including the claims of the shareholders and subordinated creditors, are left behind with the residual bank that is placed into an insolvency procedure, this measure may have a positive effect on market discipline and contain moral hazard.[120] Creditors and shareholders of banks become more certain that they have to bear losses should the bank they invested in fail and, therefore, they are likely to have more risk-monitoring incentives and set funding prices that reflect the true financial condition of the bank.[121]

Although most scholars and policymakers agree that a special legal framework for bank failures that pursues the above-mentioned objectives should exist, worldwide less agreement exists about the form such a framework should take. For example, in the US, the question whether a large financial institution, including a bank holding company, should be resolved in an administrative procedure or a judicial procedure under the US bankruptcy

116 *See* Goode 2011, para. 1.57. In his famous book *Lombard street: a description of the money market* of 1873, Bagehot noted at p. 104 already that '[t]he cardinal maxim is that any aid to a present bad bank is the surest mode of preventing the establishment of a future good bank.' As also quoted by Hüpkes 2000, p. 1. *See also* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee of the Regions and the European Central Bank, An EU framework for crisis management in the financial sector (COM(2010) 579 final, 20.10.2010), p. 2: 'Banks must be allowed to fail, like any other business.'

117 Hart 2000, p. 5.

118 Hüpkes 2010, p. 219-220. *See also* Claessens, Herring & Schoenmaker 2010, p. 58-59.

119 Hüpkes 2010, p. 219-220. *See also* Claessens, Herring & Schoenmaker 2010, p. 58-59.

120 *See* Beck 2011, p. 60-61.

121 *See* Massman 2015, p. 661; Jackson & Skeel 2012, p. 448.

Act has been fiercely debated.[122] In the EU, most commentators claim that an administrative, non-judicial resolution procedure should exist for a failing bank, including its a holding company.[123]

The next paragraph identifies the steps that have been taken at the EU level over the last decades towards the EU bank resolution framework and provides some introductory remarks about the BRRD and SRM Regulation.

3 EU bank insolvency framework

3.1 Towards a European bank insolvency framework

In 1957, six European countries, i.e., France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg, signed the Treaty of Rome with the aim to create a European Economic Community (EEC). The Treaty did not consider a financial market part of the envisaged common market. At that time, the founding Member States regarded finance and its regulation part of the national sovereignty.[124]

The first European legislative instruments to build a single financial market were only adopted in the 1970s.[125] A directive on 'the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions'[126] aimed to create the equal regulatory and supervisory treatment of financial institutions operating in one jurisdiction.[127] In 1977, the First Banking Directive introduced the principle of home country control, according to which the country in which the bank obtains authorization

122 Schillig 2016, p. 56-59. *See also* e.g., US Treasury, 'Orderly Liquidation Authority and Bankruptcy Reform', Report to the President of the United States, 21 February 2018; Gordon & Roe 2017; Kirshner 2015, p. 830-834; Jackson & Skeel 2012; Jackson 2010; Morrison 2009. The US Financial CHOICE Act to replace the Orderly Liquidation Authority under the Dodd-Frank Act with a new, judicial bankruptcy procedure for systemically important financial institutions was proposed in 2017.

123 *See* Schillig 2016, p. 56. *Contra* Amend 2009, p. 597, who claims that '[d]ie Ausführungen zum Insolvenzrecht zeigen, dass ein modifiziertes Insolvenzplanverfahren geeignet wäre, auch zur Sanierung eines systemrelevanten Kreditinstituts beizutragen. Insofern bestehen erhebliche Zweifel, ob überhaupt die Notwendigkeit besteht, völlig neue Wege zu beschreiten, um ein eigenständiges Sanierungsverfahren für diese Kreditinstitute zu kreieren.'

124 Teixeira 2017, p. 536.

125 Teixeira 2017, p. 538.

126 Council Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions (OJ L 194, 16.7.1973, p. 1)

127 Dermine 2002, p. 3.

is responsible for the regulation and supervision of the bank, including its foreign branches across the common market.[128] The Second Banking Directive of 1989 took the next step in financial integration.[129] It incorporated the principles of a single banking license, home country control, and mutual recognition of national laws. Once a bank was authorized in a Member State, it was permitted to establish branches and supply financial services throughout the EEC, without further authorization of the authorities in the jurisdiction into which this bank expands.[130] A subsidiary, rather than a branch, remained subject to the supervision and regulation of the country in which it is established. Moreover, although the adoption of the legislative instruments constituted important steps in the development of a single financial market,[131] a European framework on mutual recognition of bank insolvency measures did not exist.[132]

In 1992, a report of the Basel Committee on the liquidation of a multinational bank identified many potential issues in a cross-border bank failure.[133] The study was published following the collapse of the Bank of Credit and Commerce International (BCCI), which operated in nearly 70 countries.[134] It concluded that because there was no supranational bank insolvency framework, a multinational bank failure was likely to involve separate insolvency procedures in different jurisdictions, with multiple insolvency trustees (or liquidators), and the interaction of different insolvency and other relevant national laws. Complexities and uncertainty could result from difficulties in determining the location of the assets of the bank, diverging national insolvency set-off laws, differences in deposit protection schemes, and the fact that authorities may attempt to protect certain assets of a bank or branch (supervisory ring-fencing).[135]

128 First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (OJ L 322, 17.12.1977, p. 30) and *see* Teixeira 2017, p. 538.

129 Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (OJ L 386, 30.12.1989 p. 1).

130 Teixeira 2017, p. 540; Dermine 2002, p. 4-5.

131 *See* Teixeira 2017, p. 536-541.

132 *See* Galanti 2002, p. 50.

133 Basel Committee on Banking Supervision, 'The insolvency liquidation of a multinational bank', December 1992.

134 Basel Committee on Banking Supervision, 'The insolvency liquidation of a multinational bank', December 1992, p. 1 and 17.

135 Basel Committee on Banking Supervision, 'The insolvency liquidation of a multinational bank', December 1992 and *see* Hüpkes 2010, p. 217.

Following the BCCI failure, European rules on deposit guarantee schemes were incorporated in the Directive on Deposit Guarantee Schemes of 1994.[136] The Settlement Finality Directive of 1998, the Winding-up Directive of 2001, and the Financial Collateral Directive of 2002 then also brought some harmonization in the field of bank insolvency law.[137]

With the Winding-Up Directive, the principles of home country control and mutual recognition of the First and Second Banking Directive were implemented into a bank insolvency framework. The framework is aimed at 'the elimination of any obstacles to the freedom of establishment and the freedom to provide services within the Community'.[138] The directive covers 'reorganisation measures'[139] and 'winding-up proceedings'[140] in relation to banks and their branches in other EU Member States. It provides that these measures and procedures are decided on by the administrative or judicial authorities of the Member State in which the authorization of the bank has been granted, and are, in principle, governed by the law of this so-called 'home Member State'. Furthermore, these measures and procedures are automatically recognized and effective in the Member States in which the bank and its branches operate.[141]

However, the Winding-up Directive did not introduce similar coordination and recognition in relation to separate legal entities (subsidiaries) within a banking group. These legal entities are subject to separate reorganization

136 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes (OJ L 135, 31.5.1994, p. 5). The directive was amended by Directive 2009/14/EC of the European Parliament and the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay (OJ L 68, 13.3.2009, p. 3) and Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast) (OJ L 173, 12.6.2014, p. 149).

137 *See* Galanti 2002, p. 50-51.

138 Recital 1 Winding-Up Directive. *See* Hüpkes 2000, p. 164-165.

139 Article 2 Winding-Up Directive, as amended by article 117 BRRD, now defines the term 'reorganisation measures' as 'measures which are intended to preserve or restore the financial situation of a credit institution or an investment firm as defined in Article 4(1), point (2) of Regulation (EU) No 575/2013 and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims; those measures include the application of the resolution tools and the exercise of resolution powers provided for in Directive 2014/59/EU.' *See* Wessels 2017, para. 3.26-3.60.

140 Article 2 Winding-Up Directive, as amended by article 117 BRRD, now defines the term 'winding-up proceedings' as 'collective proceedings opened and monitored by the administrative or judicial authorities of a Member State with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure.' *See* Wessels 2017, para. 3.61-3.106.

141 The Winding-Up Directive creates some exceptions to the principle that the law of the home Member State determines all the effects of the reorganisation measures or winding-up proceedings, including for netting agreements and employment contracts. *See* Recitals 23 and 24 and articles 20-33 Winding-Up Directive. *See* Wessels 2017, para. 3.107-3.172.

measures and liquidation procedures in their jurisdictions, even though in practice the activities of banking groups are often heavily intertwined.[142] Also, the Winding-up Directive harmonized procedural aspects of bank insolvency law, but substantive insolvency law remained in the hands of the legislatures of the Member States. The literature indicates that in the years following the entry into force of the Winding-up Directive, considerable differences existed between the national bank insolvency frameworks in the EU. Diversity existed, for example, in the powers of competent supervisory authorities to impose a moratorium, the threshold conditions for the initiation of insolvency procedures, and the involvement of the court.[143]

The financial crisis that started in 2007 and intensified in 2008 put bank insolvency law back on the agenda of the EU legislature. The case of Fortis and case of HRE, for example, showed which challenges governments and authorities may face if a bank resolution framework is absent. The cases demonstrated that requirements to seek approval of the shareholders may slow down or block a rescue plan for a distressed or failing bank.[144] The former case also showed that governments or authorities may tend to pursue national objectives and adopt domestic solutions rather than a solution for a cross-border group as a whole.[145] It has been argued that the outcome of the Fortis case 'was an obvious setback to financial integration in the Benelux and was likely significantly more costly than a first-best join solution for the group as a whole would have been.'[146] According to Beck, the lack of a more comprehensive legal framework for cross-border bank resolution was 'one of the major weaknesses' of the bank resolution frameworks in the EU in those days.[147] We will consider both cases in turn.

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142 *See* Fonteyne et al. 2010, p. 50; Hüpkes 2005, p. 494. *See also* Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 89; Garcia, Lastra & Nieto 2009.

143 Garcia, Lastra & Nieto 2009. *See also* Čihák & Nier 2012, p. 417-418; Hüpkes 2005.

144 Čihák & Nier 2012, p. 401.

145 Lupo-Pasini 2017, p. 108-109; Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 111; Basel Committee on Banking Supervision, 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, p. 11.

146 Fonteyne et al. 2010, p. 13.

147 Beck 2011, p. 53.

Fortis was a Dutch-Belgian financial conglomerate with significant subsidiaries in Belgium, the Netherlands, and Luxembourg. It was regarded as systemically important in these countries.[148] When it experienced liquidity problems in September 2008, the governments of these jurisdictions stepped in and injected funding to stabilize the financial position. Unfortunately, this measure failed to calm the markets and depositors, and continuing deposit withdrawals caused new liquidity problems.[149] The authorities did not consider the opening of an insolvency procedure a suitable option because that was thought to have a significant impact on financial stability.[150] The three governments subsequently decided to proceed individually and to split Fortis into national parts.[151] The Dutch government nationalized the Dutch banking and insurance subsidiaries. The Belgian and Luxembourg government sought to sell a large stake of the Belgian-Luxembourg parts to the French bank BNP Paribas.[152] However, in December 2008 a Belgium court suspended the sale to BNP and ruled that the sales to the Dutch government and Belgium government, and the subsequent sale to BNP, needed the approval of the shareholders of Fortis.[153] The authorities did not have the legal powers to intervene quickly by overriding the rights of the shareholders.[154] After the shareholders initially opposed the plans and certain transactions were renegotiated, the shareholders approved the plans at a second meeting.[155]

The HRE case shows that even if the procedure remains within the borders of one country, it may be difficult to resolve a failing bank.[156] When HRE experienced financial problems in 2008, it was one of the largest commercial property lenders in Germany and a major issuer of covered bonds.[157] Because of its size and stake in the covered bond market, a failure was considered unacceptable.[158] When the liquidity support and government guarantees proved insufficient, the German decided to nationalize it.[159] This idea

148 Basel Committee on Banking Supervision, 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, p. 10.
149 Herring 2011, p. 43.
150 Marinč & Vlahu 2011, p. 43.
151 Lupo-Pasini 2017, p. 108-109; Čihák & Nier 2012, p. 430.
152 Wiggings, Tente & Metrick 2015, p. 9.
153 Claessens, Herring & Schoenmaker 2010, p. 50; Basel Committee on Banking Supervision, 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, p. 11.
154 Čihák & Nier 2012, p. 401.
155 Claessens, Herring & Schoenmaker 2010, p. 50; Basel Committee on Banking Supervision, 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, p. 11.
156 Fonteyne et al. 2010, p. 13.
157 Mitchell 2017, p. 81; Hopt, Kumpan & Steffek 2009, p. 541.
158 Mitchell 2017, p. 82; Hopt, Kumpan & Steffek 2009, p. 541-542.
159 Hopt, Kumpan & Steffek 2009, p. 542.

led to resistance of a large group of shareholders, who lobbied for generous state rescue terms.[160] The Bundestag enacted emergency legislation, i.e., the Financial Market Stabilization Act (*Finanzmarktstabilisierungsgesetz*) and the Financial Market Stabilization Supplementary Act (*Finanzmarktstabilisierungsergänzungsgesetz*), to amend company and takeover law. The government agency Special Fund for Financial Market Stabilization (*Sonderfonds Finanzmarktstabilisierung*, SoFFin) initially bought a small percentage of the shares in HRE's capital and then raised its share to almost 50 percent.[161] It offered high prices for the shares to induce shareholders to voluntary sell their entitlements and did not expropriate their entitlements.[162] After the endorsement of a further capital increase by the general meeting of shareholders, the SoFFin brought its stake up to 90 percent and then squeezed out the remaining shareholders under the recently amended rules.[163] The literature claims that without these new rules of company and takeover law, the German government would have been unable to nationalize HRE by October 2009.[164]

3.2 EU bank resolution framework

The (proposals for) reforms of the EU bank insolvency framework in the aftermath of the latest financial crisis have been extensively discussed in policy documents,[165] books,[166] and articles.[167] A significant development was the introduction of the BRRD and SRM Regulation. The EU bank resolution framework created by these EU legislative instruments broadly has two goals: (1) to strengthen the existing national bank resolution frameworks, and (2) to establish cross-border coordination and cooperation and bring the Member States closer towards the same standards for the resolution of failing banks in the EU. Paragraph 3.2.1 examines the bank resolution procedure introduced by the BRRD. Paragraph 3.2.2 then makes some remarks about the cross-border convergence sought by the BRRD and the unified decision-making procedure under the SRM Regulation.

160 Mitchell 2017, p. 85.
161 Hopt, Kumpan & Steffek 2009, p. 542.
162 Mitchell 2017, p. 86; Hopt, Kumpan & Steffek 2009, p. 526 and, critically, Hellwig 2012, p. 39-41.
163 Hopt, Kumpan & Steffek 2009, p. 542. *See also* Bornemann 2015, p. 456-459; Mitchell 2017, p. 86.
164 Čihák & Nier 2012, p. 401-402; Hopt, Kumpan & Steffek 2009, p. 535. *See also* Schuster 2010.
165 E.g., Merler 2018; Van der Zwet 2011.
166 E.g., Schillig 2016; Grünewald 2014.
167 E.g., Tröger 2018; Wojcik 2016.

3.2.1 *Bank resolution procedure under the BRRD*

The BRRD promises to establish a mechanism 'to prevent insolvency or, when insolvency occurs, to minimize negative repercussions by preserving the systemically important functions of the institution concerned.'[168] It requires Member States to designate a public administrative authority that performs all resolution functions and tasks and closely cooperates with, inter alia, the relevant supervisory authorities.[169] Each resolution authority 'has the expertise, resources and operational capacity to apply resolution actions, and is able to exercise their powers with the speed and flexibility that are necessary to achieve the resolution objectives.'[170] In many EU Member States, such as the Netherlands and Germany, the competent supervisory authority is the designated resolution authority.[171]

The legal framework created by the BRRD rests on three pillars: (1) preparation, (2) early intervention, and (3) resolution. First, Title II BRRD, which has the heading 'Preparation', requires banks and the competent supervisory and resolution authorities to draw up and maintain recovery and resolution plans. These plans set out the measures to be taken, respectively, to restore the financial position of the bank or to resolve it. The provisions under this Title also require the resolution authorities to ensure the non-disruptive resolvability of banks under insolvency law or the bank resolution framework. Second, Title III BRRD provides for specific measures the competent supervisory authority can take when the bank no longer meets or is likely to infringe the prudential requirements. These early intervention measures include the requirement to make changes in the business strategy and to remove or replace members of the bank management. Finally, Title IV BRRD, which is entitled 'Resolution', creates a regulatory alternative to an insolvency procedure for a bank under national insolvency law to resolve a failing or near-failing bank with the goal to, amongst other things, preserve systemic stability and minimize moral hazard.

Insolvency procedure or resolution procedure for a bank

Under the BRRD an insolvency procedure remains the preferred procedure for a distressed bank. In other words, the harmonized bank resolution procedure does not aim to replace an insolvency procedure. A resolution procedure under Title IV BRRD is triggered if a bank meets the conditions for resolution set out in article 32 BRRD. The conditions are that (1) it is con-

168 Recital 1 BRRD.

169 Article 3 BRRD.

170 Article 3(8) BRRD.

171 *See* paragraphs 2.3 and 3.3 of chapter 3. For an overview of all designated resolution authorities in the EU Member States, *see* the list of designated resolution authorities of the European Banking Authority, available at http://www.eba.europa.eu/about-us/organisation/resolution-committee/resolution-authorities.

sidered failing or likely to fail,[172] (2) any alternative private sector measure cannot prevent the failure, and (3) a resolution action is necessary in the public interest (i.e., it is necessary to fulfill the resolution objectives listed in the BRRD).[173] The resolution objectives include ensuring the continuity of 'critical functions'[174] of the bank and avoiding serious adverse effects on the financial system.[175] According to a Commission Delegated Regulation, a function is 'critical' if 'the function is provided by an institution to third parties not affiliated to the institution or group'. Furthermore, 'the sudden disruption of that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function.' Examples of such critical functions are deposit-taking, lending and loan services, payment, clearing, custody and settlement services, wholesale funding markets activities, and capital markets and investments activities.[176]

The BRRD leaves the resolution authorities discretion in their assessment of whether a bank meets the resolution conditions. The functions of the Italian banks Veneto Banca and Popolare di Vicenza, for instance, were mainly deposit-taking, lending activities, and payment services. In June 2017, the competent resolution authority, i.e., the Single Resolution Board (SRB), did not regard these functions 'critical' because they were provided to a limited number of third parties and they could be replaced. It decided not to take

172 The competent supervisory authority makes the 'failing or likely to fail' assessment, although the BRRD explicitly provides that the competent resolution authority may also make this assessment if that is provided for by national law. Article 32(1), (2) and (4) BRRD.

173 The competent resolution authority makes the assessment of whether alternative measures or actions could prevent the failure and whether the resolution action is in the public interest. Articles 31(2) and 32(1) and (5) BRRD.

174 According to article 2(1)(35) BRRD 'critical functions' are 'activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross- border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations'.

175 The other resolution objectives provided in article 31(2) BRRD are protecting (1) public funds by minimising reliance on extraordinary public financial support, (2) covered depositors, and (3) client funds and client assets.

176 Recital 4 and articles 6-7 Commission Delegated Regulation (EU) 2016/778 of 2 February 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary ex post contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines (OJ L 131, 20.5.2016, p. 41). *See also* Single Resolution Board, 'Critical functions: SRB approach in 2017 and next steps', 2018.

resolution action but to initiate an insolvency procedure.[177] As already indicated, although the bank resolution framework has now been significantly reformed and harmonized at the EU level, insolvency procedures for banks under insolvency law have remained largely in the hands of the national legislatures and regulators. Thus, the two failing Italian banks were placed into an insolvency procedure under Italian insolvency law because the 'public interest' resolution condition was not met.

If the resolution authority decides to initiate a resolution rather than an insolvency procedure, it has a toolbox at its disposal to resolve the bank in an administrative, non-judicial procedure. The resolution rules mandate that the management of the bank is dismissed in the procedure.[178] The toolbox consists of four 'resolution tools' and of 'resolution powers' to assist the implementation of the resolution tools. Examples of the resolution powers are the powers to replace or remove the management of the bank and to temporarily suspend termination rights of contractual counterparties.[179] The resolution tools are the sale of business tool, bridge institution tool, asset separation tool, and bail-in mechanism. The first three tools empower the resolution authority to reorganize the failing bank by transferring shares, or assets, rights, and liabilities to a bridge institution, private sector purchaser or an asset management vehicle.[180] Chapter 6 of the present study analyzes these three transfer tools in further detail.

Private sector contributions through bail-in

The bail-in mechanism enables the resolution authorities to change contractual rights of the shareholders and creditors by ordering a write-down of capital instruments and liabilities and subsequently swap liabilities for new equity.[181] The BRRD and the literature on bank resolution put much emphasis on this mechanism, which chapter 5 examines in more detail. Bail-in should enable the failing bank to recapitalize swiftly. It is also designed to remove the implicit guarantees of government support by requiring the participation of the shareholders and creditors in bearing the costs of restoring the balance sheet of the bank as an alternative to the injection of public money. As a result, the price of bank capital and debt instruments should be more sensitive to the risks the bank faces.[182] Only if the resolution authorities have imposed losses representing 8 percent of the liabilities on the shareholders and creditors, they can use the resolution fund that is filled

177 Single Resolution Board, 'The SRB will not take resolution action in relation to Banco Popolare di Vicenza and Veneto Banca', press release, 23 June 2017. *See also* Merler 2017.

178 Article 34(1)(c) BRRD; Article 15(1)(c) SRM Regulation. The management body and senior management is not replaced if retention of the management is considered to be necessary for the achievement of the resolution objectives.

179 Articles 63(1) and 71 BRRD.

180 Articles 38-42 BRRD.

181 Articles 43-55 BRRD.

182 Tröger 2018, p. 41.

with contributions from the banking sector, for example, to guarantee the assets or liabilities of or make loans to the bank under resolution or a bridge institution.[183]

When the BRRD was adopted in May 2014, the idea to require financial contributions from the creditors and shareholders to restore the financial position of a bank was not new at the EU level.[184] The EU rules on state aid to banks already contained the requirement of burden sharing. Articles 107 and 108 TFEU exceptionally allow the granting state aid to a bank to 'remedy a serious disturbance in the economy of a Member State',[185] provided that the European Commission approves the measure. The overarching goal is that state aid to the banking sector should be limited to prevent competition distortions and counter moral hazard.[186] According to the Commission in its Banking Communication of July 2013, the burden sharing requirement means that '[t]he bank and its capital holders should contribute to the restructuring as much as possible with their own resources. State support should be granted on terms which represent an adequate burden sharing by those who invest in the bank.'[187] It continues that the requirement normally entails, 'after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent.'[188] Similar to the bail-in mechanism under the BRRD,[189] the contributions can take the form of a write-down or a conversion into equity, provided that financial stability concerns do not require a different approach.[190] In contrast to the mechanism under the bank resolution framework, however, the Commission does not require contributions from

183 Articles 44(5) and 101 BRRD. *See also* articles 27(7) and 67 SRM Regulation (on the use of the Single Resolution Fund).

184 For an extensive analysis of the EU state aid policy, the recent case law of the CJEU on state aid to the banking sector, and the relation of the EU state aid policy to the bank resolution framework, *see* Lo Schiavo 2018. *See also* Grünewald, p. 121-134.

185 Article 107(3)(b) TFEU.

186 European Commission, Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (2013/C 216/01), para. 15.

187 European Commission, Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (2013/C 216/01), para. 15.

188 European Commission, Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (2013/C 216/01), para. 41.

189 *Cf.* Wojcik 2016, p. 105, who considers the burden sharing requirement in the 2013 Banking Communication of the Commission 'functionally equivalent' to bail-in under the BRRD. *See also* Lo Schiavo 2018, para. 4.3.

190 European Commission, Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (2013/C 216/01), para. 45.

senior creditors such as senior bondholders.[191] Thus, if resolution procedure under the BRRD is not triggered, private sector contributions in line with the Communication are, in principle, required before any public support may be granted, including in the form of precautionary recapitalization of a solvent bank.[192]

Departure from more general insolvency law
Although the bank resolution frameworks may first appear to be a fundamental shift from insolvency law, they also contain resolution rules that replicate or refer to provisions of insolvency law or consider corporate restructuring and insolvency law practices.[193] Chapters 5 and 6 of the present study will show that the bank resolution frameworks incorporate some fundamental rules and principles of insolvency law. For example, they adhere to a 'best interest of creditors' or 'no creditor worse off'-principle and the starting point is that they follow the insolvency law's distributional order of priority. Also, the overall economic result of the bank restructuring achieved in a resolution procedure may not be very different than the result of the restructuring of another type of business, whether it is a restructuring within the same legal entity or through the establishment of a new one.[194] A resolution procedure may involve reorganization and liquidation and requires the shareholders and specified creditors to bear the losses. Thus, the resolution rules do not set aside insolvency law.[195]

Most of the deviations of the resolution rules from general insolvency law reflect the perticularities of a bank failure when compared to a more traditional business failure,[196] which special characteristics were considered in paragraph 2.2.1 above. As we saw already, insolvency law is traditionally mainly directed towards the interests of the creditors of the insolvent debtor. The bank resolution rules, by contrast, grant all powers over the resolution process to an administrative authority with the aim to facilitate immediate and firm action so that the resolution objectives such as the protection of financial stability can be pursued.[197] To secure the prompt action, the decisions of the resolution authority are, in principle, not subject to judicial review throughout the resolution procedure.[198] Appeal against a

191 Lo Schiavo 2018, para. 2.1.
192 *Cf.* Article 32(4)(d) BRRD. *See* Lo Schiavo 2018, para. 6.1.
193 *Cf.* Massman 2015, p. 631 and 644; Baird & Morrison 2011, p. 287, who make a similar claim as regards the US Dodd-Frank Act.
194 Schillig 2018, para. 3.2.
195 *Cf.* Massman 2015, p. 631 and 644; Baird & Morrison 2011, p. 287.
196 *Cf.* Massman 2015, p. 644.
197 *Cf.* Massman 2015, p. 645-646. *See* paragraphs 2.2 and 4.3 of chapter 5.
198 Article 85(1) BRRD provides that Member States may require that resolution decisions are subject to ex-ante judicial approval. The Netherlands, Germany and the UK have not opted-in to this possibility.

resolution decision may be made ex-post,[199] which illustrates the transition that has taken place in most Member States from the court-based regimes for bank insolvencies to an administrative system.[200]

The no creditor worse off-principle also illustrates the transition to an administrative system for bank failures.[201] Before a resolution authority implements any resolution measures, an independent expert has to provide an estimate of the treatment that the creditors and shareholders would have received, if the bank was wound up under 'normal insolvency proceedings' instead of put into resolution.[202] As chapter 6 will examine in further detail, a normal insolvency procedure is a collective insolvency procedure that is considered 'normal' for a bank under national insolvency law when compared to a resolution procedure, whether it is under general insolvency law or a bank-specific insolvency framework.[203] The preliminary valuation is meant to inform the resolution authority on the resolution actions that can be taken without breaching the no creditor worse off-principle.[204] If the shareholders and creditors incur greater losses in resolution, they are entitled to payment of the difference. For example, if the shareholders of the bank do not receive anything in a hypothetical insolvency procedure, cancellation of their shares by a resolution authority does not place them in a worse position.[205] The emphasis of the no creditor worse off-principle, however, lays on the final valuation which the expert makes as soon as possible after the resolution action. This valuation determines if compensation is to be awarded.[206] Thus, he compares the actual treatment of the creditors and shareholders in resolution with the hypothetical outcome of an insolvency procedure for these stakeholders.

The aim of the no creditor worse off-principle is generally understood as to give shareholders and creditors a potential right to compensation as required by human rights legislation on interferences with property rights.[207] Human rights legislation, however, does not require that the safe-

199 Article 85(2)-(4) BRRD.

200 Haentjens 2016; Grünewald 2014, p. 86. *See also* Massman 2015, p. 646.

201 Article 34(1)(g) BRRD and *see* paragraph 1 of chapter 1.

202 Article 36(8) BRRD.

203 Paragraph 5.3 of chapter 6 and *see* article 2(1)(47) BRRD.

204 For an analysis of the resolution valuations, *see* Gardella 2015, para. 11.46-11.57.

205 *See* Wojcik 2016, p. 120.

206 Articles 74-75 BRRD.

207 Tröger 2018, p. 63; Wojcik 2016, p. 121; Attinger 2011, p. 10-11. Van der Velden & De Serière 2018, p. 54 claim that the no creditor worse off-principle also has another aim: if the resolution authority expects the shareholders and creditors to be worse off in resolution than in an insolvency procedure, the opening of an insolvency procedure should be the preferred course of action. According to the present author, however, the resolution conditions in article 32 BRRD rather than the no creditor worse off-principle determine whether the authority should take resolution action or initiate an insolvency procedure.

guards for creditors and shareholders are based on precisely this principle on the comparison with a hypothetical insolvency procedure.[208]

The principle that is currently in place is based on existing concepts of national insolvency law. For example, under sections 153(2) and 272(2) of the Dutch Fw, a court denies confirmation (*homologatie*) of a proposed composition within a bankruptcy procedure (*faillissementsakkoord*) or within a suspension of payments procedure (*surseance-akkoord*) if the value of the assets of the insolvent estate considerably exceed the sum proposed in the composition. According to the literature and case law, the requirement entails that the court assesses whether the consideration for the creditors is significantly less than that given in a hypothetical liquidation of the debtor's assets.[209] Moreover, in an insolvency plan procedure under the German InsO, a German court can overrule a class of creditors which has not accepted the proposed insolvency plan. One of the requirements for such a court decision is that the members of the dissenting class are not placed in a worse position than without the plan.[210] Hence, these provisions of the Fw and the InsO require the court to determine ex-ante whether the creditors receive at least as much as they would receive in a liquidation procedure.

Under the Fw and the InsO the ex-ante application of the no creditor worse off-principle by the court determines whether the measures under the composition or plan can be taken. Under the BRRD, by contrast, the resolution measures can be implemented but ex-post compensation may be awarded under the no creditor worse off-principle.[211] This example illustrates that the resolution rules allocate wide-ranging powers over the resolution process to an administrative authority rather than a court. The ex-post payment claims for shareholders and creditors under the BRRD do not interfere with the legal result of the resolution action.[212] Any difference between the ex-ante and the ex-post resolution valuation does not reverse the validity of the decision taken by the resolution authorities but may alter the economic result for the creditors and shareholders if they are compensated.[213]

This institutional architecture does not entail, however, that a resolution authority may not be cautious in the implementation of specific resolution measures. Its decision is likely to be based on preliminary valuations and assumptions and the going concern perspective of the bank resolution rules may require a large number of liabilities to be bailed-in to ensure that a

208 *Cf.* Kastelein 2014, p. 146.
209 Wessels 2014, para. 8397a; Wessels 2013a, para. 6116. Section 153(2) Fw uses the terms 'considerably exceed' ('*aanmerkelijk te boven gaan*') whereas section 272(2) Fw only uses the term 'exceed' ('*te boven gaan*').
210 Section 245 InsO. *See* paragraph 4.2.3 of chapter 5.
211 *Cf.* Articles 74-75 BRRD.
212 Tröger 2018, p. 61; Wojcik 2016, p. 132.
213 Tröger 2018, p. 61; Wojcik 2016, p. 132.

bank is sufficiently recapitalized.[214] This going concern perspective may not always correspond with the gone concern approach (the liquidation value of the assets) that forms the basis for the valuation under the no creditor worse-off principle.[215] The resolution authorities have flexibility in the exercise of their resolution powers if the valuation shows that if the bank was placed into liquidation, the value of the assets of the bank would have impaired significantly and the creditors, therefore, would not have been paid back in full.[216] In December 2015, the bankruptcy trustees of the Dutch DSB Bank, which failed in 2009, announced that they offer almost all senior and subordinated creditors of this bank to pay in full their claims, minus the interest claims against the bank. This announcement shows that it is not self-evident that creditors of a bank suffer significant losses in a liquidation procedure.[217]

Bank resolution framework as part of bank insolvency law

Generally agreed definitions of the terms 'insolvency procedure' and 'resolution procedure', when referring to a bank, do not exist in the literature and policy documents.[218] Some studies use the term 'insolvency procedure' as an umbrella term for a resolution procedure and a traditional insolvency procedure for a bank under insolvency law, while some other documents prefer 'resolution' as the overarching term. For example, the term 'bank insolvency proceedings' in an IMF and World Bank policy paper on bank insolvency law, published in 2009, covers both 'bank restructuring', which aims 'to secure the continuation of the bank's business, in whole or in part, as an economic unit', and the placement of the bank into liquidation.[219] By contrast, in 2010, the Basel Committee recommended countries to have in place 'special resolution regimes' that include a 'liquidation option' for banks.[220] The previous sections showed that the BRRD makes a clear distinction between a bank resolution procedure on the one hand, and a 'normal' insolvency procedure for a bank on the other hand.[221] The proposal

214 Tröger 2018, p. 61-64. *Cf.* Article 46(2) BRRD. *See also* Gleeson & Guynn 2016, para. 9.71.

215 Tröger 2018, p. 63-64; Wojcik 2016, p. 123-125; Gleeson & Guynn 2016, para. 9.46 and 9.74-9.75; Adolff & Eschwey 2013, p. 969-971.

216 Gleeson & Guynn 2016, para. 9.46 and 9.74-9.75.

217 Bankruptcy report no 36 of the bankruptcy trustees of DSB Bank N.V. 30 April 2018 (Faillissementsverslag no. 36 van de curatoren van DSB Bank N.V. 30 april 2018), para. 8.6. *See also* Gleeson & Guynn 2016, para. 9.75.

218 *See* Schillig 2016, p. 9-11.

219 International Monetary Fund & The World Bank, 'An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency', April 2009, p. 15, 35 and 44.

220 Basel Committee on Banking Supervision, 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, p. 23-24. Similarly, according to the Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions', October 2014, p. 7-8, one of the resolution powers of a resolution authority should be the power to 'effect the closure and orderly wind-down (liquidation) of the whole or part of a failing firm'.

221 *Cf.* Articles 2(1)(47) and 32(1) and (5) BRRD.

for the BRRD which the European Commission published in 2012 called the bank resolution regime 'a special insolvency regime for institutions'.[222]

The present study uses the term 'bank insolvency law' as an umbrella term for both bank resolution law and the more traditional bank insolvency law.[223] It characterizes bank resolution law as a part of bank insolvency law in the Netherlands, Germany and England. It should be noted, however, that this use of the term 'bank insolvency law' may not correspond with the views of some insolvency scholars that the term 'insolvency law' is to be used in a strict sense as only encompassing liquidation procedures responding to common pool problems.[224] It is in line, however, with the view of other scholars that insolvency law seeks to address both common pool problems and anticommons problems.[225]

The use of 'bank insolvency law' as an umbrella term seems to be justified by the fact that a bank resolution procedure often involves both reorganization and liquidation, for instance, if the resolution authority transfers a part of the banking business to a bridge institution and initiates a liquidation procedure for the residual entity.[226] Thus, the boundary between the two types of measures may be difficult to detect.[227] The Winding-up Directive, which is an important pillar of the EU bank insolvency framework,[228] distinguishes between reorganization measures and winding-up procedures for banks. It includes the application of resolution tools and powers in its

222 Explanatory Memorandum Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM(2012) 280 final, 6.6.2012, 2012/0150 (COD), p. 5.

223 *Contra* Schillig 2016, p. 9-11, who prefers to use the term 'resolution' as umbrella term for both the application of the resolution tools and powers and an insolvency procedure under insolvency law. Even though this book uses the term 'bank insolvency law' in a broad sense, a bank resolution procedure may not qualify as 'insolvency proceedings' in EU legislative instruments. Article 68(1) BRRD explictly provides that resolution measures under the BRRD may not be considered 'insolvency proceedings' under the Settlement Finality Directive. Article 2(j) Settlement Finality Directive defines 'insolvency proceedings' as any collective measure provided for in the law intended to wind up or reorganize the bank. *See* Haentjens 2017, para. 7.88-7.89. On the Settlement Finality Directive, *see* footnote 107.

224 E.g., Madaus 2018.

225 E.g., De Weijs 2012.

226 *Cf.* Article 37(6) BRRD and article 22(5) SRM Regulation, which provide that if the resolution authority transfers only a part of the bank under resolution's assets, rights and liabilities to a private sector purchaser or a bridge institution, the residual entity is to be 'wound up under normal insolvency proceedings' within a reasonable timeframe.

227 *Cf.* Moss, Wessels & Haentjens 2017, para. 2.54.

228 *Cf.* e.g., Moss, Wessels & Haentjens 2017.

definition of the term 'reorganisation measures'.[229] As a result, similar to other types of reorganization measures and liquidation procedures, bank resolution procedures are governed by the procedural, cross-border bank insolvency principles that the Winding-up Directive created.[230]

The boundaries between the conditions for the opening of a resolution procedure and for the initiation of an insolvency procedure have also become blurred. As already indicated, under the BRRD the threshold conditions for the commencement of an action by the resolution authority include the condition that the bank is 'failing or likely to fail'.[231] When a bank crosses the 'failing or likely to fail' threshold, the resolution authority determines if it initiates an insolvency procedure or a resolution procedure for the bank.[232] Chapter 6 will show that the Dutch Fw also explicitly refers to the 'failing or likely to fail' resolution threshold condition as one of the thresholds for the commencement of a bank insolvency procedure. Under the UK Banking Act 2009 (BA 2009), the 'failing or likely to fail' condition is one of the conditions for the BoE and the PRA to apply to the court for a bank insolvency order to start a bank insolvency procedure.[233] Besides reaching the traditional thresholds of cash flow insolvency and balance sheet insolvency, a bank is considered 'failing' if its violation of prudential banking requirements justifies the withdrawal of the authorization of the bank and if extraordinary public support is needed.[234] The 'likely to fail' condition is satisfied if the bank is expected to reach the 'failing' threshold 'in the near furture'.[235] Thus, an infringement or expected infringement in the near future of the requirements for the continuing authorization in a way that would justify the withdrawal of the authorization, including the own funds and liquidity

229 Article 2 Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (OJ L 125, 5.5.2001, p. 15); Article 117(2) BRRD, which define 'reorganisation measures' as 'measures which are intended to preserve or restore the financial situation of a credit institution or an investment firm as defined in Article 4(1), point (2) of Regulation (EU) No 575/2013 [CRR, LJ] and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims; those measures include the application of the resolution tools and the exercise of resolution powers provided for in Directive 2014/59/EU'. For a discussion of which procedures which within the scope of the Winding-Up Directive, *see* Moss, Wessels & Haentjens 2017, para. 2.54-2.55.

230 *See* Grünewald 2014, p. 101.

231 For an in-depth analysis of the circumstances under which a bank is deemed 'failing or likely to fail' under the BRRD, *see* Schelo 2015, p. 92-100.

232 Article 32(1) and (5) BRRD.

233 Paragraph 5.3 of Chapter 6.

234 Article 32(1) and (4) BRRD.

235 Article 32(4) BRRD.

requirements, is an important indicator that the authorities may need to consider the bank 'regulatory insolvent' and have to take action.[236]

Moreover, the literature recognizes that a resolution procedure attempts to address both common pool problems and anticommons problems, which insolvency scholars describe as a justification for liquidation and reorganization procedures.[237] As chapter 6 will discuss in more detail, the transfer tools offer an alternative means to distribute the value of the common pool of assets in a coordinated procedure.[238] Chapter 5 will ascertain that the resolution framework also seeks to overcome anticommons problems by granting an administrative authority the power to bind all shareholders and creditors to the necessary restructuring measures.[239]

3.2.2 *Harmonized procedures and coordinated and unified decision-making process*

The BRRD did not only aim to strengthen the existing national bank resolution frameworks but also to establish a harmonized legal framework for bank resolution. Furthermore, it requires cross-border cooperation and coordination between the national competent supervisory and resolution authorities. Such an integrated EU resolution regime has been widely recognized to be essential to resolve the mismatch between, on the one hand, the intertwined, cross-border group structures of many banks in the EU and, on the other hand, the largely national focus of the bank insolvency laws of the Member States.[240] The European Parliament, for instance, underlined in 2010 that

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236 *See* Gleeson & Guynn 2016, para. 9.44-9.45; European Banking Authority, Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU, Final Report, EBA/GL/2015/07, 26 May 2015. *See also* article 59 BRRD, which provides for some 'early' threshold conditions when the resolution authorities can exercise the write down or conversion of capital instruments and eligible liabilities tool. For a discussion of this tool, *see* paragraph 3 of chapter 5.

237 Madaus 2018; De Weijs 2012.

238 Paragraph 4.3 of chapter 6 and *see* Schillig 2018, para. 2.2; De Weijs 2013, p. 216.

239 Paragraphs 2.2 and 4.3 of chapter 5 and *see* Schillig 2018, para. 3.2; Schillig 2016, p. 65-66; De Weijs 2013, p. 217-221.

240 Fonteyne et al. 2010, p. 55 and *see* Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 11, which notes that '[w]hile the operation of cross border banks has become highly integrated, (with the result that business lines and internal services have become interconnected and cannot be easily separated along geographical borders of Member States), crisis management as well as related legislative frameworks of banks has remained national.' *See also* Grünewald 2014, p. 106-108.

> 'it is evident that the time has arrived for Europe to make choices between further steps towards a common future or a nationalistic path. The latter is definitely not a solution. But the implementation of the former requires a lengthy process of convergence and mutual trust building, while immediate solutions are needed to tackle the risks posed by Systemic Banks. [...] In fact, less than 50 banks (out of 12,000 in the EU) represent 70% of banking assets. The high risk they embody results from their size, complexity and interconnectedness with the rest of the system. Their problems send shock waves across sectors and countries.'[241]

Moreover, one of the recitals of the BRRD underlines that

> '[t]he absence of common conditions, powers and processes for the resolution of institutions is likely to constitute a barrier to the smooth operation of the internal market and hinder cooperation between national authorities when dealing with failing cross-border groups of institutions. This is particularly true where different approaches mean that national authorities do not have the same level of control or the same ability to resolve institutions. Those differences in resolution regimes may affect the funding costs of institutions differently across Member States and potentially create competitive distortions between institutions. Effective resolution regimes in all Member States are necessary to ensure that institutions cannot be restricted in the exercise of the internal market rights of establishment by the financial capacity of their home Member State to manage their failure.'[242]

Thus, the BRRD is an instrument of the EU legislature to avoid obstacles to the exercise of the freedom of establishment and the free provision of services within the EU internal market.[243] Ensuring that the Member States have similar approaches to and procedures for bank resolution should avoid competition distortions in the banking sector in the EU. It should create a level playing field.[244] Also, the greater convergence of the national resolution rules, including their objectives, the conditions for intervention, and the available tools, is regarded one of the crucial elements to promote

241 European Parliament, Committee on Economic and Monetary Affairs, 'Report with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector' (2010/2006(INI), 28 June 2010), Explanatory Statement, para. 13-14.

242 Recital 9 BRRD.

243 Recital 3 SRM Regulation. The BRRD was adopted on the basis of article 114 TFEU. For an extensive analysis of article 114 TFEU as the legal basis for most EU legislative instruments that established the Banking Union, including the BRRD, *see* Tuominen 2017.

244 *See* Tuominen 2017, p. 1369.

the coordinated resolution of banks that have operations in multiple countries.[245]

To this end, the BRRD aims to bring all EU Member States closer towards the same resolution standards as part of the EU Single Rulebook, which is the common regulatory framework for the banks in the EU internal market.[246] As chapter 7 will discuss in more detail,[247] the European Banking Authority (EBA), which is an EU agency, plays an essential role in achieving consistency in the interpretation and application of this regulatory framework by developing binding and non-binding regulatory documents.[248] Examples include its technical standards, guidelines, and opinions. Furthermore, Title V BRRD contains rules on the resolution of internationally operating banking groups and the preparation of the resolution decisions by authorities in resolution colleges.[249] As indicated above, the resolution of a cross-border operating bank is also governed by the procedural, cross-border bank insolvency principles that were created by the Winding-up Directive.

In addition to contributing to the convergence of the bank resolution framework in the EU, the EU bank resolution framework has sought to entrust the decision-making on the resolution of some banks to a central authority. Under the SRM Regulation, the SRB applies many of the resolution rules of the BRRD in a unified and centralized resolution procedure for the 'signifi-

245 *See* Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 18; Basel Committee on Banking Supervision, 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, p. 26-27; Fonteyne et al. 2010, p. 50. *See also* Herring 2003, p. 38.

246 *Cf*. The report of the High-Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, 25 February 2009 (De Larosière Report), p. 27-29, which stressed that the EU financial sector should be equipped with 'a set of consistent core rules.'

247 Paragraph 3.2 of chapter 7.

248 Regulation 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12) (EBA Regulation), as amended by Regulation 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013 (OJ L 287, 29.10.2013, p. 5).

249 *See* Haentjens 2017, para. 8.01-8.13.

cant'[250] and cross-border operating banks in the nineteen EU Member States that form the Euro Area, including the Netherlands and Germany.[251] In relation to the other banks within the SRM, the national resolution authorities are directly responsible to adopt the resolution decisions. These other banks are the banks that are considered less-significant and do not have a parent and subsidiaries established in more than one SRM participating Member State.[252]

The SRM is the second pillar of the Euro Area's Banking Union, in which the European Central Bank (ECB)'s centralized banking supervision within the Single Supervisory Mechanism (SSM) constitutes the first pillar.[253] It builds on the substantive, common foundation created by the BRRD. Under the SRM Regulation, the SRB draws up the resolution plans and adopts all decisions relating to the resolution of the significant and cross-border operating banks.[254] Thus, for these banks the Board sidesteps the national resolution authorities in the assessment of whether a resolution or insolvency procedure needs to be initiated.[255] It can then adopt a resolution scheme that specifies which resolution tools need to be applied and resolution powers need to be exercised.[256] If the European Commission and the Council have not expressed any objections to this decision,[257] the scheme enters into force and the relevant resolution authorities at national level implement it based on national law transposing the BRRD.[258] The national resolution

250 Article 6 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63) (SSM Regulation) stipulates that a bank is considered 'significant' if (1) the total value of its assets exceeds EUR 30 billion; (2) the ratio of its total assets over the GDP of the Member State of establishment exceeds 20 percent (unless the total value of its assets is below EUR 5 billion); (3) following a notification by the relevant national supervisory authority that it considers the bank of significant relevance with regard to the domestic economy, the ECB considers the bank of significant relevance; (4) the ECB considers, on its own initiative, the bank of significant relevance; (5) it is one of the three most significant banks established in a Member State; or (6) it is a beneficiary of direct assistance from the European Financial Stability Facility or the European Stability Mechanism.

251 Article 7(2) SRM Regulation; Article 6(4)-(5) SSM Regulation. According to the European Court of Auditors, in January 2017 the SRB was competent to take the resolution decisions for 141 banks: 8 global systemically important banks, 118 other significant banks and 15 cross-border less significant banks. *See* European Court of Auditors, 'Single Resolution Board: Work on a challenging Banking Union task started, but still a long way to go', Special Report December 2017, no. 23.

252 Articles 2, 3(1)(24) and 7(2)-(3) SRM Regulation.

253 *See* Wojcik 2016, p. 93-95 and 100-104; Zavvos & Kaltsouni 2015.

254 Articles 7(2)-(5) SRM Regulation.

255 Article 18(1) SRM Regulation.

256 Article 18(6) SRM Regulation.

257 Article 18(7)-(8) SRM Regulation.

258 Articles 18(9) and 29 SRM Regulation.

authorities have to cooperate closely with the Board when carrying out their responsibilities under the SRM Regulation and inform the Board of the resolution measures they may take.[259]

4 Conclusions

This chapter discussed the desirability of a special legal framework for bank failures and analyzed which bank insolvency rules exist at the EU level.

Paragraph 2 examined the main policy goals of general insolvency law and why a corporate insolvency procedure may not work for a failing bank. It is generally recognized that banks have to be considered different from many other types of companies because their failure can cause severe damage to the rest of the financial system and the broader economy. Nevertheless, the paragraph showed that a bank resolution framework does not reject the traditional framework of insolvency law, but it heavily relies on insolvency law. A bank resolution framework aims to both (1) replicate the economic outcome of an insolvency procedure for the shareholders and some of the creditors so that market distortions known as moral hazard are minimized, and (2) protect financial stability and the critical functions of banks, such as deposit-taking.

Paragraph 3 then explored the main developments in the field of EU bank insolvency law before the entry into force of the BRRD. It ascertained that before the latest financial crisis, only a few rules in the field of bank insolvency law were harmonized at the EU level. The Winding-up Directive provides for procedural, cross-border bank insolvency rules but does not harmonize substantive bank insolvency law. The paragraph also introduced the bank resolution procedure established by the BRRD. The cross-border convergence and coordination sought by the BRRD and the unified decision-making procedure under the SRM Regulation were discussed in the last sections of the chapter.

259 Article 7(3) SRM Regulation.

3 Designing a national, bank-specific insolvency framework

1 Introduction

Chapter 2 examined some key aspects of the EU development towards harmonization in the field of bank insolvency law. This chapter investigates the road towards the bank resolution frameworks at the national level. It concludes that over the years, banks have acquired a more special position within Dutch, German, and English law. National, formal prudential supervisory frameworks were created first in the three investigated jurisdictions, although in different periods. Later on, the national legislatures adopted some special rules for bank insolvencies, such as the rule that the supervisory authority may file the petition addressed to the court for the initiation of an insolvency procedure. Bank failures, such as the failure of the Dutch Teixeira de Mattos in 1966, the collapse of the German Herstatt Bank in 1974, and the failures during the UK secondary banking crisis in 1974-1975, acted as catalysts for expansion of and amendments to the national bank supervisory and insolvency frameworks. In response to bank failures during the latest financial crisis, the three jurisdictions introduced national bank resolution frameworks and, subsequently, implemented the EU bank resolution framework. The chapter aims to show that the establishment of these bank resolution frameworks must be seen in the context of the historical trend towards further expanding bank-specific supervisory and insolvency frameworks as a reaction to bank insolvencies.

Paragraphs 2, 3 and 4 discuss the bank supervisory and insolvency frameworks in the Netherlands, Germany, and the UK, respectively. They have a similar structure. Paragraphs 2.1, 3.1 and 4.1 examine some key developments and rules in the field of banking supervision and bank insolvency before the introduction of the national bank resolution frameworks. Paragraphs 2.2, 3.2 and 4.2 then turn to an investigation of the bank resolution frameworks which the three jurisdictions introduced from 2008. The last sections of paragraph 2, 3 and 4 make some introductory remarks about the incorporation of the EU bank resolution framework into Dutch, German, and UK law, respectively.

2 Netherlands

2.1 Key aspects of the national bank supervisory and insolvency framework prior to 2012

2.1.1 Historical developments in the field of banking supervision and bank insolvency law

The Dutch Central Bank (*De Nederlandsche Bank*, DNB) was established in 1814 on the initiative of King Willem I to facilitate lending and, thereby, regenerate trade.[1] Its activities included lending against collateral, discounting trade bills, and issuing bank notes.[2] When the Dutch banking sector started to grow in the nineteenth century, DNB gradually became 'the bank of the bankers' in the sense that it became an essential source of liquidity for the Dutch banking sector.[3] Moreover, it developed into a lender of last resort, providing liquidity assistance to individual banks in financial distress.[4] When the *Rotterdamsche Bankvereeniging* (Robaver) came in financial difficulties in 1924, DNB went even further. It organized a consortium to buy shares issued by Robaver to stabilize the share price.[5] The literature concludes that Robaver fulfilled such an important function in the Dutch financial system and economy that it could not be allowed to fail.[6] A memorandum of DNB dating from 1927 states that since a bank failure could not only cause damage for the creditors but also have disruptive effects on the economy at large, DNB did have no choice but to support the bank in such a case and prevent its failure.[7]

In those days, DNB started to play a role as bank supervisor as well, although its supervisory activities were of 'a parental and informal nature'.[8] In 1932, it took up its tasks as prudential supervisor in a more formal way by requesting banks quarterly balance sheets, which were even replaced by monthly reports after the failure of Mendelssohn & Co a few years later.

1 Vanthoor 2004, p. 20; Van der Zwet 2001, p. 2; De Vries 1994, p. 743; Klompé & Van der Vossen 1990, p. 262.
2 Vanthoor 2004, p. 20.
3 Touw 1997, p. 625; Klompé & Van der Vossen 1990, p. 262. *See also* De Vries 1994, p. 743-744; Mooij & Prast 2002, para. 2; Vanthoor 2004, p. 89-94.
4 Vanthoor 2004, p. 91; Mooij & Prast 2002, para. 2.
5 Vanthoor 2004, p. 115; Mooij & Prast 2002, para. 2.
6 Vanthoor 2004, p. 115; Mooij & Prast 2002, para. 2. *See also* De Vries 1994, p. 727 who concludes that '[i]n terms of magnitude and nature of intervention, the Rotterdamsche Bankvereeniging was in a class of its own.' De Swaan 1994, p. 324 notes that 38 of the 139 banks that were set up in the period 1884-1913 were liquidated by the end of 1913. These banks operated only on a small scale. Thus, DNB did not rescue all banks. *See also* Vanthoor 2004, p. 113-114.
7 De Swaan 1994, p. 325; Touw 1997, p. 625.
8 Mooij & Prast 2002, para. 2. *See also* De Swaan 1994, p. 325-326.

The reports mainly served to gain more insights into the development of the banking sector.[9] The Bank Act (*Bankwet*) of 1948 conformed the tasks of DNB in the field of monetary and prudential supervision.[10] Moreover, the Credit System Supervision Act (*Wet toezicht kredietwezen,* Wtk) of 1952 and 1954 required, amongst other things, banks to be registered and to provide DNB monthly and annual financial statements. DNB was granted the authority to give a bank a notification and a recommendation to adhere to a particular line of conduct in response to the financial information provided by the bank and also to publish its recommendation.[11] Furthermore, DNB could apply for a suspension of payments procedure for the bank after approval by the president of the court if it considered the bank unable to pay its due debts.[12]

In the 1960s and 1970s, the Dutch financial sector changed significantly as a result of mergers and an expansion of the range of activities undertaken by banks.[13] When Teixeira de Mattos failed in 1966, and many depositors lost their money, it became clear that the existing Wtk needed to be amended. DNB had given several warnings but had a false impression of the financial position of this bank since Teixeira de Mattos falsified its balance sheet data.[14] The Wtk 1978 provided DNB more supervisory powers and broadened the scope of the prudential supervision by DNB.[15] It established a system for deposit insurance, which guaranteed depositors the repayment of their money in the bank up to a certain amount. Furthermore, the Act created license requirements, which contrasted with the existing mere registration requirement.[16] The Wtk 1978 also provided more instruments in case a bank was in financial problems. It granted DNB the authority to appoint an undisclosed administrator (*stille curator*) and, if the solvency or liquidity of a bank showed signs of a dangerous development and no improvement of that development could reasonably be expected, to request the court to declare the emergency procedure applicable in respect of a bank.[17] The emergency procedure is a bank-specific suspension of payments procedure. The next paragraph discusses both the undisclosed administrator and emergency procedure in further detail.

9 Vanthoor 2004, p. 119; Mooij & Prast 2002, para. 2; De Swaan 1994, p. 325; Klompé & Van der Vossen 1990, p. 262; Coljé 1988, p. 10-11.
10 *See* Mooij & Prast 2002, para. 3; Van der Zwet 2001, p. 9; Coljé 1988, p. 11; Aufricht 1967, p. 466.
11 *See* Klompé & Van der Vossen 1990, p. 263-264.
12 Klompé & Van der Vossen 1990, p. 264.
13 *See* Hoekstra & Frijns 2014, p. 223; Mooij & Prast 2002, para. 4. *See also* De Vries 1994, p. 728-729; Van Zanden & Griffiths 1989, p. 234-235.
14 Hoekstra & Frijns 2014, p. 223; Vanthoor 2004, p. 222; Mooij & Prast 2002, para. 4.
15 *See* Hoekstra & Frijns 2014, p. 223-224; Prast & Van Lelyveld 2004, p. 3-4; Mooij & Prast 2002, para. 4-5; Klompé & Van der Vossen 1990, p. 264.
16 Vanthoor 2004, p. 286; Mooij & Prast 2002, para. 5.
17 Vanthoor 2004, p. 286-290. *See also* Mooij & Prast 2002, para. 5; Klompé & Van der Vossen 1990, p. 264-265; Kerstholt 1982, p. 39-41.

In the following decades, the financial supervisory architecture went through structural reforms. An important change in the supervision resulted from the removal of the ban on combining banking and insurance activities in one financial institution. The removal led to an emergence of large financial conglomerates that combined banking, insurance, and securities activities.[18] Since the increased intertwinement of financial institutions and their activities required more intensive cooperation between DNB and the Pensions and Insurance Supervisory Authority (*Pensioen- en Verzekeringskamer*), the supervisory authorities merged in 2004.[19] Furthermore, in 2002 the sectoral supervisory model was replaced by a cross-sectoral supervisory structure, known as the Twin Peaks-model. In this model, DNB became the prudential supervisory authority for all financial institutions.[20] Five years later, the sector-specific financial supervisory acts, including the Wtk 1992, were incorporated into one act, i.e., the Act on financial supervision (*Wet op het financieel toezicht*, Wft).

2.1.2 Possible measures by DNB in case of financial difficulties prior to 2012

Following its entry into force, the Wft provided DNB several instruments to intervene in a bank in severe financial distress. The instruments were the appointment of an undisclosed administrator and the request to the court to declare the emergency procedure applicable, which measures were already briefly discussed in the previous paragraph.

DNB was – and still is – empowered to appoint an undisclosed administrator over a financial institution, including a bank, in case (1) the institution does not comply with the Wft, or (2) there are signs of a development which may put the own funds, solvency or liquidity of the institution at risk.[21] The appointment is not disclosed.[22] For that reason the prefix 'undisclosed' is used in the literature.[23] The Wft does not provide for the objectives of the administration, but the literature maintains that the main task of the administrator is to control the corporate bodies of the institution, such as the general meeting of shareholders, board of directors, and supervisory

18 Mooij & Prast 2002, para. 6; Touw 1997, p. 632. *See also* De Leeuw 1996, p. 57-92.
19 Hoekstra & Frijns 2014, p. 224-225.
20 *See* Hoekstra & Frijns 2014, p. 225. *See also* Oppelaar 2010, p. 23-49.
21 Section 1:76 Wft. Section 1:76(2) and (4) Wft explicitly indicate that the starting point is that DNB only appoints an undisclosed administrator if the bank fails to comply with a prior instruction of DNB. Moreover, according to the legislative history (Fourth memorandum of amendment to the Dutch Draft Act on Financial Supervision (*Kamerstukken II* 2005/06, 29708, no. 19), p. 411), only severe violations of standards should give reason for the appointment.
22 *See* Fourth memorandum of amendment to the Dutch Draft Act on Financial Supervision (*Kamerstukken II* 2005/06, 29708, no. 19), p. 412. *See also* De Serière 2010, para. 5.
23 Wessels 2016, para. 1528.

board (*raad van commissarissen*).[24] These bodies may only act with the approval and in accordance with the instructions of the administrator.[25] According to the legislative history, the aim of the appointment is to get a 'further grip [...] on the business operations' in case 'it is considered to be not yet opportune to terminate the activities, to withdraw the license, or to request the opening of an emergency procedure'.[26]

The legislative history of the Wtk 1978 explicitly indicates that the emergency procedure was introduced 'to provide for an additional procedure of decisive nature'[27] to ensure that the deposits in a failing bank were unavailable as shortly as possible.[28] Moreover, the procedure was designed for the cases in which there was 'no hope of recovery' of the financial position of the bank.[29] The Wft empowered DNB to request the court of the jurisdiction in which the bank was established – but from 2010 only the Amsterdam district court – to declare the emergency procedure applicable.[30] In the procedure, one or more court-appointed administrators took control over the bank. They exercise all powers of the board of directors and supervisory board.[31] DNB granted the administrators the powers to proceed to (1) reorganization measures, by transferring all or a part of the obligations of the bank to a third party, (2) liquidation of the bank's business in full or in part, or (3) a combination of the reorganization measures and liquidation.[32]

24 Grundmann-van de Krol 2012, p. 739; Roth 2008, p. 292; Geskes & De Vries 2006, p. 27.
25 Section 1:76(5) Wft.
26 Fourth memorandum of amendment to the Dutch Draft Act on Financial Supervision (*Kamerstukken II* 2005/06, 29708, no. 19), p. 410: 'verdergaande greep […] op de bedrijfsvoering' als 'het nog niet opportuun is om de activiteiten te beëindigen, de vergunning in te trekken of de noodregeling aan te vragen'. *See also* Grundmann-van de Krol 2012, p. 737-740.
27 In Dutch: 'een aanvullende voorziening van slagvaardige aard te geven'.
28 Explanatory Memorandum to the Dutch Draft Credit System Supervision Act (*Kamerstukken II* 1970/71, 11068, no. 3), p. 15. *See also* Jonker 1975, p. 424-425; Kerstholt 1982, p. 40-41.
29 Explanatory Memorandum to the Dutch Draft Credit System Supervision Act (*Kamerstukken II* 1970/71, 11068, no. 3), p. 14: 'zonder hoop op herstel'.
30 Section 3:160 Wft. *See* Paragraph 5.3.2 of chapter 6. Similar to the Wtk 1978, under section 3:160 Wft the condition for the opening of the emergency procedure was that the solvency or liquidity of a bank showed signs of a dangerous trend and no improvement could reasonably be expected.
31 Section 3:175 Wft.
32 Section. 3:163(1) Wft. *See* Wessels 2016, para. 1530.

The statutory objective of the administrators was to safeguard the interest of the joint creditors of the bank,[33] which, according to policy documents, was problematic since it did not leave room for financial stability concerns.[34] In addition, the procedure involved a comprehensive moratorium so that the bank could, in principle, not be required to fulfill its obligations, there was a 'standstill'.[35] The emergency procedure currently still exists but the pending proposal for the Act recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) is intended to repeal the procedure.[36]

The Fw provided – and still provides – for a third instrument for DNB in case a bank is in severe financial distress, which is the request to the court to declare bankruptcy on a bank. The suspension of payments procedure under the Fw is not applicable to banks.[37] Since 2005, the Fw contains a bank-specific bankruptcy chapter, which is Chapter 11AA. At that time, the sections in Chapter 11AA Fw provided already that only DNB had the power to file the request to the court, apart from the request filed by the bank itself.[38] Moreover, since 2010 only the Amsterdam district court can make the bankruptcy declaration in relation to a bank with a registered seat in the Netherlands. Hence, it is an exception to the rule in section 2 Fw that, in principle, the district court of the residence of the debtor issues the bankruptcy order.[39]

2.1.3 Pre-crisis bank supervisory and insolvency framework in practice

In practice, the three above-mentioned measures by DNB – the appointment of an undisclosed administrator, request to the court to declare the emergency procedure applicable, and request to the court to put a bank into bankruptcy – have been taken in several cases. Examples are the appointment of an undisclosed administrator, opening of an emergency procedure, and subsequent bankruptcy order for the Amsterdam-American Bank in 1981.

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33 Section 3:175(2) Wft. *Cf.* Section 33(2) Wtk 1978. The Explanatory Memorandum to the Dutch Draft Credit System Supervision Act (*Kamerstukken II* 1986/87, 19806, no. 3), p. 4 states that the interests of the creditors should be safeguarded by, for instance looking for potential candidates to take over the business of the failing bank. On the protection of the interests of creditors in the emergency procedure, *see* Kerstholt 1982, p. 40-41; Jonker 1975, p. 424-425; Van Eekelen 1971, p. 94.

34 International Monetary Fund, 'Kingdom of the Netherlands-Netherlands: Publication of Financial Sector Assessment Program Documentation – Technical Note on Crisis Management and Bank Resolution Frameworks', IMF Country Report No. 11/207, July 2011, p. 16. *See also* Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 4.

35 Van den Berg 2012, p. 49. *Cf.* Section 3:176(1) and (5) Wft.

36 Proposal for the Dutch Act on recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) (*Kamerstukken II* 2017/18, 34842, no. 2).

37 Section 214(4) Fw.

38 Section 212k Fw. *See* Wessels 2009, para. 1545.

39 Section 212h Fw. *See* Wessels 2016, para. 1540a.

Following emergency procedures, a bankruptcy procedure was also opened for the Tilburge Hypotheekbank (1982), Van der Hoop Bankiers (2005), Indover bank (2008), and DSB Bank (2009).[40] Furthermore, in 2008, the court declared the emergency procedure applicable to the Dutch branch of the Icelandic Landsbanki, i.e., Icesave.[41] These banks all had relatively small balance sheets.[42]

Nevertheless, during the latest financial crisis, various policy documents and academic studies concluded that the existing instruments of DNB in relation to a distressed or failing bank had been proven inadequate. The supervisory powers of DNB were mainly preventive and when a bank ran into severe financial problems, the applicable tools under the Wft were not directed at an orderly resolution.[43]

For example, the powers of an undisclosed administrator were – and are – limited. The administrator does not have restructuring tools but is dependent on the decision-making bodies of the bank if it wants to enforce a specific course of action. Also, the Wft does not empower DNB to give instructions to the administrator.[44] The Wft granted an administrator in an emergency procedure more powers than an undisclosed administrator. Nonetheless, DNB did not have the authority to direct the transfer of the bank's business as a going concern. In most cases, the emergency procedure resulted in the opening of a bankruptcy procedure rather than the orderly continuation of the bank's operations.[45] By way of illustration, when the emergency procedure was declared applicable in respect of DSB Bank on 12 October 2009,[46] the administrators concluded that the bank was immediately 'sidelined' ('*buitenspel gezet*').[47] Its participation in TARGET2 – the payment system operated by the Euro system – was terminated as a result

40 *See* Wessels 2016, para. 1530-1531; Coljé 1988, p. 126-127. *See also* Vanthoor 2004, p. 289-290; Kerstholt 1982, p. 41.

41 *See* Diamant & Kaptein 2011.

42 *See* Van Daal 2009.

43 Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 4.

44 Van den Berg 2012, p. 49; International Monetary Fund, 'Kingdom of the Netherlands-Netherlands: Publication of Financial Sector Assessment Program Documentation—Technical Note on Crisis Management and Bank Resolution Frameworks', IMF Country Report No. 11/207, July 2011, p. 16; De Serière 2010, para. 5.

45 Van den Berg 2012, p. 49; Raaijmakers, Rank & Peeters 2011, p. 179-180.

46 Rb. Amsterdam, 12 October 2009, ECLI:NL:RBAMS:2009:BJ9939.

47 Statement of R.J. Schimmelpenninck (administrator in the emergency procedure and trustee in the bankruptcy procedure for DSB Bank), in A.A.M. Deterink, H. Oosterhout & E.M. Jansen Schoonhoven, 'Deskundigenbericht inzake Bepaling werkelijke waarde onteigende effecten en vermogensbestanddelen SNS Bank en SNS Reaal per 1 februari 2013', Enterprise Chamber of the Amsterdam Court of Appeal (*Hof Amsterdam, Ondernemingskamer*), 27 April 2018, case number 200.122.906/01 OK, p. 189. *See also* R.J. Schimmelpenninck & B.F.M. Knüppe, Rapport curatoren, Onderzoeken naar de oorzaken van het faillissement van DSB Bank N.V., June 2012, p. 115.

of the opening of the emergency procedure.[48] It could not receive or make any payments. Only a week later, DSB Bank was put into bankruptcy.[49]

2.2 National bank resolution framework 2012-2014

In June 2012 the Dutch legislator enacted the Financial Institutions Special Measures Act (*Wet bijzondere maatregelen financiële ondernemingen*) or 'Intervention Act' (*Interventiewet*),[50] which introduced a national bank resolution framework and required several amendments to the Wft and the Fw.[51]

The new Chapter 3.5.4a Wft gave DNB the authority to initiate and prepare 'behind the scenes' the forced transfer of (a part of) the business of a failing bank[52] to a third party, i.e., a private sector purchaser or a bridge institution. The following criteria had to be met: (1) there were signs of a dangerous development regarding the bank's own funds, solvency, or liquidity, and (2) it was reasonably foreseeable that this development could not be reversed sufficiently or promptly.[53] DNB's transfer plan (*overdrachtsplan*) could provide for the transfer of the bank's deposit agreements,[54] the assets

48 *Cf.* Section 38(1) Conditions Target2-NL, which provides that '[t]he participation of a PM account holder [such as a bank, LJ] in TARGET2-NL shall be immediately terminated without prior notice or suspended if one of the following events of default occurs: (a) the opening of insolvency proceedings with regard to the PM account holder'. The Conditions refer to Article 2(j) Settlement Finality Directive for the definition of the term 'insolvency proceedings', which is 'any collective measure provided for in the law of a Member State, or a third country, either to wind up the participant or to reorganise it, where such measure involves the suspending of, or imposing limitations on, transfers or payments'.

49 Rb. Alkmaar, 19 October 2019, ECLI:NL:RBALK:2009:BK0570.

50 Wet van 24 mei 2012 tot wijziging van de Wet op het financieel toezicht en de Faillissementswet, alsmede enige andere wetten in verband met de introductie van aanvullende bevoegdheden tot interventie bij financiële ondernemingen in problemen (Wet bijzondere maatregelen financiële ondernemingen), *Stb.* 2012, 241. The Act came into force with retroactive effect from 20 January 2012. On the Intervention Act, *see* Financial Stability Board, 'Peer Review of the Netherlands: Review Report', 11 November 2014, p. 30-31; Van Galen 2013, p. 266-279; Bierens 2013b; Van IJperenburg 2012; Van den Hurk & Strijbos 2012; Wibier 2011.

51 In addition to Chapter 3.5.4a Wft (the transfer regime) and Part 6 Wft (the powers of the Minister of Finance) discussed below, the Intervention Act introduced Chapter 3.5.8 Wft, which was entitled 'Post-measure counterparty rights' (*Rechten wederpartij na een gebeurtenis*). The provisions in this chapter provided that counterparty rights, such as right to terminate an agreement or require collateral on the occurrence of a trigger event, were limited. For example, the rights could not be exercised if they were triggered by the (preparation of the) measures introduced by the Intervention Act. *See* Rank 2013; Van den Berg 2012, p. 52; Raaijmakers, Rank & Peeters 2011, p. 181; Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 36-37.

52 DNB could also do so in respect of an insurance company.

53 Section 3:159c Wft.

54 Pursuant to Section 3:159h Wft the transfer of deposit agreements covered by the deposit guarantee scheme could be financed with funds from the Dutch deposit guarantee scheme.

and (other) liabilities of the bank, and the shares issued by the bank.[55] A transferor would execute the transfer plan, following the Amsterdam district court's approval of the plan and declaration that the transfer regime (*overdrachtsregeling*) was applicable.[56] DNB was also authorized to submit the transfer plan to the district court in its request to declare the emergency procedure applicable or put the bank into bankruptcy. In that case, the administrator or trustee, respectively, would implement the transfer plan.[57]

Moreover, Part 6 Wft granted – and still grants – the Dutch Minister of Finance two powers in the interest of safeguarding the stability of the financial system. Section 6:1 Wft authorizes the Minister to take immediate measures (*onmiddelijke voorzieningen*) in relation to a financial institution, such as a bank. Possible immediate measures include the temporary suspension of voting rights of shareholders.[58] Furthermore, following the entry into force of the Intervention Act, section 6:2 Wft empowered the Minister to expropriate (1) securities issued by or issued with the cooperation of a bank or (2) assets (*vermogensbestanddelen*) of a financial institution. The condition for the implementation of these measures is that the Minister is of the opinion that 'the stability of the financial system is gravely and immediately endangered by the situation in which a financial institution having its seat in the Netherlands finds itself'. Furthermore, the legislative history of the Intervention Act explicitly indicates that expropriation under section 6:2 Wft is the *ultimum remedium* and can only be used if there are no suitable alternatives.[59]

The Intervention Act also amended Chapter 11AA Fw. For example, at that time, the Fw did not provide for a bank-specific condition to declare bankruptcy on a bank without prior application of the emergency procedure. The general threshold condition of section 1 Fw applied, i.e., whether the debtor has ceased to pay his debts. According to the Dutch legislature, this criterion left DNB little room to weigh up all interests involved in a bank failure.[60] The Intervention Act aligned the conditions for the application for bankruptcy with the conditions for the request to declare the emergency procedure or transfer regime under the Wft applicable. Thus, the conditions became (1) whether there were signs of a dangerous development regarding the bank's own funds, solvency, or liquidity, and (2) it was reasonably foreseeable that this development could not be reversed sufficiently or in a timely manner.

55 Section 3:159c(2) Wft.
56 Sections 3:159u, 3:159ij, 3:159z and 3:159ad Wft.
57 Sections 3:159c, 3:161 and 3:162c Wft and sections 212hc and 212hg Fw.
58 Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 30.
59 Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 30-31 and 68.
60 Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 30 & 78. *See* Wessels 2012, para. 1543b-1543c.

The bank resolution framework established by the Intervention Act was put to the test for the first time on 1 February 2013 with the nationalization of the Dutch financial conglomerate SNS Reaal.[61] The Minister of Finance decided to expropriate all outstanding shares in, all subordinated bonds issued by and all subordinated loans taken up by both holding company SNS Reaal and by SNS Bank.[62] SNS Bank was the fourth largest bank in the Netherlands, and SNS Reaal was the second largest Dutch life insurance company and the fifth largest non-life insurance company. A failure of SNS Reaal and SNS Bank would, according to DNB and the Minister of Finance, pose unacceptable risks to the stability of the Dutch financial system.[63] The expropriated shares and subordinated bonds were transferred to the Dutch State, whereas the subordinated debts, other than securities, were transferred to a separate vehicle. Senior debt was excluded from the expropriation under section 6:2 Wft.[64] The Minister also ordered several immediate measures under section 6:1 Wft, including the removal of the board of directors and supervisory board of both SNS Bank and SNS Reaal.[65] In a subsequent appeal against the expropriation decree, which was lodged by several hundred interested parties, the Administrative Jurisdiction Division

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61 On the run-up to the nationalization of SNS REAAL and the measures taken, *see* Hoekstra & Frijns 2014; Financial Stability Board, 'Peer Review of the Netherlands: Review Report', 11 November 2014, p. 46-54.

62 *See* Decree by the Minister of Finance of 1 February 2013 regarding the expropriation of securities and assets of SNS REAAL NV and SNS Bank NV in connection with the stability of the financial system, and to take immediate measures with regard to SNS REAAL NV (Besluit tot onteigening van effecten en vermogensbestanddelen SNS REAAL NV en SNS Bank NV in verband met de stabiliteit van het financiële stelsel alsmede tot het treffen van onmiddellijke voorzieningen ten aanzien van SNS REAAL NV, *Stcrt.* 2013, 3018).

63 DNB considered SNS Bank a systemically important financial institution. According to the Minister of Finance on 1 February 2013, the failure of SNS Bank and SNS Reaal would place a heavy burden on other Dutch banks. It would trigger recourse to the deposit guarantee scheme which was funded on an *ex post* basis through a levy on the banks. Moreover, the failure would lead to social unrest and undermine confidence in the financial system. *See* Letter of the Dutch Minister of Finance to the Parliament of 1 February 2013 (*Kamerstukken II* 2012/13, 33532, no. 1), p. 6.

64 Section 6:2 Wft gives the Minister of Finance the power to expropriate any assets and liabilities of and/or securities issued by the relevant financial institution, including the senior debt. According to the Minister, however, the Dutch banking sector depended strongly on senior debt as source of funding. So far, no unsecured creditor had ever been forced to contribute to the rescue of a systemically relevant bank in the Euro Area. The sudden expropriation of senior debt could lead to higher funding costs for the Dutch banking sector, which the Minister considered to be undesirable. *See* Decree by the Minister of Finance of 1 February 2013 regarding the expropriation of securities and assets of SNS REAAL NV and SNS Bank NV in connection with the stability of the financial system, and to take immediate measures with regard to SNS REAAL NV, p. 16; Letter of the Dutch Minister of Finance to the Parliament of 1 February 2013 (*Kamerstukken II* 2012/13, 33532, no. 1), p. 9-10. *See also* Haentjens 2013, p. 72.

65 *See* Sections 2 and 3 Decree by the Minister of Finance of 1 February 2013 regarding the expropriation of securities and assets of SNS REAAL NV and SNS Bank NV in connection with the stability of the financial system, and to take immediate measures with regard to SNS REAAL NV.

of the Council of State (*Afdeling Bestuursrechtspraak van de Raad van State*) upheld the major part of the decision.[66] Furthermore, the decision led to separate court procedures on the damages to be paid as compensation to the expropriated investors.[67]

The first application of the Intervention Act received much public attention. Firstly, it sparked a debate about the private sector contributions in case of a bank failure. In the SNS case, the senior debtholders were left untouched. Moreover, although the Wft did not explicitly provide for a bail-in mechanism at that time, the application of the expropriation instrument in 2013 resulted in investors being forced to bear a part of the costs of restoring the balance sheet of SNS Reaal and SNS Bank. The subordinated creditors and shareholders are considered to have been *de facto* bailed-in.[68]

Secondly, the application of the Intervention Act gave rise to review and evaluations of the Dutch bank resolution framework.[69] It was argued, for instance, that DNB should have the power to intervene in holding companies of financial institutions. In the case of SNS Reaal, only the Minister of Finance was authorized to intervene in SNS Reaal under Part 6 Wft.[70] Furthermore, the power of the Minister to expropriate debt (liabilities) of a financial institution, not issued as securities, was considered to require a

66 Administrative Law Section of the Dutch Council of State (*Raad van State*) 25 February 2013, ECLI:NL:RVS:2013:BZ2265. The Minister also intended to expropriate any future (senior) claims that shareholders and bondholders might have against SNS Reaal or SNS Bank in connection with their holdings. The Council of State did not uphold this part of the decision because it was considered inconsistent with the decision of the Minister to only expropriate shareholders and subordinated (and no senior) debtholders. *See* Administrative Law Section of the Dutch Council of State (*Raad van State*) 25 February 2013, ECLI:NL:RVS:2013:BZ2265, para. 31.2. *See also* Bierens 2013a, p. 115-116.

67 *See* A.A.M. Deterink, H. Oosterhout & E.M. Jansen Schoonhoven, 'Deskundigenbericht inzake Bepaling werkelijke waarde onteigende effecten en vermogensbestanddelen SNS Bank en SNS Reaal per 1 februari 2013', Enterprise Chamber of the Amsterdam Court of Appeal (*Hof Amsterdam, Ondernemingskamer*), 27 April 2018, case number 200.122.906/01 OK; Janssen & Tegelaar 2016. At the moment of finalizing this dissertation (August 2018), the final outcome of the court procedures on the compensation to expropriated investors is not yet known.

68 Haentjens 2014a, p. 31; Bierens 2013a; Hoeblal & Wiercx 2013, p. 275-276. *See also* Haentjens 2013, p. 72-73.

69 In January 2014, the review of the actions taken by DNB and the Minister of Finance in the SNS case and of the Intervention Act by two Dutch evaluation committees was published. The committees also made recommendations to improve the current framework. *See* Hoekstra & Frijns 2014; Dutch Ministry of Finance, Review of Intervention Act, January 2014 (Annex to *Kamerstukken II* 2013/14, 33532, no. 32).

70 Hoekstra & Frijns 2014, p. 281-283; Dutch Ministry of Finance, Review of Intervention Act, January 2014 (Annex to *Kamerstukken II* 2013/14, 33532, no. 32), p. 27. The power of DNB to also intervene in a holding company under Chapter 3.5.4a Wft was introduced in section 3:159b Wft by the Financial Markets Amendment Act 2016 (*Wijzigingswet financiële markten 2016*), but at that time Chapter 3.5.4a Wft no longer applied to banks. *See* paragraph 2.3 below.

more explicit statutory basis. Section 6:2 Wft had to be amended to make clear that the scope of the expropriation tool was broader than the assets (*vermogensbestanddelen*) of, and securities issued by the institution.[71] Section 6:2 Wft now also grants the Minister of Finance the power to expropriate claims against a financial institution.

2.3 Dutch implementation of the EU bank resolution framework

In November 2015, the Dutch legislature transposed the BRRD into Dutch law and aligned Dutch law with the SRM Regulation by creating Part 3a Wft. DNB was appointed as the national resolution authority and one of the executive directors of DNB was made responsible for resolution.[72] Moreover, the transfer regime in Chapter 3.5.4a Wft did no longer apply to banks.[73] Part 6 Wft continues to provide for the powers of the Minister of Finance in respect of banks alongside the bank resolution framework of Part 3a Wft and the SRM Regulation, including the expropriation power. According to the parliamentary notes, the application of the EU bank resolution framework is to be considered first and Part 6 Wft is emergency power legislation ('*staatsnoodrecht*').[74] Therefore, according to the present author, it is questionable whether Part 6 Wft will be used again for a bank.

The legislative history of the Dutch act to implement the EU bank resolution framework indicates that since the SRM Regulation is directly applicable at the national level, only those rules of the BRRD which are not provided for in the SRM Regulation, were incorporated into Dutch law.[75] For example, the SRM Regulation contains provisions on each of the four resolution tools but refers to the BRRD for the further details about these tools, which detailed rules sections 3a:28-3a:48 Wft implemented.[76] However, Part 3a Wft does not only implement the EU bank resolution framework by

71 Hoekstra & Frijns 2014, p. 287; Dutch Ministry of Finance, Review of Intervention Act, January 2014 (Annex to *Kamerstukken II* 2013/14, 33532, no. 32), p. 32.

72 Decree of 15 December 2014 to amend the Decree implementation EU regulations financial markets to implement the SRM Regulation (*Stb*. 2014, 542). *See also* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 43-45.

73 Chapter 3.5.4a Wft still applies to insurance companies. The proposed Act on the recovery and resolution of insurance companies is intended to repeal many provisions introduced by the Intervention Act. Proposal for the Dutch Act on recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) (*Kamerstukken II* 2017/18, 34842, no. 2).

74 According to the parliamentary notes, section 6:2 Wft provides for a national power of the Minister of Finance and does not implement articles 56-58 BRRD (which provide for a temporary public ownership tool) because the SRM Regulation does not provide for such a power. *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 51.

75 Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 40.

76 Articles 24-27 SRM Regulation.

copying and pasting BRRD provisions. The Dutch legislature chose not to transpose several detailed BRRD articles but to refer to these provisions in the Wft explicitly. Furthermore, because the scope of the BRRD is broader than the scope of the SRM Regulation in that the BRRD also applies to investment firms and branches of EU institutions established outside the EU,[77] the Wft provides that for these entities several provisions of the SRM Regulation apply mutatis mutandis.[78] By way of illustration, the third and fourth subsection of section 3a:44 Wft on the bail-in tool provide that

> '3. De Nederlandsche Bank exercises its powers, as referred to in the first and second subsection, in accordance with articles 49 and 50 of the bank recovery and resolution directive.
> 4. In the event of application to an entity which does not fall within the scope of the single resolution mechanism regulation, article 27, the first to the fifth and the twelfth to the fifteenth subsection, of the single resolution mechanism regulation applies mutatis mutandis. Article 20, first to the fifteenth subsection, of the single resolution mechanism regulation applies mutatis mutandis to the valuation.'[79]

The result is that the Dutch bank resolution framework cannot be understood without turning to both the BRRD and SRM Regulation and hardly a distinction is made between the principle that an EU regulation is directly applicable at the national level and the principle that a directive has to be transposed into national law. Unfortunately, the chosen way of implementation does not make Part 3a Wft very clear and accessible.[80]

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77 *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 7.

78 *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 41.

79 The third and fourth subsection of section 3a:44 Wft provide in Dutch: '3. De Nederlandsche Bank oefent de bevoegdheden, bedoeld in het eerste en het tweede lid, uit overeenkomstig het bepaalde ingevolge de artikelen 49 en 50 van de richtlijn herstel en afwikkeling van banken en beleggingsondernemingen. 4. Bij de toepassing op een entiteit die niet valt onder de werking van de verordening gemeenschappelijk afwikkelingsmechanisme, is artikel 27, eerste tot en met vijfde en twaalfde tot en met vijftiende lid, van de verordening gemeenschappelijk afwikkelingsmechanisme van overeenkomstige toepassing. Op de waardering van de activa en passiva is artikel 20, eerste tot en met vijftiende lid, van die verordening van overeenkomstige toepassing.'

80 This section is based on a paragraph of the reaction of the Hazelhoff Centre for Financial Law to the consultation proposal for the Dutch Act to implement the EU bank resolution framework, of which reaction the present author is one of the authors. *See* Hazelhoff Centre for Financial Law, Universiteit Leiden, Reactie inzake het consultatievoorstel Implementatiewet Europees kader voor herstel en afwikkeling van banken en beleggingsondernemingen van 21 november 2014, 19 December 2014, available at https://www.universiteitleiden.nl/binaries/content/assets/rechtsgeleerdheid/instituut-voor-privaatrecht/20141219-reactie-consultatie-implementatie-brrd---leiden.pdf, p. 1-2. For a similar opinion, *see also* Advice of the Dutch Council of State (Raad van State) on the proposal for the Dutch Act to implement the EU bank resolution framework (*Kamerstukken II* 2014/15, 34208, no. 4), p. 4-5.

3 Germany

3.1 Key aspects of the national bank supervisory and insolvency framework prior to 2008

3.1.1 Historical developments in the field of banking supervision and bank insolvency

In Germany, the Reichsbank opened its doors in 1875. This central bank gained the monopoly over the issuance of banknotes in 1909 but became only responsible for the supervision of all bank operating in Germany in 1934.[81] Several bank failures had occurred in the preceding decades, including the collapses of the Rheinisch-Westfälische Bank and the Vereinsbank in Berlin in 1891. Nevertheless, supervisory rules only applied to specific types of banks, including the Sparkassen and mortgage banks. The principles of a market economy (*'liberalen Grundeinstellung zur allgemeinen Gewerbefreitheit'*)[82] predominated in the German banking sector, as a result of which proposals for a formal supervisory framework for all banks were rejected.[83]

During a banking crisis in 1931, which was triggered by a bank failure in Austria and exacerbated by the collapse of the German Darmstädter und Nationalbank, public trust in the German banking sector declined, and a large bank run ensued.[84] The German government intervened by ordering a two-day closure of all banks and providing guarantees for bank liabilities and capital injections.[85] The problems in the 1930s also triggered the creation of a formal banking supervisory system, first under emergency decrees and subsequently under the Banking Act (*Kreditwesengesetz*, 'KWG') of 1934.[86] The KWG introduced licensing procedures, rules on liquidity and capital, and requirements for banks to disclose information about their financial position. Moreover, it established a supervisory agency within the Reichsbank, i.e., the *Aufsichtsamt für das Kreditwesen*, and an executive body, i.e., the *Reichskommissar*.[87]

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81 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 1-6; Vieten 1996, p. 56-57. *See also* Binder 2005, p. 52-56.

82 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 1.

83 Busch 2009, p. 82-83; Binder 2005, p. 52-53; Schuster 1967, p. 69.

84 Busch 2009, p. 81; Binder 2005, p. 53-54.

85 Busch 2009, p. 81; Binder 2005, p. 53-55.

86 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 4; Busch 2009, p. 84; Binder 2005, p. 55-56.

87 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 7; Busch 2009, p. 84.

After the Second World War, banking supervision was decentralized to the states (*Länder*), although the KWG remained into force.[88] The amended KWG of 1962 reintroduced a federal supervisory framework and made a federal agency, i.e., the Federal Banking Supervisory Office (*Bundesaufsichtamt für das Kreditwesen*, BAKred), responsible for the supervision.[89] A period without major banking crises (a period '*geprägt von lang anhaltender, relative Stabilität und Prosperität*'[90]) followed but ended with the collapse of Herstatt Bank in 1974. This failure was the result of heavy losses on foreign exchange transactions. After other banks failed to organize a rescue plan, the BAKred ordered the closure of Herstatt Bank.[91] The collapse had a significant impact. It triggered massive recourse to the deposit guarantee fund which the Association of German Banks (*Bundesverband deutscher Banken*) administered since 1966.[92] A panic and bank run that hit the entire banking sector ensued and the Bundesbank (the central bank) was forced to provide emergency liquidity assistance.[93] The developments led to new, major amendments to the KWG. Amongst other things, the new Act granted the BAKred the powers to carry out on-site inspections, to impose a temporary moratorium, and to file the petition for the initiation of an insolvency procedure.[94] The three major banking groups, i.e., the private sector commercial banks, savings banks, and cooperative banks, established and expanded their privately managed deposit guarantee schemes.[95] Moreover, the Bundesbank and the banking industry established the *Liquiditäts-Konsortialbank*, which was authorized to provide solvent banks liquidity support.[96] Nevertheless, scholars note that this facility remained relatively small and of minor practical importance.[97]

In the early 2000s, the German financial supervisory architecture changed. Similar to the Netherlands, at that time Germany had separate supervisory authorities for banking, insurance, and securities markets. In 2002, these three authorities merged into the newly established Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, BaFin).[98]

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88 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 8; Busch 2009, p. 84; Gläser 1999, p. 38.

89 Busch 2009, p. 85; Gläser 1999, p. 38.

90 Binder 2005, p. 56.

91 Busch 2009, p. 100; Basel Committee on Banking Supervision, 'Bank Failures in Mature Economies', April 2004, p. 5-6.

92 Busch 2009, p. 100.

93 Busch 2009, p. 100.

94 Binder 2005, p 59; Gläser 1999, p. 39.

95 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 18. *See also* Busch 2009, p. 100-108.

96 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 17; Bornemann 2015, p. 454-455; Binder 2005, p. 59.

97 Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/Fischer 2016, Einführung, para. 17; Bornemann 2015, p. 454.

98 Wymeersch 2007, p. 297; Schüler 2005, p. 288-291.

The Bundesbank remained involved in financial supervision, as 'the fourth musketeer'[99] next to the BaFin, whereas the involvement of the central banks of the states (*Landeszentralbanken)* in the central banking system was narrowed.[100] The KWG continued to be the primary legal basis for banking supervision. In the supervisory model, the BaFin acted as the only decision-making authority and became responsible for, for example, licensing and closing down banks, whereas the Bundesbank acquired operational tasks in banking supervision, such as the evaluation of documents, reports, and annual accounts and the conduct of audits of banking operations.[101]

3.1.2 Possible measures by the BaFin in case of financial difficulties prior to 2008

In the years before the introduction of the national bank resolution framework in 2008, the fourth division of the KWG, which is entitled 'Measures in special cases' (*Maßnahmen in besonderen Fällen*), provided for several supervisory instruments to respond to financial problems of a bank.

The objective of section 45 KWG is to prevent the insolvency of a bank through timely action.[102] Section 45 KWG empowered – and still empowers – the BaFin to take measures that are 'largely noiseless' (*weitgehend geräuschlos*)[103] to improve the own funds or liquidity position, including a limitation of dividend payments and lending.[104] At that time, the BaFin was only authorized to take these measures after the bank had failed to remedy the deficiency within a period set by the supervisor.[105]

If, as a 'next level' (*nächsten Stufe*),[106] there was a 'danger' (*Gefahr*)[107] that a bank was no longer able to discharge its obligations to its creditors or there were grounds for suspecting that an effective supervision of the bank was not possible,[108] under section 46 KWG the BaFin was – and still is – authorized to take measures to avert the risks.[109] In the years before the establishment of the national bank resolution framework in 2008, the possible

99 Sanio 2003, p. 56. *Cf.* Section 7(1) KWG: '[d]ie Bundesanstalt und die Deutsche Bundesbank arbeiten nach Maßgabe dieses Gesetzes zusammen.'

100 Wymeersch 2007, p. 297; Sanio 2003, p. 56-57.

101 Dietrich & Vollmer 2012, p. 127; Schüler 2005, p. 305-307; Sanio 2003, p. 57.

102 Dombret 2012, p. 30.

103 Ruzik 2009, p. 136.

104 Binder 2009a, p. 25; Binder 2005, p. 129-131 and 197-208.

105 Binder 2009a, p. 27. In 2009, section 45 KWG was amended. Under the new provision, it was sufficient that there was an expected deterioration of the bank's financial position. *See* Pannen 2012, p. 90; Hellwig 2012, p. 40-41. *See also* Pannen 2010, p. 6-17.

106 Pannen 2010, p. 18.

107 Section 46 KWG did not define the term '*Gefahr*'. On the meaning of this requirement *see* Binder 2005, p. 133-148; Pannen 2010, p. 18-21.

108 *See* Pannen 2010, p. 22-23.

109 The prior application of the measures under section 45 KWG was not required for the application of section 46 KWG. *See* Pannen 2010, p. 18.

actions included (1) to prohibit or restrict the acceptance of deposits, funds or securities and the granting of loans, (2) to issue instructions to the bank's management, (3) to prohibit the management to carry out its activities, or limit the performance of these activities, and (4) to appointment an administrator (*Aufsichtsperson*) to assist the BaFin.[110] The bank would inform such an administrator about important decisions, and the administrator would observe if the bank met its obligations but did not represent the bank.[111] In contrast to the measures under section 45 KWG, these measures under section 46 KWG were difficult to be kept secret for the public.[112] Moreover, the literature maintains that the actions were mainly directed towards protection and prevention of the worsening of the institution's financial position rather than towards the orderly continuation of the operations.[113] Thus, they were not aimed at a reorganization (*'[m]it einer echten "Sanierung" hat dies alles nichts zu tun.'*)[114]

The German legislature introduced a moratorium tool in section 46a KWG following the failure of Herstatt Bank in 1974 to provide the non-depositor creditors of the bank the opportunity to reach a restructuring agreement and, thereby, prevent the opening of a formal insolvency procedure.[115] It granted the BaFin the authority to impose the moratorium without court involvement.[116] The legislative history expects the moratorium to last no longer than six months.[117] Binder considers the creation of this tool the first step towards a German, bank-specific insolvency framework.[118] In those

110 *See* Pannen 2010, p. 23-30; Binder 2005, p. 131-148 and 209-231.
111 Pannen 2010, p. 29-30; Binder 2009a, p. 28.
112 Ruzik 2009, p. 137.
113 Binder 2009a, p. 28.
114 Lorenz 2010, p. 1047.
115 Bericht und Antrag des Finanzausschusses über den von der Bundesregierung eingebrachten Entwurf eines Zweiten Gesetzes zur Änderung des Gesetzes über das Kreditwesen, Deutscher Bundestag, Drucksache 7/4631, 23 January 1976, p. 8: 'Durch § 46 a soll der Konkurs für den Bereich der Kreditwirtschaft nicht ausgeschlossen werden, doch soll das Bundesaufsichtsamt die Möglichkeit erhalten, durch die Anordnung eines vorübergehenden Moratoriums den beteiligten Wirtschaftskreisen Zeit für Überlegungen und Maßnahmen zu geben, die einen Schaden für die Gläubiger des Kreditinstituts und für die gesamte Kreditwirtschaft möglichst gering halten. [...] Die nicht durch die Einlagensicherung geschützten Gläubiger, also insbesondere die Gläubiger, die Kreditinstitute sind, werden während des Moratoriums zu prüfen haben, ob sie – z.B. durch teilweisen Forderungsverzicht, durch Übernahme von Geschäftsteilen oder durch andere zur Sanierung geeignete Maßnahmen – die offene Insolvenz des Kreditinstituts verhindern wollen und können.' *See* Bornemann 2015, p. 452; Binder 2013a, p. 281-282; Binder 2011, p. 243.
116 *See* Asser 2001, p. 98-100.
117 Bericht und Antrag des Finanzausschusses über den von der Bundesregierung eingebrachten Entwurf eines Zweiten Gesetzes zur Änderung des Gesetzes über das Kreditwesen, Deutscher Bundestag, Drucksache 7/4631, 23 January 1976, p. 8. *See* Pannen 2010, p. 37.
118 Binder 2013a, p. 281. For an extensive discussion of the moratorium tool under section 46a KWG, *see* Binder 2005, p. 231-247.

days, the conditions for the moratorium were the same as the conditions under section 46 KWG. Furthermore, section 46a KWG required that the moratorium aims to 'avert an insolvency procedure' (*Vermeidung des Insolvenzverfahrens*).[119] Possible measures were a ban on all sales and payments, a closure of the business with the customers, and a prohibition to accept those payments not intended to settle debts owed to the bank.[120] If senior managers had been prohibited from carrying out their activities under sections 36 or 46 KWG, during the moratorium the court, at the request of the BaFin, could appoint persons to manage and represent the bank.[121]

In addition to the moratorium tool for individual banks, the KWG provided – and provides – for a moratorium tool for any bank if there is reason to fear that banks may encounter financial difficulties that warrant expectations of grave danger to the economy as a whole, and particularly to the orderly functioning of the general payment system. Under those circumstances, section 47 KWG authorizes the German government, after consulting the Bundesbank, to establish a moratorium by statutory order. Possible measures include the temporarily closure of banks.[122] The moratorium tool was based on a similar tool in an emergency decree that was enacted during the banking crisis in the 1930s.[123] In the period following the moratorium, the government may take measures aimed at the resumption of payments, credit transfers, and stock exchange business.[124]

Finally, if insolvency could not be prevented, an insolvency procedure was to be opened for the bank.[125] Some authors used the term 'special insolvency law' (*Sonderinsolvenzrecht*) when referring to the German bank insolvency framework,[126] which according to some of them included the

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119 On the meaning of this requirement, *see* Pannen 2010, p. 39-43; Binder 2005, p. 148-155.

120 *See* Pannen 2010, p. 36-61. Section 46(1) KWG provided for a few exceptions to the moratorium. For example, according to the last sentence, the provisions of the InsO relating to the protection of payment and security and settlement systems as well as of central banks' collateral security and of financial collateral arrangements shall apply mutatis mutandis. The subsection implemented the Settlement Finality Directive and the Financial Collateral Directive. *See* Pannen 2010, p. 50-53 and *cf.* footnote 107 of chapter 2.

121 Section 46a(2) KWG.

122 Section 47(2) KWG. *See* Pannen 2010, p. 61.

123 Binder 2005, p. 726; Binder 2009a, p. 29.

124 Section 48 KWG.

125 *Cf.* Bericht und Antrag des Finanzausschusses über den von der Bundesregierung eingebrachten Entwurf eines Zweiten Gesetzes zur Änderung des Gesetzes über das Kreditwesen, Deutscher Bundestag, Drucksache 7/4631, 23 January 1976, p. 8: 'Unabhängig vom Zeitablauf wird das Bundesaufsichtsamt die Aufhebung des Moratoriums immer dann verfügen, wenn der Moratoriumszweck erreicht ist oder sich herausstellt, daß die zur Vermeidung des Konkurses ergriffenen Maßnahmen nicht den gewünschten Erfolg haben. Im letzten Fall wird das Bundesaufsichtsamt gemäß § 46 b die Konkurseröffnung beantragen.'

126 Thole 2012, p. 220-221; Pannen 2010, p. 8-9; Grabau & Hundt 2003, p. 276; Huber 1998.

measures the BaFin could take under sections 45-48 KWG.[127] However, besides these measures the BaFin could take to prevent formal insolvency, in the period before 2008, German law only provided only for a few special insolvency law provisions for banks.[128] Thus, general insolvency law governed the most substantial part of the insolvency procedure. Section 46b KWG provided – and provides – for an important departure from the InsO, namely the exclusive right for the BaFin to petition for the opening of an insolvency procedure.[129] The German legislature introduced the provision following the Herstatt Bank failure. The provision was based on the idea that the BaFin is better placed to determine at which stage such a procedure has to be initiated and that it should have the opportunity to take its other measures under the KWG first.[130]After the opening of an insolvency procedure, the BaFin had hardly powers to influence the course of the procedure. Bornemann notes that an insolvency trustee (*Insolvenzverwalter*) was not even required to provide the BaFin any information about the procedure.[131]

3.1.3 Pre-crisis bank supervisory and insolvency framework in practice

In practice, the application of the insolvency framework to a failing bank was several times avoided through successful, privately negotiated restructuring transactions with contributions from the relevant deposit guarantee scheme.[132] For example, in 2002 Schmidt Bank was rescued by a consortium of German banks and the deposit guarantee scheme.[133]

Where insolvency could not be avoided, the implications were in most cases limited.[134] The banking sector experienced a few large failures, especially during the crisis in the early 1930s, the failure of Herstatt Bank in 1974, and

127 Huber 1998.

128 Bornemann 2015, p. 542-453.

129 *See* Bornemann 2015, p. 543.

130 Ruzik 2009, p. 137; Dombret 2012, p. 30. *See also* Bericht und Antrag des Finanzausschusses über den von der Bundesregierung eingebrachten Entwurf eines Zweiten Gesetzes zur Änderung des Gesetzes über das Kreditwesen, Deutscher Bundestag, Drucksache 7/4631, 23 January 1976, p. 11: 'Die Aufsichtsbehörde kann aufgrund ihrer laufenden Überwachung des Geschäftsbetriebs, insbesondere auch im Zusammenhang mit nach §§ 46 und 46 a angeordneten Maßnahmen, am besten beurteilen, wann die Voraussetzungen des Konkurses gegeben und Sanierungsmaßnahmen erfolglos sind [...] Hierdurch wird gleichzeitig verhindert, daß Gläubiger durch Stellung eines Konkursantrages ein Kreditinstitut in die Insolvenz hineintreiben, ohne daß zuvor versucht werden konnte, durch Maßnahmen nach § 46 Abs. 1 und § 46 a den Konkurs zu vermeiden.'

131 Bornemann 2015, p. 453. The requirement for the insolvency trustee to inform the BaFin was added to section 46b(3) KWG by the German Bank Restructuring Act (*Restrukturierungsgesetz*) in 2011. *See* Obermüller 2011, p. 191-192 and *see* paragraph 5.3.3 of chapter 6.

132 Bornemann 2015, p. 455.

133 Bornemann 2015, p. 455. *See also* Binder 2005, p. 478-479.

134 Bornemann 2015, p. 455.

the collapse of Schröder, Münchmeyer, Hengst & Co in 1983.[135] Nevertheless, Bonn maintained in 1999 that the German banking sector was 'more stable and resistant to crises than most other banking systems' ('*stabiler und krisenresistenter* […] *als die Merzahl der anderen Bankensysteme*').[136] According to the information provided by the BaFin, between 2000 and mid-2009 15 bank insolvencies took place in Germany. These insolvencies concerned mostly small institutions.[137]

The financial crisis that hit the EU in 2007 had severe implications for the German banking industry and the public financial assistance provided to the banking system, especially through schemes that guarantee bank liabilities and recapitalization schemes, was significant. The Landesbanken were amongst the first banks to run into trouble.[138] Amongst the banks that were rescued by the German government was HRE, which case chapter 2 discussed.[139]

As was illustrated in paragraph 3.1.2, at that time the framework that applied in case a bank faced financial difficulties was not directed towards orderly resolution of the bank. For example, the German legislator in 1976 considered that the moratorium under section 46a KWG would only lead to an insolvency procedure in the worst-case scenario.[140] In practice, however, most moratoria resulted in the insolvency of the bank rather than restructuring.[141] A moratorium led to a freeze of the operations of the bank, including a large part of the contractual relationships with third parties,[142] without

135 Bonn 1999, p. 533. *See also* Basel Committee on Banking Supervision, 'Bank Failures in Mature Economies', April 2004, p. 4.

136 Bonn 1999, p. 533. *See also* Bornemann 2015, p. 455; Basel Committee on Banking Supervision, 'Bank Failures in Mature Economies', April 2004, p. 4.

137 *See* Antwort der Bundesregierung auf die Kleine Anfrage der Abgeordneten Frank Schäffler, Florian Toncar, Jens Ackermann, weiterer Abgeordneter und der Fraktion der FDP, Vollzogene „Maßnahmen in besondere Fällen" nach dem Gesetz über das Kreditwesen durch die Bundesanstalt für Finanzdienstleistungsaufsicht, Drucksache 16/13131, 22 May 2009, p. 3; Brogl 2012, p. 12. *See also* Bornemann 2015, p. 455. The Federal Government also notes that the BaFin took its 'Measures in case of danger' ('*Maßnahmen bei Gefahr*') under section 46 KWG 29 times in the period 2005-2008, and it imposed a moratorium under section 46a KWG on 4 banks in the period 2007-2009.

138 *See* Bornemann 2015, p. 455-456; Dietrich & Vollmer 2012, p. 128-129; Hüfner 2010; Petrovic & Tutsch 2009, p. 35-41. For an in-depth discussion of the German response to the various bank failures and how the banks were rescued, *see* Mitchell 2017, p. 65-101.

139 Paragraph 3.1 of chapter 2.

140 Bericht und Antrag des Finanzausschusses über den von der Bundesregierung eingebrachten Entwurf eines Zweiten Gesetzes zur Änderung des Gesetzes über das Kreditwesen, Deutscher Bundestag, Drucksache 7/4631, 23 January 1976, p. 4: 'Das Moratorium mündet ungünstigstenfalls in den Konkurs, den allein das Bundesaufsichtsamt beantragen kann.'

141 *See* Binder 2005, p. 532,

142 *Cf.* footnote 415 on the exceptions to the moratorium.

taking into account the effects on the rest of the financial system.[143] Moreover, during the moratorium, the BaFin did not have the power to force the creditors of the bank to agree with restructuring measures but could 'at most buy the institution time' ('*die Institut allenfalls "Zeit kaufen"*').[144]

3.2 National bank resolution framework 2008-2014

The national bank resolution framework that the German legislature introduced from 2008 can be distinguished in two parts: the resolution regime created in 2008-2009, which mainly had an emergency character, and the regime that entered into force in 2011, which had a more permanent character.

As briefly discussed in chapter 2,[145] the Financial Market Stabilization Act of 2008 and the Financial Market Stabilization Supplementary Act of 2009 established a federal fund (the SoFFin) to provide distressed banks liquidity and capital support and amended German takeover and company law. The latter amendments enabled the SoFFin to gain control over and avoid the failure of the bank HRE.[146] Furthermore, the supplements to this resolution regime that were introduced in 2009 established a 'bad bank regime' under the Financial Market Stabilization Fund Act (*Finanzmarktstabilisierungsfondsgesetz*, FMStFG).[147] A first model allowed banks to transfer securities to a special purpose vehicle (SPV) in return for debt instruments issued by the SPV to the bank and guaranteed by the SoFFin.[148] Thus, impaired financial assets would be exchanged for guaranteed bonds.[149] Under a second model, banks were allowed to transfer risk positions[150] (*Risikopositionen*) and non-core business divisions (*nichtstrategienotwendige Geschäftsbereiche*) to a winding-up agency governed by federal or state law.[151] In December 2009,

143 Hellwig 2012, p. 41 and *see* Binder 2011, p. 243-246; Binder 2009b, p. 20-21. The German legislature noted in this context in 2010 that 'die bislang vorhandenen bankaufsichtsrechtlichen Instrumente zur Insolvenzbewältigung sind für die Sanierung von systemrelevanten Banken nicht geeignet. Diese Maßnahmen zielen darauf ab, den Geschäftsbetrieb einzufrieren und die Vertragsbeziehungen zu anderen Finanzmarktteilnehmern zu unterbrechen und können damit dieselben Folgen wie eine Insolvenz auslösen.' Gesetzentwurf der Bundesregierung, Restrukturierungsgesetz, Deutscher Bundestag, Drucksache 17/3024, 27 September 2010, p. 1.

144 Lorenz 2010, p. 1047. *See also* Plank et al. 2012, p. 187; Hellwig 2012, p. 41; Binder 2009a, p. 28-30; Binder 2005, p. 148-155 and 532-535.

145 Paragraph 3.1 of chapter 2.

146 *See* paragraph 3.1 of chapter 2; Bornemann 2015, p. 456-459 and, critically, Hellwig 2012, p. 39-41. *See also* Obermüller 2011, p. 204-218; Pannen 2010, p. 68-100.

147 The amendments were introduced by the Act to Develop Financial Market Stability (*Gesetz zur Fortentwicklung der Finanzmarktstabilisierung*), which entered into force on 23 July 2009. For a discussion of the 'bad bank regime', *see* Günther 2012, p. 177-192; Pannen 2010, p. 100-111; Karpenstein 2009; Wolfers & Rau 2009.

148 Section 6a FMStFG.

149 *See* Bornemann 2015, p. 460-461; Laier 2009, p. 436-437; Wolfers & Rau 2009, p. 2402-2403.

150 *Cf.* Section 8a(2) FMStFG.

151 Sections 8a and 8b FMStFG.

the first winding-up agency, which was called the *Erste Abwicklungsanstalt*, was created for landesbank WestLB to ring-fence specific assets and stabilize the bank.[152] In contrast to the BRRD and SRM Regulation as regards the asset management vehicle that can now be established, the German bad bank regime provided that the shareholders of the bank remain liable for losses that exceeded those estimated at the time of the transfer to the SPV or winding-up agency.[153] Moreover, the transfer to an SPV or a winding-up agency could only be made upon request of the bank itself.[154]

On 1 January 2011, the German Bank Restructuring Act (*Restrukturierungsgesetz*) entered into force. The provisions in this omnibus act introduced (1) the Credit Institution Reorganization Act (*Gesetz zur Reorganisation von Kreditinstituten,* KredReorgG), (2) amendments to the KWG, and (3) the Restructuring Fund Act (*Gesetz zur Einrichtung eines Restrukrierungsfonds für Kreditinstitute*). The sections below will discuss the KredReorgG and the amendments to the KWG.[155]

The KredReorgG provided – and still provides – for two types of procedures, i.e., a voluntary recovery procedure (*Sanierungsverfahren*) and a voluntary reorganization procedure (*Reorganisationsverfahren*).[156] The provisions on the latter procedure were based on Part 6 of the InsO on the insolvency plan procedure. At that time, any German bank was allowed to initiate the recovery procedure,[157] but only banks of systemic relevance could be subject to the reorganization procedure.[158] For both procedures the bank has to notify the BaFin,[159] submit a recovery or reorganization plan, and propose a recovery advisor (*Sanierungsberater*) or a reorganization advisor (*Reorganisationsberater*), respectively.[160] The BaFin can then file an application with the Higher Regional Court (*Oberlandesgericht*) to open the procedure, and the Court appoints the advisor.[161]

152 *See* Bornemann 2015, p. 462; European Commission, Decision of 20 December 2011 on the State aid C 40/2009 and C 43/2008 for the restructuring of West LB AG (2013/245/EU); Karpenstein 2009, p. 415.

153 Sections 6b(1)(1) and 8a(4)(1) FMStFG.

154 *See* Karpenstein 2009, p. 414-415; Wolfers & Rau 2009.

155 On the establishment of the restructuring fund (*Restrukturierungsfonds*), *see* Bornemann 2015, p. 474-478; Schuster & Westpfahl 2011b, p. 286-289; Bachmann 2010, p. 470.

156 For an extensive discussion of the KredReorgG, *see* Rapp 2014; Höher 2012; Webers 2012; Schuster & Westpfahl 2011a.

157 *Cf*. Sections 1(1) and 2(1) KredReorgG.

158 For the opening of a reorganization procedure, section 7(2) KredReorgG required that the bank's viability was threatened (*Bestandgefährdung*) and that this position posed a threat to financial stability (*Systemgefährdung*). The restriction has been criticized by Bachmann 2010, p. 463 & 465. *See also* Schuster & Westpfahl 2011a, p. 225.

159 In case an unsuccessful recovery procedure preceded the reorganization procedure, the application for the latter procedure had to be made by the recovery advisor. Section 7(1) KredReorgG.

160 Sections 2(2) and 7(1) KredReorgG.

161 Sections 3(1) and 7(3)-(5) KredReorgG.

During a recovery procedure under the KredReorgG, the recovery advisor has the task to implement the recovery plan, which, in principle, may provide for all measures suitable for a rescue of the bank, such as the issuance of shares.[162] He has several powers, including the power to issue instructions to the management.[163] In contrast to the recovery procedure, the reorganization procedure permits the interference with rights of creditors and shareholders, such as through a debt-to-equity swap.[164] The reorganization plan may also provide for the liquidation of the bank.[165] It must be accepted by a majority of the creditors and shareholders, who would vote in different groups.[166] Only after approval of the plan, the court may confirm the procedure.[167]

The literature expects the reorganization procedure to take a long time (*'eine mindestens monatelange Verfahrensdauer'*).[168] Moreover, it has been argued that the initiation of the procedure will create a significant systemic risk (*'reicht womöglich schon die Verbreitung der Nachricht über die Einleitung eines Reorganisationsverfahrens, um Vertragspartner in großer Zahl zum Abbruch ihrer Beziehungen zu bewegen und damit die Gefahr einer Systemkrise heraufzubeschwören'*).[169] So far, both the restructuring and reorganization procedures have not been used. The potential for systemic risk and the fact that the management of the bank has to initiate the procedures, and thus 'surrender' itself to the procedures, are the reasons that many scholars argue that the procedures are unlikely to be used at all.[170]

162 Sections 2(2) and 6 KredReorgG.

163 Sections 4 and 5 KredReorgG.

164 Sections 9-12 KredReorgG. *See* Schelo 2011, p. 188; Schuster & Westpfahl 2011a, p. 226-229; Attinger 2011, p. 28-29.

165 Secion 8(1) KredReorgG. *See* Bliesener 2012, p. 133; Lorenz 2010, p. 1049.

166 Section 19(2) and (4) KredReorgG specifies the conditions under which a group of creditors or shareholders can be overruled in its opposition to the plan. *See* Schuster & Westpfahl 2011a, p. 228-229.

167 Sections 16-20 KredReorgG.

168 Bliesener 2012, p. 134.

169 Zimmer 2010, p. 4. *See also* Bliesener 2012, p. 134; Pflock 2014, p. 295. Under section 20(1) KredReorgG the court has one month to reach a decision in the reorganization procedure. According to Attinger 2011, p. 30-31, the timeframe 'seems unrealistically long in light of the systemic risk created by the ailing bank'.

170 Pflock 2014, p. 295; Schillig 2014, p. 70-71; Hellwig 2012, p. 44-45; Plank et al. 2012, p. 190-191; Attinger 2011, p. 30-31; Bachmann 2010, p. 462-463 and 465; Lorenz 2010, p. 1049. According to Müller-Eising et al. 2011, p. 70, '[e]s dürfte fraglich sein, inwieweit das Sanierungsverfahren in der Praxis genutzt wird, da es – im Vergleich zu einer privatautonomen Lösung mit den Gläubigern – das zu sanierende Institut doch in ein „starres Korsett" zwingt. Zudem erscheint die Einschaltung eines strengen Verfahrensregelungen unterworfenen Sanierungsberaters gegenüber einer freiwilligen Bestellung eines Geschäftsleitungsmitglieds für Restrukturierungsfragen eher fernliegend, zumal tiefgreifende Eingriffsbefugnisse in die Geschäftsleitung mit dem gerichtlichen Sanierungsverfahren einhergehen.' According to the German legislature, both procedures aimed to provide for private autonomous decision-making on crisis management ('dient der eigenverantwortlichen Krisenbewältigung'). Gesetzentwurf der Bundesregierung, Restrukturierungsgesetz, Deutscher Bundestag, Drucksache 17/3024, 27 September 2010, p. 2.

While the KredReorgG focuses on the initiative of the bank itself, the amendments which the Bank Restructuring Act made to the KWG strengthened the intervention powers the BaFin had at its disposal. Besides some changes to the BaFin's supervisory powers under sections 45-46b KWG,[171] the Bank Restructuring Act introduced sections 48a-s KWG. The latter provisions granted the BaFin the authority to transfer all or a part of the assets and liabilities of a bank to a private sector purchaser or bridge institution without court involvement.[172] The conditions for the use of the transfer powers were that (1) the bank's viability was threatened ('*in seinem Bestand gefährdet*'), (2) this position posed a threat to financial stability ('*es hierdurch die Stabilität des Finanzsystems gefährdet*'), and (3) the threat for the stability of the financial system could not be averted in any other way.[173] The transfer regime only allowed the separation of the institution's 'healthy' parts. The residual 'bad bank' would be made subject to an insolvency procedure.[174]

Following the entry into force of the Bank Restructuring Act, the literature highlighted several shortcomings in the German bank resolution framework. For example, sections 48a-s KWG allowed a transfer of assets and liabilities of a bank but, in contrast to the BRRD, did not provide for the power to transfer the shares issued by a failing bank. The legislative history suggests that the legislature intended to provide for a tool to safeguard only the systemic relevant parts of a bank, and it was reluctant to introduce the legal authority to expropriate the entitlements of shareholders.[175] Several scholars claimed that the lack of a share transfer instrument could make the resolution of a German bank difficult since a share transfer may operationally be easier to realize than a transfer of the business of the bank.[176] Furthermore, Bliesener and Bachmann both maintained that German law should require banks to draw up recovery and resolution plans to prepare the measures that can be taken in case of distress or failure.[177] The German

171 *See* Pannen 2012, p. 93-98. The BaFin's moratorium power continued to exist but under section 46 KWG.

172 Section 48a(1) KWG.

173 Section 48a(2) KWG. *See also* section 48b KWG.

174 Sections 48j(3) and 48k(2) KWG. *See* Bornemann 2015, p. 469; Bliesener 2012, p. 148-149; Bachmann 2010, p. 467. *See also* Gesetzentwurf der Bundesregierung, Restrukturierungsgesetz, Deutscher Bundestag, Drucksache 17/3024, 27 September 2010, p. 3: '[v]orteil einer solchen Übertragung von systemrelevanten Geschäftsteilen auf einen anderen Rechtsträger (Brückenbank) ist, dass Stabilisierungsmaßnahmen sich in der Folge auf die neue Bank konzentrieren können, während die beim Altinstitut verbleibenden nicht systemrelevanten Teile gegebenenfalls im Rahmen eines herkömmlichen Insolvenzverfahrens abgewickelt werden können.'

175 *See* Gesetzentwurf der Bundesregierung, Restrukturierungsgesetz, Deutscher Bundestag, Drucksache 17/3024, 27 September 2010, p. 62.

176 Schillig 2014, p. 83; Bliesener 2012, p. 137; Van der Zwet 2011, p. 19. *See also* Bachmann 2010, p. 470; Zimmer 2010, p. 3.

177 Bachmann 2011, p. 470; Bliesener 2012, p. 135-135. *See also* Kenadjian 2013, p. 11 and 14-16.

legislature introduced such a requirement for banks in 2013, in anticipation of the entry into force of the BRRD.[178]

3.3 German implementation of the EU bank resolution framework

The BRRD was implemented through the newly created Recovery and Resolution of Institutions and Financial Groups Act (*Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen*, SAG).[179] The SAG entered into force on 1 January 2015. While the Federal Agency for Financial Market Stabilization (*Bundesanstalt für Finanzmarktstabilisierung*, FMSA) was first designated as the resolution authority, since 1 January 2018 the BaFin is the German resolution authority and the FMSA has been incorporated into the BaFin.[180]

Notwithstanding the new bank resolution framework, the KredReorgG still provides for the court-supervised restructuring procedure and reorganization procedure that were considered in paragraph 3.1.3.[181] The reorganization procedure can now only be initiated if the bank meets the conditions for the opening of a resolution procedure referred to in section 77 SAG.[182] The present author assumes that the possibility to open such a procedure under the KredReorgG does not hinder the opening of a resolution procedure under the SAG and is only an option for the BaFin if such a procedure is likely to be successful.[183] Also, sections 45-48 KWG continue to provide for the 'Measures in special cases' that were discussed in paragraph 3.1.2, including the moratorium. It has been argued that the fact that in one of the first bank insolvency cases in Germany after implementation of the BRRD, the BaFin decided to impose a moratorium under the KWG shows that in practice this supervisory power may continue to play a significant role in the German bank recovery and resolution framework.[184] Section 38(5) SAG stipulates that the power of the BaFin to appoint a special manager (*Sonderbeauftragter*) under section 45c KWG, which was introduced by the Bank Restructuring Act in 2011, remains unaffected by the power to appoint

178 *See* Bornemann 2015, p. 486.

179 The SAG was amended by the Law for the Adaption of the National Bank Resolution Law on the Single Resolution Mechanism of 2 November 2015 (Gesetz zur Anpassung des nationalen Bankenabwicklungsrechts an den Einheitlichen Abwicklungsmechanismus und die europäischen Vorgaben zur Bankenabgabe (Abwicklungsmechanismusgesetz). For a discussion of the structure of the SAG, compared to the structure of the BRRD, *see* Binder 2015a.

180 Section 3(1) SAG.

181 *See* Bauer & Hidlner 2015, p. 253-254.

182 Section 7(2) KredReorgG.

183 *Cf.* Bornemann 2015, p. 466-467.

184 Binder 2017c, para. 11.13. The moratorium was imposed in February 2016 in relation to Maple Bank. *See* www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Pressemitteilung/2016/pm_160207_maple.html.

a temporary administrator under section 38 SAG, which implements article 29 BRRD.[185] Both types of measures seem to have the same effect potentially. The BaFin can appoint both the special manager and the temporary administrator as an early intervention measure to replace the management body or to add him with powers to that body. It has the discretion to grant either of them the necessary powers and specify the tasks to deal with the particular circumstances, including to restore sound and prudent management.[186]

4 The UK

4.1 Key aspects of the national bank supervisory and insolvency framework prior to 2009

4.1.1 Historical developments in the field of banking supervision and bank insolvency

The BoE was established in 1694 as a privately held commercial bank to raise funds for the government to finance the war against France.[187] It became the bank of the government and manager of national debt and, later on, it developed into one of the most important banks in London.[188] The BoE was not brought into public ownership until 1946.[189] Although its notes only became legal tender in England and Wales under the Bank of England Act of 1833, issuing banknotes was already an important function of the BoE from the days of its establishment.[190]

In the nineteenth century, the BoE developed into the bank of the bankers as it held deposits of the other London banks.[191] Since its depositors could arrange for a payment to be made by drawing on their accounts with the BoE, the BoE facilitated payments as well.[192] Furthermore, in periods

185 *See* Bauer & Hidlner 2015, p. 254.

186 *Cf*. Section 38(1) SAG; Section 45c(2) KWG. *See also* Schillig 2013, p. 777-779; Lorenz 2010, p. 1052.

187 Busch 2009, p. 128; Saw 1944, p. 11-13; Ogden 1988, p. 78-80. On the development of the BoE into a central bank in the modern sense, *see* Wood 2006, p. 32 et seq.; Collins 1988, p. 167-193. On the historical development of banking in the United Kingdom, *see* Cottrell 1994, p. 1137-1273; Collins 1988; Ogden 1988, p. 76-78.

188 Collins 1988, p. 10-11 and 168-169; Bowen 1995, p. 1. *See also* Kynaston 2012, p. 12-13.

189 Collins 1988, p. 167.

190 Collins 1988, p. 11; Bank of England, 'The Bank of England note: a short history', *Bank of England Quarterly Bulletin* 9 (1969), p. 211-213.

191 Goodhart 2018, p. 161; Collins 1988, p. 170. *See also* Ogden 1988, p. 82-85; Bank of England, 'The functions and organization of the Bank of England', *Bank of England Quarterly Bulletin* 6 (1966), p. 233-234.

192 Goodhart 2018, p. 161.

of liquidity pressure on the other banks, it provided the extra cash the banking sector needed. Accordingly, it also started to act as a lender of last resort.[193] This role as lender of last resort did not entail that the BoE was willing to lend to all banks that sought assistance.[194] It was a commercial bank and was only willing to lend on good collateral.[195] For instance, the BoE refused to provide liquidity to Overend, Gurney & Company in 1866 'when it became clear that that firm had become little more than a financial shell.'[196] The firm failed after 'the Governor took the view that the Bank could not assist one concern unless it was prepared to assist the many others which were known to be in similar plight'[197] and a major panic then spread through the whole banking system.[198] In 1878, the City of Glasgow Bank failed after fraud and mismanagement were discovered and the BoE refused to provide financial support because that there was no danger to the banking system.[199] By contrast, when Barings asked for liquidity assistance two years later, the governor of the BoE set up a guarantee fund to which the BoE itself and the banking industry contributed to avoid a failure that would put the whole banking system at risk.[200]

In contrast to the formal banking supervisory frameworks that were introduced in the Netherlands and Germany in the first half of the twentieth century, in England, a statutory framework for the prudential supervision of individual banks by the Bank of England (BoE) did not play a prominent role until the late 1970s.

After the Second World War, the BoE favored the continuance of its informal oversight and self-regulation.[201] The informal approach was considered to be flexible and personal.[202] The Bank of England Act 1946 had provided the BoE the powers to make recommendations and issue directions to

193 Collins 1988, p. 170 and 188-189. *See also* Goodhart 2018, p. 162-164.

194 *See* Collins 1988, p. 189.

195 Goodhart 2018, p. 163; Collins 1988, p. 189.

196 Collins 1988, p. 189. *See also* Bank of England, 'The demise of Overend Gurney', Bank of England Quarterly Bulletin 56 (2016), p. 94- 106.

197 King 1936, p. 242. As also cited by Flandrean & Ugolini 2011, p. 12-13. *See also* Roberts 1995, p. 158-159.

198 *See* Flandrean & Ugolini 2011, p. 13; House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 8-9; Ogden 1988, p. 122-126. *See also* Kynaston 2012, p. 79-85. The failure of Overend Gurney led to a debate about the role of the BoE as lender of last resort. In 1873, Bagehot published its famous work *Lombard Street: A Description of the Money Market* in which he advocated liquidity support to banks in times of crisis, but only at high interest rates and on good collateral. *See* Goodhart 2018, p. 163; Kynaston 2012, p. 87-89; Wood 2006, p. 89-94.

199 Roberts 1995, p. 177; Ogden 1988, p. 136-137.

200 Kynaston 2012, p. 137-138; Roberts 1995, p. 177-178. *See also* Ogden 1988, p. 143-151

201 Hall 1999, p. 3-4; Roberts 1995, p. 180. *See also* Busch 2009, p. 128-131.

202 Bank of England, speech by G. Blunden, 'The supervision of the UK banking system', *Bank of England Quarterly Bulletin* 15 (1975), p. 189-190. *See also* Binder 2005, p. 60.

banks, but these powers were not used.[203] Moreover, a system of recognition and authorization existed, but this was based on various acts and 'the complexity of the legal provisions and the potentially conflicting criteria used in determining such recognitions left much to be desired. Nor did the supervisory system inspire overwhelming confidence'.[204] According to Hall, important reasons why not much pressure existed to create a more formal system were the lack of large banking crises and the simplicity of the balance sheets of banks.[205]

In the early 1970s, the money markets expanded, many foreign banks entered the London markets, and the so-called 'fringe' or secondary banks, which were not fully supervised by the BoE and 'operated on the fringe of the banking system', gained a large share in banking market.[206] When the secondary banks, including London and Countries Securities, experienced financial problems, the BoE stepped in to prevent the crisis from spreading to other banks.[207] It established a 'lifeboat' operation, i.e., a consortium with the clearing banks, to rescue some banks and, later on, provided banks with financial assistance on its own.[208] As a response to the developments during the secondary banking crisis and to implement the First Banking Directive[209] into UK law, the British legislature enacted the first Banking Act in 1979.[210] The Act created an authorization procedure for banks, established ongoing supervisory procedures adopted by the BoE, and introduced a deposit guarantee scheme.[211] It was replaced by the Banking Act 1987 after it failed to prevent the failure of Johnson Matthey Bank.[212] Amongst other things, the new statutory framework created the BoE Board of Banking Supervision, extended the BoE's supervisory powers, including the power to require information from banks, and changed the authorization procedure.[213]

203 Hall 1999, p. 3; Bank of England, 'The secondary banking crisis and the Bank of England's support operations', *Bank of England Quarterly Bulletin* 18 (1978), p. 230.

204 Hall 1999, p. 4. *See also* Hadjiemmannuil 1996, p. 10-12; Gardener 1986, p. 70-73.

205 Hall 1999, p. 4.

206 Metcalfe 1982, p. 78.

207 Buckle & Thompson 2004, p. 334; Busch 2009, p. 142-145. On the secondary banking crisis, *see* Bank of England, 'The secondary banking crisis and the Bank of England's support operations', *Bank of England Quarterly Bulletin 18* (1978), p. 230-239; Reid 1982; Hadjiemmannuil 1996, p. 26-31; Hall 1999, p. 6-8.

208 Metcalfe 1982, p. 79-80; Bank of England, 'The secondary banking crisis and the Bank of England's support operations', *Bank of England Quarterly Bulletin 18* (1978), p. 232-235.

209 *See* paragraph 3.1 of chapter 2.

210 *See* Hadjiemmannuil 1996, p. 31-37.

211 Hall 1999, p. 27-29.

212 Roberts 1995, p. 181. *See also* Hall 1999, p. 30-35.

213 Hall 1999, p. 36-39.

Two large bank failures in the early 1990s gave rise to new amendments to the banking supervisory framework.[214] The first was the collapse of the BCCI in 1991, which case was referred to in chapter 2.[215] BCCI was a multinational bank with many branches in the UK, and in 1980 the BoE authorized it as a licensed deposit-taker under the 1979 Banking Act.[216] Although the BoE had evidence of fraudulent activity at the bank, the BoE allowed BCCI to continue operating and decided to close it in 1991 only.[217] While BCCI already had a negative reputation for many years, Barings was one of the oldest banks in the country with a good reputation.[218] In 1995, Barings suffered significant losses in unauthorized derivatives transactions and was placed into administration after efforts by the BoE to organize a rescue operation failed. The administrators, finally, arranged that the Dutch bank ING took over Barings.[219] The BoE was then widely criticized for its supervision in relation to BCCI and Barings.[220]

At the end of the 1990s, the UK government decided to overhaul the supervisory framework and to transfer the BoE's supervisory powers to a newly created, single authority. The Financial Services Authority (FSA) became responsible for prudential and conduct of business supervision of banks and other financial institutions under the Financial Services and Markets Act 2000 (FSMA 2000).[221] Comparable to the developments in the Netherlands and Germany only a few years later, the regulatory reforms in the UK were argued to reflect the blurring boundaries between the different financial markets and products.[222]

4.1.2 Possible measures by the FSA in case of financial difficulties prior to 2008

Following its entry into force, the FSMA 2000 did not give the FSA the power to take control of the management of or to intervene in a bank in financial difficulties, except for some supervisory powers 'to discipline authorized persons for regulatory failures.'[223] For example, the FSA was authorized to cancel or vary the permission that was given to the bank

214 Busch 2009, p. 149.
215 Paragraph 3.1 of chapter 2.
216 Buckle & Thompson 2004, p. 336-337; Hadjiemmannuil 1996, p. 46-47.
217 Busch 2009, p. 149-150; Buckle & Thompson 2004, p. 336-337; Hadjiemmannuil 1996, p. 46-49 and 266. *See also* Hall 1999, p. 121-134.
218 Busch 2009, p. 151, who notes about Barings' reputation that 'even the Queen had an account there.'
219 Hogan 1996, p. 91-92; Hadjiemmannuil 1996, p. 49-50 & 268-269. See also Hall 1999, p. 135-161.
220 Campbell & Cartwright 2002, p. 55.
221 Busch 2009, p. 154-156; Sykes & Allen 2005, p. 141-158.
222 Sykes & Allen 2005, p. 143-144.
223 Campbell & Cartwright 2002, p. 120.

to undertake regulated activities. The condition for such a measure was a breach or likely breach of the threshold conditions the bank had to satisfy on a continuing basis,[224] not carrying on a regulated activity for a long period, or protection of the interests of consumers.[225] It was argued that these broad conditions entailed that 'the FSA has considerable power to take action at the first sign of trouble.'[226]

Bank insolvencies were dealt with under the general insolvency framework established by the IA 1986 and the Insolvency Rules 1986. According to Cranston, the main reasons why a special bank insolvency framework did not exist in the UK were that bank insolvencies could be dealt with speedily under the general insolvency framework and systemic risks were addressed by lender of last resort assistance by the BoE and prudential supervision. Moreover, depositors were protected by the deposit guarantee scheme.[227] Similarly, Campbell and Cartwright maintained in 2002 that

> '[t]here has never been any call for the introduction of special provisions to deal with bank insolvencies, and in view of the provisions of FSMA and the creation of the FSA as a regulator for the entire financial sector it seems unlikely that there will be any activity in this in the near future.'[228]

Hence, the determination of whether a bank was insolvent was based on the traditional cash flow and balance sheet tests under the IA 1986,[229] and failure to comply with the prudential requirements was considered 'a regulatory rather than an insolvency matter'.[230] Although a special regime for bank insolvencies did not exist, the FSMA 2000 contained a few rules on bank insolvencies. These rules included that the FSA was entitled to initiate those insolvency procedures provided for under the IA 1986, in addition to

224 Under section 41 FSMA 2000, a financial institution that applied for permission to carry on regulated activities had to satisfy specific threshold conditions and must continue to satisfy these while authorized. The threshold conditions listed in Schedule 6 to the FSMA 2000 related to legal status, location of offices, appointment of claim representatives, close links, adequate resources, and suitability ('fit and proper test'). *See* Simpson in Blair 2009, p. 82-84.

225 Section 45 FSMA 2000.

226 Campbell & Cartwright 2002, p. 47-48.

227 Cranston 2002, p. 18. *See also* Hadjiemmanuil 2004, p. 230: '[t]he [UK insolvency, LJ] system has operated well and without controversy over the years, and nobody argues for its replacement by an administrative system.'

228 Campbell & Cartwright 2002, p. 209.

229 *Cf*. Section 123 IA 1986 (definition of inability to pay debts). It was possible for a bank to be put into administration before it was technically insolvent. Under section 8(1) IA 1986, the court could make an administration order if it was satisfied that the company was or was likely to become unable to pay its debts.

230 Campbell & Cartwright 2002, p. 116-117.

the bank and the bank's directors and creditors,[231] and it was entitled to be heard in the insolvency procedure.[232]

Especially administration under the IA 1986 seemed to be a favored procedure to resolve a failing bank.[233] Until 1989, banks were excluded from this procedure.[234] Since then several banks have been made subject to it, including Chancery in 1991 and Barings in 1995.[235] At that time, section 8 IA 1986 provided that the court appointed an administrator to take control of the bank with a particular purpose. The purpose was to (1) facilitate the survival of the bank as a going concern, (2) allow the negotiation and approval of a voluntary arrangement or compromise between the bank and its creditors, or (3) ensure a more advantageous realization of the bank's assets than in a winding up.[236] When the administration order was presented to the court, a moratorium came into effect.[237] In respect of Chancery and Barings, the administration procedure was considered successful.[238] It has been argued that the procedure especially proved its worth in these two cases because the court was willing to act quickly and in relative secrecy.[239] In the Chancery case, for example, the court issued the administration order only two hours after the petition was filed.[240]

231 *Cf.* e.g., sections 9(1) (application for administration order made by the company, directors, or creditors) and 124(1) (application for winding up by the court made by the company, directors, or creditors) IA 1986.
232 *Cf.* e.g., sections 359 (petition for administration order), 362 (entitled to be heard, attend meetings, and receive information during administration), 367 (petition for winding up by the court), 371 (entitled to be heard, attend meetings, and receive information during the winding up procedure) FSMA 2000. *See* Hadjiemannuil 2004, p. 293.
233 Hüpkes 2000, p. 74. Campbell & Cartwright 2002, p. 123 and Hüpkes 2000, p. 75-76 discuss why administrative receivership under the IA 1986 was not of relevance to insolvent banks. In 1983, the BoE published the Bank of English Notice to Recognized and Licensed Deposit Takers, stating that banks should not grant floating charges over their assets. As a result, banks did not normally give floating security and the administrative receivership was not available to them. According to Campbell & Cartwright 2002, p. 123, outside administration the company voluntary arrangement (CVA) under the IA 1986 was also unlikely to be relevant to a failing bank because of the lack of a moratorium on actions of creditors.
234 The Banks (Administration Proceedings) Order 1989/1276 extended the availability of administration under the IA 1986 to banks. *See* Hogan 1996, p. 90; Campbell & Cartwright 2002, p. 124-125.
235 *See* Campbell & Cartwright 2002, p. 139-143; Hogan 1996.
236 Section 8(1) and (3) IA 1986. Since the entry into force of the Enterprise Act 2002, schedule B1 to the IA 1986 provides for the relevant sections on administration. Paragraph 3 of Schedule B1 now stipulates the purpose of administration, which is discussed in paragraph 4.2.3 of chapter 6 of the present study. For a discussion of the purposes of administration under the 'old' regime and the revised regime since the Enterprise Act 2002, *see* Goode 2011, para. 11.25.
237 *See* Campbell & Cartwright 2002, p. 134-135.
238 Campbell & Cartwright 2002, p. 139-143; Hogan 1996.
239 Campbell & Cartwright 2002, p. 145-146; Hüpkes 2000, p. 76-77.
240 Campbell & Cartwright 2002, p. 140 and 145; Hüpkes 2000, p. 76.

4.1.3 Pre-crisis bank supervisory and insolvency framework in practice

In September 2007, the UK experienced its first bank run since the run on the City of Glasgow Bank in 1878 and its first large banking crisis since the collapse of Barings in 1995.[241] The announcement that Northern Rock needed emergency liquidity assistance from the BoE, along with concerns that the deposit guarantee scheme did not offer small depositors full protection,[242] triggered a public panic.[243] Northern Rock was the fifth biggest mortgage bank in the UK but was not considered systemically important and did not have significant international operations.[244] It raised money directly in the short-term wholesale markets and had also securitized a large part of its loan portfolio.[245] The bank ran into trouble when the institutional, short-term investors in the whole-sale market where not willing to roll over their credit lines.[246] The authorities judged that the case of Northern Rock posed a significant threat to the confidence in the banking sector as a whole.[247] The bank run was brought to a halt when the UK government announced that it guaranteed all existing deposits at Northern Rock.[248] This measure did not solve the problems at the bank itself. Private solutions, such as the sale of Northern Rock to another bank, were considered inadequate.[249] About five months after the bank run, emergency legislation, i.e., the Banking (Special Provisions) Act 2008, enabled the UK Treasury to bring Northern Rock into public ownership by a share transfer.[250] In the meantime, the Parliamentary inquiry into the Northern Rock case had stressed above all the need for a special bank resolution framework.[251]

241 Campbell 2011, p. 39-40.

242 At that time, the UK deposit guarantee scheme covered 100 percent of the first GBP 2,000 and 90 percent of the next GBP 33,000. Moreover, it was unclear how long depositors would have to wait to receive payments. *See* Randell 2012, p. 106; Singh & LaBrosse 2010, p. 73-79; House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 87-103 (noting at p. 94 that reimbursement 'could take months, maybe years').

243 Randell 2012, p. 106; Campbell & Lastra 2009, p. 476; Lastra 2008, p. 166.

244 Final report of the High-level expert group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen (Liikanen Report), October 2012, p. 59; Campbell & Lastra 2009, p. 474; Lastra 2008, p. 166.

245 Campbell & Lastra 2009, p. 474. *See also* House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 10-14.

246 Final report of the High-level expert group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen (Liikanen Report), October 2012, p. 59.

247 Randell 2012, p. 106.

248 Singh & LaBrosse 2010, p. 69; Campbell & Lastra 2009, p. 477; Lastra 2008, p. 166. *See also* House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 125-126.

249 *See* Mitchell 2017, p. 109-112.

250 Randell 2012, p. 107; Campbell 2011, p. 40; Lastra 2008, p. 167.

251 House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 81-83. *See* Avgouleas 2009, p. 202.

The UK government subsequently also used its powers under Banking (Special Provisions) Act 2008 to take all shares issued by Bradford & Bingley into public ownership and transfer the deposit business of Kaupthing Singer & Friedlander and Heritable Bank to another bank.[252] These banks were all relatively small institutions. Furthermore, from October 2008 it provided capital injections to the much bigger institutions Royal Bank of Scotland, Lloyds, and Halifax Bank of Scotland, and it launched other liquidity and capital support measures for the banking sector in general.[253]

The Northern Rock case and subsequent cases of other banks in severe distress gave rise to the question whether the available corporate insolvency procedures were appropriate to deal with bank failures. Although, as noted above, administration was considered successful in relation to Chancery in 1991 and Barings in 1995, this procedure was not used for Northern Rock.[254] Campbell has argued that Northern Rock was nationalized for political reasons and that administration was an appropriate procedure for Northern Rock if action had been taken quickly.[255] However, since the bank failures during the latest financial crisis, most UK policymakers and scholars seem to recognize the importance of an administrative-based resolution framework for banks.[256] In contrast to the failures in the early 1990s, the debacles in 2007 and 2008 threatened the system as a whole.[257] It has been argued that a major obstacle in the Northern Rock case was that the authorities did not have the power to take over the control of the bank from its shareholders and management at an early stage.[258] Furthermore, it is submitted that if Northern Rock had entered administration instead of nationalization, the moratorium imposed in the procedure would have caused significant panic amongst depositors and in the markets.[259]

252 *See* Singh et al 2016, para. 6.05-6.09. *See also* Mitchell 2017, p. 113-116; Randell 2012, p. 107.

253 Randell 2012, p. 107; Singh 2011, p. 907-916. *See also* Mitchell 2017, p. 116-139; Petrovic & Tutsch 2009, p. 79-85; House of Commons Treasury Committee, Banking Crisis: dealing with the failure of the UK banks, Seventh Report of Session 2008-09, 1 May 2009, p. 45-72.

254 *See* Campbell 2011, p. 40-41.

255 Campbell 2011, p. 41-42. *See also* Mitchell 2017, p. 111-115, discussing that the UK Conservatives favored administration rather than nationalization of both Northern Rock and Bradford & Bingley.

256 *See* e.g., Goodhart 2018, p. 169; Singh 2010, p. 4-5; Brierley 2009, p. 4-5; Lastra 2008, p. 167-168 and *see* House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 73-86.

257 *See* Mitchell 2017, p. 137.

258 Singh 2010, p. 5; Brierley 2009, p. 4-5; House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 82.

259 Singh 2010, p. 4-5; House of Commons Treasury Committee, The Run on the Rock, Fifth Report of Session 2007-08, Volume I, January 2008, p. 81-83. *See also* Mitchell 2017, p. 110-111 and 114.

4.2 National bank resolution framework 2009-2014

In February 2009, the BA 2009 entered into force to replace the Banking (Special Provisions) Act 2008 and establish a more permanent framework.[260] The Act provided for three stabilization options in its Special Resolution Regime (SRR), namely the transfer of shares or property to a private sector purchaser, the transfer of all or a part of the business of the failing bank to a bridge bank, and temporary public ownership.[261] Moreover, the BA 2009 introduced a bank insolvency procedure and a bank administration procedure.[262] Thus, for the first time, the UK had a bank-specific insolvency framework.[263]

The BA 2009 defined the purpose of the SRR for banks as 'to address the situation where all or a part of the business of a bank has encountered, or is likely to encounter, financial difficulties.'[264] Hence, it allowed intervention at an early stage if financial distress rather than only when the bank had crossed the insolvency threshold.[265] The BoE became the resolution authority that was empowered to make the transfers to a private sector purchaser or a bridge bank without court involvement. This authority has been considered a major shift from the existing, court-supervised corporate insolvency procedures.[266]

The FSA and Treasury were also provided with an important role in bank resolution. Similar to the role of a competent supervisory authority in a resolution procedure under the BRRD, the FSA as supervisor determined whether the bank had to be considered 'failing or likely to fail' the threshold conditions to carry on its banking business under the FSMA 2000.[267] The second trigger for the use of the stabilization options under the BA 2009 was that the FSA was satisfied that it was not reasonably likely that action would be taken that allowed the bank to satisfy these threshold conditions.

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260 The Banking Act 2009 was accompanied by the Code of Practice of the Treasury (HM Treasury, Banking Act 2009 Special Resolution Regime: Code of Practice) and several statutory instruments, including the Banking Act (Bank administration) (Modification for Application to Banks in Temporary Public Ownership) Regulations 2009, the Bank Administration (Sharing Information) Regulations 2009, and the Banking Act 2009 (Third Party Compensation Arrangement for Partial Property Transfers) Regulations.

261 Sections 11-13 BA 2009.

262 Part II and Part III BA 2009.

263 *See* Campbell 2011, p. 42.

264 Section 1(1) Banking Act.

265 *See* Campbell 2011, p. 43, who notes that such a timely intervention was not completely new since paragraph 11 of Schedule 1B to the IA 1986 provides that the court may make an administration order in relation to a company if it is satisfied that the company is or is likely to become unable to pay its debts. *Cf*. footnote 524 and the resolution conditions in section 7 BA 2009.

266 Campbell 2011, p. 43.

267 Section 41 FSMA 2000.

The BoE and the Treasury were then competent to decide whether the third condition for the use of the private sector purchaser or bridge bank tool was met, namely, in short, whether such use was justified in the public interest.[268] Only the Treasury was authorized to exercise the third stabilization option, i.e., the transfer of the bank into temporary public ownership, which option is discussed below in paragraph 4.3.[269]

As indicated above, in addition to the SRR in Part 1, the BA 2009 provided for the bank insolvency procedure in its Part 2 and bank administration procedure in Part 3. The focus of the UK government following the Northern Rock case initially only was on the establishment of the SRR. The development of a special bank insolvency and administration procedure was only considered later on in the legislative process.[270] Both the bank insolvency procedure and administration procedure built on the insolvency procedures available under the IA 1986, with some modifications. The bank insolvency procedure was argued to be the preferred option for a failing bank, 'unless the public interest considerations weigh in favour of an exercise of a stabilisation option.'[271] Both procedures continued to exist after the implementation of the BRRD into the BA 2009 and are further examined in chapter 6.[272]

In March 2009, the BoE made its first use of the SRR. It transferred Dunfermline Building Society's retail and wholesale deposits, branches, head office, and mortgages to private sector purchaser Nationwide Building Society. The social housing mortgage portfolio and associated deposits were transferred to a temporary bridge bank, and the residual entity went into bank administration under the BA 2009. The BoE took its decision following a significant deterioration of the financial position of the bank.[273] Furthermore, the bank insolvency procedure has been applied as well, namely to Southsea Mortgage and Investment Company Limited in 2011.[274]

Although it has been argued that the procedures under the BA 2009 worked well in these two cases,[275] the cases also highlighted some possible challenges in bank resolution.[276] For example, following the splitting up of the balance sheet between the three different legal entities in the Dunfermline

268 Section 8 BA 2009.
269 Sections 9 and 13 BA 2009.
270 *See* Singh et al. 2016, para. 7.03-7.08.
271 Section 5.19 Banking Act 2009 special resolution regime code of practice, November 2010. *See also* Brierley 2009, p. 8.
272 Paragraph 5.3 of chapter 6.
273 Bank of England, Dunfermline Building Society, News release 30 March 2009, available at http://www.bankofengland.co.uk/archive/Documents/historicpubs/news/2009/030.pdf. *See also* Schillig 2016, p. 259-260; Singh 2009, p. 21-23; Campbell 2011, p. 46-47.
274 *See* Verrill & Durban 2015, p. 538.
275 Campbell 2011, p. 46-47; Carter 2012, p. 150.
276 *See* Davies & Dobler 2011, p. 220-221.

case, an audit identified that the definition of 'commercial loans' in the transfer documentation had unintentionally allowed a transfer of some additional commercial loans to the purchaser. These loans were not part of the agreed sale, and the bank administrator had managed them, assuming that they had not been transferred. The Treasury then solved the issue by using its power under section 75 BA 2009 to amend the definition of 'commercial loans' in the transfer documentation with retrospective effect. Thus, this case showed that splitting the business of a bank may be complicated in a resolution procedure.[277]

The Financial Services Act 2012 (FSA 2012) and the Financial Services (Banking Reform) Act 2013 (FSA 2013) amended the BA 2009. The FSA 2012 provided that two new financial supervisory authorities, i.e., the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA), replaced the FSA. The PRA at the BoE became responsible for the prudential regulation and supervision of many financial institutions, including banks, and the FCA for the conduct of business regulation and supervision and for the prudential regulation and supervision of non-PRA regulated institutions, such as smaller investment firms.[278] Accordingly, under the new supervisory framework, the PRA became responsible for the assessment of whether the first two conditions for the use of the stabilization options for a bank under the BA 2009 were satisfied.[279] In anticipation of the entry into force of the BRRD, the FSA 2013 amended the BA 2009 to include a bail-in tool in the SRR. However, the tool did not come into effect before the transposition of the BRRD into UK law.[280]

4.3 UK implementation of the EU bank resolution framework

The BRRD was implemented into UK law by way of amendments to, inter alia, the BA 2009, FSMA 2000 and the PRA Rulebook and FCA Handbook. Since the EU legislature based the BRRD to a large extent on the BA 2009, incorporation of the EU bank resolution framework into UK law did not require major changes to the national bank resolution regime.[281] For example, the BRRD provides for a public interest test for the application of the resolution tools, a set of statutory resolution objectives, and safeguards for the involved creditors that are similar to those included in the original

277 Davies & Dobler 2011, p. 220-221.
278 Schillig 2016, p. 151.
279 Section 7 BA 2009.
280 *See* HM Treasury, Transposition of the Bank Recovery and Resolution Directive, July 2014, para. 11.1-11.3. The Independent Commission on Banking suggested in 2011 that the SRR of the BA 2009 should be supported by a bail-in tool. *See* Independent Commission on Banking, Final Report: Recommendations, September 2011, para. 4.62-4.87.
281 *See* Brierley 2017, p. 460-461.

BA 2009.[282] The asset separation tool, however, was not present in the latter Act,[283] although the BA 2009 allowed a transfer of the 'bad assets' of the bank under resolution to a bridge bank.[284]

Under the amended BA 2009, the BoE continues to be the designated resolution authority. As initially provided for under the BA 2009, the Treasury also has a resolution tool at its disposal. It – rather than the BoE – may exercise the power to temporarily take a bank into public ownership by transferring shares or other securities in a bank to a nominee of the Treasury or a company owned by the Treasury under sections 9 and 13 BA 2009. These sections of the BA 2009 now incorporate article 58 BRRD on the temporary public ownership tool. The condition for the use of this power is, in addition to the general resolution conditions, that it is necessary to (a) resolve or reduce a serious threat to the stability of the UK financial system, or (b) protect the public interest, where the Treasury has provided financial assistance to the bank to resolve or reduce a serious threat to the stability of the UK financial system, or the BoE has provided public financial support.[285] Thus, this measure is clearly considered the *ultimum remedium*.[286] Also, the Treasury may only take it if least 8 percent of the liabilities of the bank have been bailed-in.[287] The Dutch and German legislatures have not implemented article 58 BRRD into Dutch and German law, respectively, because the SRM Regulation does not provide for this temporary public ownership tool.[288] Since the UK is not an SRM participating Member State, it has transposed the BRRD into UK law but does not apply the SRM Regulation.

5 Conclusions

This chapter showed that over the years, banks have acquired a more special position within Dutch, German, and UK law. The establishment of bank resolution frameworks in the Netherlands, Germany, and the UK in recent years must be seen in the context of the historical trend towards further

282 Brierley 2017, p. 460-461. For a comparison between the SRR under the original BA 2009 and the resolution framework created by the BRRD, *see* Schillig 2014.

283 *See* HM Treasury, Transposition of the Bank Recovery and Resolution Directive, July 2014, para. 10.1.

284 Banking Act 2009 special resolution regime code of practice, November 2010, para. 8.6. *See* Schillig 2014, p. 87.

285 Section 9 BA 2009.

286 *Cf.* Sections 6.43 and 6.51-6.54 Banking Act 2009 special resolution regime code of practice, March 2017.

287 Section 6.53 Banking Act 2009 special resolution regime code of practice, March 2017. *Cf.* Articles 37(10 and 56(1) BRRD.

288 *Cf.* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 51; Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014, p. 206.

expanding bank-specific supervisory and insolvency frameworks as a reaction to bank insolvencies. Various bank failures in the three jurisdictions have acted as catalysts for amendments to the national bank supervisory and insolvency frameworks. These include not only the failures of the latest financial crisis but also the collapse of Teixeira de Mattos in 1966 and Herstatt Bank in 1974 and the failures during the UK secondary banking crisis in 1973-1975.

National, formal prudential supervisory frameworks were created first in the Netherlands, Germany, and England, although in different periods. The Dutch and German supervisory authorities have run a more formal regime since the first half of the twentieth century, whereas in the UK the developments during the secondary banking crisis of the 1970s only gave rise to the first Banking Act. Following the establishment of the formal supervisory frameworks, some special rules for bank insolvencies were adopted, such as the rule that the supervisory authority may file the petition addressed to the court for the initiation of an insolvency procedure. Moreover, the Dutch legislature introduced the emergency procedure as a bank-specific suspension of payments procedure in 1978 and the German bank supervisory authority was assigned a moratorium power in 1976. In the UK, bank insolvencies were dealt with under the general insolvency provisions until 2008.

4 National and supranational coherence

1 Introduction

The implementation of an EU directive into national law is usually associated with some sort of alignment of the EU legislation with existing national legislation.[1] We associate harmonization of laws through a directive typically with the bringing together of the laws of the EU Member States and a process in which elements are combined to make it a coherent whole.[2] At the same time, it is an accepted view that EU secondary legislation often contains detailed rules and terminology that are difficult to integrate into the national law.[3] Moreover, since the rules stemming from an EU directive or regulation interface with diverse areas of national law and national legal cultural diversity, the entry into force of the EU legislation does not necessarily result in full convergence of the areas of national law that are affected by the EU legislation.[4]

The present study aims to test how the bank resolution frameworks relates to private law at the national level. Chapters 5 and 6 will, therefore, analyze several important relations between the bank resolution rules, principles, and objectives, and the rules, principles, and objectives of domestic private law that are directly affected by or closely related to the bank resolution frameworks. The emphasis is on the relationship with national substantive insolvency law. Furthermore, since the SRM Regulation mainly creates an institutional framework and all resolution decisions in the EU are implemented under national law transposing the BRRD, the present study focuses on the national rules stemming from the BRRD rather than on the SRM Regulation.

This chapter makes explicit which benchmarks are used in the book to assess the relations. More specifically, the chapter defines two notions of coherence, namely national coherence and supranational coherence, to

1 *Cf*. e.g., HM Government, 'Transposition guidance: how to implement EU Directives into UK law effectively', February 2018, para. 2.19-2.20, which discusses the question of '[h]ow do I bring EU legislation into harmony with existing UK law?' and that one should '[t]hink about the best way to implement so that there is no overlap or contradiction with existing legislation.'

2 Wessels & Fletcher 2012, p. 22-23; Van Gerven 2006, p. 65; Boodman 1991, p. 702.

3 *See* Smits 2012, p. 14-15.

4 *See* Havu 2012, p. 26-29.

examine the relations at the national levels. On that basis, it can be explored how the EU legislation has been aligned with national law and which possible differences may arise in bank resolution procedures across jurisdictions. Thus, the chapter does not advocate the ideal of coherence in a national legal system or at the EU level as a whole. The goal of the sections below is also not to improve the general legal coherence theory in the literature. The notions of coherence are rather defined to analyze the bank resolution frameworks.

In practice, the coherence standards may not always prevail over other considerations when determining policy actions in the field of bank resolution. For instance, the national legislatures may have to weigh the coherence concerns against other considerations, such as the optimal realization of certain policy goals and objectives, to determine how the bank resolution frameworks should develop. Furthermore, the EU secondary legislation typically requires specific changes in the law that are considered economically or socially desirable without taking into account the coherence with existing national law of the new rules stemming from EU law.[5] Also, the law is not politically neutral and only technical, and in some cases, legislatures and judges make decisions that are influenced by external factors and are not solely based on the law in the books.[6] Research shows, for example, that, in practice, courts are sometimes reluctant to apply EU law because of their national legal traditions.[7]

Nevertheless, as already indicated in chapter 2,[8] one of the goals of the EU bank resolution framework is that market participants price bank capital and debt instruments based on the actual default probability rather than the expected government subsidy. Accordingly, the framework should enable these participants to get an accurate picture of their possible position and losses in a bank failure.[9] We, therefore, might expect both the EU and national legislatures to seek to create clear bank resolution frameworks that contribute to clarity of rights of parties and predictability of the interpretation and application of the law. Coherence considerations in the further development of the bank resolution frameworks may help to avoid uncertainties about the bank resolution rules. Furthermore, the BRRD also seeks to establish a harmonized bank resolution framework and the SRM Regulation to enhance uniform application of the bank resolution rules.

5 *See* Hesselink 2001, p. 40.

6 As particularly advocated by the Critical Legal Studies movement. *See* generally e.g., Kennedy 1976. On European private law, *see* e.g., Kennedy 2002; Hesselink 2002a; Hesselink 2002b.

7 Caruso 1997, p. 21-22 and 26-27.

8 Paragraphs 2.2.2, 2.2.3 and 3.2.1 of chapter 2.

9 Tröger 2018, p. 36-37 and 41-42; Paterson 2017, p. 619-621.

Accordingly, we may also expect the EU legislature to at least consider how supranational coherence in the application and interpretation of bank resolution rules can be enhanced in the development of the EU bank resolution framework.

Paragraph 2 of this chapter further discusses why clarity of and consistency in the bank resolution frameworks are essential. Paragraph 3 then sets out a scheme developed in the literature to analyze how a national legal order evolves and concludes that the development of EU law differs in comparison with the national legal orders. Also, it explores what according to the literature in the investigated jurisdictions are the implications of the entry into force of EU secondary legislation for the national legal orders. Paragraphs 4 and 5 then explore the notions of national coherence and supranational coherence.

2 Call for clarity and consistency in the bank resolution frameworks

In a short story that has the heading 'Eight Ways to Fail to Make Law', Fuller tells about Rex, a king who tried to create and maintain a system of legal rules in his country but did not succeed. In one of his attempts, for instance, Rex made a code that was 'truly a masterpiece of obscurity.' Both his legal experts and other citizens did not understand a single sentence. Rex then asked his staff to clarify the code. Unfortunately, the next version was full of inconsistencies: 'there was not a single provision in the code that was not nullified by another provision inconsistent with it.' After a few other unsuccessful attempts, the king decided to act as the only judge in the country. However, he was unable to ensure congruence between his decisions and the existing law. The first act of the successor of Rex thereupon was to take the powers of government away from the lawyers in the hope that his subjects would be happy without laws.[10] According to Fuller, his tale illustrates that there are 'eight kinds of legal excellence toward which a system of rules might strive',[11] which include the requirements to create clarity of laws and to avoid contradictions such as logical inconsistencies in the law.[12]

10 Fuller 1964, p. 33-38.
11 Fuller 1964, p. 41.
12 Fuller 1964, p. 65-70. The other requirements are: generality, public promulgation, no retroactivity, laws should not require impossible results, constancy trough time, and congruence between laws as they are announced and applied. *See* Fuller 1964, p. 46-91.

The legislatures of the EU Member States do not have an easier job than the king in the story of Fuller. National law has been more and more governed by EU legislation that deals with very specific topics and objectives and contains rules and terminology that are entirely different from that in the existing national legislation. The national legislatures are charged with the difficult task of implementing the rules of directives into their domestic laws and aligning their national laws with regulations. In addition to the legislatures and courts at the national and EU level, actors such as EU agencies have been increasingly involved in the development of EU law by drafting guidelines and other regulatory products. Hence, multiple actors and sources have become involved in the making of legal norms.[13]

The EU bank resolution framework provides an excellent example of the complexity of EU law. The previous chapters considered and the following chapters will illustrate that the framework provides for rules, principles, and objectives and contains terminology that deviate from that in existing national private law. At the same time, these rules, principles, and objectives have to be interpreted and applied in a way that is consistent with domestic private law, and vice versa. Chapter 1 already indicated that the European Commission noted in this context in its Impact Assessment accompanying the proposal for the BRRD that

> '[b]ecause the crisis management tools and powers are used at the point when an institution is failing or has failed, they inevitably interact with national insolvency regimes. Substantive insolvency law is not harmonised, and the measures proposed in the bank resolution framework need to be implemented in a way that is consistent with that national law. Furthermore, the application of the tools and exercise of the powers will almost certainly affect contractual and property rights, that are also rooted in national law.'[14]

The literature has already advocated alignment of bank resolution rules with existing rules of insolvency law. Lubben, for example, employed the idea of consistency of the resolution rules with more general insolvency law to argue that the bank resolution rules provided by the US Dodd-Frank Act should be harmonized with the US Bankruptcy Code. He argues, amongst other things, that to ensure that the result of financial distress is clear and

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13 For an analysis of the development of European private law by multiple state actors *see* Van Schagen 2016.

14 Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 79.

predictable, the consequences of rejecting an executory contract should be comparable in the procedures under both acts.[15]

The present study maintains that in the EU there is a need to adequately incorporate the bank resolution framework into the existing body of national law. The better aligned the bank resolution framework and national private law are, the more predictable the results of bank resolution procedures become.[16] Furthermore, potential differences in the interpretation and application of the regime across the Member States have to be considered in the further development of the EU bank resolution framework. In this way, the bank resolution frameworks in the EU can produce consistent outcomes.

Why are clarity and consistency in the EU bank resolution framework so important? Clarity of the bank resolution rules and confidence of market participants in these rules, including of banks, creditors, and shareholders, are considered necessary preconditions for the EU bank resolution framework to reach its underlying policy goal of strengthening market discipline.[17]

As discussed in chapter 2,[18] averting the moral hazard problems arising from the expected injection of public funds in banks should they ultimately run into trouble is one of the main pillars of the EU bank resolution framework. To restore market discipline and, thus, ensure that the costs of bank capital are sensitive to actual risks rather than implicit government guarantees, the resolution rules require the shareholders and creditors of a failing bank to absorb the losses and risks in resolution as an alternative to a government-funded rescue.[19]

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15 Lubben 2011, p. 1262 and 1276-1277. On the treatment of executory contracts under the Dodd-Frank Act, *see* Baird & Morrison 2011, p. 302. *See also* Lubben 2012, p. 204-205: 'In an ideal world, the treatment of derivatives under the Bankruptcy Code, the Securities Investor Protection Act, the OLA [Title II of Dodd-Frank, LJ], and other insolvency statutes would be entirely reconsidered, and these various insolvency systems would be further integrated. [...] regardless of the type of debtor, it seems that if financial institutions are allowed twenty-four hours to save their financial contracts, real economy companies should also have this option. Moreover, if financial institutions are to ever use Chapter 11 as their resolution tool, such a change is quite obviously necessary.'

16 *Cf.* Kirshner 2015, p. 832; Lubben 2012, p. 197; Lubben 2011, p. 1262.

17 Tröger 2018, p. 37 and 45-46; Cappiello 2015, p. 433-434. *Cf.* Article 31(2)(b) BRRD.

18 Paragraphs 2.2.2, 2.2.3 and 3.2.1 of chapter 2.

19 *See* Tröger 2018, p. 36 & 40. *See also* Avgouleas & Goodhart 2015, p. 3-5; Zhou et al. 2012, p. 20.

The prevailing view in the literature is, however, that market participants can only price the bank capital based on the actual default probability if they know what to expect.[20] Hence, they need to be able to predict to a certain extent the chances of a start and the outcome of a resolution procedure, such as their potential losses in bail-in.[21] While it is an accepted view that discretionary application of the resolution tools and powers is essential to allow authorities to determine on a case-by-case basis which measures are necessary, it is also believed that the discretionary elements in the bank resolution framework have to be limited.[22] In particular, the literature argues that the uncertainty created by the discretionary use of the framework has to be limited by making the bank resolution procedure as clear and predictable as possible.[23] This condition requires that the bank resolution criteria and procedures are clearly specified in legislation.[24] Clarity and predictability in cross-border bank resolution procedures have been argued to benefit in many cases from greater a convergence of national bank resolution frameworks.[25]

3 Existence and structure of a national and the EU legal order

3.1 Multi-layered conception of national law

Before we can explore in more detail what the literature has considered the implications of the entry into force of EU secondary legislation for the Dutch, German, and English legal orders, including for their clarity and consistency, we first have to determine how a national legal order evolves and how this evolvement differs from the development of EU law.

The theoretical starting point of this analysis of a national legal order is the 'multi-layered conception' of the law developed by Tuori. According to this approach, which builds on the tradition of legal positivism,[26] national law consists of three layers.[27] The first level is the visible surface level, which contains, for example, statutes and other regulations, court decisions in individual cases, and publications by legal scholars.[28] It is traditionally

20 Tröger 2018, p. 36-37 and 45-46; Allen et al. 2015, p. 44.
21 Tröger 2018, p. 37. *See also* Krahnen & Morretti 2015, p. 136-142.
22 Tröger 2018, p. 37 and 46; Zhou et al. 2012, p. 10-11. *Cf.* Goodhart & Schoenmaker 2009, p. 160, who 'propose full transparency on crisis-management arrangements (the "how" question) but constructive ambiguity on the application of these arrangements (the "whether" question).'
23 Zhou et al. 2012, p. 11.
24 Tröger 2018, p. 46. *See also* Sjöberg 2014, p. 194-197.
25 Krimminger 2011, para. 11.85 & 11.89.
26 *See* Tuori 2002, p. 5-8.
27 Tuori 2002, p. 147-196; Tuori 1999, p. 403-412. The ideas of Tuori show some similarity with the concept of a national legal system as multi-level framework discussed by Bussani 2000.
28 Tuori 2002, p. 154-155; Tuori 1999, p. 403-404.

analyzed within the borders of each jurisdiction.[29] The layer is subject to continuous change due to the debate to which, depending on the legal culture, the legislature, judges, and academics contribute.[30]

In addition to this top level, the law has two deeper layers, which are the legal culture and the deep structure. The legal culture is more stable than the first level and has been shaped over time. Although it forms a whole, according to Tuori, it has methodical, conceptual and normative elements.[31] The methodical side, which is also called 'juridical logic', includes the prevailing doctrine of the sources of law and the hierarchy of these sources. It also consists of standards to solve inconsistencies between rules and methods of interpretation of legal norms, such as interpretation by analogy or teleological interpretation.[32] The general doctrines of different areas of law form the conceptual and normative elements of the legal culture. Examples are legal concepts such as 'contract' in private law and 'intent' in criminal law, and general legal principles, such as 'pacta sunt servanda', 'nulla poena sine lege' and 'proportionally'.[33]

Finally, Tuori calls the third and most stable layer of the law the 'deep structure' or 'common core'.[34] It represents what several legal cultures, such as the Roman Germanic and Anglo-Saxon legal cultures, have in common, despite mutual differences at the other two levels. Thus, the level has a wider geographical scope than the other layers of the law.[35] Examples of the components of this level are basic legal concepts and fundamental principles, including human rights.[36]

Although we can distinguish between the surface level, legal culture and deep structure, in practice the layers are closely connected. For example, a judge does not reach his decision in court based on only the materials that are available at the surface level but also applies legal concepts and principles of the two other layers of the law.[37] Furthermore, lawmaking and court decisions produce immediate outcomes in surface level materials but may also leave traces in the legal culture and deep structure.[38] Also, the deeper layers create preconditions for and restrictions on the development of the surface level. To take an example, the legal doctrines of the legal culture

29 Tuori 2002, p. 185.
30 Tuori 2002, p. 155; Tuori 1999, p. 403-404.
31 The literature uses the term 'legal culture' in a variety of ways. For a brief discussion of the concept of legal culture, *see* Nelken 2012.
32 Tuori 2002, 166-168 and 192.
33 Tuori 2002, p. 174-179.
34 Tuori 2002, p. 183-184; Tuori 1999, 405.
35 Tuori 2002, 194.
36 Tuori 2002, p. 183-192.
37 Tuori 1999, p. 408.
38 Tuori 1999, p. 407.

may link and justify decisions in similar court cases, which is conducive to legal predictability.[39]

If we apply this scheme to EU law, the picture becomes very different. Because EU secondary legislation made by the EU institutions often only deals with specific topics, it has a fragmentary character.[40] Moreover, the expansion of EU law, including the directives and regulations and decisions of the Court of Justice of the European Union (CJEU), mainly takes place on a surface level. The CJEU has emphasized that the EU created 'a new legal order of international law' that 'on the entry into force of the Treaty, became an integral part of the legal systems of the Member States'.[41] The case law of the CJEU and EU legislation also provide for general legal principles, such as the principle of proportionality.[42] Nevertheless, the primary and secondary legislation of the EU lacks fully developed deeper levels. It is dependent on its continuous interactions with the national legal orders and is intertwined with the diverse legal cultures of the Member States.[43] This point is illustrated by the fact that, although national courts are required to interpret national law, where possible, in conformity with EU law,[44] legal scholars expect the courts to also interpret and apply the rules of EU law through the lens of existing national legislation and their national legal cultures.[45] Van Dam, for example, notes that:

> 'European rules provide the body but the national courts have to provide them with a soul in the spirit of Community law. This process will often be influenced along the lines of national legal concepts, language, political, socio-economic and cultural backgrounds. This is particularly the case if the rule provides for general concepts rather than precise technical rules.'[46]

Thus, the reliance on the existing surface level and deeper levels of national law affect the way in which EU law is understood and applied.[47]

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39 Tuori 1999, p. 409-410.

40 Wilhelmsson 1999, p. 444 notes that EU law is 'scattered'. According to Roth 2002, p. 762 EU law has a 'pointillist' character: it is 'patchy, piece-meal legislation that does not end up with a balanced, well-drawn picture when you look at it from not too close.'

41 Case 6/64 *Costa v ENEL* [1964] ECR 585; Case 26/62, *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1, para. 12

42 Tuori 1999, p. 413. For a discussion of general principles of EU law, *see* Hartkamp 2012, para. 105-151.

43 Wilhelmsson 2002, p. 80-81; Tuori 1999, p. 412-413; Wilhelmsson 1999, p. 439. *See also* Walker 2015, p. 23-26, who analyzes the debate on the systemic character of EU law.

44 *See* Hartkamp 2012, para. 100.

45 Havu 2012, p. 29; Wilhelmsson 2002, p. 81; Tuori 1999, p. 413.

46 Van Dam 2007, p. 72.

47 Havu 2012, p. 28; Wilhelmsson 2002, p. 81; Wilhelmsson 1999, p. 449; Tuori 1999, p. 412-413. *See also* Künnecke 2008, showing that German and English courts have diverging approaches to the Europeanisation of tort law rules. Teubner 1998, p. 17-19, however, argues that some rules have closer ties to the national legal culture and social discourse than other rules.

3.2 Impact of EU law on the national legal orders

The English, Dutch, and German literature have extensively discussed what is the effect of EU secondary legislation, particularly of directives, on the national legal orders.

In the legal tradition of the European continental lawyers, including the Dutch and German lawyers, national law, or at least private law, forms an integrated system of rules and principles.[48] According to Bloembergen and Canaris, unity ('*eenheid*', '*Einheit*') and consistency ('*samenhang*', '*Folgerichtigkeit*') are characteristics of such a system.[49] This systemization is regarded to contribute to clarity and legal certainty, for instance because court cases can be dealt with in a systemic, logical manner.[50] Given this emphasizes on systemization, it is not surprising that inconsistencies in the law are perceived to threaten the coherence in the legal order.[51] In particular, in the debate on the EU integration of the law, the Dutch and German literature has very much focused on the fragmentation of their legal systems caused by EU legislative actions.[52] Since EU secondary legislation only deals with specific topics and objectives as a result of the limited competences of the EU legislature, such as with the removal of internal market impediments, it is considered to cause a part of national law to fall apart. It creates one part affected by EU law and one part only governed by national law.[53]

Hesselink clarifies the point that EU law has created 'frictions'[54] in the national legal systems with an example from Dutch law.[55] The Burgerlijk Wetboek (BW) traditionally distinguishes between the legal concepts 'nullity' (*nietigheid*) and 'annullability' (*vernietigbaarheid*). The Dutch legislature implemented article 6 Unfair Terms in Consumer Contract Directive[56]

48 *See e.g.* Caruso 1997, p. 5-6. *Cf.* Friedmann 1967, p. 16, who notes that a legal system constitutes 'a structure in which the different organs, participants, and substantive prescriptions of the legal order react upon each order' and it is 'essentially the corollary to the increasing complexity of modern society, in which millions of individuals depend on the functioning of a complicated network of legal rules of many different types, and the interplay of public authorities of many different levels.'

49 Canaris 1983, p. 11-12; Bloembergen 1977, p. 2-3. *See also* Bloembergen 1992, p. 316-317.

50 Loos 2007, p. 516. *See also* Bloembergen 1977, p. 325-326.

51 Loos 2007, p. 516.

52 E.g., Smits 2012; Roth 2002.

53 Van Gerven 2006, p. 66. *See also* Wissink 1999, p. 4-5.

54 Hesselink 2001, p. 41.

55 Hesselink 2004, p. 406 and 410-412.

56 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ L 95, 21.4.1993, p. 29-34). Article 6 of this directive provides that 'Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.'

(which provides, in short, that unfair terms used in a consumer contract shall not be binding on the consumer) in section 6:233 BW, a general provision on standard terms in contracts. Similar to other contracts, the clause in a contract with a consumer was valid unless the consumer or the court at the request of the consumer, annulled it.[57] The CJEU, however, then held that:

> '[t]he protection which the Directive confers on consumers [...] extends to cases in which a consumer who has concluded with a seller or supplier a contract containing an unfair term fails to raise the unfair nature of the term, whether because he is unaware of his rights or because he is deterred from enforcing them on account of the costs which judicial proceedings would involve.'[58]

This paragraph seems to refer to the Dutch nullity (which the court must rule on its own motion) instead of annullability.[59] According to Hesselink, the decision illustrates that an important part of Dutch law is not developed exclusively by the Dutch courts and legislature but together with the EU court and legislature, which phenomenon puts the idea of private law as a coherent national system under pressure.[60] More concretely, he notes that:

> 'the concept of annullability […] in the Dutch civil code no longer has the same meaning in all cases: 'to annul' […] in Article 6:233 BW means something different when it is applied to consumer contracts from what it means when applied to other contracts to which Article 6:233 may be applicable and – broader – from other cases of (an)null(abil)ity in the BW. The reason for this is that the preservation of the unity of the concept of (ver)nietig(baar)heid is no longer exclusively in the hands of the Dutch Hoge Raad [Supreme Court, LJ].' [61]

In sum, the Dutch and German legal scholars have pointed especially to a disintegration of their national legal system caused by the EU legislation that aims at European integration.[62]

Can English law also be understood as a system?[63] Statute law has historically played a different role in the development of English law than it has played in continental Europe. The reason is that courts performed an important role in developing the common law.[64] The literature and judges have emphasized that the common law is traditionally more oriented towards

57 Hesselink 2004, p. 406-407. *Cf.* Section 3:49 BW.
58 Case C-473/00 *Cofidis* [2002] ECLI:EU:C:2002:705, para. 33 and 34.
59 Hesselink 2004, p. 405-407.
60 Hesselink 2004, p. 406 & 410.
61 Hesselink 2004, p. 407.
62 *See* Hesselink 2001, p. 41; Joerges 1997, p. 385. Van Gerven 2001, p. 490-491 calls these effects the 'bright side' (i.e., uniformity between national laws) and 'dark side' (i.e., national fragmentation) of harmonization.
63 *See* Riesenhuber 2011, p. 122.
64 Zwalve 2008, p. 58-59; Van Gerven 2006, p. 42; Zweigert & Kötz 1998, p. 265.

individual cases than systemization. For example, they indicate explicitly that

> '[t]he common law is a historical development rather than a logical whole, and the fact that a particular doctrine does not logically accord with another or others is no ground for its rejection'[65]

and that

> '[t]he common law was never systematised nor has it ever aspired to be. [...] In England law is seen as a technique of dispute resolution. In other words, the role of the law, and therefore the role of the courts, is to solve the problem presented to it by litigants.'[66]

Although a more significant part of English law is now provided for by statutes enacted by Parliament, such as the BA 2009 and the IA 1986, statute law still does not aim to regulate English law as a whole but deals with particular topics. Moreover, it uses and presupposes the doctrines developed by the courts.[67] This may explain the less-systematized approach to the law of English lawyers than of their Dutch and German colleagues.[68] Teubner, for example, notes about the concept of 'good faith' that

> '[t]he specific way in which continental [European, LJ] lawyers deal with such a 'general clause' is abstract, open-ended, principle oriented, but at the same time strongly systematised and dogmatised. This is clearly at odds with the more rule-oriented, technical, concrete, but loosely systematised British style of legal reasoning, especially when it comes to the interpretation of statutes.'[69]

Nevertheless, the literature has voiced concerns about the challenges presented by the integration of EU law into English law. The UK government's official guidance document on the transposition of directives contains a paragraph on how EU legislation has to be brought 'into harmony' with existing national law so that 'transposition neither has unintended consequences in the UK nor risks infraction.'[70] Scholars indicate, however, that

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65 Lord Porter in *Best v Samuel Fox & Co. Ltd* [1952] AC 716, 727. As also referred to by Riesenhuber 2011, p. 122-123. *See also* Legrand 1996, p. 65-67.

66 Legrand 1996, p. 65-66. *See also* Legrand 1997a, p. 50.

67 Zwalve 2008, p. 65; Zweigert & Kötz 1998, p. 200-201.

68 Van Gerven 2006, p. 42.

69 Teubner 1998, p. 19.

70 HM Government, 'Transposition guidance: how to implement EU Directives into UK law effectively', February 2018, para. 2.19-2.20. See also HM Government Cabinet Office, Guide to making legislation', July 2017, para. 5.1, stating that '[m]istaken perceptions of what the law requires can encourage risk-aversion and inaction. Excessively complex or inaccessible legislation hinders economic activity. It places burdens on people, communities and businesses. It damages people's trust in the law. Good law is: necessary, clear, accessible, effective and coherent.'

the aim stated in this document to 'create one coherent regulatory regime'[71] of EU and UK legislation has not always been achieved. For example, it has been argued that the fact that the implementations into English law of directives in the field of consumer law continued 'to be scattered across a range of measures rather than having been combined into one more coherent Act of Parliament' caused fragmentation in domestic consumer legislation. Arguably, the fragmentation made it more difficult to identify and apply the relevant rules.[72]

Other UK lawyers have been more concerned about the ties of the law with national cultures and traditions and the difficulties these ties create in the European harmonization project.[73] For instance, in a well-known analysis of the effect of the above-mentioned Unfair Terms in Consumer Contract Directive on English law, Teubner gave his opinion on the possibility of legal transplants. The literature typically uses the term 'legal transplant' as a metaphor for a rule that is transplanted from one country to another.[74] When Teubner wrote his article, the feasibility of such legal transplants had been fiercely debated. While Watson had provided historical evidence to show that legal transplants have been commonplace in law,[75] Legrand had claimed that legal transplants are impossible. A rule cannot simply be displaced from one jurisdiction to another without undergoing a fundamental change in meaning as a result of differences in the legal cultures.[76] Hence, Legrand emphasized the diverging legal traditions. An implication of this conclusion was, according to Legrand, that harmonization in legislation at the EU level also cannot result in effective convergence of legal systems.[77] In his thesis, Teubner then took the concept of 'good faith', a major pillar of the continental European contract law and through the Unfair Terms in Consumer Contract Directive also introduced into English contract law, as an example of a transplanted rule. The concept had been transposed with some difficulty into English law because it does not sit well with the traditional English contract law concepts and practice. Teubner submitted that the metaphor of legal transplant is misleading and that the term 'legal irritant'

71 HM Government, 'Transposition guidance: how to implement EU Directives into UK law effectively', February 2018, para. 2.20.

72 Twigg-Flesner 2015.

73 E.g., Teubner 1998; Collins 1995.

74 E.g., Berkowitz et al. 2003.

75 Watson 2000. *See also* Fedtke 2012.

76 Legrand 1997b. *See also* Teubner 1998, p. 14.

77 Legrand 1996, who notes at p. 57 that 'rules are but the outward manifestation of an implicit structure of attitude and reference, they are a reflection of a given legal culture.' Smits 2007, p. 1196 does not fully agree with Legrand. He argues that 'Legrand is right to say that European legal systems "have not been converging" and "are not converging." To hold that they also "will not be converging" is a more problematic statement because this is unpredictable: legal culture can change.'

is a better expression. A rule cannot move easily to a new environment and continue to play its old role. He argued that

> 'when a foreign rule is imposed on a domestic culture [...] something else is happening [...] it works as a fundamental irritation which triggers a whole series of new and unexpected events.' The transferred rules 'are not transformed from something alien into something familiar, not adapted to a new cultural context, rather they will unleash an evolutionary dynamic in which the external rule's meaning will be reconstructed and the internal context will undergo fundamental change.'[78]

Hence, the result of importing the foreign rule can be that the legal system in the recipient jurisdiction is changed, but it does not become the same as the original legal system. Instead, it may disorder the law. Teubner emphasized the ties of the law with the legal culture and the social context. He expected the concept of 'good faith' to be understood differently in different jurisdictions because of differences in the legal traditions and market practices. Therefore, in his view, no convergent effect would be achieved, but the result is a new concept in English law that has little to do with the concept in continental European contract law.[79]

In sum, although they have a less-systematized approach to the law than Dutch and German scholars, English lawyers have also pointed to the specific legal concepts of EU law that do not always fit very well into their domestic law.

4 Coherent relations with national private law

The question arises how can be determined whether an EU directive has been brought 'into harmony' with and fits well into existing national law.[80] According to the present author, the notion of horizontal, local coherence developed in this paragraph offers a useful tool for such an analysis.[81]

78 Teubner 1998, p. 12.

79 Teubner 1998. *See also* Smits 2007, p. 1196.

80 *Cf.* Dworkin 1986, p. 228-232, who discusses 'fit' in the context of how judges decide cases.

81 The question of whether coherence in the law is important has been heavily debated in the literature. The scholars of the Critical Legal Studies movement would read an analysis of whether some rules, objectives, and principles of an area of law accord with rules, objectives, and principles of another areas of law as the present study makes with reservations. They claim that the law contains many opposing principles and ideals. *Cf.* Unger 2015, p. 143-178; Kennedy 1976, p. 1685.

As already noted, this book does not advocate the ideal of coherence in the whole of the law. As Raz claims, the law is not a single act but its content is the product of various activities of courts and legislatures, and its specific fields contain different legal norms, underlying principles, and policy goals.[82] As such, achieving coherence between all legal components of the entire legal system seems unfeasible.[83] Legislatures often introduce rules that deviate from existing rules or have a different meaning in the context of their particular field.[84] Horizontal, local coherence rather calls for coherence in one specific field or amongst closely dependent branches.[85]

The following chapters use this idea of 'area-specific coherence'[86] as a tool to explore how the EU bank resolution framework has been aligned with national private law and whether inconsistencies exist. In particular, they apply a notion of constitutive coherence in the law, which means that a coherence test is applied to the legislation and case law of a jurisdiction to determine what the law is. This notion is to be distinguished from coherence accounts of judicial reasoning, which is about coherence in deciding court cases.[87] As stated above, several relations of the rules, principles, and objectives of the bank resolution frameworks with specific branches of national private law have been selected for this analysis. The investigation focuses on the relations with rules, principles, and objectives of private law which directly interact with or are closely related to the resolution rules, which especially include substantive insolvency law. Further research might consider whether the bank resolution framework fits well into other aspects of the national legal culture and the social environment, as Teubner did in his analysis of the concept of good faith, but that is for another day.

The literature has extensively debated the role of coherence in the law, but there is no general agreement about what coherence constitutes precisely.

82 Raz 1992, p. 296 and 310.

83 *Cf.* Levenbook 1984, p. 371. *Contra* Dworkin 1986, who advocates coherence in the whole legal system. In particular, Dworkin claims that the 'government [should] speak with one voice, to act in a principled and coherent manner towards all its citizens'. This requires the adherence to two principles: 'a legislative principle, which asks lawmakers to try to make the total set of laws morally coherent, and an adjudicative principle, which instructs that the law be seen as coherent in that way, so far as possible.' The latter principle 'instructs judges to identify legal rights and duties, so far as possible, on the assumption that they were all created by a single author – the community personified – expressing a coherent conception of justice and fairness.' Dworkin 1986, p. 165, 176 and 225.

84 *See* Desmet 1987, p. 133-134.

85 *Cf.* Raz 1992, p. 310; Levenbook 1984, p. 371-372.

86 Levenbook 1984, p. 371.

87 For an extensive analysis of coherence theories in legal reasoning, *see* Amaya 2015.

Legal theorists often use rather vague terms such as 'hang together'[88] and 'tightly knit unit'.[89] Raz views coherence in terms of unity in principles underlying the court decisions and legislation.[90] Kress and Bertea, by contrast, both provide a list of criteria to evaluate coherence.[91] According to the present author, we can distinguish between two aspects of coherence in the law. At the surface level of the law, a rule of the bank resolution framework is coherent with the surface level material in the field of private law with which it interacts if a consistent relation exists. At a deeper level, a coherent relation requires that the bank resolution framework shares some of its general principles and objectives with directly related areas of law.[92]

We saw already that coherence in the relations with the existing national law is not the only principle that national legislatures consider when implementing EU secondary legislation. As such, coherence is an ideal feature in the relations that rivals other principles.[93] The main aim of making the relations coherent is to make them comprehensible, which feature promotes legal certainty and predictability.[94] According to Brouwer, a national legislature typically weighs the coherence concerns against considerations that include clarity, thrift, completeness, and the optimal realization of general legal principles, values, and objectives.[95] These principles can all be fulfilled in different degrees. For example, the legislature may have to weigh pursuing specific objectives in a field of law against the principle to reach full

88 MacCormick 1984, p. 37. Kress 2010, p. 521 claims that '[a]n idea or theory is coherent if it hangs or fits together, if its parts are mutually supportive, if it is intelligible, if it flows from or expresses a single unified viewpoint. An idea or theory is incoherent if it is unintelligible, inconsistent, ad hoc, fragmented, disjoined, or contains thoughts that are unrelated to and do not support one another.'

89 Alexy & Peczenik 1990, p. 130. *See also* Bertea 2005, p. 156-157.

90 Raz 1992, p. 286.

91 Kress 2010, p. 521-522 lists the properties consistency, comprehensiveness, completeness, monism, unity, articulateness and justified. According to Bertea 2005, p. 159 coherence should at least include consistency, comprehensiveness and completeness, support of varying scope and force, and cross-connection and mutual justification between the parts as a whole.

92 The notion of coherence discussed here, is based on the notion of coherence of Haentjens 2007, p. 13-28. *See also* Smits 2012, p. 10 who also distinguishes between two aspects of coherence, namely coherence of the law itself and coherence of the policies underlying the legal norms. MacCormick 1984, p. 38 and Tuori 2002, p. 170, by contrast, claim that consistency is not a condition for coherence.

93 *Cf*. MacCormick 1984, p. 47. *See also* Alexy & Peczenik 1990, p. 145.

94 *See* Smits & Letto-Vanamo 2012, p. 2.

95 Brouwer 1999, 232-236; Haentjens 2007, 15-16. Brouwer 1999, p. 232 uses the term 'mixed-value good', indicating that full realization of the principles cannot always be reached. Haentjens 2007, p. 16-17 also uses this term and argues that the meta-principles which are used for the weighing of conflicting legal principles (the requirements of optimization, consistency and proportionality) should be applied to weigh the systemic principles against each other.

coherence. Which balance the legislature ultimately chooses depends on the facts and legal possibilities.[96]

If a particular rule stems from EU secondary legislation, the national legislature has less influence on the outcome of the balancing act. Several authors have claimed that EU secondary legislation pursues political, economic, and social objectives and does not consider the coherence of the law in which it has to be integrated.[97] Indeed, directives and regulations that are adopted under article 114 TFEU, for instance, provide for rules that are considered of particular importance for the development of the internal market. It is up to the national legislature to incorporate the EU rules into national law and assess to what extent the principles other than the realization of specific objectives in the law can also be adhered to, including coherence of the rule stemming from EU law with closely related, existing rules of national law.

Consistency

Consistency requires that the relevant surface level material has a non-contradictory and logically valid character.[98] In the present study, it means that particular rules of the bank resolution framework and rules of national private law which directly interact with or are closely related to the resolution rules do not contradict each other and have a logically valid relation.[99] This book uses the term 'rules' broadly to cover legal rules and norms formulated in legislation and case law.[100]

The consistency analysis distinguishes between three levels of coherence in the investigated relations: coherence, moderate coherence, and incoherence.[101] If the following chapters ascertain that a particular relation is moderate coherent or incoherent, it will be explored whether coherence in the relationship can be enhanced.

In some cases, a conflict between two rules can be settled, and the rules can continue to exist alongside each other without their application or interpretation being questioned by introducing a clause that one rule derogates

96 *See* Alexy 2000, p. 295. *See also* Alexy & Peczenik 1990, p. 145.
97 Manko 2015, p. 14; Hesselink 2001, p. 40. *Cf.* Van Gerven 2001, p. 493-494 who argues that the laws of the Member States must also have an impact on European law. In particular, the European legislature should look for principles which the national laws have in common.
98 Haentjens 2007, p. 18-19.
99 *Cf.* Kress 2010, p. 521-522; Haentjens 2007, p. 18-19; Tuori 2002, p. 170; Bloembergen 1992, p. 316-325.
100 Civil law jurisdictions and common law jurisdiction traditionally have a different approach to the concept of rules. For example, in the civil law tradition, rules are considered to be part of the legal system, under the common law, according to Legrand 1996, p. 67-68, '[j]udicial decisions may, in time, produce what *appears* like a set of rules [...] Common law "rules" having minimal prescriptive impact, the courts effectively make and unmake the law at will.'
101 *Cf.* Haentjens 2007, p. 25-26.

from the other rule. To take a simple example from the literature, the rule that a student is not allowed to leave the classroom during a class conflicts with the rule that he or she has to leave the school building in the event of a fire alarm. The conflict is not problematic if an exception to the prohibition to leave the classroom exists so that the student is allowed to leave if the alarm goes off.[102]

In other cases, a conflict between two rules can be avoided if one rule pre-empts the other.[103] Traditional solutions include general standards of interpretation of the legal culture, such as the rule that a later law repeals an earlier law (*lex posterior derogat priori*) and that special laws repeal general laws (*lex specialis derogat generali*).[104] Standards such as that EU law has precedence over conflicting national law may solve inconsistencies between rules developed by legislatures or courts at different levels.[105]

If in the following chapters of the present study, the bank resolution framework provides for explicit deviations from national private law, or the above-mentioned general standards of interpretation can solve a conflict in the relation between a bank resolution rule and a private law rule, the relation is considered moderate coherent.

An inconsistency may be problematic and undermine legal certainty if, for instance, two contradictory rules or definitions are simultaneously applicable, or a rule of the bank resolution framework does not fit logically into the branch of private law with which it interacts or to which it is closely related.[106] For example, a relation may not have a logically valid character because the effect of the application of a bank resolution rule in private-law terms is unclear. Hence, in these cases, the legislature or court has not explicitly solved the rule conflict, and the above-mentioned standards to solve rule conflicts also do not sufficiently settle the inconsistency. An incoherent relation is established.

A general example to illustrate the point that two contradictory rules can apply to the same case at the same time relates to fire safety. Assume that a national fire service regulation requires the keys of cars to be left in the ignition at all times so that, if necessary, the cars can be removed from the showroom quickly. Such a policy contradicts the car theft insurance policy

102 Alexy 2000, p. 295.
103 *See* Kress 2010, p. 529; Alexy 2000, p. 295-296.
104 Langer & Sauter 2017, p. 43. *See also* Desmet 1987, p. 115-139.
105 Langer & Sauter 2017, p. 43; Hartkamp 2012, para. 8, who refers to the European Court of Justice case 6/64 *Costa v. ENEL* [1964] ECLI:EU:C:1964:66. *See also* Kress 2010, p. 529; Alexy 2000, p. 295-296.
106 *Cf.* Haentjens 2007, p. 18-19.

of many insurance companies that do not allow that keys are left in the car.[107] Thus, the car owners are subject to two mutually exclusive rules.[108]

However, the parts of the national bank resolution frameworks that are analyzed in the following chapters especially give a few examples of resolution rules which do not have a logically valid relation with national private law. In these cases, the conflicts of rules can be solved if the legislature or a court clarifies and explicitly provides how the inconsistent rules relate to each other. Such a solution makes the relation between the inconsistent rules moderate coherent rather than incoherent.[109]

A general example from Dutch law illustrates this point. Section 6:217(1) BW provides that, as a general rule of Dutch private law, an agreement requires an offer and its acceptance. Section 5:1(a) Wft explicitly indicates that the meaning of an offer of securities to the public under the Wft, which offer may require a prospectus,[110] is broader than the meaning of a general private law offer.[111] The offer under the Wft also includes issuing an invitation to make an offer and placing securities through financial intermediaries. Thus, the section provides for an explicit derogation from the general private law rule of section 6:217(1) BW and creates a moderate coherent relation with private law.

Unity

In addition to consistency between the bank resolution rules and rules of national private law at the surface level, the following chapters investigate if the bank resolution framework shares some underlying, principles and objectives with directly related areas of law, which are national corporate restructuring and insolvency law.

Hence, the present study does not claim that the law is based on one consistent set of principles.[112] It instead assesses whether the implemented bank resolution frameworks and restructuring and insolvency law have some general principles and objectives in common. The term 'principles' is in that context understood as fundamental and basic standards.[113] As Bork

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107 Dutch Ministry of Economic Affairs, *Strijdige regels in de praktijk, Resultaten meldpunt strijdige regels*, November 2003, p. 9.
108 *Cf.* Haentjens 2007, p. 19.
109 *Cf.* Haentjens 2007, p. 26-27.
110 Sections 5:2-5:5 Wft.
111 *See* Grundmann-van de Krol 2012, p. 73-77.
112 As emphasized in particular by the Critical Legal Studies movement. The scholars of this movement claim that the law has many irresolvable opposed principles and ideals, and a judge has to make a choice which is not dictated by the law. *See* Kennedy 1976, p. 1724. *See also* Maris van Sandelingenambacht 2002, p. 114.
113 *See* Bork 2017, p. 12-13.

suggests, principles are the 'building blocks underlying the rules' and they systemize the law and legitimize the legal consequences of the rules.[114]

Most legal theorists seem to support an investigation of the underlying, general principles and objectives as part of a coherence analysis. They claim that consistency between rules is not sufficient for coherence in the law.[115] Raz maintains that the more unified the set of principles underlying the rules is, the more coherent is the law. In turn, there will be less coherence in the law if all principles result from a broader set of principles with a unified approach, or even less if this set contains pluralistic and unconnected principles.[116]

MacCormick illustrates the argument that coherence is to be considered in terms of unity of principles with an example.[117] Assume that the road traffic laws in a country aim to promote the safety of road users, the economy in the use of fuel, and the prevention of excessive wear and tear of road surfaces. One of the important principles of the laws is, for instance, that motor traffic on the roads must not unduly endanger human life, which principle justifies speed limit laws. The legislature in the country introduces a statue that provides for different speed limits for different cars according to the color in which the cars are painted. One might say that this color-based speed limit does not entirely cohere with the other road traffic laws because the color-based limit fails to adhere to the common principles of the traffic laws. The color-based speed limit seems to be arbitrary because the different treatment of differently painted, but otherwise similar, cars cannot be explained by reference to the relevant principles of the other road traffic laws.[118]

Pawlowski provides an example of the role of underlying principles and objectives in insolvency laws.[119] Under the German InsO, the insolvency plan procedure facilitates a reorganization of the business of a debtor with the objective, as is explicitly stated in section 1 InsO, to satisfy the credi-

114 Bork 2017, p. 13. For a discussion of the meaning of the word 'legal principles', *see also* Tuori 2002, p. 177-179. On the distinction between rules and principles, *see also*, famously, Dworkin 1977, p. 22 et seq., although the present study does not necessarily adhere to this theory.

115 E.g., Smits & Letto-Vanamo 2012, p. 2; Nieuwenhuis 2005, p. 27; Tuori 2002, p. 170 Brouwer 1992, p. 181. Alexy & Peczenik 1990, p. 130 claim that 'consistency is a necessary but not sufficient condition for coherence. Physics and chemistry, for example, are highly coherent with each other, whereas there is a lesser degree of mutual coherence between physics and religion although it cannot be said that they contradict each other.' *Cf.* however European Commission, Communication for the Commission to the European Parliament and the Council: A more coherent European contract law. An action plan (2003/C 63/01), which suggests that 'coherence' means consistency in the law.

116 Raz 1992, 286.

117 MacCormick 1984, p. 39-40.

118 *See* MacCormick 1984, p. 39-40.

119 Pawlowski 2001, p. 51.

tors collectively. Thus, it is used as an instrument to satisfy the creditors' interests best. The German legislature based this procedure largely on Chapter 11 of the US Bankruptcy Code. However, according to Pawlowski, the relevant provisions of the InsO may be interpreted and applied differently than the equivalent provisions of the Bankruptcy Code. In contrast to the objective of the InsO, the US Chapter 11 traditionally has a strong debtor rather than creditor orientation and has focused on the rescue of the company. Hence, although some surface level rules may look similar, divergences in the procedures which the rules provide for may be rooted in different objectives and principles.[120]

The following chapters seek to unpack some principles and objectives of national corporate restructuring and insolvency law, on the one hand, and bank resolution law, on the other hand. If the areas of law share some principles and objectives, this contributes to a coherent relation between the fields.

5 Supranational coherence in interpretation and application of the bank resolution rules

We saw in chapter 2 that the BRRD is an instrument of the EU legislature that aims to contribute to the establishment and functioning of the EU internal market in financial services.[121] Its recital 44 stresses that the 'national resolution authorities should have at their disposal a minimum harmonized set of resolution tools and powers' and that the exercise of these tools and powers should be subject to common conditions, objectives, and principles. The EU legislature expects the harmonized legal framework for bank resolution to foster the cooperation and coordination between authorities when dealing with a failing cross-border operating bank. Also, it should avoid obstacles to the exercise of the freedom of establishment and the free provision of services within the internal market, for instance, because divergent national approaches to bank resolution affect the funding costs of banks differently across jurisdictions.[122]

120 Pawlowski 2001, p. 51. *See also* Eidenmüller 2018, para. 3.3.2.

121 *See* paragraph 3.2.2 of chapter 2; Tuominen 2017, p. 1369.

122 Recital 9 BRRD; Recitals 3 and 4 SRM Regulation. *Cf*. European Parliament, Committee on Economic and Monetary Affairs, 'Report with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector' (2010/2006(INI), 28 June 2010), Explanatory Statement, para. 5, which notes that '[p]resently there is patchwork of national frameworks, not always compatible between themselves. It is difficult to deal swiftly and efficiently with cross-border groups involving several jurisdictions. A robust and sound European single financial market requires coherence and cohesiveness of regulations across the 27 members.' and in the accompanying Motion for a European Parliament Resolution, para. N that 'a robust response to crisis requires a coherent and comprehensive approach entailing […] an effective EU crisis-management framework for financial institutions.'

The term 'harmonized' or 'harmonization' does not have one definition in the literature. Adopting Boodman's general description, harmonization is 'a process in which diverse elements are combined or adapted to each other so as to form a coherent whole while retaining their individuality.'[123] In the context of the EU, according to Lohse, the term refers to 'a conscious process that has the aim of leading to the insertion of a concept into the national legal orders, which triggers a process of adaption to form a European concept as uniform as required to serve the objectives of the European Union.'[124] Thus, some form of approximation is preferred over fragmentation in the particular field of law.[125]

The above-mentioned definitions of the term 'harmonization' suggest that the harmonization process does not necessarily result in unification.[126] The term is in the EU most commonly used for the process triggered by directives.[127] Similar to other directives, the BRRD gives the EU Member States discretion as to their implementation. It binds the Member States as to the result to be achieved and leave to the national authorities the choice of form and methods.[128] Although some scholars claim that many directives provide for detailed rules that leave the Member States not much room in the implementation,[129] it is well established, as discussed in paragraph 3 of this chapter, that the effect of directives ultimately depends on the national transpositions.[130]

It should be noted that the BRRD contains minimum harmonization clauses.[131] Minimum harmonization means that the EU legislation establishes a minimum level of harmonization from which the national legislation may derogate to create more stringent rules.[132] It is the present author's view that in the context of the BRRD, the minimum harmonization entails that the Member States may adopt more stringent provisions than created by the BRRD as long as the provisions promote the achievement of the resolution

123 Boodman 1991, p. 702.
124 Lohse 2012, p. 313.
125 Havu 2012, p. 27. *See also* Van Gerven 2006, p. 45-47.
126 *See also* Slot 1996, p. 379. According to Lohse 2012, p. 311, 'unification is [...] the most intensive form of harmonisation. Approximation can be sufficient if that way obstacles to free movement are removed or, respectively, the aim of the European legislative act can be reached.'
127 *See* Slot 1996, p. 379. *Contra* Lohse 2012, p. 297, who suggests that the term 'harmonization' should be understood more broadly to also cover the effect of regulations. Cf. article 114 TFEU, which uses the term 'approximation'.
128 Article 288 TFEU.
129 Lohse 2012, p. 310; Slot 1996, p. 379.
130 Havu 2012, p. 27.
131 Recital 10 BRRD.
132 *See* Slot 1996, p. 384-386.

objectives and adherence to the resolution principles of the BRRD.[133] For the SRM participating Member States, the SRM Regulation does not leave the Member States much discretion to establish additional, national resolution tools and powers. The SRM Regulation explicitly indicates that it aims to enhance the uniform application of the bank resolution regime and it does not give the Member States the option to keep own instruments for a resolution procedure.[134] Instead, for most banks a resolution scheme of the SRB will prescribe which measures specified in the BRRD the national resolution authorities have to implement.[135]

In the debate about the further harmonization of the EU bank resolution framework, scholars and policymakers have paid much attention to the possible differences in the interpretation and application of the bank resolution framework across the Member States. As chapter 1 indicated, this debate has partly focused on the divergences caused by differences in substantive insolvency law. In addition to a notion of national coherence to assess the relations of the bank resolution rules, principles, and objectives with private law, the following chapters, therefore, use a notion of supranational coherence to identify some of the differences across jurisdictions.[136] The chapters investigate if uniformity in interpretation and a possible degree in similarity in the results of the application of the studied EU-derived bank resolution rules exist at the level of the Member States. Thus, in this analysis of supranational coherence, only comparable-looking bank resolution rules in the investigated jurisdictions are not sufficient.[137] Moreover, we need to distinguish the notion of supranational coherence in the law which this book uses

133 *See* Sluysmans et al. 2015, p. 391.

134 Recital 11 SRM Regulation: 'The uniform application of the resolution regime in the participating Member States will be enhanced as a result of it being entrusted to a central authority such as the SRM.' Recital 18 SRM Regulation: 'In order to ensure a level playing field within the internal market as a whole, this Regulation is consistent with Directive 2014/59/EU. It therefore adapts the rules and principles of that Directive to the specificities of the SRM and ensures that appropriate funding is available to the latter.'

135 Articles 23 and 29 SRM Regulation.

136 *Cf*. European Parliament, Committee on Economic and Monetary Affairs, 'Report with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector' (2010/2006(INI), 28 June 2010), Explanatory Statement, para. 5, which notes that '[p]resently there is patchwork of national frameworks, not always compatible between themselves. It is difficult to deal swiftly and efficiently with cross-border groups involving several jurisdictions. A robust and sound European single financial market requires coherence and cohesiveness of regulations across the 27 members.' and in the accompanying Motion for a European Parliament Resolution, para. N that 'a robust response to crisis requires a coherent and comprehensive approach entailing […] an effective EU crisis-management framework for financial institutions.'

137 For a similar notion of coherence in the field of EU competition law, *see* Havu 2012, p. 26.

from coherence in decision-making by national and EU authorities, which type of coherence has been advocated by other scholars.[138]

We can distinguish between two types of supranational differences. Although in some cases a sharp distinction cannot be made, given the aim to explore supranational coherence in the bank resolution framework, the identification of a line between these two types of differences seemed essential.

First, differences in interpretation and application of the bank resolution rules between jurisdictions may be caused by diverging interpretations of provisions and incorrect implementations of the EU legislation. Diamant gives an example of a provision of the Financial Collateral Directive that has been interpreted in diverging ways at the national level. Following the implementation of this directive in 2003, the rule that financial collateral is provided if it is 'in the possession or under the control of the collateral taker' was understood differently in national law. The English literature and courts favor a strict approach to the 'possession or control' requirement, which approach is based on the control requirement that forms the basis for the distinction between a floating charge and fixed charge under English law. The Belgium legislature had a less strict approach when implementing the directive by providing that the requirement is satisfied if a pledge is created under Belgium law. In her thesis, Diamant concludes that the Collateral Directive has led to a lesser degree of harmonization of property law than initially was believed the implementation of the Directive would bring.[139]

Second, the transposition of EU legislation may result in divergences between the Member States that are not caused by an incorrect implementation of a provision or an unclear provision in the EU law but remain within the boundaries of the harmonized legal framework. The legal culture and existing rules of national law often mold the legal concept or term stemming from EU law. For example, the Winding-up Directive provides a broad definition of the term 'liquidator' and the insolvency laws of the Member States have to give further substance to the term.[140]

138 Besson 2004, who discusses a notion of European coherence according to which 'all national and European authorities should make sure that their decisions cohere with the past decisions of other European and national authorities that create and implement the law of a complex but single European legal order.' *See also* Bertea 2005, who considers coherence in the case law of the CJEU.

139 Diamant 2014, p. 112-119, 128-135 and 246-247. In 2016, the CJEU gave a ruling on the question of what constitutes the 'possession or control' requirement for the purpose of the Financial Collateral Directive. Case C156/15, Private Equity Insurance Group v Swedbank [2016] ECLI:EU:C:2016:851.

140 Article 2 Winding-up Directive.

It should be noted that the mere finding of potential differences in the bank resolution procedures of the investigated jurisdictions does not justify further approximation of laws at the EU level. First, since the scope of the present study is limited to the bank resolution frameworks of three jurisdictions, the results of the following chapters may not represent the resolution frameworks of all EU Member States. Second, the EU legislature has only limited competences for the adoption of measures for such approximation. As chapter 7 will discuss, article 114 TFEU provided the legislative basis for the legislative instruments that established the current bank resolution framework, and the European Commission considers this provision also the appropriate legal basis for several proposed legislative instruments in the field of bank resolution.[141] Article 114 TFEU allows the EU the adopt 'measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.' It is well established that the mere disparity between national legislation does not justify recourse to this article. In the words of the CJEU, a measure adopted under article 114 TFEU 'must genuinely have as its object the improvement of the conditions for the establishment and functioning of the internal market.'[142] Related to this point, according to the principle of subsidiarity the EU may only adopt the measures under article 114 TFEU if the objectives of the proposed action cannot be sufficiently achieved by the Member States but can rather be better achieved at the EU level. The principle of proportionality also limits the competences of the EU by requiring that the content and form of the EU action not exceed what is necessary to achieve the objectives of the EU Treaties.[143]

The present study explores the potential differences in the bank resolution procedures in the three jurisdictions to identify, as an initial question, what we can put on the table in the debate about the closer harmonization of the EU bank resolution framework. Further research might consider whether the conclusions that the present study draws can also be reached regarding other jurisdictions and if the found differences justify recourse to section 114 TFEU.

141 Paragraph 3.2 of chapter 7. For an extensive discussion of whether article 114 TFEU is the proper legal basis for the EU legislative instruments in the field of bank resolution, *see* Tuominen 2017.

142 Case C-376/98, *Germany v Parliament and Commission (Tobacco Advertising I)* [2000] ECLI:EU:C:2000:544, para. 84 and *see* Tuominen 2017, p. 1366; Azoulai 2015, para. II; Moloney 2014, p. 1653; Kuipers 2014, p. 179-180 who all note that in more recent cases, the CJEU has adopted a less rigid interpretation on the scope of article 114 TFEU.

143 For an in-depth discussion of the principle of subsidiarity and the principle of proportionality, *see* Schütze 2015.

6 Conclusions

This chapter developed two notions of coherence to assess the relations between the national bank resolution frameworks and branches of national private law that are directly affected by or closely related to the bank resolution frameworks. The following chapters investigate several examples of relations. Such an analysis shows how the EU legislation has been aligned with existing national law and which possible differences may arise in the bank resolution procedures across jurisdictions. Coherence considerations in the further development of the EU bank resolution framework may help to avoid uncertainties about the bank resolution framework that complicate the assessment by market participants when buying bank capital and debt instruments of their possible position and losses in a bank failure. Thus, the coherence notions are tools to ascertain which parts of the national bank resolution frameworks and which supranational differences in interpretation and application of the resolution rules may have to be considered in the further development of the resolution framework.

First, the preceding paragraphs developed a notion of horizontal, local coherence in national law to assess coherence in the relations between the bank resolution frameworks and national private law. This type of coherence requires that at the surface level of the law, a rule of the bank resolution framework has a consistent relation with rules in the field of private law. It means that they should have a non-contradictory and logically valid character. A moderate coherent relation may exist between the rules if the rules are inconsistent but the law explicitly provides that one rule derogates from the other rule or if general standards of interpretation can solve the rule conflicts. An incoherent relation is established if the legislature or court has not explicitly solved the inconsistency between two rules and the standards to solve rule conflicts also do not sufficiently settle it. If, at a deeper layer, bank resolution law shares some of its principles and objectives with directly related areas of law, this contributes to coherence between the fields of law.

Second, the preceding sections developed a notion of supranational coherence. The following chapters investigate if uniformity in interpretation and a possible degree in similarity in the results of the application of the studied bank resolution rules exist at the level of the Member States. For example, the chapters may find possible differences that are caused by diverging interpretations of provisions or incorrect implementations of the BRRD. The next chapters may also conclude that differences in the application and interpretation of the bank resolution rules possibly arise that remain within the boundaries set by the harmonized legal framework. They may, for instance, be the result of differences in substantive insolvency law.

Part II

Bank resolution framework of selected jurisdictions

5 European bank resolution framework: bail-in mechanism[1]

1 Introduction

This chapter focuses on the legal framework on bail-in. The BRRD and SRM Regulation distinguish between two types of tools for effecting the write-down and conversion powers, i.e., the write-down or conversion of capital instruments and eligible liabilities tool and the bail-in tool. The tools are here together referred to as 'bail-in mechanism' and their application as 'bail-in'. The analysis is structured as follows. Paragraph 2 briefly examines conceptual aspects of the bail-in mechanism from a regulatory perspective and an insolvency law perspective. Paragraph 3 discusses the bail-in mechanism as codified in the BRRD and SRM Regulation. Paragraphs 4 and 5 then investigate several prominent relations between the objectives, principles, and rules of the national legal frameworks on bail-in on the one hand, and national private law on the other hand. The analysis illustrates how the domestic legal frameworks on bail-in interact with and how they have been embedded into private law.

More specifically, the main question in paragraph 4 is whether the national legal frameworks on bail-in and the national company and general insolvency laws share some important principles, especially from the perspective of the trend in the EU to introduce corporate restructuring procedures as an alternative to traditional court-centered procedures. Hence, this paragraph investigates the deeper levels of the national legal orders, namely the principles.

Paragraph 5 then analyzes three sets of bail-in rules. It will be shown in this paragraph that the national legislatures closely aligned some of the rules with existing fields of national private law by, for instance, replicating existing private law rules and concepts for the bank resolution framework. The paragraph also shows that other bail-in rules explicitly depart from national private law and that the connection of some rules with private law is unclear. Moreover, the sections indicate that both differences in national substantive insolvency law and different national solutions for the application of the bail-in rules may create divergent outcomes in bank resolution procedures across jurisdictions.

1 This chapter contains and builds on the following work previously published by the author: Janssen 2018a; Janssen 2018b; Janssen 2017.

Paragraph 5.1 discusses the effects of a reduction of liabilities of a bank by a resolution authority on the claims themselves and related guarantees under national law. The next paragraph examines whether conversion of debt to equity in bank resolution follows the formalities and practice normally followed for such conversion in a financial restructuring under national law. Paragraph 5.3 scrutinizes how the hierarchy of claims in bail-in, including the protection offered by the bail-in rules to several types of claims by excluding them from bail-in, relates to the insolvency ranking of claims recognized under national law.

2 Conceptual aspects of the bail-in mechanism from a regulatory and insolvency law perspective

2.1 Bail-in mechanism from a regulatory perspective

The function of the share capital of any stock company has been considered threefold. Firstly, the capital, which is provided by the shareholders who benefit if the company can pay dividends but are in insolvency only paid after all creditors of the company, enables the company to finance its daily activities. Secondly, it serves as a basis for apportioning each shareholder a share in the control over the company. Finally, for the company's creditors, it is considered to form a 'buffer' and guarantee that the company can continue its activities and fulfill its commitments in the foreseeable future.[2]

In contrast to many other companies, banks are required to hold an adequate level of regulatory capital that is composed of a layer of share capital as well as a mix of subordinated debt and hybrid capital.[3] A thick layer of this regulatory capital may ensure that in a collective insolvency procedure, shareholders and investors in subordinated debt rather than the bank's depositors and the wider economy, shoulder a large part of the losses. Outside such a formal insolvency procedure, however, the mere subordination of debt, in principle, does not provide any help in absorbing losses made by the bank.[4]

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2 Olaerts 2003, p. 4; Schutte-Veenstra 1991, p. 6-7.

3 For a theoretical discussion of the functions and structure of a bank's capital, *see* Diamond & Rajan 2000, p. 2431-2465.

4 Gleeson & Guynn 2016, p. 196; Gleeson 2012, p. 14; Financial Services Authority, 'A regulatory response to the global banking crisis', Discussion Paper 09/2, March 2009, p. 62-70. *See also* Cahn & Kenadjian 2015, p. 218-219; Kenadjian 2013, p. 229 who argues that loss-absorbing capital and debt instruments are essential because banks 'operate with a very thin equity capital layer of a few percent, one that would be inconceivably think outside the financial sector, which can be eaten through every quickly by losses and which, as we saw in the 2008/2009 crisis, can be very hard to replace, especially in the midst of a crisis.'

Therefore, over the past several years an important aspect of the regulatory reforms in the EU has been restricting capital and debt instruments that qualify as regulatory capital. A part of the regulatory capital must now have a so-called 'loss-absorbing capacity' much earlier than the moment the bank meets the requirements for the opening of an insolvency procedure.[5] Contingent capital instruments, such as contingent convertible bonds (CoCos) and write-down bonds, have acquired increasing support from the banking sector, regulators, and academics.[6] The terms and conditions of these instruments have a clause generally providing that they are written down or they are converted into equity when a predetermined trigger event occurs.[7] Thus, it ensures the possibility of a reduction of debt through write-down or a share capital increase through conversion of debt.[8] Under the Capital Requirements Regulation[9] (CRR) capital instruments may only count as Additional Tier 1 (AT1) instruments if the instruments can absorb losses at a trigger point that relates to a bank's Common Equity Tier 1 (CET1) capital ratio.[10]

A statutory bail-in mechanism is to be considered a supplement to these contingent capital instruments issued by banks.[11] It allows authorities to recapitalize a bank by ordering the write-down of capital instruments and liabilities so that losses are absorbed and requiring a subsequent conversion of debt into share capital so that the bank or a successor entity is provided with new capital. While contingent capital instruments can be triggered if the issuing bank's operations are still considered going concern, the bail-in mechanism may be applied in a wider range of circumstances. The application depends on the exercise of discretion by the resolution authority rather

5 *See* Schillig 2016, p. 281-285; Gleeson & Guynn 2016, p. 196-198; Joosen 2015, p. 187 *et seq.*; Cahn & Kenadjian 2015, p. 218-219; Kenadjian 2013, p. 229; Gleeson 2012, p. 14.

6 *See* e.g., Schillig 2016, p. 281-285; Avdjiev et al. 2013; Pazarbasioglu et al.; Calomiris & Herring.

7 *See* Gleeson 2012, p. 14; Pazarbasioglu et al. 2011, p. 4; Basel Committee on Banking Supervision, 'Basel III: A global regulatory framework for more resilient banks and banking systems', December 2010, revised version June 2011; Basel Committee on Banking Supervision, 'Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability', August 2010, p. 4-5.

8 *See* Schillig 2016, p. 283.

9 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

10 Articles 52(1)(n), 54(1), 92(1)(a) CRR; Joosen 2015, p. 216-221. Article 54(1)(a) CRR defines the trigger event as the situation when the CET1 capital ratio referred to in article 92(1)(a) CRR falls below either (1) 5,125 percent or (2) a higher level than 5,125 percent, where determined by the bank and specified in the provisions governing the instrument. Under article 54(1)(b) CRR, insitutions may specify in the terms and conditions of the issued instrument one or more trigger events in addition to that referred to in point (a).

11 *See* Joosen 2015, p. 228; Bliesener 2013, p. 191; Kenadjian 2013, p. 229-230; Zhou et al. 2012, p. 6.

than a contractually agreed trigger event.[12] Accordingly, in practice, the trigger of the application of the contingent capital instruments may not always precede the use of the bail-in mechanism. The implementation of the statutory bail-in may also follow the occurrence of the contractual trigger event.[13]

Hence, a statutory bail-in mechanism is intended to serve the function of ensuring a 'private penalty' or 'private insurance'. Losses are imposed on the persons who have some form of financial claim against the bank rather than on the general public.[14] It facilitates a swift restructuring of the balance sheet of the bank.[15] The mechanism also ensures that not only share capital and other forms of regulatory capital but also other types of liabilities of a bank now fulfill the function of standing at the top rungs of the loss distribution ladder and provide a financial buffer.[16]

Nonetheless, this does not necessarily mean that resolution authorities consider bail-in the most appropriate resolution strategy for all types of bank failures. For example, the BoE believes that application of the bail-in mechanism is the most appropriate resolution measure to recapitalize the largest and most complex UK banks in case of their failure. The balance sheets of these banks are said to be so complex and highly interconnected with the broader financial system that other types of resolution measures may not be possible or desirable in practice. These measures include a break-up and sale of a part of the failing bank or a transfer of the part to a bridge institution.[17] At the same time, scholars warn that the use of the bail-in mechanism, and especially its application in case of a large, systemic

12 *See* Joosen 2015, p. 216; Gleeson 2012, p. 15.

13 Schillig 2016, p. 283-284. Joosen 2015, p. 229 calls it a 'double dip'. Hoeblal & Wiercx 2013, p. 272 call it a 'tweetrapsraket die noodlottige gevolgen lijkt te hebben voor een crediteur die op basis van contractuele voorwaarden als pleister op de wonde een aandelenbelang wist te verwerven, maar datzelfde belang vervolgens weer op het spel ziet staan door een besluit van de afwikkelingsautoriteit.'

14 *See* Tröger 2015, para. 3.2; Avgouleas & Goodhart 2015, p. 4, who both refer to Huertas 2013, p. 167-169 for the discussion of the replacement of the public subsidy with a private penalty, and to Gordon & Ringe 2015, p. 1300 and KPMG, 'Bail-in liabilities: Replacing public subsidy with private insurance', July 2012 (available at http://www.banking-gateway.com/downloads/whitepapers/core-banking-systems/bail-in-liabilities/) for the concept of private insurance or self-insurance. For the comparison of the bail-in mechanism with insurance, *see also* Zhou et al. 2012, p. 7. For a discussion of the concept of burden sharing in the context of bank resolution, *see* Gardella 2015, p. 376 *et seq.*; Grünewald 2014. *Cf.* Joosen 2015, p. 222, arguing that '[i]n the BRRD the bail in mechanism is placed in the context of penalization of creditors and shareholders, rather than a burden sharing mechanism that was the original concept of the international authorities advocating the contingent capital mechanism.'

15 *See* Sommer 2014, p. 217.

16 Wojcik 2016, p. 112; Binder 2015a, p. 108; Sommer 2014, p. 222.

17 Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 16.

bank failure, may trigger a panic amongst creditors and spread financial problems to other parts of the financial system. If other banks hold many bail-inable liabilities, for instance, bail-in weakens the overall stability of the banking sector. The application of the mechanism or news about its possible use is expected to create incentives for creditors to withdraw their deposits and sell their claims on a large scale, which further weakens the balance sheets of banks. The present author agrees with these scholars that in these cases with contagion risks, bail-in may have to be coupled with an injection of some form of public funds to counter the threat of large-scale disruption to the financial system.[18] Contagion risks also require authorities to set limits on the cross-holdings of bail-inable instruments by other financial institutions, to impose a temporary stay on actions of certain counterparties against a distressed bank, and to exclude certain liabilities from the application of the bail-in mechanism.[19]

2.2 Bail-in mechanism from an insolvency law perspective

The concept of bail-in may remind insolvency lawyers of the so-called 'chameleon equity firm', which was proposed by Adler many years ago.[20] In brief, this company issues debt in several tranches. When it shows signs of financial distress, the claims in the classes are retained to the extent the claims can be met. The highest tranche that cannot be paid is automatically converted into equity, whereas the remaining lower layers, including the original equity class, are automatically wiped out, as was contractually specified. In this way, the firm can continue its operations with a group of former creditors having control over the firm as shareholders.[21]

In a similar form, a statutory bail-in mechanism creates an alternative type of financial restructuring procedure in which the bank as the debtor is relieved from a part of its debt burden. It can also be said to be a means to mirror loss absorption in an insolvency procedure.[22] Its purpose is to produce the ex-ante effect of imposing market discipline and minimizing moral hazard. As indicated in chapter 2,[23] investors are expected to be alert about the financial position of the bank and to price bank capital accordingly if they know that losses are primarily by borne by them.[24]

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18 Schoenmaker 2018; Avgouleas & Goodhart 2015, p. 21-22 and 29.
19 *See* Schoenmaker 2018; Zhou et al. 2012, p. 22.
20 Adler 1993, p. 311-346. For a discussion of Adler's proposal, *see also* Schillig 2016, p. 281, who discusses the chameleon equity firm in the context of contingent capital and bail-in.
21 Adler 1993, p. 323 et seq.
22 Grünewald 2017, p. 290; Wojcik 2016, p. 107; Burkert & Cranshaw 2015, p. 445; Hadjiemmanuil 2015, p. 233.
23 Paragraphs 2.2.2, 2.2.3 and 3.2.1 of chapter 2.
24 Tröger 2018, p. 41; Avgouleas & Goodhart 2015, p. 4.

The literature also argues that the mechanism illustrates the function of the bank resolution rules in overcoming possible so-called anticommons problems in bank resolution procedures,[25] which problems were already briefly discussed in chapter 2.[26] In theory, a bank has the option to negotiate with its creditors and shareholders on a financial restructuring if it is financially troubled and its shareholders are unwilling to invest additional capital. The measures may include conversion of the outstanding debt into one or more classes of share capital and a debt reduction.[27] It is a contractual solution that requires the consent of all affected shareholders and creditors. Accordingly, the financial restructuring plan does not go ahead, or can only be partially implemented, if some shareholders and creditors hold out during the negotiations by not approving the proposed arrangement. Creditors and shareholders may withhold their consent because they expect to have a chance to have a better individual position without the plan. They may, for instance, speculate that the government bails-out the bank if they do not give their consent to the measures.[28] These problems with hold out behavior of creditors and shareholders are generally known as anticommons problems.[29] The solution to anticommons problems offered by the bank resolution rules is that an administrative decision overrules the shareholders and creditors of a bank. For example, as is further considered in paragraph 4.3 below, the bail-in rules empower the resolution authority to decide on and implement the necessary financial restructuring measures, although with the safeguard for the affected shareholders and creditors that they will not be made worse off than in a hypothetical insolvency procedure.[30]

3 Bail-in mechanism as codified in the BRRD and SRM Regulation

The BRRD and SRM Regulation divide a resolution authority's bail-in powers between two different instruments, but many characteristics of the tools are the same. The first instrument is the write-down or conversion of capital instruments and eligible liabilities tool, which is not a resolution tool within the definition of the BRRD and SRM Regulation.[31] The literature has

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25 Schillig 2016, p. 61-66; De Weijs 2013.
26 Paragraph 2.2.1 of chapter 2.
27 At the end of 2016, bondholders of the Italian Banca Monte dei Paschi di Siena were proposed a voluntary conversion of their claims into equity. Yet, not enough bondholders approved the plan.
28 De Weijs 2013, p. 217-221.
29 De Weijs 2013, p. 210-215; De Weijs 2012.
30 De Weijs 2013, p. 217-221.
31 In the parliamentary notes to the Dutch Part 3a Wft, the write-down or conversion of capital instruments and eligible liabilities tool is called the 'AFOMKI' tool (AFschrijven of OMzetten van KapitaalInstrumenten). *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 17-18.

called its application a 'Kleiner Bail-in'.[32] Its scope is limited to a bank's so-called 'relevant capital instruments', which are AT1 and Tier 2 (T2) instruments,[33] and so-called 'eligible liabilities', which meaning is further discussed below. The tool is exercised either independently of a resolution procedure and before the conditions for resolution are met, or in combination with the application of the resolution tools if a resolution procedure has been commenced.[34] In the former case, a resolution authority can only use the instrument in relation to eligible liabilities if the bank has issued these eligible liabilities internally within the banking group.[35] Shares, reserves, and other CET1 items of the bank are always written down before this tool is applied.[36]

The second bail-in instrument is the bail-in tool, which is part of the resolution authority's toolbox in a resolution procedure. The resolution authority applies the tool following the application of the write-down or conversion of capital instruments and eligible liabilities tool. It can use the bail-in tool to recapitalize the bank under resolution. It may also exercise the tool to capitalize a bridge institution to which claims or debt instruments of the bank are transferred, or complement the application of the resolution tools to transfer parts of the bank to a private sector purchaser or asset management vehicle.[37] Thus, the measures can be taken in relation to the existing bank, which the literature calls an open-bank bail-in, as well as to a non-operating firm while a part of the business are transferred to a new entity, which scholars often call closed-bank bail-in.[38] In the former case, the BRRD and SRM Regulation do not allow that the financial restructuring measures are applied in an isolated manner but require that they are accompanied with the creation of a reorganization plan that sets out measures to restore the bank's long-term viability.[39] As paragraph 5.3 further discusses, not all

32 Hübner & Leunert 2015, p. 2263.
33 Article 2(1)(74) BRRD; Article 3(1)(51) SRM Regulation.
34 Articles 37(2), 59(1) BRRD; Articles 21(7), 22(1) SRM Regulation.
35 Article 59(1) BRRD; Article 21(7) SRM Regulation.
36 Article 60(1) BRRD; Article 21(10) SRM Regulation. *See* Huertas 2016, p. 16, who notes that '[s]trictly speaking, common equity is not subject to bail-in as it already bears first loss and is the instrument in which bail-in may convert other liabilities.' and *see* European Banking Authority, Consultation Paper, Draft Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments, EBA/CP/2014/40, p. 5, which sets out at '[s]hareholders sit at the bottom of the insolvency creditor hierarchy, and are therefore the first creditors to absorb losses on both a going-concern basis and in an insolvency. This position should be reflected in resolution, where shareholders should also be the first to absorb losses, and do so before more senior creditors.'
37 Article 43(2) BRRD; Article 27(1) SRM Regulation. *See* Wojcik 2016, p. 107.
38 *See* Binder 2015a, p. 109-110. On these two different resolution approaches, i.e., the open bank bail-in and the closed bank bail-in approach, *see* Krimminger & Nieto 2015, p. 5; Chennells & Wingfield 2015, p. 234.
39 Article 52 BRRD; Article 27(16) SRM Regulation.

liabilities fall within the scope of the resolution authority's bail-in tool and the bail-in powers are to be applied tranche by tranche,[40] following to a large extent 'a reverse order of priority of claims'[41] under national insolvency law.[42]

To ensure that banks have a sufficient amount of capital instruments and liabilities on their balance sheets that can be made subject to the bail-in mechanism, resolution authorities require banks to meet at all times a minimum requirement for bail-inable capital instruments and liabilities. The requirements are known as the Minimum Requirement for own funds and Eligible Liabilities (MREL) and Total Loss-absorbing Capacity (TLAC).[43] The BRRD calls the bail-inable liabilities that count towards the MREL or TLAC requirement of a bank 'eligible liabilities'.[44] The resolution authority may exercise the write-down or conversion of capital instruments and eligible liabilities tool in relation to these eligible liabilities.[45] The requirements aim to ensure that a large part of the losses can be absorbed and that the bank can subsequently be recapitalized, although the recapitalization requirement as part of the standards does not apply to a bank that is expected to be liquidated.[46]

A simple example illustrates the application of the bail-in mechanism under the BRRD and SRM Regulation.[47] Suppose the ECB as competent supervisory authority concludes that a bank needs to take a substantial loss on

40 *Cf.* G. Franke et al. 2014, p. 565, who compare the hierarchy of liabilities in bail-in to a securitization transaction in which also several tranches are distinguished.

41 Wojcik 2016, p. 111.

42 Article 48 BRRD; Article 17 SRM Regulation.

43 Articles 45-45m BRRD; Articles 12-12g SRM Regulation; Article 72a-72l and 92a CRR; Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities (OJ L 237, 3.9.2016, p. 1).

44 Article 2(1)(71a) BRRD; Article 3(1)(49a) SRM Regulation; Article 72a CRR. Before entry into force of the recent amendments to the BRRD, the liabilities that were not excluded from bail-in were called 'eligible liabilities'. The term 'eligible liabilities' is now used for debt that counts towards MREL under articles 45-45k BRRD. 'Bail-inable liabilities' is the term now used for the capital instruments and liabilities that do not qualify as CET1, AT1 and T2 instruments and are not excluded from the scope of bail-in under article 44(2) BRRD. *See* Article 2(1)(71) BRRD.

45 Articles 59 and 60 BRRD; Article 21 SRM Regulation.

46 Article 45c(2) BRRD; Article 12d(2) SRM Regulation; Article 2(2) Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities (OJ L 237, 3.9.2016, p. 1).

47 For a detailed discussion of the application of the bail-in mechanism, s*ee also* e.g., Wojcik 2016, p. 111; Gleeson & Guynn 2016, p. 177-181 and 190-192; Schelo 2015, p. 121-125; Andrae 2014, p. 30-31; Gleeson 2012, p. 5-8.

its loan book and therefore no longer complies with the regulatory capital requirements. It decides together with the SRB that it meets the conditions for the opening of a resolution procedure.[48] Based on a valuation of the bank's assets and liabilities and a resolvability assessment and resolution plan that have been made beforehand, the SRB assesses which resolution actions need to be taken, what part of the bank's capital should be made subject to bail-in measures, and what should in the end be the capital position of the bank, which is in this case the 'target' of the bail-in measures.[49] The BRRD requires that the recapitalization is enough to allow the bank to meet the capital requirements again and to restore market confidence in the bank.[50] The Board then adopts a so-called resolution scheme, which places the bank under resolution and determines the application of the resolution tools.[51]

In this hypothetical case, the resolution authority concludes that it does not combine bail-in with the application of other resolution tools. The resolution scheme enters into force after the European Commission and the Council have not expressed any objections within 24 hours.[52] The Board then sends the scheme to the relevant national resolution authorities, which implement the measures in accordance with the BRRD, as transposed into national law.[53] The write-down or conversion of capital instruments and eligible liabilities tool is in this case first applied to fully write-down the relevant capital instruments and bail-inable liabilities that count towards the MREL. This measure covers the losses made by the bank and returns the difference between the asset side and liability side of the bank's balance sheet (the net asset value) to zero.[54] The next step in this case is the conversion of other liabilities into equity to recapitalize the bank.[55]

It is worth noting that the BRRD and SRM Regulation do not explicitly provide that a resolution authority is empowered to convert a liability of the bank in another type of debt – such as the conversion of a senior liability in subordinated debt that qualifies as an AT1 or T2 capital instrument and, as a result, as regulatory capital. According to the literature, if a resolution authority is empowered to convert a claim against the bank into shares in the bank, it should also be empowered to transform it in a less subordinated position such as a subordinated claim.[56] One can also argue that article 64

48 Article 32(1) BRRD; Article 18(1) SRM Regulation.
49 Articles 10-14, 36(1), (4), 59(10) BRRD; Articles 8-9, 20(1), (5) SRM Regulation.
50 Article 46(2) BRRD.
51 Article 18(1), (6), 23 SRM Regulation.
52 Article 18(7) SRM Regulation. For a more detailed discussion of the decision-making procedure within the SRM, *see* Schillig 2016, p. 147-150; Zavvos & Kaltsouni 2015, p. 127-138.
53 Articles 18(9), 23, 29 SRM Regulation.
54 Article 60(1) BRRD; Articles 21(10)-(11), 29 SRM Regulation.
55 Articles 46, 48(1), 60(1) BRRD.
56 Kastelein 2014, p. 129.

BRRD provides for a legal basis for this conversion because it stipulates that a resolution authority is empowered to modify the terms of a contract to which the bank under resolution is a party when exercising its resolution powers.

4 Parallels between principles of bail-in and principles of corporate financial restructuring outside traditional formal insolvency procedures

4.1 Introduction

Over the past years, not only the rules governing the restructuring of bank debt but also the laws governing the restructuring of financial obligations of non-financial corporate debtors have been paid considerable attention by the EU legislature.[57] In the EU, there has been an increasing focus on pre-insolvency restructuring and 'business rescue' as an alternative to traditional, court-centered insolvency procedures.[58] For example, in 2014 the European Commission adopted a Recommendation that encourages the Member States to amend their national corporate restructuring laws so as

> 'to ensure that viable enterprises in financial difficulties, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole.'[59]

Two years after the publication of the Recommendation, the Commission published a proposal for a directive which, amongst other things, aims to harmonize the substantive rules governing corporate restructuring proce-

57 For an overview of the EU developments in the field of corporate restructuring and insolvency laws since 2011, including the policy documents published by the European Parliament and the European Commission, *see* European Commission, 'Initiative on insolvency', Inception Impact Assessment, 2 March 2016, available at http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_just_025_insolvency_en.pdf; Wessels 2015c, p. 208-212; Eidenmüller & Van Zwieten 2015, p. 633-637; Madaus 2014, p. 82.

58 *See* e.g., Eidenmüller 2017, p. 274-276; Wessels 2015c, p. 207.

59 Recital 1 European Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, available at http://data.europa.eu/eli/reco/2014/135/oj. According to the Recital, the second objective of the Recommendation is 'giving honest bankrupt entrepreneurs a second chance across the Union.' For a discussion of the Recommendation, *see* Eidenmüller & Van Zwieten 2015. Only a few Member States undertook reforms to implement the Recommendation. *See* Directorate-General Justice & Consumers of the European Commission, 'Evaluation of the Implementation of the Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, 30 September 2015, available at http://ec.europa.eu/justice/civil/files/evaluation_recommendation_final.pdf.

dures.[60] The proposed rules exclude banks and other financial institutions from their scope.[61] According to the draft directive, national corporate restructuring frameworks should facilitate a restructuring 'where there is likelihood of insolvency'[62] to enable a debtor to continue operating. Such a 'restructuring' can be a financial restructuring, such as a rescheduling of payments, a debt to equity swap, and a reduction of the value of creditor claims.[63] A restructuring plan shall be deemed to be adopted if the required majority of the debtor's affected creditors in each class agrees with it. If certain conditions are met, one or more classes of creditors in which the necessary majority is reached can also bind one or more dissenting classes.[64] Shareholders may, rather than shall, be allowed to vote on the plan in a separate group.[65] If the arrangement affects the interests of dissenting affected parties, it has to be confirmed by a judicial or administrative authority at the end of the process, which has to check, amongst other things, that the dissenting parties are not worse off under the plan than in the event of liquidation of the debtor's business.[66] An imposition of a restructuring on dissenting creditors and shareholders as included in the proposed directive is in the literature generally called a 'cramdown'.

The EU developments towards the facilitation of pre-insolvency corporate restructuring procedures as an alternative to traditional, court-centered insolvency procedures cannot be studied in isolation from national developments in the field of corporate restructuring and insolvency law. The literature indicates that many EU Member States have recently introduced or proposed rules to reform their domestic restructuring and insolvency legislation, driven by regulatory competition as well as developments during

60 Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM (2016) 723 final, 22.11.2016) ('Proposed Directive on preventive restructuring frameworks'). For an extensive discussion of the proposed directive, *see* Eidenmüller, 2017, who also criticises the proposal because, in his opinion, only economically viable companies should have the opportunity to restructure, and the others should be liquidated. *Cf.* Tollenaar 2016, p. 305-311.

61 Article 1(2) Proposed Directive on preventive restructuring frameworks.

62 Article 4 Proposed Directive on preventive restructuring frameworks.

63 Article 2(2) Proposed Directive on preventive restructuring frameworks defines the term 'restructuring' as 'changing the composition, conditions, or structure of a debtor's assets and liabilities or any other part of the debtor's capital structure, including share capital, or a combination of those elements, including sales of assets or parts of the business, with the objective of enabling the enterprise to continue in whole or in part.'

64 Articles 9-11 Proposed Directive on preventive restructuring frameworks.

65 Article 12 Proposed Directive on preventive restructuring frameworks.

66 Articles 8-11 Proposed Directive on preventive restructuring frameworks.

the latest financial crisis.[67] In most of these jurisdictions, procedures have been introduced that allow some form of restructuring.[68] Common tendencies of the procedures in some Member States several years ago already included that an arrangement that is negotiated amongst the creditors can be crammed down on a dissenting minority, and that a restructuring procedure can be started at an early stage, i.e., earlier than the moment a formal insolvency procedure can be opened.[69]

These developments beg the question if restructuring procedures under Dutch, German, and English company and general insolvency law allow (i) a cramdown in (ii) a financial restructuring outside a traditional court-centered insolvency procedure. Moreover, it raises the question if these national restructuring procedures share these two principles with the bail-in mechanism. Paragraph 4.2 investigates the first question. It shows that the domestic laws all provide for corporate restructuring procedures that are initiated by a plan proposal and end with a court confirmation that can bind dissenting creditors and shareholders to a majority vote. Only English law, however, provides for such a corporate procedure outside the context of a formal insolvency procedure, which is mainly the English scheme of arrangement procedure. In the Netherlands, a proposal for a similar procedure is pending, which is the extrajudicial plan (*onderhands akkoord*) procedure. Paragraph 4.3 then concludes that the application of the bail-in mechanism has both of the two characteristics: the resolution authority imposes a financial restructuring on the creditors and shareholders outside a traditional court-centered insolvency procedure. These conclusions about the shared principles of national corporate restructuring law and the bank resolution frameworks are further analyzed in the coherence study in chapter 7.

67 Eidenmüller & Van Zwieten 2015, p. 627; Wessels 2015c, p. 207; Wessels 2011, p. 28. *See also* Finch 2010, who notes at p. 502 that '[i]n the new millennium, governments around the world have sought, with an increasing urgency, to establish higher quality rescue processes. In the United Kingdom, for example, the Enterprise Act 2002 was passed in order to improve the insolvency procedures available to troubled corporations and to rejuvenate the broader "rescue culture".'

68 Wessels 2015c, p. 207-208.

69 Wessels 2015c, p. 208 & 210; Pieckenbrock 2012; Wessels 2007, p. 255. *See also* Commission Staff Working Document Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (SWD(2016) 357 final, 22.11.2016), p. 15-22; De Weijs 2012, p. 74-75. Pieckenbrock's study includes the legislation in England, France, Italy, Belgium, Austria, and Germany. Other common tendencies discussed by Pieckenbrock include that the debtor can be allowed to keep control over its business, that new financing for the business is protected, and that a debt to equity swap is one of the possibilities.

4.2 Financial restructuring under national company and insolvency law

4.2.1 Corporate financial restructuring under English law

Over the last two decades, the scheme of arrangement under English company law[70] has become increasingly popular as a tool for a financial restructuring for corporate debtors, also for companies with their seat in other countries.[71] The Companies Act 2006 (CA 2006) defines it as 'a compromise or arrangement [that, LJ] is proposed between a company and (a) its creditors, or any class of them, or (b) its members, or any class of them.'[72] One of the advantages of the use of a scheme is that the CA 2006 does not require the debtor company to be insolvent, and a restructuring can, therefore, take place at an early stage of financial distress of the debtor.[73] In the scheme of arrangement procedure, the shareholders and creditors, who may include the secured creditors, are divided into and vote on the scheme in classes. Section 899 CA 2006 provides that the court may sanction the scheme if a majority in number representing 75 percent in value in each relevant class of creditors or shareholders approved it. Hence, a majority of creditors or shareholders in a class can bind a minority within the same class. Before sanctioning the scheme, the court assesses the fairness and reasonableness of the scheme, which includes, according to case law, an examination of whether the majority in the approving class fairly represented that class and that a reasonable man would approve the scheme.[74] The Act does not explicitly provide that a whole dissenting class in a scheme of arrangement procedure can be crammed down.[75] Nevertheless, according to the literature, case law suggests the court may sanction a scheme that excludes

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70 Part 26 CA 2006. On 26 August 2018, the UK government announced proposals to introduce a new restructuring mechanism and moratorium. The proposals are available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf. These proposals will not be further discussed.

71 Eidenmüller & Van Zwieten 2015, p. 626-627; Payne 2014a, p. 175 and 188; Payne 2013, p. 564. For a discussion of the cross-border issues if a non-English company uses a scheme or arrangement under English law, *see* Payne 2014a, p. 286-324; Chan Ho 2011, p. 434-443. *See also* Sax & Swierczok 2017, p. 601-607.

72 Section 895(1) CA 2006.

73 Payne 2014a, p. 176; Payne 2013, p. 567.

74 Finch & Milman 2017, p. 410-411 refer to several cases which provide for the following summary of the role of the court: '[i]n exercising its power of sanction […] the Court will see: First, that the provisions of the statute have been complied with. Secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and, Thirdly, that the arrangement is such as a man of business would reasonably approve'. *Re Anglo-Continental Supply Company Limited* [1922] 2 Ch 723.

75 Payne 2014b, para. III, 3.

a class of creditors or shareholders and disregards their votes, and hence forces them to accept the scheme, provided that this class has 'no economic interest in the company'.[76]

For example, in the case *Re Bluebrook Ltd*[77] the restructuring proposal involved a transfer of the assets of the corporate group to newly established companies in a pre-pack administration procedure. A majority of the senior creditors agreed on schemes of arrangement to swap their claims into most of the shares in the new companies. The junior creditors and shareholders would be left behind with the old group structure that did not have any substantial assets, and they did not have the opportunity to vote on the scheme. The junior creditors challenged the schemes on the grounds of fairness. The court, however, preferred the valuation that showed that the value of the assets of the distressed companies in the group was not sufficient to cover the claims of the senior creditors. It, therefore, concluded that the junior creditors were 'out of the money'. The junior creditors had no economic interest in the company and it was appropriate to sanction the schemes.[78]

The CVA[79] forms another tool for a corporate financial restructuring under English law, whether it is as a stand-alone procedure or within an administration or winding-up procedure under the IA 1986. As is further discussed in Chapter 6, until the entry into force of the IA 1986, liquidation was considered the cornerstone of English insolvency law.[80] The CVA was introduced to promote a so-called 'rescue culture' and to enable a company to enter into an informal but binding agreement with its creditors, such as a composition of debts.[81] For the use of a CVA, the company does not have to be insolvent.[82] In contrast to a scheme of arrangement, the creditors vote as one single class on the proposed arrangement and a CVA does not result from a court order.[83] English courts also do not have powers to overrule dissenting creditors if the required majority has not consented to the CVA.[84] Furthermore, one of the limitations of the use of the CVA is that the arrangement cannot bind the secured and the preferential creditors without their consent.[85] The CVA needs to be approved by 75 percent of the creditors at the creditors' meeting and by a majority in value of the shareholders present

76 Chan Ho 2009. *Cf. In re Tea Corporation Limited* [1904] 1 Ch 12.
77 *Re Bluebrook Limited and other companies* (IMO) [2009] EWHC 2114.
78 Kornberg & Paterson 2016, para. 3.388-397; Payne 2014a, p. 43-45.
79 Part I IA 1986; Schedule A1 to the IA 1986.
80 Payne 2014b, para. III, 2.
81 Finch & Milman 2017, p. 417; Payne 2014b, para. III, 2; Tribe 2009, p. 465-466.
82 Finch & Milman 2017, p. 418; Kornberg & Paterson 2016, para. 3.246.
83 Kornberg & Paterson 2016, para. 3.246.
84 De Weijs 2012, p. 77.
85 Payne 2014b, para. III, 2. *Cf.* Section 4(3)-(4) IA 1986.

at the shareholders' meeting. Once approved, it in principle binds every creditor who was entitled to vote. Scholars note that this means that a form of cramdown within the class of creditors is possible in the procedure.[86] If the creditors but not the shareholders approve the CVA, the vote of the creditors prevails and the arrangement becomes effective, although a creditor or shareholder may then challenge the CVA in court on the grounds of unfair prejudice or material irregularity.[87]

4.2.2 Corporate financial restructuring under Dutch law

The literature has much discussed that Dutch law does not provide for an adequate statutory procedure for a corporate financial restructuring outside the formal insolvency procedures under the Fw, i.e., the bankruptcy procedure and the suspension of payments procedure.[88] These formal procedures provide the debtor and its creditor the possibility to agree on a composition plan. However, the procedures are more focused on liquidation than on a restructuring and rescue of the business. Several Dutch companies have implemented a restructuring through a scheme of arrangement under the English CA 2006.[89] The limited options for a financial restructuring outside a formal insolvency procedure that existed or exist under Dutch law are twofold.

First, until 1981 the Act on the meeting of bearer debt instruments (*Wet op de vergadering van schuldbrieven aan toonder*) provided one option to force creditors and shareholders of a corporate debtor to cooperate in a financial restructuring outside a formal insolvency procedure. Under the Act, a three-fourths majority of bondholders could take decisions in a meeting of bondholders that were binding on all bondholders.[90] Based on this Act Dutch courts allowed the conversion of bonds into shares in several cases in the first half of the twentieth century.[91]

Second, the option that still exists for a debtor is to reach an agreement with his creditors and shareholders that is governed by general rules of private law. Case law has determined that in exceptional circumstances dissenting

86 Payne 2014b, para. III, 2.
87 Sections 4a(2)-(6) and 6 IA 1986. *See* Kornberg & Paterson 2016, para. 3.254-276.
88 E.g., Vriesendorp, Hermans & De Vries 2013, para. 2.
89 Mennens & Veder 2015, para. 1.
90 *Stb.* 1934, 279.
91 Tollenaar 2008, p. 61 and *see* e.g., Rb. Amsterdam 8 February 1940, *Nederlandse Jurisprudentie* 1940/270; HR 24 June 1936, *Nederlandse Jurisprudentie* 1937/302; Hof Amsterdam 12 February 1936, *Nederlandse Jurisprudentie* 1936/496. In its decision of 12 February 1936, the Amsterdam Court of Appeal held that 'dit besluit zeer ingrijpend is voor de obligatiehouders, omdat zij bij liquidatie, dwangaccoord na surséance, of bij faillissement nog kans hebben op eenige uitkeering, terwijl zij als aandeelhouders achter de schuldeisers zullen komen.'

creditors and shareholders can be compelled to cooperate in such a case. In 2005, the Dutch Supreme Court held that dissenting creditors can be forced to agree with the measures if the rejection by these creditors constitutes an abuse of power and the creditors, therefore, could not have reasonably refused the proposed restructuring plan.[92] The fact that a dissenting creditor is aware or should be aware of the debtor's poor financial position is insufficient to conclude that the creditor misused his power. In principle, the interests of the debtor in preventing the need to open a formal insolvency procedure do not outweigh the interests of the creditor in the satisfaction of his claims out of the debtor's assets.[93] Thus, the Supreme Court set a high standard.[94] Moreover, it follows from case law that shareholders, although in principle they cannot be forced to make additional investments when a company is in dire straits,[95] under certain circumstances may have to allow a share issuance and accept a dilution of their shares and a change in the control structure.[96] The Enterprise Chamber of the Amsterdam Court of Appeal can order immediate relief measures (*onmiddellijke voorzieningen*)[97] entailing that requirements in the articles of association or statutory requirements are put aside, such as the shareholders' approval required for a capital increase, and the issuance of shares can take place if the financial situation of the company so requires.[98] Three requirements need to be met: (1) the company faces financial difficulties and its existence is threatened, (2) there is a deadlock in the decision-making within the company, and (3)

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92 HR 12 August 2005, *Nederlandse Jurisprudentie* 2006/230 (*Groenemeijer/Payroll*).

93 HR 12 August 2005, *Nederlandse Jurisprudentie* 2006/230 (*Groenemeijer/Payroll*), para. 3.5.2-3.5.4.

94 Hummelen 2016, p. 193-194; Mennens & Veder 2015, para. 2.1; Wessels 2013a, para. 6208-6240; Soedira 2011, p. 267-271. Considering the Supreme Court judgement and case law of lower courts, Wessels 2013a, para. 6240 concludes that a rejection by a creditor might be considered an abuse of power if the debtor presents his creditors a well-documented and independently reviewed offer that shows that he does his utmost to settle his debts and that in a formal insolvency procedure the creditors would receive less than under the offered plan.

95 *See* Asser/Van Solinge & Nieuwe Weme 2-IIa 2013, para. 131; Hof Amsterdam 11 March 2004, *Jurisprudentie Onderneming & Recht* 2004/190 (*Piton/Booij*), para. 4.11.

96 Draft explanatory memorandum to the *Wet Continuïteit Ondernemingen II*, 14 August 2014, available at www.internetconsultatie.nl/wco2, p. 18-19; Asser/Van Solinge & Nieuwe Weme 2-IIa 2013, para. 131.

97 Section 2:349a(2) BW.

98 Bergervoet 2015, p. 312; Draft explanatory memorandum to the *Wet Continuïteit Ondernemingen II*, 14 August 2014, available at www.internetconsultatie.nl/wco2, p. 18-19. *Cf*. Hof Amsterdam (Ondernemingskamer) 25 May 2011, *Jurisprudentie Onderneming & Recht* 2011/288; HR 25 February 2011, *Jurisprudentie Onderneming & Recht* 2011/115; Hof Amsterdam (Ondernemingskamer) 31 December 2009, *Jurisprudentie Onderneming & Recht* 2010/60 (*Inter Access*); Hof Amsterdam (Ondernemingskamer) 11 March 2004, *Jurisprudentie Onderneming & Recht* 2004/190 (*Piton/Booij*); Hof Amsterdam (Ondernemingskamer) 25 April 2002, *Jurisprudentie Onderneming & Recht* 2002/128 (*Gorillapark*); Hof Amsterdam (Ondernemingskamer) 15 November 2001, *Jurisprudentie Onderneming & Recht* 2002/6 (*Decidewise*); HR 19 October 2001, *Jurisprudentie Onderneming & Recht* 2002/5 (*Skygate*).

there is no alternative solution available than the issuance of new shares.[99] In this way, conversion of a loan into shares in the company may be effectuated even though a major shareholder rejected the proposed plan.[100] Hence, only in specific circumstances, the continued existence of the company may outweigh the interests of a major shareholder in retaining a certain degree of control in the company.[101]

On 5 September 2017, the draft bill for the Act on Court Confirmation of Extrajudicial Restructuring Plans to Avert Bankruptcy (*Wet Homologatie Onderhands Akkoord ter Voorkoming van Faillissement,* WHOA) was published.[102] The approach taken in the draft bill is to introduce a statutory procedure in the Fw to bind shareholders and creditors, including the preferential and the secured creditors, to a restructuring plan (*akkoord*) outside a bankruptcy or suspension of payments procedure.[103] Scholars note that the proposed procedure fits well with the 'corporate rescue tendency in the international insolvency law' ('*corporate rescue-tendens in het internationale insolventierecht*').[104] The Ministry of Justice and Security based the draft bill partly on the English provisions on the scheme of arrangement.[105]

If the draft bill is passed in its current form and similar to the English scheme of arrangement, for the restructuring plan to be offered there is no requirement that the debtor company is insolvent.[106] Furthermore, the draft bill does not limit the possible content of the plan, the affected creditors and shareholders vote in classes, and the stakeholders are bound to the restructuring plan once the court confirms it.[107] Unlike the English CA 2006 regarding the scheme of arrangement, the draft bill explicitly provides that with the confirmation of the Dutch restructuring plan not only a so-called 'intra-class cramdown' but also a 'cross-class cramdown' can take place.[108] That is,

99 Bergervoet 2015, p. 312-313; Doorman 2010, para. 3. *Cf.* De Kluiver 2006, p. 21.

100 *Cf.* Hof Amsterdam (Ondernemingskamer) 31 December 2009, *Jurisprudentie Onderneming & Recht* 2010/60 (*Inter Access*); HR 25 February 2011, *Jurisprudentie Onderneming & Recht* 2011/115.

101 Bergervoet 2015, p. 312-313; Draft explanatory memorandum to the *Wet Continuïteit Ondernemingen II*, 14 August 2014, available at www.internetconsultatie.nl/wco2, p. 18; Asser/Van Solinge & Nieuwe Weme 2-IIa 2013, para. 131.

102 The draft bill is available at https://www.internetconsultatie.nl/wethomologatie.

103 Section 369 et seq. Fw.

104 Mennens & Veder 2015, para. 5.

105 *Cf.* Vriesendorp, Hermans & De Vries 2013.

106 Sections 370-371 Fw provide that a debtor can offer a restructuring plan if he 'anticipates that he will be unable to continue paying his due and payable debts' and a creditor can initiate the offering of the plan if it is 'reasonably likely that a debtor will be unable to continue paying his debts'.

107 Sections 373-374 and 381-382 Fw.

108 *See* De Brauw Blackstone Westbroek, response in the consultation on the Draft Bill on the WHOA of 30 November 2017, available at www.internetconsultatie.nl/wethomologatie/reacties, p. 7-8. *Cf.* Sections 380(1), 381(1) and (4) Fw.

the plan may not only bind dissenting creditors or shareholders within the same class but also a whole dissenting class or classes. A class approves the plan if the creditors or shareholders in the class representing at least two-thirds of the total value of the claims or issued capital, respectively, held by the class vote in favor of the plan.[109] If one or more classes vote against the restructuring plan, the court can declare the restructuring plan binding on all creditors and shareholders who were entitled to vote. However, in this case, safeguards for the shareholders and creditors apply.[110] The court may decide to refuse confirmation, for example, if creditors or shareholders in a dissenting class receive less under the plan than they would receive in a bankruptcy procedure or if they are not fully repaid while a lower ranking group receives or retains rights under the restructuring plan.[111]

4.2.3 Corporate financial restructuring under German law

Three different German legal frameworks can govern a restructuring of the right side of the balance sheet of a non-financial corporate debtor: company law, the Bond Act (*Schuldverschreibungsgesetz*) and insolvency law.[112] A pre-insolvency procedure that can be used for a financial restructuring and is similar to the English scheme of arrangement and the proposed Dutch extrajudicial restructuring plan procedure does not exist under German law.

Firstly, the German Stock Corporation Act (*Aktiengesetz*, AktG) offers several measures that can be used for a financial restructuring outside a formal insolvency procedure under the InsO. These include a reduction of the share capital to compensate for a decline in the value of assets[113] and a share capital increase by issuing new shares.[114] The AktG requires a decision of a majority of at least three-fourths of the share capital represented at the shareholders' meeting for such a capital decrease and increase.[115] These requirements entail that the shareholders can, in principle, easily block important restructuring decisions and have been widely considered a major hurdle in restructuring procedures.[116]

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109 Section 378(4)-(5) Fw.

110 Section 381 Fw also provides for several safeguards for dissenting creditors and shareholders in a class which approved the plan. Under Section 381(3) Fw the court does not confirm the plan if, for example, a creditor or shareholder receives less under the plan than he would receive in a bankruptcy procedure.

111 Section 381(4) Fw.

112 *See* Häfele 2013, p. 42-46.

113 For a discussion of a capital reduction under the AktG as a balance sheet restructuring ('*Buchsanierung*'), *see* HüfferKomm-AktG/Koch 2016, Sections 222 and 229; Häfele 2013, p. 49-53; Von Jacobs 2010, p. 80-88; Wirth 1996, para. 3.

114 Section 182 AktG. *See* HüfferKomm-AktG/Koch 2016, Section 182; Bork 2012a, para. 15.05.

115 Sections 182, 222 and 229 AktG.

116 Bork 2012a, para. 5.06 and 15.06; Schuster 2010; Von Jacobs 2010, p. 83.

However, the German Federal Court of Justice has recognized a shareholder's duty of loyalty (*Treuepflicht*) in relation to the company and the other shareholders, which may require shareholders to consider the interests of the company.[117] In *Girmes*,[118] for instance, the Court held that the duty of loyalty amongst shareholders prevented the minority shareholders from blocking a decision on a capital reduction for selfish motives. The decision had the support of the majority and might have saved the company from insolvency in which the shareholders were in a worse economic position. This does not entail, however, that shareholders are always required to vote in favor of restructuring measures.[119] The literature considers the case a special case and argues that the duty cannot be used as a basis for a restructuring procedure.[120] Regarding the cooperation of creditors in a restructuring outside an insolvency procedure, the Federal Court of Justice ruled in a leading decision that a creditor cannot be forced to agree with debt restructuring measures because the majority of the creditors agrees with the measures. It would infringe constitutional property rights. In this case, the debt restructuring measure was a claim reduction. The case in literature often referred to as the 'arrangement disturber' (*Akkordstörer*) decision.[121]

Secondly, the Bond Act (*Gesetz über Schuldverschreibungen aus Gesamtemissionen*) also facilitates a financial restructuring. Under the Bond Act the terms and conditions of bonds issued under German law may allow a majority of the bondholders to force the other bondholders to accept a modification of the terms and conditions.[122] Thus, the scope of application of the Act is limited to bonds. Possible measures are, for instance, a reduction of the principal amount due, a subordination of the claims, and conversion of the bonds into shares.[123]

Thirdly, the InsO provides for a formal insolvency procedure in which a company can enter into a binding restructuring plan with its creditors and shareholders, which is the insolvency plan procedure. Under section 270b InsO the court can first open a so-called protective shield procedure (*Schutzschirmverfahren*) in which an imminently illiquid or over-indebted

117 Bundesgerichtshof 19 October 2009, II ZR 240/08, BGHZ 183,1 (*Sanieren oder Ausscheiden*); Bundesgerichtshof 20 March 1995, II ZR 205/94, BGHZ 129, 136 (*Girmes*).

118 Bundesgerichtshof 20 March 1995, II ZR 205/94, BGHZ 129, 136 (*Girmes*).

119 Häfele 2013, p. 80-86; Bork 2012a, para. 5.06; Schuster 2010, p. 332-335; Westpfahl 2010, p. 397-399. *See also* Madaus 2011.

120 Bork 2012a, para. 5.06; Schuster 2010, p. 332-335.

121 Bundesgerichtshof 12 December 1991, IX ZR 178/91, BGHZ 116, 319 (*Akkordstörer*). *See* Bitter 2010, p. 167-169; Westpfahl 2010, p. 395-397. For a discussion of a new system with duties for creditors to cooperate in restructuring cases which is developed by Eidenmüller, *see* Eidenmüller 1999, Chapter 6.

122 Sections 4-22 Bond Act. *See* Thole 2014, p. 2365-2368; Häfele 2013, p. 44-46.

123 Section 5(3) Bond Act. Under Article 5(4) Bond Act most of the measures require a majority of at least 75 percent of the relevant bondholders.

company has a few months to work out an insolvency plan under the supervision of a preliminary administrator (*Sachwalter*). This procedure entails that restructuring measures in an insolvency plan can already be prepared before a formal insolvency procedure may subsequently be opened.[124] For the financial restructuring to take place, the court has to open an insolvency procedure. This has been criticized in literature.[125]

The InsO explicitly provides that an insolvency plan in an insolvency plan procedure can include financial restructuring measures such as the conversion of creditors' claims into shares, decrease or increase of share capital, and exclusion of pre-emption rights.[126] The insolvency plan needs to be approved by affected creditors and shareholders and confirmed by a court.[127] In the past, restructuring measures affecting shareholders' rights could only be implemented in an insolvency plan procedure with the consent of the shareholders as required under company law, which was considered a major hurdle in restructuring procedures.[128] In 2012, German insolvency law was amended to facilitate corporate restructurings.[129] The InsO now provides that shareholders are party to the insolvency plan procedure and, where relevant, shareholder resolutions required for certain

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124 For a critical discussion of the procedure under Section 270b InsO, *see* Madaus 2012, p. 104-107.

125 E.g., Madaus 2017, p. 333, who concludes that: '[e]ine formelle Insolvenz lässt sich auf diesem Wege nicht vermeiden. Damit kauft man sich all die negativen Folgen einer – auch nur kurzen – Verfahrenseröffnung ein. Insbesondere für Unternehmensgruppen enden die Beherrschungsverträge bzw. die Beherrschungsmöglichkeiten und eine allenfalls koordinierte Verfahrensabwicklung nach dem jeweiligen Konzerninsolvenzrecht tritt an deren Stelle. Aber auch bei nicht konzerngebundenen Unternehmen kommt es zu den negativen Folgen eröffneter Insolvenzverfahren im Hinblick auf Covenants in Finanzierungs- und Lieferverträgen oder aber auch auf Kundenbeziehungen und Imagepflege. Insgesamt ist die Option Schutzschirm mithin nicht geeignet, um noch relativ gut finanzierten Unternehmen bei Akkordstörerproblemen zu helfen. Zugleich bietet die Mehrheitsmacht in § SCHVG § 5 SchVG nur eine Option für Anleiherestrukturierungen, nicht aber ein Instrument für sämtliche Formen finanzieller Restrukturierungen. Eine auf diese konkrete Problemstellung fokussierte vorinsolvenzliche Sanierungshilfe fehlt dem deutschen Recht.'

126 Section 225a(2) InsO.

127 Sections 244-248 and 254 InsO.

128 Kleindiek 2012, p. 545; Spetzler 2010, p. 434-437; Eidenmüller & Engert 2009, p. 542-543 and 549; Piekenbrock 2009, p. 268-270. According to the German legislature, the strict separation between company law and insolvency law needed to be abandoned to facilitate the application of capital restructuring measures within an insolvency plan procedure, in particular, the conversion of creditor claims into shares. Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen, Deutscher Bundestag, Drucksache 17/5712, 4 May 2011, p. 18.

129 *See* Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen, Deutscher Bundestag, Drucksache 17/5712, 4 May 2011, p. 17. The InsO was amended by the Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (ESUG) of 7 December 2011, Federal Law Gazette (Bundesgesetzblatt) 2011, Part I, p. 2582-2591.

measures under company law are deemed to have been adopted if the insolvency plan has been agreed on.[130] Shareholders and creditors vote in different classes and can be forced to accept the insolvency plan if a majority by vote and value in their class agrees with the proposal. Also, a 'cross-class cramdown' is possible under the InsO. However, German scholars have been very reluctant to accept the introduction these amendments to the insolvency plan procedure that aim to facilitate that dissenting shareholders of the company can be bound to the measures and, as a result, their rights modified.[131] The InsO now aims to protect creditors and shareholders with the requirements that if a class has not accepted the proposal, the dissent of creditors can only be replaced by a court decision if (1) the members of the class are not placed in a worse position than without the plan, (2) they participate to a reasonable extent in the economic value devolving on the parties under the plan,[132] and (3) at least a majority of all classes has approved the proposal.[133] Moreover, conversion of claims into shares cannot take place against the will of the relevant creditors.[134]

4.3 Financial restructuring under the bank resolution rules

Because the bail-in mechanism gives resolution authorities far-reaching powers to impose losses on creditors and shareholders and convert certain claims into shares, the literature considers it the 'innovative Herzstück der BRRD',[135] a 'Wunderwaffe'[136], 'the most controversial weapon among the guns in the [BRRD, LJ] arsenal'[137] and 'the most significant regulatory achievement in post-crisis efforts to end "Too Big To Fail"'.[138] It is the present author's view, however, that the substantive effect of the measures may not be very different from the effect of a financial restructuring for other types of businesses. As is further discussed below, the most important difference is that an administrative authority has discretionary powers to implement the financial restructuring by regulatory decision.[139]

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130 Sections 217 and 254a(2) InsO. *See* UhlenbruckKomm-InsO/Luër/Streit 2015, Section 254a, para. 6-11; Kleindiek 2012, p. 546.

131 E.g., Madaus 2011.

132 *Cf.* Section 245(2)-(3) InsO.

133 Section 245 InsO. *See* Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen, Deutscher Bundestag, Drucksache 17/5712, 4 May 2011, p. 18; Thole 2014, p. 2370-2372; MünchKomm-InsO/Drukarczyk 2014, Section 245, para 14-101.

134 Sections 225a(2) and 230(2) InsO. *See* Schwarz 2015, p. 234-236; MünchKomm-InsO/Eidenmüller 2014, section 230, para. 44-70.

135 Adolff & Eschweg 2013, p. 962, also cited by Binder 2015a, p. 120.

136 Thole 2016, p. 67.

137 Bliesener 2013, p. 191.

138 Ringe 2018, p. 3.

139 Schillig 2018, para. 3.2.

Similar to the developments in corporate restructuring and insolvency law to facilitate the implementation of a financial restructuring where there is a 'likelihood of insolvency', bail-in takes place outside a traditional, court-centered insolvency procedure and preferably also at an early stage of financial difficulties. For example, the resolution authorities can exercise the write-down or conversion of capital instruments and eligible liabilities tool already before any resolution action is taken.[140] As indicated in chapter 2,[141] a bank resolution procedure in which the bail-in tool can be applied can be opened when the resolution conditions are met, which conditions include the condition that a bank has crossed the 'failing or likely to fail' threshold. This condition is satisfied if the bank is expected to be failing in the 'near future', for instance, because the bank is likely to infringe soon the requirements for continuing authorization in a way that would justify the withdrawal of the authorization, such as the own funds requirements.[142] The SRM Regulation confirms that the resolution procedure should preferably be opened at an early stage of failure. Its recitals explicitly state that '[t]he decision to place an entity under resolution should be taken before a financial entity is balance sheet insolvent and before all equity has been fully wiped out.' [143]

Furthermore, the bail-in mechanism is a financial restructuring mechanism that can be used to force creditors and shareholders to accept the restructuring measures, although not through an arrangement between the debtor and a certain percentage of its creditors and shareholders and confirmed by a court, but by administrative decision.[144] The resolution authority decides on the application of the write-down and conversion powers. Article 53(1) BRRD explicitly provides that the exercise of the bail-in powers takes effect and is immediately binding on the bank and affected creditors and shareholders. Hence, it is not a cramdown of a dissenting minority in a class or one or more dissenting classes, as may be the case in a financial restructuring under national company and insolvency law, but of all creditors and shareholders. German legal scholars have considered the introduction of the bail-in mechanism in the SAG 'revolutionary', mainly because the literature has extensively discussed whether an infringement of rights of shareholders in an insolvency plan procedure under the InsO is in line with the constitutional protection of these rights under German law. Surprisingly, the introduction of the bail-in mechanism has not been as fiercely debated in the literature as was the amendment to the InsO under which dissenting shareholders can be directly bound to an insolvency plan.[145]

140 Article 59(3) BRRD; Article 21(1) SRM Regulation. *See* paragraph 3 above.
141 Paragraph 3.2.1 of chapter 2.
142 Article 32(1) and (4) BRRD.
143 Recital 57 SRM Regulation.
144 De Weijs 2013, p. 219.
145 Burkert & Cranshaw 2016, p. 450.

The role of the stakeholders in a corporate financial restructuring is different than in bail-in. In contrast to the bail-in procedure, in a corporate financial restructuring there are typically negotiations and the decision reflects the commercial judgement of the stakeholders. Two arguments can be put forward as to why the financial restructuring in a bank resolution procedure is largely taken out of the hand of the creditors, shareholders, and court and implemented by an administrative authority. These arguments tie in with the reasoning discussed in chapter 2 of why special rules for bank failures should exist. Firstly, the use of a court to play an oversight role in the procedure and allowing creditors and shareholders to negotiate and reach an agreement on the restructuring is time-consuming. It is an accepted view in the EU that administrative authorities are better suited to manage a bank resolution procedure and take the necessary proactive decisions in the public interest because they can act quickly without the need for lengthy negotiations.[146] As we saw already in chapter 2,[147] in a bank failure time is often of the essence to prevent a further weakening of the financial position of the bank, and a spread of the financial problems to other parts of the financial system. Secondly, even if creditors and shareholders are allowed to negotiate on a restructuring plan, the majorities required in a corporate financial restructuring procedure under insolvency law may not be reached. As stated in chapter 2[148] and paragraph 2.2 of this chapter, creditors and shareholders are expected to seek to disrupt the restructuring by not approving the proposed measures. They may speculate that the government will never let the bank fail and will be forced to provide public financial support instead.[149] The intervention by an administrative authority is therefore needed, so the argument goes, to bind all shareholders and creditors to the necessary restructuring measures.[150] Accordingly, from a corporate restructructuring and insolvency law perspective, this authority may need to be regarded to act as a party in which hands all individual rights are brought together and which has much discretionary power to take decisions and manage the procedure.[151]

146 *See* e.g., Haentjens 2016, p. 24-25; Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (SWD(2012) 166 final, 6.6.2012), p. 11, stating that '[i]nsolvency procedures may take years' and that '[b]ank resolution […] ensures that decisions are taken rapidly in order to avoid contagion.' *See also* Cassese 2017, p. 244, who argues that 'courts are reactive (they act upon request of a party) and not proactive, while modernized resolution procedures require preventive measures to avoid insolvency.'

147 Paragraph 2.2.1 of chapter 2.

148 Paragraph 2.2.1 of chapter 2.

149 De Weijs 2013, p. 217-221.

150 Schillig 2016, p. 65-66; De Weijs 2013, p. 217-221.

151 Schillig 2018, para. 3.2; Schillig 2016, p. 66.

5 Implementation of the bail-in rules into national law

5.1 Effects of a reduction of liabilities

5.1.1 Introduction

This paragraph further investigates the implementation of the bail-in framework in Dutch, German, and English law. It questions what kind of liabilities fall within the scope of the bail-in powers, and what is the effect of bail-in on the debt of the bank and related guarantees under national law.

5.1.2 Definition of the term 'liabilities'

We saw in paragraph 3 of this chapter that under the BRRD bail-in is conducted by writing-down and converting a bank's so-called 'relevant capital instruments' and 'bail-inable liabilities'. Relevant capital instruments are AT1 instruments and T2 instruments under the CRR.[152] Bail-inable liabilities are capital instruments and liabilities that do not qualify as CET1, AT1 and T2 instruments and are not excluded from the scope of bail-in under article 44(2) BRRD.[153] As paragraph 5.3 below discusses in more detail, excluded liabilities are, inter alia, liabilities that are fully secured and deposits up to the amount covered by a deposit guarantee scheme. The BRRD also gives the resolution authorities the power to exclude or partially exclude other types of liabilities in exceptional circumstances.[154]

The BRRD does not provide what exactly are 'liabilities' that qualify as bail-inable liabilities. Hence, it seems to give resolution authorities some discretion in their assessment what is to be bailed-in to restructure the balance sheet of a bank.[155] The bail-in rules do require the authorities, however, to allocate the losses equally between capital instruments and liabilities of the same rank and not to bail-in one class of bail-inable liabilities if a more junior class remains substantially unconverted or not written down.[156]

152 Article 2(1)(74) BRRD.

153 Article 2(1)(71) BRRD. Before entry into force of the recent amendments to the BRRD, these liabilities were called 'eligible liabilities'. The term 'eligible liabilities' is now used for debt that counts towards the MREL under articles 45-45k BRRD. *See* paragraph 3 of this chapter.

154 Article 44(2)-(3) BRRD.

155 *Cf*. Recital 70 BRRD, which states that 'in order to ensure that the bail-in tool is effective and achieves its objectives, it is desirable that it can be applied to as wide a range of unsecured liabilities of a failing institution as possible.'

156 Article 48(2) and (5) BRRD. *See also* paragraphs 3 and 5.3 of this chapter, which explain that the bail-in mechanism has to be applied in a certain order. As discussed in paragraph 5.3, a recently enacted EU directive requires Member States to create a class of non-preferred senior bank debt, which can be bailed-in after regulatory capital and (other) subordinated liabilities but before senior liabilities.

It is the present author's view that the term 'liabilities' should be interpreted broadly to include all contractual and non-contractual payment obligations of the bank that have arisen before the implementation of the resolution measures. The definition of the term in the rules of the UK PRA that implement article 55 BRRD seems to support this view. Article 55 BRRD requires banks to include in their non-EEA law governed contracts a clause by which the creditor or party to the agreement creating the liability recognizes that the liability may become subject to bail-in.[157] According to the PRA Rulebook, 'liability' means in this context 'any debt or liability to which the BRRD undertaking is subject, whether it is present or future, certain or contingent, ascertained or sounding only in damages.'[158] The PRA notes that it aligned this definition with the definition of 'provable debts' in English insolvency law, which provides that 'in a bank insolvency all claims by creditors are provable as debts against the bank, whether they are present or future, certain or contingent, ascertained or sounding only in damages.'[159] Under this definition, a resolution authority has to power to bail-in all liabilities that are not excluded liabilities, whether they are, for instance, liabilities under a debt instrument that are payable in the future, contingent liabilities such as liabilities under guarantees that can transform into payment obligations, liabilities for breach of contract, or liabilities in tort. According to the present author, the definition provided by the PRA can also be used to interpret the terms 'passiva' and 'Verbindlichkeiten', which are not defined in part 3a Wft and the SAG, respectively.

5.1.3 *Effects of the reduction*

Write-down and conversion are in the BRRD together referred to as 'reduction'.[160] Article 53(3) BRRD provides what is the effect of a full reduction of a bank's liability.[161] It uses the term 'principal amount of a liability', which should according to the European Commission be interpreted as the original sum owed or the remaining part thereof. The provision also contains the term 'outstanding amount payable in respect of a liability',

157 *See* Rank & Uiterwijk 2016.

158 PRA Rulebook, CRR Firms, Contractual Recognition of Bail-in, section 1.2.

159 Rule 262 Bank Insolvency (England and Wales) Rules 2009 (SI 2009/356), as referred to in Prudential Regulation Authority, 'The contractual recognition of bail-in: amendments to Prudential Regulation Authority Rules', June 2016, p. 8. *Cf.* Rule 14.2(1) Insolvency (England and Wales) Rules 2016/1024, providing that '[a]ll claims by creditors except as provided in this rule, are provable as debts against the company or bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages.' and rule 14.1(3), Insolvency (England and Wales) Rules 2016/1024, defining the term 'debt' in winding-up and administration as '(a) any debt or liability to which the company is subject at the relevant date; (b) any debt or liability to which the company may become subject after the relevant date by reason of any obligation incurred before that date; (c) any interest provable as mentioned in rule 14.23.'

160 *Cf.* e.g., Article 48(1) BRRD.

161 *Cf.* Article 63(1)(e) BRRD.

which may include other elements such as accrued interest on the principal amount up to the date on which the resolution measures are triggered.[162] If a resolution authority reduces the principal amount of or outstanding amount payable in respect of a liability to zero,

> 'that liability and any obligations or claims arising in relation to it that are not accrued at the time when the power is exercised shall be treated as discharged for all purposes, and shall not be provable in any subsequent proceeding in relation to the institution under resolution or any successor entity in any subsequent winding-up.'

If the resolution authority reduces the principal or outstanding only in part, under article 53(4) BRRD the liability is treated as discharged to the extent of the amount reduced. The relevant instrument or agreement that created the original liability continues to apply in relation to the residual amount of or outstanding amount payable in respect of the liability. Article 60 BRRD provides that if the resolution authority applies the write-down or conversion of capital instruments and eligible liabilities tool, the effect of the reduction is permanent and

> 'no liability to the holder of the relevant capital instrument shall remain under or in connection with that amount of the instrument, which has been written down, except for any liability already accrued, and any liability for damages that may arise as a result of an appeal challenging the legality of the exercise of the write-down power'.

It is the present author's view that articles 53 and 60 BRRD aim to ensure that bail-in of a capital instrument or liability releases the bank by operation of law from this debt. Under Dutch law, the effect on the liability of the bank is to be considered equivalent to the effect of a remission (*kwijtschelding*) of a debt under section 6:160 BW and under German law equivalent to the effect of a remission (*Erlass*) of a debt under section 397 Bürgerliches Gesetzbuch (BGB). Hence, the obligation is terminated.[163] Under English law, discharge of liabilities by operation of law can also take place, for instance, if it is a discharge of liabilities of a bankrupt individual under sections 279-280 IA 1986. The effect of such discharge by operation of law is also the release of the debtor from the debt.[164]

Following bail-in, a resolution authority may write-up (increase) the value of claims of creditors and holders of capital instruments which it has written down if the final resolution valuation shows that the level of write-down

162 European Commission, Q&A Bank Recovery and Resolution Directive, January 2015, Article 43 BRRD.
163 *Cf.* Asser/Sieburgh 6-II 2017, para. 312; MüKoBGB/Schlüter 2016 section 397, para. 7.
164 *See* Fletcher 2017, para. 11.009.

should be less than has taken place.[165] DNB has noted that it means that a part of the claims then 'revives' by operation of law at its original terms and conditions to reimburse the relevant creditors and shareholders.[166] The BRRD and SRM Regulation only explicitly provide for this possibility after a write-down.[167] It is the present author's view that one should interpret the term 'write-down' in this provision as also including conversion so that the value of claims which have been converted into equity can also be increased. Creditors whose claims are affected by conversion into equity may also be appropriated more equity value as compensation if the final valuation shows that the net asset value of the bank is higher than the value according to the provisional valuation.[168] In contrast to the reduction of a liability under articles 53 and 60 BRRD, the write-up of the debt by the resolution authority does not seem to have an equivalent provision in national private law.

According to the present author, it is unclear what is the scope of the phrase 'any obligations or claims arising in relation to it' in article 53(3) BRRD.[169] The wording of the provision suggests that it includes a right of a guarantor to be indemnified by the bank as principal debtor for payments made under a guarantee to a creditor of the bank. This is especially suggested by the phrase 'shall not be provable in any subsequent proceeding in relation to the institution under resolution or any successor entity'. Article 44(2) BRRD explicitly excludes liabilities of the bank that are fully secured from the scope of bail-in. This exclusion covers only *in rem* security arrangements and does not cover liabilities of the bank secured by personal security such as a guarantee of a group company or a third party.[170] It would mean that following bail-in, under article 53(3) BRRD both the principal claim and the indemnity claim against the bank are treated as discharged by operation of law. This effect seems sensible because bail-in of the principal liability owed to the creditor may not provide a solution for the financial problems of the bank if the guarantor then has a claim against the bank.[171]

165 Article 46(3) BRRD; Article 20(12) SRM Regulation.
166 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 10.
167 Article 46(3) BRRD; Article 20(12) SRM Regulation.
168 *Cf*. Article 50 BRRD.
169 The literature has not devoted much attention to the meaning of Article 53(3) BRRD. *But see* Schillig 2016, p. 295-296, who also discusses that the meaning of the provision in not entirely clear.
170 Article 2(1)(67) BRRD defines the term 'secured liability' as 'a liability where the right of the creditor to payment or other form of performance is secured by a charge, pledge or lien, or collateral arrangements including liabilities arising from repurchase transactions and other title transfer collateral arrangements.' *See also* European Banking Authority, Single Rulebook Q&A, no. 2015/1779, Article 44 BRRD.
171 Schillig 2016, p. 295-296.

Article 53(3) BRRD does not exclude the possibility that 'any obligations or claims arising in relation to it' also include a claim of a bank's creditor under a guarantee. If this is the case, a creditor may lose both his claim against the bank and his claim against a guarantor who promised to indemnify the creditor for losses resulting from the default of the bank as principal debtor. In case of conversion of a claim of a creditor into equity, the creditor may still have a claim against the guarantor for the amount that is left after a deduction of the value of the equity claim from the value of the claim under the guarantee.[172] If the mentioned phrase does not cover a claim of a bank's creditor under a guarantee, it depends on the provisions in the guarantee agreement and on national private law whether a discharge of the principal debt claim by operation of law results in a release of the guarantee liability.

Section 3a:25 Wft copies article 53(3) and (4) BRRD, although without the phrases 'for all purposes' and 'and shall not be provable in any subsequent proceeding in relation to the institution under resolution or any successor entity'.[173] Hence, the provision does not provide any clarification regarding the scope of the phrase 'any obligations or claims arising in relation to it'. It is the present author's view that section 3a:25 Wft and article 53(3) and (4) BRRD only aim to ensure that if an authority reduces a bank's liability, the bailed-in (part of the) debt can no longer be collected from this bank. The provisions do not aim to interfere in the relationship of a creditor and another party and do not require that a claim of this creditor against the other party is also treated as discharged by operation of law.[174]

One possible interpretation of section 3a:25 Wft then is that following bail-in of a bank's liability a creditor has a claim against a surety (*borg*) under section 7:855(1) BW because the bank does not pay off his debts because his liability was bailed-in. Thus, the bank has failed to perform its obligations. Under section 7:855(1) BW, a surety is liable after the principal debtor has made default.[175] The indemnity claim of the surety against the bank may then be treated as discharged under section 3a:25 Wft, as discussed above.

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172 *See* De Serière 2014, p. 176.

173 Section 3a:25(1) Wft provides in English that 'Notwithstanding article 3a:25a, if the Dutch Central Bank reduces to zero the principal amount of or outstanding amount payable in respect of a liability under article 3a:21, first paragraph, that liability and any obligations or claims arising in relation to it that are not accrued at the time when the power is exercised shall be treated as discharged.' It is the present author's view that the phrase 'for all purposes' is vague. The insertion of the phrases 'for all purposes' and 'shall not be provable in any subsequent proceeding in relation to the institution under resolution or any successor entity' would not make any relevant difference for the meaning of section 3a:25(1) Wft.

174 *Contra* Schillig 2016, p. 295, who holds the view that under Article 53(3) BRRD also the claim under a guarantee is treated as discharged.

175 Section 7:855(1) BW reads in Dutch: '[d]e borg is niet gehouden tot nakoming voordat de hoofdschuldenaar in de nakoming van zijn verbintenis is tekort geschoten.'

The creditor may also still have a claim against a co-debtor who is jointly and severally liable (*hoofdelijk mede-schuldenaar*) under section 6:6 BW.

This interpretation of section 3a:25 Wft corresponds to section 160 Fw on the composition in a bankruptcy procedure.[176] According to case law, a bankruptcy composition that is sanctioned by the court under sections 153 and 157 Fw has a limited effect. It only denies the enforceability of the parts of the claims against the insolvent debtor that remain unpaid. These parts become a natural obligation (*natuurlijke verbintenis*).[177] The fact that the remaining claims cannot be enforced at law does not entail, however, that the claim a creditor has against a surety or co-debtor of the insolvent debtor also becomes unenforceable. Section 160 Fw provides that the bankruptcy composition does not affect the latter claim.[178] Thus, a surety remains fully liable to the creditor under a suretyship guarantee if the principal debtor's liability to the creditor is reduced (the creditor gives discharge) under the composition. The section provides an exception to section 7:851(1) BW, under which the obligation of the surety is accessory to the obligation of the principal debtor and to section 6:7(2) BW, which provides that the settlement of the obligation by one of the co-debtors who are jointly and severally liable also discharges the other co-debtor against the creditor.

It is questionable, however, whether the above-mentioned interpretation of section 3a:25 Wft is correct. The Dutch legislature introduced section 160 Fw to provide for a statutory exception to the normally accessory nature of the claim against a surety or co-debtors who are jointly and severally liable. Since Part 3a Wft does not provide for an equivalent rule, it is questionable that an exception that is similar to the exception in section 160 Fw applies.

Another possible interpretation of section 3a:25 Wft and according to the present author the better view is that following bail-in the surety is no longer liable to the creditor and the co-debtor no longer for the joint and several obligation (*hoofdelijke verbintenis*). The bank's liability which the surety guaranteed in accordance with sections 7:850 et seq. BW and for which the co-debtor was jointly and severally liable under section 6:6(2) BW is treated as discharged. As indicated above, section 7:851(1) BW explicitly provides that the obligation of the surety is accessory to the obligation of the principal.

176 Under section 272(5) Fw, section 160 Fw also applies to a composition in a suspension of payments procedure (*surseance-akkoord*).

177 HR 31 January 1992, *NJ* 1992, 686 (*Van der Hoeven/Comtu*). *See* Bergervoet 2014, para. 96.

178 For a discussion of section 160 Fw, *see* Bergervoet 2014, para. 96; Wessels 2013a, para. 6021-6023; Soedira 2011, p. 191-195. *Cf.* Sections 369(7) and 370(2) Fw, which are part of the draft bill on the extra judicial restructuring plan procedure and provide that a claim of a creditor against a third party such as a guarantor or an indemnity claim of a third party against the debtor can be included in a restructuring plan. On the procedure, *see* paragraph 4.2.2 of this chapter.

Thus, in this view, the surety is discharged from his obligation because of the discharge of the bank from its liability by operation of law under Part 3a Wft. The legislative history of Part 3a Wft confirms this view. It notes that if a parent company has issued a so-called '403 statement' (403-*verklaring*) and the resolution authority bails-in its subsidiary's liabilities, a creditor cannot seek recourse against the parent company under section 6:6(2) BW.[179] In a 403 statement the parent company assumes joint and several liability for certain debts of its subsidiaries in accordance with section 2:403 BW. According to the parliamentary notes, a creditor cannot seek recourse against the parent company in such a case because the subsidiary is discharged from its liability.[180] The position of a guarantor may be different if the guarantee agreement is structured as an independent guarantee (*onafhankelijke garantie*) and the creditor beneficiary is entitled to payments on first demand and without evidence of the size of his loss. In such a case, the obligation of the guarantor is typically independent of that of the obligor and the beneficiary is entitled to receive payments in accordance with the terms of the guarantee.[181]

German law and English law seem to have their own approaches to the possible effects of a debt reduction.

The SAG incorporates article 53(3) and (4) BRRD into German law by transposing a concept of the insolvency plan procedure provided by section 254(2) InsO. According to the latter provision:

> '[d]ie Rechte der Insolvenzgläubiger gegen Mitschuldner und Bürgen des Schuldners sowie die Rechte dieser Gläubiger an Gegenständen, die nicht zur Insolvenzmasse gehören, oder aus einer Vormerkung, die sich auf solche Gegenstände bezieht, werden durch den Plan nicht berührt. Der Schuldner wird jedoch durch den Plan gegenüber dem Mitschuldner, dem Bürgen oder anderen Rückgriffsberechtigten in gleicher Weise befreit wie gegenüber dem Gläubiger.'[182]

Similarly, section 99(8) SAG provides that a write-down or conversion of a bank's liability does not affect the rights the involved creditors may have against the debtor's co-debtor (*Mitschuldner*), a surety (*Bürge*) or any other

179 Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 93-94.

180 Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 94, discussing that in practice in most cases the banking group as a whole and not only the subsidiary will be made subject to resolution.

181 *See* Russcher 2018.

182 Translation by the present author: the plan does not affect the rights the insolvency creditors have against the co-obligors and guarantors of the debtor as well as the rights of these creditors to objects that are not part of the insolvency estate or deriving from a priority notice covering those objects. The debtor shall be discharged under the plan of the claims against himself of the co-obligors, guarantors or any other redressing party in the same way as he is discharged of the claims of the insolvency creditors.

party who is liable for the debtor's obligations (*sontige Dritte*).[183] Thus, the claims against these third parties remain to exist.[184] Section 99(8) SAG provides for an exception to the normally accessory nature of the suretyship (*Bürgschaft*), comparable to section 254(2) InsO.[185] To fully achieve the intended effects of the reduction, under section 99(8) SAG the bank's obligation in relation to the mentioned third parties is treated as discharged to the same extent as the bank's original liability is reduced. Hence, if a guarantor satisfies the claims against the bank, this party may have an indemnity claim against the bank but only up to the amount that is left after the application of the write-down and conversion powers under the SAG.[186] The legislative history suggests that section 99(8) SAG was introduced, inter alia, for the guarantees (the so-called *Gewährträgerhaftung*) of the public founding entities of the German Sparkassen, Landesbanken or other public sector banks, typically municipal or state governments. The guarantees, although restricted to ensure compatibility with the European Commission's state aid procedures,[187] generally make the banks' owners fully liable for the banks' obligations.[188]

The BA 2009 seems to have the most flexible approach. It provides that the resolution authority exercises its bail-in powers in a resolution procedure by making one or more so-called 'resolution instruments', i.e., legal orders. Where the bank is subject to bail-in, these resolution instruments may 'make special bail-in provision with respect to a specified bank', which is done for

183 Section 99(8) SAG reads: '[d]ie Rechte der Inhaber relevanter Kapitalinstrumente oder der Gläubiger gegen Mitschuldner, Bürgen und sonstige Dritte, die für Verbindlichkeiten des Instituts oder gruppenangehörigen Unternehmens haften, werden durch die Anwendung des Instruments der Beteiligung der Inhaber relevanter Kapitalinstrumente oder des Instruments der Gläubigerbeteiligung nicht berührt. Das Institut oder gruppenangehörige Unternehmen sowie deren Rechtsnachfolger werden jedoch durch die Anwendung der in Satz 1 genannten Instrumente gegenüber dem Mitschuldner, dem Bürgen, dem sonstigen Dritten oder anderen Rückgriffsberechtigten in gleicher Weise befreit wie gegenüber dem Inhaber relevanter Kapitalinstrumente oder dem Gläubiger.'

184 *See* Beschlussempfehlung und Bericht des Finanzausschusses (7. Ausschuss), BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/3088, 5 November 2014, p. 328. *Cf.* MünchKomm-InsO/Huber 2014, section 254, para. 25-32; UhlenbruckKomm-InsO/Lüer/Streit 2015, section 254, para. 12-15.

185 *Cf.* Section 767(1) BGB; UhlenbruckKomm-InsO/Lüer/Streit 2015, section 254, para. 14; MünchKomm-InsO/Huber 2014, section 254, para. 25.

186 *See* Engelbach & Friedrich 2015, p. 667. *Cf.* Sections 774 and 426 BGB; UhlenbruckKomm-InsO/Lüer/Streit 2015, section 254, para. 15; MünchKomm-InsO/Huber 2014, section 254, para. 31. Thole 2016, p. 63 notes that Section 254(2) InsO is in literature argued to have unintended side effects, for instance, because it encourages a guarantor to push the principal debtor to fulfil his obligations in the run-up to the insolvency procedure, and that it remains to be seen whether section 99(8) SAG may also have such effects.

187 *See* the European Commission's press release IP/02/343 of 28 February 2002, available at: http://europa.eu/rapid/press-release_IP-02-343_en.htm?locale=en.

188 Beschlussempfehlung und Bericht des Finanzausschusses (7. Ausschuss), BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/3088, 5 November 2014, p. 327-328.

the purpose of, or in connection with, reducing, deferring or canceling a liability of the bank.[189] The BA 2009 allows the BoE, for instance, to cancel a liability owed by the bank, and modify a liability or the terms of a contract under which the bank has a liability.[190] It can use these powers, for example, to reduce a liability of the bank, or discharge 'persons from further performance of obligations under a contract and dealing with the consequences of persons being so discharged.'[191] According to the Banking Act 2009 special resolution regime code of practice, an example of the latter measure is that the BoE discharges the bank from obligations created by a contract, such as a cancelation of future coupon payments.[192] It is the present author's view that the phrase 'dealing with the consequences of persons being so discharged' can be interpreted broadly. It may allow the resolution authority to explicitly provide that following a discharge of the bank from its obligations to a creditor, a guarantor who guaranteed the performance of the underlying contract under a suretyship guarantee is also discharged from his liability under the guarantee. In practice, such a provision may be relevant if doubts exist as to whether the liability of the guarantor is preserved after a reduction or cancelation of the liability of the bank as principal debtor by statute (under the resolution instrument under the BA 2009).[193] The general rule under English private law is, however, that the surety is discharged if the principal liability is extinguished by operation of law.[194] An example provided in the literature is that the guarantor of a hire-purchase contract is discharged from liability when the creditor exercises his right to repossession, which discharges the hirer under the Consumer Credit Act 1974.[195]

The authority the BoE seems to have to explicitly provide what are the consequences of a reduction of a bank's liability on a guarantee bears an interesting likeness to the possible release of a third-party guarantee under a scheme of arrangement under the CA 2006. English courts have held that they have jurisdiction to sanction a scheme that includes the release of a third-party guarantee which the scheme creditors have in respect of their primary claims against the scheme company, even though the third party is not a party to the scheme. In *Re Lehman Brothers (Europe) International* the Court of Appeal held the release of the third-party guarantee to be 'merely ancillary to the arrangement between the company and its own creditors'.[196]

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189 Sections 12A(1), (2), (2A) and (3) and 48B(4)(a) BA 2009.

190 Section 48B(1) BA 2009; section 6.38 Banking Act 2009 special resolution regime code of practice, March 2017.

191 Section 48B(6)(b) BA 2009.

192 Section 6.39 Banking Act 2009 special resolution regime code of practice, March 2017.

193 The author is grateful to Ms. S. Paterson for the discussion on this point.

194 McKendrick 2016, para. 30.41; Andrews & Millett 2005, para. 9.021, for discussions of the discharge of a surety by operation of law.

195 Andrews & Millett 2005, para. 9.021, who refer to the case *Unity Finance Ltd v Woodcock* [1963], 1 W.L.R. 455.

196 *Re Lehman Brothers (Europe) International* (in administration) [2009] EWCA Civ 1161, para. 63.

The release would benefit the creditors because an indemnity claim of the guarantor would otherwise adversely affect the balance sheet of the scheme company and thus what they might recover under the scheme.[197]

5.2 Conversion process

5.2.1 Introduction

Paragraph 3 of this chapter discussed a hypothetical application of the bail-in mechanism vis-à-vis a bank which has a negative asset value. The bail-in rules recognize that a bank can also have a positive net asset value, i.e., the total value of its assets is more than the value of its liabilities, instead of a net asset value which is zero or negative.[198]

In the scenario in which the net asset value is positive, the resolution authority converts claims of creditors into shares. The nominal value of the existing shares may be partly written-down first, but the current shareholders have to retain at least the value that would be left for them in an insolvency procedure.[199] The BRRD uses the term 'dilution' of the existing shareholders in this context.[200] New shares or other instruments of ownership are issued, and the existing shareholders do not fully lose their investments, but their economic and voting rights are proportionally reduced.[201]

By contrast, in the scenario in which the net asset value is zero or negative, the resolution authority is required to first fully write-down the nominal value of the shares and other CET1 items, to then write-down other capital instruments and liabilities, and to finally convert claims into equity.[202] The conversion is carried out by way of either a cancellation of existing shares and issuance of new instruments of ownership to the bailed-in creditors or a transfer of the existing shares to them.[203] In this second scenario, the question arises why only a write-down of a bank's liabilities is not sufficient for a loss absorption and recapitalization. Although losses can indeed be absorbed in that way, the effect of only writing-down liabilities would be

197 *See Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch), para. 15-20 and *see* for a discussion Kornberg & Paterson 2016, para. 3.340-3.343; Payne 2014a, p. 24.
198 *See* European Banking Authority, Final Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments, EBA/GL/2017/04.
199 *See* European Banking Authority, Final Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments, EBA/GL/2017/04, p. 5-7.
200 Article 47(1)(b) BRRD.
201 *See* the definition of 'dilution' provided by European Banking Authority, Final Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments, EBA/GL/2017/04, p. 3-4.
202 *See* European Banking Authority, Final Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments, EBA/GL/2017/04, p. 4-5.
203 Article 47(1)(a) BRRD.

advantageous to the bank's existing shareholders. Their shares in the company's capital are not affected while it is likely that they would not retain any value in an insolvency procedure. Moreover, they may benefit if the value of the company increases in the future while the measures do not adhere to the resolution principle that shareholders bear first losses.[204] Therefore, under the BRRD and SRM Regulation, liabilities cannot be written-down if the net asset value of the bank is zero or negative without first also writing-down the nominal value of the share capital.

The central question in the sections below is whether the conversion of debt to equity under the bank resolution rules follows the formalities and practice for such conversion normally followed in a financial restructuring under national law. The BRRD does not prescribe a particular process but requires national law to fill in the technicalities and details of the execution of the conversion.[205] It only requires that procedural impediments to the conversion existing under articles of association, contract or law are removed, which include, for example, pre-emption rights of existing shareholders. Also, resolution authorities are not subject to requirements to obtain consent or approval from any person, to publish a notice or prospectus or to file or register a document with an authority.[206] This means, for example, that no approval of the general meeting of shareholders is necessary for a cancellation of shares of the bank under resolution, that a prospectus does not have to be circulated if shares are issued in a resolution procedure, and that resolution authorities can modify the terms of a contract to which a bank under resolution is a party without consent of the counterparty.[207] The BRRD also provides that banks can be required to maintain at all times a sufficient amount of authorized share capital so that an issuance of new shares can take place.[208]

5.2.2 Conversion process under German law

The SAG and its legislative history both suggest that the application of the bail-in mechanism under German law follows to a large extent general company and insolvency law.

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204 Thole 2016, p. 63; Schelo 2015, p. 135. *Cf.* Articles 34(1)(a), 46-48 and 63(1) BRRD. According to Schelo 2015, p. 135-136 in some cases only a debt write-down may be considered, for instance, if the bank is state-owned and no equity can be given to the creditors. *Cf.* Articles 43(4), 63(3) BRRD.

205 Schelo 2015, p. 136.

206 Articles 54 and 63(2) BRRD.

207 *See* De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 16; Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 80. *Cf.* Case 41/15, *Gerard Dowling and Others v Minister for Finance* [2016] ECLI:EU:C:2016:836, in which the CJEU held that the interests of shareholders and creditors cannot be held to prevail in all circumstances over the general interest of the stability of the financial system.

208 Article 54(1) BRRD.

The parliamentary notes on the proposal for the SAG explicitly indicate that technically the effect of bail-in is a reduction of the company's nominal share capital and a subsequent capital increase under sections 183, 228 and 229 AktG.[209] In a debt-to-equity-swap under the AktG, such a capital reduction can take place, for instance, to first compensate for a decline in the value of the assets.[210] The subsequent capital increase is then a capital increase against contributions in kind. Creditors acquire shares in the capital in exchange for the assignment of their claims to the company or the remission of the debt.[211] Obviously, the comparison in the parliamentary notes with such a so-called 'Kapitalschnitt'[212] under the AktG is a simplification. For example, under sections 89, 90 and 99 SAG the scope of the write-down powers of the resolution authority does not only extend to a bank's share capital.

Section 99(4) SAG, which closely resembles section 254a(2) InsO on the effect of an insolvency plan in an insolvency plan procedure,[213] provides that the resolution decision replaces all decisions and approvals which company law requires for the ordered measures. Also, resolutions, announcements, and other measures required in the preparation of the measures under company law as well as declarations of involved parties needed for the implementa-

209 Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014, p. 177, which notes that: '[t]echnisch bedeutet dies, dass im Fall einer Aktiengesellschaft zunächst das Grundkapital gemäß §§ 228, 229 AktG zum Zweck der Verlustdeckung herabzusetzen ist und gleichzeitig eine Kapitalerhöhung gegen Leistung einer Sacheinlage gemäß § 183 AktG durchgeführt wird.' *See also* Schillig 2016, p. 302.

210 Section 229(1) AktG.

211 Section 183 AktG. *See* Schwarz 2015, p. 63 and 70-71. It has been debated in German literature whether in case of conversion into equity under company law, a creditor's claim should be considered a contribution in kind or a contribution in cash under company law and, accordingly, the nominal value or the actual value of the claim is the relevant value. *See* Häfele 2013, p. 55; Simon & Merkelbach 2012, p. 123; Wirsch 2010, p. 1131-1132; Eidenmüller & Engert 2009, p. 543; Ekkenga 2009, p. 589. *Contra* Cahn et al. 2010.

212 *See* e.g., MünchKomm-AktG/Oechsler 2016, section 229, para. 5.

213 *See* Thole 2016, p. 63. Section 254a(2) InsO reads: '[w]enn die Anteils- oder Mitgliedschaftsrechte der am Schuldner beteiligten Personen in den Plan einbezogen sind (§ 225a), gelten die in den Plan aufgenommenen Beschlüsse der Anteilsinhaber oder sonstigen Willenserklärungen der Beteiligten als in der vorgeschriebenen Form abgegeben. Gesellschaftsrechtlich erforderliche Ladungen, Bekanntmachungen und sonstige Maßnahmen zur Vorbereitung von Beschlüssen der Anteilsinhaber gelten als in der vorgeschriebenen Form bewirkt. Der Insolvenzverwalter ist berechtigt, die erforderlichen Anmeldungen beim jeweiligen Registergericht vorzunehmen.' Section 99(4) SAG provides that '[d]ie Abwicklungsanordnung ersetzt für die in ihr angeordneten Maßnahmen alle nach Gesellschaftsrecht erforderlichen Beschlüsse und Zustimmungen, sofern diese nicht bereits vor Anwendung des Instruments der Beteiligung der Inhaber relevanter Kapitalinstrumente oder des Instruments der Gläubigerbeteiligung gefasst worden sind. Ladungen, Bekanntmachungen und sonstige Maßnahmen zur Vorbereitung von gesellschaftsrechtlichen Beschlüssen gelten als in der vorgeschriebenen Form bewirkt. Die Abwicklungsanordnung ersetzt auch alle rechtsgeschäftlichen Erklärungen der Beteiligten, die zur Umsetzung der gesellschaftsrechtlichen Maßnahmen erforderlich sind.'

tion of the measures under company law are deemed to have been effected in the prescribed form. According to the parliamentary notes, section 99(4) SAG

> 'regelt die Einzelanordnungen, die durch die Abwicklungsanordnung gemäß § 77 zu treffen sind, um die wirksame Umsetzung der Instrumente zu erzielen. Insbesondere kann die Abwicklungsanordnung die Einziehung von Anteilen oder Löschung anderer Instrumente des harten Kernkapitals an einem Institut oder gruppenangehörigen Unternehmen, eine Kapitalherabsetzung oder -erhöhung, die Leistung von Sacheinlagen und den Ausschluss von Bezugsrechten vorsehen. Dabei ersetzt der Verwaltungsakt alle für diese Maßnahmen gemäß Gesellschaftsrecht erforderlichen Beschlüsse der Anteilsinhaber.'[214]

Thole questions if it follows from section 99(4) SAG that for the resolution measures in principle all relevant German company law requirements have to be met, but if the resolution decision explicitly includes specific company law measures, the relevant procedural requirements referred to in the section are deemed to have been met.[215] Section 254a InsO takes a similar approach.[216] It is the present author's view that the above-mentioned parliamentary notes suggest that section 99(4) SAG indeed follows this approach. If the resolution decision explicitly provides for company law measures such as capital reduction and increase and disapplication of preemption rights to implement the application of the bail-in mechanism, the decision replaces the relevant procedural company law requirements such as shareholder resolutions.

The SAG disapplies several provisions of general company and insolvency law. For instance, section 99(6) SAG, which is largely a copy of section 254(4) InsO,[217] provides that after the conversion of claims into shares the

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214 Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014, p. 176. Translation by the present author: governs the individual orders to be taken by the resolution order under § 77 to achieve the effective implementation of the instruments. In particular, the resolution order may provide for the cancellation of shares or cancellation of other Common Equity Tier 1 instruments in an institution or group of companies, a capital reduction or -increase, the provision of contributions in kind and the exclusion of pre-emption rights. In doing so, the administrative act replaces all shareholder resolutions necessary for these measures under company law.

215 Thole 2016, p. 63.

216 *See* MünchKomm-InsO 2014, section 254a, para. 1-15.

217 Section 254(4) InsO reads: '[w]erden Forderungen von Gläubigern in Anteils- oder Mitgliedschaftsrechte am Schuldner umgewandelt, kann der Schuldner nach der gerichtlichen Bestätigung keine Ansprüche wegen einer Überbewertung der Forderungen im Plan gegen die bisherigen Gläubiger geltend machen.'. Section 99(6) SAG states that: '[w]erden berücksichtigungsfähige Verbindlichkeiten in Anteile oder andere Instrumente des harten Kernkapitals am Institut oder am gruppenangehörigen Unternehmen umgewandelt, kann das Institut oder gruppenangehörige Unternehmen keine Ansprüche wegen einer fehlerhaften Bewertung der umgewandelten Verbindlichkeiten gegen die bisherigen Gläubiger oder Inhaber relevanter Kapitalinstrumente geltend machen.'

new shareholders are not liable for any shortfall in value (*Differenzhaftung*) because their claims were initially overvalued, which risk would otherwise exist for them under the AktG.[218] The literature has argued that the provision suggests that in bail-in under the SAG the creditors' claims are assigned to the bank as contributions to the capital in kind, as would normally be the case in a debt to equity swap under the AktG.[219] Hence, it results in extinction of the claims because the creditors and debtor become the same person.[220] According to the legislative history, making the new shareholders in such a case liable for a shortfall in the value of their claims is not appropriate because these shareholders have neither agreed with the conversion of their claims nor with the conversion rate.[221] Moreover, the German legislature included in the SAG an exception to the statutory subordination of shareholder loans under section 39 InsO. A claim is not subordinated by operation of law if the creditor has also become a shareholder of the company only because of the application of the bail-in mechanism.[222] Accordingly, a situation in which creditors are 'hit twice' because bail-in also affects the remaining claims of these new shareholders is avoided.[223]

Under sections 89 and 90 SAG the relevant capital instruments and liabilities are to be converted into shares or other CET1 instruments ('*Anteile oder andere Instrumente des harten Kernkapitals*').[224] The SAG does not indicate whether a resolution authority can also first convert the capital instruments and liabilities into tradeable instruments that give rights to acquire shares. By contrast, under the BRRD capital instruments and liabilities are converted into shares or into other instruments of ownership, which include instruments that are convertible into or give a right to acquire shares.[225] It is the present author's view that the SAG leaves room for such an interim conversion as long as the result of the process is conversion into CET1 instruments. This interpretation would entail that, at least in theory, under the SAG an exchange mechanic can be used that is similar to the proposed mechanics under the Wft and the BA 2009, which the sections below will discuss. The German resolution authority has not provided clarification as to whether it intends to use such a procedure in bail-in.

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218 *See* Thole 2016, p. 63; Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014, p. 177. *Cf*. Sections 27(3) and 183(2) AktG.

219 Thole 2016, p. 63

220 Schelo 2015, p. 136.

221 Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014, p. 177.

222 Section 99(5) SAG.

223 *See* Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014, p. 177.

224 *Cf*. Section 2(32) SAG, which defines 'Instrumente des harten Kernkapitals' by referring to the requirements for CET1 instruments in Article 28 CRR. Under the CRR CET1 instruments are mainly ordinary shares.

225 Articles 2(61), 47(1)(b) and 63(f) BRRD.

5.2.3 Conversion process under English and Dutch law

The UK and Dutch resolution authorities have both published papers which describe at a high level how the authorities anticipate the conversion process to look like under UK and Dutch law respectively. The resolution authorities may, however, choose a different application of the bail-in mechanism in practice since the BA 2009 and the Wft do not prescribe these procedures.[226] The proposed procedures deviate quite significantly from the usual process for conversion of debt to equity under national company and insolvency law, under which creditors typically agree to cancel all or a part of the debt in exchange for equity in the company, and may also differ from the procedures used for bail-in in other jurisdictions. They seem to have been based on the recommendation of the Financial Stability Board to ex-ante disclose an anticipated bail-in process that facilitates, where relevant, the continued trading of instruments and liabilities until the bail-in procedure is completed, the distribution of equity to the affected creditors, and the identification of former liability holders. Transparency about the intended bail-in process is expected to enhance market confidence in and predictability of the measures.[227]

According to its paper titled 'The Bank of England's approach to resolution', the BoE expects the process to convert relevant capital instruments and liabilities of a bank under resolution into equity, which includes the required valuations, to take 'several months'.[228] It developed a procedure in which bailed-in creditors are first provided certificates of entitlement, and they are delivered a share in the bank under resolution's capital only at a later date. The paper hardly contains explicit references to provisions of English private law that the BoE has to consider to implement the conversion. It does refer to the hierarchy of claims under insolvency law that is followed in bail-in.[229] The BA 2009 provides that the provisions on bail-in in a resolution instrument take effect 'despite any restrictions arising by virtue of contract or legislation or in any other way'.[230]

226 The parliamentary notes to part 3a Wft briefly discuss a procedure for the execution of bail-in under Dutch law that is similar to the procedure proposed by the Dutch resolution authority. *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 22-23 and 92.

227 Financial Stability Board, 'Principles on bail-in execution', 21 June 2018, principle 10.

228 Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 37. *See also* Philippon & Salord 2017, p. 47: '[r]egulators have about 50 hours to resolve a bank (from Friday night in New York to Monday morning in Tokyo). On the other hand, it takes at least six months to value the assets (six months is the estimate of the Bank of England and is probably a lower bound).'

229 Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 18.

230 Section 48S(1) BA 2009.

When a bank enters a resolution procedure, the BoE first announces which capital instruments and liabilities may fall within the scope of bail-in and suspends trading, or cancels the listing of, instruments. Legal title to the existing shares of the bank under resolution is transferred to a third-party depositary bank, which holds the shares on trust on behalf of the bailed-in creditors until they can be delivered to these creditors.[231] An administrator controls the voting rights of the shares during this period. In the meantime, the creditors are provided various types of tradeable instruments, i.e., certificates of entitlement, by the bank under resolution, which different types reflect the different creditors' positions in the creditor hierarchy. The certificates are issued into the accounts of the central securities depository of the creditors and represent a right to potentially receive shares as compensation.[232] Accordingly, bailed-in creditors who do not want or are not allowed to become a shareholder of a bank can sell the entitlements.[233] The different types of certificates will form the basis for the use of different conversion rates for different classes of creditors, such as a different rate for junior creditors than for senior creditors. Once the required valuations are finalized and the resolution authority announces the final terms of bail-in, the holders of the certificates will have to prove their beneficial ownership of the shares in the bank and give instructions for the delivery of the shares. If they do so, the depository bank credits the shares to their central securities depositary accounts, and the certificates are cancelled.[234] Accordingly, the overall result of the process is conversion of claims of creditors against the bank in shares in the capital.[235]

The Dutch legislature and the Dutch resolution authority have proposed a similar procedure with claim rights, i.e., claim rights to newly issued shares in the capital of the bank, to implement the conversion under Dutch law.[236]

231 *See* Gracie 2014, p. 416.
232 *See* Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 38; Gracie 2014, p. 416.
233 *Cf.* Coffee 2010, p. 35: 'if the debt security converts into common stock, the newly issued common stock would predictably come to be owned by the same categories of institutional investors as already held that common stock. Little would change. This is both because some debt investors (for example, money market funds) cannot legally hold common stock and, more generally, because the holders of debt securities tend to be risk averse (or at least want to maintain their prior portfolio balance and so, after conversion, will replace the former debt security that they held with a new debt security by selling the common stock that they receive).'
234 *See* Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 37-38; Gracie 2014, p. 416.
235 *Cf.* Section 583(3)(c) CA 2006, under which the release of a liability of the company for a liquidated sum is in a debt to equity swap under company law normally considered a contribution in cash to the capital of the company.
236 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 9; Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 22-23 and 92.

It has been argued in the legislative history of part 3a Wft, however, that for the sake of clarity a procedure in which the conversion of claims into shares is directly implemented is to be preferred instead of this procedure with claim rights.[237]

Section 3a:6 Wft provides that DNB's decision on the application of the bail-in mechanism, including the preparation or implementation, is not subject to specific requirements. More particularly, under subsection 1 it is not subject to any consent requirements, which include requirements for approval of the general meeting of shareholders in sections 2:96 and 2:99 BW. Under subsection 2, the decision is not subject to any notification or procedural requirement, including the procedural requirement under section 2:100 BW to give creditors the opportunity to lodge an objection against a measure and the procedural requirement for an audit opinion under sections 2:94a and 2:94b BW. An exception is that the bank under resolution and several authorities have to be notified under articles 81 and 83 BRRD. Under subsection 3, the decision is not subject to any other limitation imposed by law, articles of association or contract. The minimum capital requirement for a public limited liability company under section 2:67 BW is an example of the latter limitation.[238]

Sections 3a:21(1) and 3a:44(1) Wft provide an explicit legal basis for the conversion process with the above-mentioned claim rights. The provisions empower DNB to convert capital instruments and liabilities into rights to newly issued shares. Hence, the conversion into the claim rights takes place by operation of law pursuant to the administrative decision of DNB. Under sections 3a:22(1) and 3a:45(1) Wft DNB may require the bank under resolution to issue new shares. According to a paper published by DNB, if not all creditors entitled to the claim rights are yet known, the creditors will be asked to contact the bank themselves. Also, the claim rights are transferable but are not necessarily listed on an official market.[239] The resolution authority expects to set a fixed period of a few weeks in which the claim rights are to be exercised, following either the issuance of the rights or the announcement of the conversion rates. Unexercised claim rights then expire, and unclaimed shares are sold in the market.[240]

The question arises what is the precise nature of the claim rights in the resolution procedure under the Wft. Van der Velden and De Serière classify

237 Annex to *Kamerstukken II* 2014/15, 34208, no. 5, p. 7 (Comments to the proposal for the Implementation Act European framework for recovery and resolution of banks and investment firms of G.W. Kastelein & V.P.G. de Serière, 23 June 2015).

238 *See* Explanatory Notes to the Dutch Draft Amending Act Financial Markets 2017 (*Kamerstukken II* 2016/17, 34634, no. 3), p. 13-15; Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 80-82.

239 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 9 and 21.

240 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 11.

them as personal claims (*vorderingen op naam*).[241] According to DNB, the claim rights bear a resemblance to pre-emption rights of shareholders under section 2:96a BW.[242] Indeed, the claim rights seem to be comparable with pre-emption rights because they are also transferable and can be exercised against the bank in relation to an issue of new shares. They are optional rights (*wilsrechten*), which means that with a declaration of intent (*wilsverklaring*) a new legal relationship (*rechtsbetrekking*) is created, [243] i.e., the right holders become shareholders.

An important difference between the proposed UK and Dutch conversion procedures is, for example, that in the procedure of the BoE the existing shares in the capital of the bank are transferred to a depository bank and finally to the certificate holders.[244] In the Dutch procedure, by contrast, new shares are issued to be first held on trust (*ten titel van beheer*) by a newly created foundation and finally transferred to the claim right holders. The existing shares in the capital of the bank are canceled rather than transferred by the resolution decision.[245]

It is the present author's view that the papers do not address all relevant aspects of the conversion procedures. To take an example, in contrast to the BoE paper, the Dutch paper does not discuss if different types of claim rights are issued for the different types of creditors, as a basis for different conversion rates for different classes of creditors in the creditor hierarchy.

Furthermore, it remains unclear in both papers whether the tradeable certificates/claim rights are to be transferred together with the part of a liability to the creditor that is not reduced by the resolution authority and with the rights to a potential write-up at a later stage. If a certificate/right holder can sell his certificate/claim right separately from the non-reduced part of his claim against the bank, it may become unclear who is entitled to a write-up of the bailed-in claim of the creditor at a later stage.[246]

Moreover, the Dutch paper and the Wft do not provide how the application of the bail-in mechanism relates to section 3:229 BW. Under this section, a right of pledge (*recht van pand*) or right of mortgage (*recht van hypotheek*)

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241 Van der Velden & De Serière 2018, p. 58.

242 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 9.

243 Snijders & Rank-Berenschot 2017, para. 30. *See also* Snijders 1999.

244 Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 38.

245 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 10.

246 DNB discusses this question in both its consultation and its final paper but does not answer the question. It only mentions that it realizes 'that linking claim rights to converted claims is complex and [that it] will study this in more detail.' De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 22; De Nederlandsche Bank, 'Operation of the bail-in tool', consultation paper June 2016, p. 16.

entails by operation of law a right of pledge on all claims for compensation which take the place of the secured assets. This provision on proprietary substitution (*substitutiepandrecht*) applies, for example, to actions arising from an unlawful act (*onrechtmatige daad*), insurance claims and compensation for expropriation. If a mortgaged house is burnt down, the former mortgage holder is granted a right of pledge on the fire insurance claims against the insurance company.[247] It is the present author's view that it would be consistent with current practice if the rule on propriety substitution applies if pledged claims against or pledged shares in the capital of the bank under resolution are bailed-in. The right of pledge would be substituted with a right of pledge on shares after conversion of a creditor's claim or on a compensation claim, such as claims the bank's former creditors and shareholders potentially have in accordance with the no creditor worse off-principle.[248]

Also, both the DNB paper and the BoE paper do not discuss if the market value of the claim rights/certificates of entitlement plays a role in the determination of the rate of conversion of debt to equity. The papers do consider that the rights/certificates may be traded before the exercise of the rights. The resolution authority uses this period to set the conversion rates and, hence, to decide how much equity value each holder of claim rights/certificate holder receives. It follows from articles 36 BRRD and 20 SRM Regulation and a Commission Delegated Regulation that the allocation of value to a creditor in bail-in depends on the economic valuation of the bank's assets and liabilities and on the estimated market value of the shares that are issued or transferred to the right holder/certificate holder as consideration.[249] The BRRD requires the resolution authorities to set a conversion rate that ensures that creditors and shareholders receive at least the value which they would have received had the bank been wound up under national insolvency law (the no creditor worse off-principle). It means that the expected value of the combined equity and debt claims of these stakeholders after bail-in has to be equal or greater than their expected realization in an insolvency procedure.[250] Moreover, the BRRD requires the

247 Snijders & Rank-Berenschot 2017, para. 509; Asser/Van Mierlo & Van Velten 3-VI* 2010/58-60.

248 *Cf.* 3a:20 Wft.

249 *See* Articles 1(h) and 10-13 Commission Delegated Regulation (EU) 2018/345 of 14 November 2017 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for assessing the value of assets and liabilities of institutions or entities (OJ L 67, 9.3.2018, p. 8–17). *See also* Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 36-37.

250 *See* Articles 50 and 75 BRRD; European Banking Authority, 'Final Guidelines on the rate of conversion of debt to equity in bail-in', EBA/GL/2017/03, 5 April 2017, para. 1.16-1.23. *See also* section 6C(4)(d) BA 2009; sections 3a:21(3) and 3a:44(3) Wft; section 98 SAG.

resolution authorities to respect the insolvency creditor hierarchy.[251] Thus, in principle, each euro of claims of subordinated creditors should not be allocated more value of equity claims than each euro of claims the senior creditors is receives.[252]

In practice, the value of a failing company's business and shares is often uncertain. In corporate financial restructurings procedures under Dutch and English law, including the proposed extrajudicial restructuring plan (*onderhands akkoord*) procedure under the Fw and the scheme of arrangement procedure under the CA 2006, a court has to assess the value to confirm the restructuring plan. The English literature,[253] and to a lesser extent also the Dutch literature,[254] have debated which valuation methods should be used in these procedures to determine, amongst other things, which creditors and shareholders should receive any value under the restructuring plan. In scheme of arrangement procedures, the English courts traditionally put weight on the hypothetical positions of the creditors and shareholders if the schemes were not sanctioned to determine, for instance, who should be allocated an equity stake.[255]

Sections 6E and 48X BA 2009, article 20 SRM Regulation and a related Commission Delegated Regulation do not seem to prevent a valuer in a bank resolution procedure from taking into account the market value of the claim rights/certificates to estimate the market value of the shares that are to be allocated to the former creditors.[256] However, a valuer may decide not to base its decisions on the market value of the claim rights/certificates if this value does not fully represent the accurate share value. It is the present author's view that the value of the claim rights/certificates may be used for other purposes in the context of a resolution procedure. Assume, for example, that former creditors of the bank use the information about the value of the claim rights/certificates in a valuation dispute following the procedure to argue that the estimated market value of the shares allocated to them

251 *See* Articles 34(1)(a), (b) and (f) and 50 BRRD; European Banking Authority, 'Final Guidelines on the rate of conversion of debt to equity in bail-in', EBA/GL/2017/03, 5 April 2017, para. 1.24-1.26.

252 Huertas 2012, p. 81.

253 *See* Paterson 2017, p. 612-613; Kornberg & Paterson 2016, para. 3.383-3.397; Payne 2014a, p. 249-253.

254 *See* e.g., Van den Berg 2017, who discusses the valuation approach adopted in the prposed extrajudicial restructuring plan (*onderhands akkoord*) procedure under the Fw. *See also* Tollenaar 2016, p. 123-139 for a discussion of valuation in corporate restructuring plan procedures in general.

255 *See* Paterson 2017, p. 612-613; Kornberg & Paterson 2016, para. 3.383-3.397.

256 *Cf*. Article 36 BRRD; Articles 1(h) and 10-13 Commission Delegated Regulation (EU) 2018/345 of 14 November 2017 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for assessing the value of assets and liabilities of institutions or entities (OJ L 67, 9.3.2018, p. 8–17).

was incorrect.[257] These former creditors are likely to be highly motivated to advocate a lower market value of their shares so that they can claim, for instance, a greater stake in the capital of the resolved bank. This is particularly relevant if the price of the claim rights/certificates was depressed because they were traded in a period in which the bank is in financial distress and the outcomes of the resolution procedure were uncertain. The market value of the claim rights/certificates is then a piece of information available in the jurisdictions in which the conversion procedures with the claim rights/certificates are used. It could result in, for example, valuation disputes based on different pieces of information following resolution procedures under English and Dutch law than under the laws of Member States which do not follow a similar conversion procedure.[258]

5.3 Hierarchy of claims in bail-in

5.3.1 Introduction

A fundamental question in the design of a bank resolution framework is to whom and in what order the losses and costs of the recapitalization of a bank under resolution are allocated.[259] This paragraph discusses the role of national insolvency law in the determination of the priority amongst shareholders and creditors in bail-in. The central question is how the hierarchy of claims in bail-in, including the protection offered by the bail-in rules to several types of claims by excluding them from bail-in, relates to the insolvency ranking of claims recognized under national law.

5.3.2 Hierarchy of claims in bail-in

One option for the loss allocation in bail-in is to apply the rules of the applicable insolvency law on the distribution of proceeds in liquidation. Traditionally, the starting point in such a distribution is the *pari passu* treatment of creditors, which means that all creditors are paid *pro rata* to the extent of their pre-insolvency entitlements.[260] This principle has been considered

257 *Cf.* Article 36(13) BRRD; article 20(15) SRM Regulation.

258 The author is grateful to Ms. S. Paterson for the discussion on this point.

259 *See* Hüpkes 2011, para. 5.11-5.32.

260 Finch & Milman 2017, p. 511. *Cf.* Section 3:277(1) of the Dutch Civil Code (*Burgerlijk Wetboek*), which provides that, in principle, creditors have amongst each other and in proportion to the amount of their claims an equal right to be paid from the net proceeds of the debtor's assets. According to Section 14.12(2) Insolvency (England and Wales) Rules 2016, in administration and winding-up by the court '[d]ebts other than preferential debts rank equally between themselves and, after the preferential debts, must be paid in full unless the assets are insufficient for meeting them, in which case they abate in equal proportions between themselves.'

the most fundamental principle of insolvency law.[261] However, insolvency laws generally do not rigidly apply the principle but contain priority rules and recognize a ranking or hierarchy of claims or creditors in liquidation to determine who are paid first out of the available pool of assets. According to the literature, such a ranking reflects legal, social and moral decisions made and policy goals pursued in a specific jurisdiction and has often been developed over a long period.[262] For example, under many national insolvency laws employees of an insolvent company enjoy priority over the general body of creditors in liquidation for the claims for unpaid wages.[263] The ranking is also of relevance in other types of insolvency procedures, such as for the formation of classes of creditors in a reorganization procedure.[264]

Another approach is to protect certain types of liabilities by excluding them from the scope of bail-in.[265] One of the primary objectives of insolvency law is traditionally the satisfaction of the creditors to the maximum extent possible. Hence, insolvency procedures are directed towards the protection of the private interests of parties. As will be further discussed in chapter 6, bank resolution procedures under the BRRD and SRM Regulation, by contrast, are thought to pursue mainly the resolution objectives that include the objectives to protect critical functions of the bank and avoid adverse effects on the financial system.[266] Thus, the procedures are oriented towards the protection of public interests. These objectives justify the exclusion of several categories of liabilities in bail-in to avoid that risks spread to other parts of the financial system and to enable the bank to continue its day-to-day operations. Bank liabilities subject to contagion risks, such as deposits, as well as liabilities arising from essential services and business lines are to be exempted from bail-in.[267] Although this means that the excluded liabilities

261 Bork 2017, p. 115-117; Goode 2011, para. 8.02. *See also* Wiórek 2005, p. 74. The EU Recast Insolvency Regulation and the Winding up Directive recognize the importance of the principle. Article 23(2) Recast Insolvency Regulation: '[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.' Recital 12 Winding up Directive: '[t]he principle of equal treatment between creditors, as regards the opportunities open to them to take action, requires the administrative or judicial authorities of the home Member State to adopt such measures as are necessary for the creditors in the host Member State to be able to exercise their rights to take action within the time limit laid down.'

262 De Serière 2014, p. 166-167; Mucciarelli 2013, p. 179-180; Garrido 1995, p. 25-53. For an overview of the statutory insolvency ranking in various jurisdictions, *see* Wessels & Madaus 2017, p. 240-250; McCormack et al. 2016, p. 112-136; Faber et al. 2016.

263 UNCITRAL, 'Legislative Guide on Insolvency Law', Part 2 2004, p. 272-273.

264 Wood 2013, p. 212-213.

265 *See* Huertas 2013, p. 172-173.

266 Article 31(2) BRRD; Article 14(2) SRM Regulation.

267 *See* De Serière 2014, p. 166-170; Bliesener 2013, p. 198-209. *See also* Gleeson & Guynn 2016, para. 1.07.

preserve their original position in insolvency, in bail-in they are treated *de facto* senior to debt that is 'bail-inable'.[268]

The bail-in rules in the BRRD and SRM Regulation combine the insolvency ranking of claims under national law with the approach mentioned above to carve out various types of claims in the public interest.[269]

The so-called 'resolution principles' provide a further starting point for the hierarchy of claims in bail-in.[270] According to the principles, the bank under resolution's shareholders bear first losses and its creditors take losses after the shareholders, in principle in accordance with the ranking of claims recognized under national insolvency law. Moreover, creditors in the same class are treated equitably, unless otherwise stipulated in the BRRD and SRM Regulation. The latter principle is reflected in the provision that in bail-in the losses are to be allocated pro-rata between capital instruments and liabilities of the same rank.[271] In the Netherlands and Germany, article 15(1) SRM Regulation explicitly provides for the resolution principles. The Dutch ministerial Regulation on the performance of duties and cross-border cooperation by financial supervisors Wft (*Regeling taakuitoefening en grensoverschrijdende samenwerking financiële toezichthouders Wft*) and section 68 SAG also refer to them. Furthermore, the resolution principles are reflected in several sections of the BA 2009[272] and can more explicitly be found in sections 6.7-6.12 of the Banking Act 2009 special resolution regime code of practice.

In addition to the resolution principles, the BRRD and SRM Regulation provide for a list with liabilities excluded from bail-in. The excluded liabilities are (i) the part of deposits covered by a deposit guarantee scheme,[273] (ii) secured liabilities,[274] (iii) liabilities arising from the holding of client assets or client money or from the bank acting as a fiduciary in a fiduciary relationship, (iv) short-term liabilities to other institutions and to payment

268 Chan-Lau & Oura 2016, p. 21.

269 Articles 44 and 48(1) BRRD; Articles 17 and 27(3) and (5) SRM Regulation. *See also* Recital 77 BRRD, which provides that '[e]xcept where otherwise specified in this Directive, resolution authorities should apply the bail-in tool in a way that respects the pari passu treatment of creditors and the statutory ranking of claims under the applicable insolvency law.'

270 Article 34(1) BRRD; Article 15(1) SRM Regulation.

271 Article 48(2) BRRD; Article 17(1) SRM Regulation.

272 E.g., Sections 6B, 12AA, 20, 36A, 48B(8) and 48N BA 2009.

273 Article 6 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149–178).

274 Article 2(1)(67) BRRD defines 'secured liability' as 'a liability where the right of the creditor to payment or other form of performance is secured by a charge, pledge or lien, or collateral arrangements including liabilities arising from repurchase transactions and other title transfer collateral arrangements.' Under Article 44(2) BRRD the part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured, falls within the scope of bail-in.

and securities settlement systems, (v) certain liabilities owed to employees, (vi) liabilities owed to commercial and trade creditors arising from the provision of goods and services that are 'critical to the daily functioning' of the bank's operations, such as IT services,[275] (vii) liabilities owed to tax and social security authorities, provided that they qualify as preferential liabilities under national law, and (viii) liabilities owed to deposit guarantee schemes.[276] The resolution authorities also have discretion to exclude or partially exclude other categories of liabilities in exceptional circumstances. Such an exclusion is, for instance, allowed if the authorities find that 'it is strictly necessary and proportionate to achieve the continuity of critical functions and core business lines' or 'to avoid giving rise to widespread contagion'.[277] The literature notes that a resolution authority may on this basis exclude, for example, derivatives liabilities that are not secured liabilities or short-term liabilities to other institutions.[278]

Also, the BRRD and SRM Regulation create a ranking between a bank's subordinated liabilities. They require that losses are imposed on capital instruments that count as AT 1 and T2 capital instruments under the CRR, which are subordinated liabilities to investors in the bank, before other subordinated liabilities. Only if AT1 and T2 instruments are reduced in full, other subordinated debt and senior debt are to be reduced or converted in ascending order under national insolvency law.[279] Furthermore, as discussed in paragraph 5.3.4 below, the BRRD now creates a new debt class that can be bailed-in immediately after contractually and statutory subordinated liabilities have been bailed-in.[280]

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275 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 3 seems to incorrectly state that excluded liabilities include 'claims of commercial or trade creditors <u>and</u> claims arising from the provision of goods or services to the Bank that are critical to the daily functioning of its operations' (emphasis added, LJ). Article 44(2) BRRD and article 27(3) SRM Regulation, by contrast, provide that the excluded liabilities include liabilities to 'a commercial or trade creditor <u>arising</u> from the provision [...] of goods or services that are critical to the daily functioning of its operations' (emphasis added, LJ).

276 Article 44(2) BRRD; Article 27(3) SRM Regulation.

277 Article 44(3) BRRD; Article 27(5) SRM Regulation. On the discretionary exclusion of liabilities from bail-in *see* Gardella 2015, p. 394-396. Franke, Krahnen & Von Lüpke 2014, p. 564 and Adolff & Eschwey 2013, p. 964 argue against such a power for resolution authorities to exclude liabilities. According to Tröger 2018, p. 57-60, the terms used to exclude liabilities from the scope of bail-in are vague, and the margin of discretion given to authorities is a source of legal uncertainty.

278 Bliesener 2013, p. 205-208. *Cf*. Article 49 BRRD; Recital 17 Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances 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, 1.6.2016, p. 11–20); Section 4 Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014 (SI 2014/3350).

279 Article 48(1) BRRD; Article 17(1) SRM Regulation.

280 Article 108(2)-(7) BRRD.

5.3.3 National insolvency rankings of claims

The sections below offer a brief overview of the insolvency ranking of claims under Dutch, German, and English law. They show that the three jurisdictions have own approaches to this hierarchy. They all provide directly or indirectly for the protection of several categories of creditors.

Most of the Dutch provisions that grant priorities to particular types of creditors and claims can be found in the BW and specific statutes rather than the Fw.[281] Section 3:278 BW provides that creditors who can assert a right of pledge, right of mortgage, preferential right (*voorrecht*),[282] or another statutory ground for priority, such as the possessory lien[283] (*retentierecht*), are granted priority. Accordingly, in case of a 'concursus creditorum' a right of mortgage and right of pledge can be exercised as if the insolvency procedure had not been opened and tax authorities and employees have, amongst others, a right to preferential payment.[284] Claims against the insolvency estate (*boedelvorderingen*), i.e., essentially the costs of the insolvency procedure,[285] are to be paid in priority to all insolvency claims.[286] Several other rights, such as set-off rights, give creditors quasi-priority (*feitelijke preferentie*).[287] The literature notes that most of the priorities granted under Dutch law can be historically explained. The reasons that have been put forward in legislative history for the priority status of tax claims, for example, include that the public treasury cannot choose its debtors.[288] The result is a complex system with many classes of creditors that need to be paid in priority to the ordinary unsecured, non-preferential insolvency creditors, and the latter group of creditors often receives nothing in a bankruptcy procedure.[289] Several authors believe that the principle that creditors have equal rights to proportional payment does not amount that much under Dutch insolvency law.[290]

281 *Cf.* Wiórek 2005, p. 140-141, who discusses in which European countries the ranking of claims can be found in general private law provisions, in which the order can be found in a special insolvency act, and in which the order can be found in general insolvency law. For a discussion of all types of insolvency and administration claims under Dutch law, *see* Faber & Vermunt 2016.

282 Sections 3:283-289 BW distinguish between specific privileges and general privileges.

283 Sections 3:290-291 BW.

284 Section 57(1) Fw; Sections 3:278, 3:288(c)-(e) BW; Section 21 Tax Collection Act 1990 (*Invorderingswet*). For a discussion of the priorities based on security rights, preferential rights, and other statutory grounds, *see* Verstijlen 2006, p. 1157-1228; Erasmus 1976.

285 Van Buchem-Spapens & Pouw 2013, p. 62. The Fw does not define the term 'boedelschulden', the exact meaning derives from case law.

286 For a discussion of the administration claims (*boedelvorderingen*), *see* e.g., Van Mierlo 2004; Verstijlen 1998, p. 165-189.

287 Section 53 Fw. *See* Verstijlen 2006, p. 1219-1220.

288 Erasmus 1976, p. 37, 56-79.

289 *See* Wessels 2010; Verstijlen 2006, p. 1161.

290 E.g., Hummelen 2016, p. 16-17; Wessels 2010; Van Apeldoorn 2010, p. 25-42; Vriesendorp 2001, p. 3-11.

Proposals to change the current system for the distribution of the realization proceeds by, for instance, limiting the scope of the administration claims (*boedelvorderingen)* and preferential claims,[291] have been very much debated in the literature but no significant changes have been adopted so far.[292]

The approach of Dutch insolvency law to preferential rights in insolvency shows some similarity to the policy of English insolvency law. Both laws recognize several types of creditors whose insolvency claims are satisfied ahead of the insolvency claims of the ordinary unsecured, non-preferential creditors. In winding-up and in administration under English law, creditors with fixed security, including a mortgage or a lien, or quasi-security, such as a retention of title, can realize the security to satisfy their claims.[293] Provided that the ranking has not been altered by agreement, the next in line are successively (1) creditors with claims resulting from expenses in the procedure, such as the remuneration of the office holder and post-liquidation transactions,[294] (2) preferential creditors, (3) floating charge holders, and then (4) creditors with unsecured insolvency claims. Only if the claims of these creditors are satisfied, statutory interest, non-provable liabilities,[295] and the shareholders are successively paid. The English legislature changed the order of priorities following the in 1982 published report of the Cork Committee, which investigated and provided recommendations on the reform of English insolvency law. The report notes that, at that time, a *pari passu* distribution of unencumbered assets was seldom, if ever, achieved in practice because of the existence of many types of debts that had to be paid in priority to the unsecured insolvency claims.[296] The changes that were introduced by the Enterprise Act 2002 include the abolishment of the preferential treatment of tax claims. Moreover, the legislature introduced the rule that a prescribed part of the insolvency company's assets that would otherwise be used to satisfy the claims of floating charge holders, has to be used to pay the creditors with unsecured insolvency claims.[297] The category of preferential liabilities now still includes liabilities to employees.[298]

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291 *See* Mennens 2013; Van Mierlo 2004.

292 Faber & Vermunt, para. 12.03.

293 Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 18; Schillig 2016, p. 367.

294 Section 115 IA 1986; Rules 3.50 and 7.108 Insolvency Rules 2016. *See* Goode 2011, para. 8.32-39.

295 Non-provable liabilities are liabilities that are incurred during the insolvency procedure but do not qualify as expenses of the procedure, such as tort liabilities where the cause of action arises after the start of the procedure. *See* Anderson, Cooke & Gullifer 2016, para. 8.21-22.

296 Cork Report 1982, p. 317. *See also* Finch & Milman 2017, p. 515.

297 Goode 2011, para. 8.20. *Cf.* Section 176A IA 1986.

298 Section 386 IA 1986; Schedule 6 to the IA 1986, para. 8-10 and 13. *See also* Anderson, Cooke & Gullifer 2016, para. 8.62.

In Germany, most of the provisions on the different categories of creditors in insolvency procedures can be found in the InsO. Until 1999, specific groups of creditors, such as employees, churches, social security authorities, and schools, were granted the privilege in insolvency of being paid before the general class of insolvency creditors. It was generally acknowledged at that time that for specific reasons these groups were not all free to choose on their debtor.[299] With the enactment of the InsO, the separate classes with creditors who were granted preferential treatment were formally abolished.[300] The legislative history indicates that the privileges based on the personal characteristics of creditors were considered arbitrary. One of the purposes of the reforms was to create a fairer distribution in insolvency procedures ('[m]*ehr Verteilungsgerechtigkeit im Insolvenzverfahren*') as in many procedures at that time a large part of the proceeds of the realization of the debtor's assets were used to pay the preferential claims.[301] Nevertheless, this does not mean that the InsO does not acknowledge different creditor groups. Four groups of creditors are distinguished: (1) creditors who are entitled to claim separation of specific assets from the estate (*Aussonderungsberechtigte Gläubiger)*,[302] such as creditors with a right of ownership or usufruct, and creditors who have the right to claim privileged distribution of proceeds (*Absonderungsberechtigte Gläubiger)*,[303] including creditors with a security right; (2) creditors with administration claims (*Masseverbindlichkeiten*),[304] such as the insolvency court for court fees incurred after the commencement of the insolvency procedure, (3) general insolvency creditors, and (4) subordinated creditors.[305] Moreover, according to several scholars, in essence, German insolvency law still acknowledges preferential rights for

299 Ruzik 2010, p. 658; KuhnKomm-KO/Uhlenbruck 1994, Section 61, para. 24.

300 Ruzik 2010, p. 667; Wiórek 2005, p. 102-103. On the historical developments in the field of German insolvency law and the introduction of the InsO *see* Kodek 2014, p. 221-222; MünchKomm-InsO/Stürner 2013, Einleitung, para. 31-45c.

301 Gesetzentwurf der Bundesregierung, Entwurf einer Insolvenzordnung (InsO), Deutscher Bundestag, Drucksache 12/2443, 15 April 1992, p. 81 and 90. *See* Ruzik 2010, p. 671; Wiórek 2005, p. 107; According to UhlenbruckKomm-InsO/Pape 2015, section 1 InsO, para. 12 the privileges were considered 'der Feind jeden Rechts.' For a discussion of the changes to German insolvency law as of 1999, *see* Kamlah 1996, p. 417-435, who notes at p. 434 that under the former insolvency legislation 'virtually all of the debtor's encumbered assets are generally needed to pay the many priority claims, if a proceeding goes forward at all. Under new laws, these former priority claims will be dealt with on an equal basis with all other unsecured claims, thus presumably increasing the average dividend payable to general unsecured creditors.'

302 Section 47 InsO.

303 Sections 49-52 InsO.

304 Sections 53-55 InsO.

305 Under Section 39 InsO some claims are subordinated by operation of law, but parties may also contractually agree on the subordination.

certain creditors.[306] Given that some claims of tax authorities are treated as administration claims, and set-off and netting rights grant creditors *de facto* privileges in insolvency, the literature argues that the InsO uses mechanisms that have a similar effect as awarding formal preferential treatment over the general insolvency creditors.[307] Also, liabilities under a social plan (*sozial plan*) that may be adopted to protect the employees in an insolvency procedure are granted a *de facto* privilege as they qualify as administration claims.[308]

In sum, Dutch and English law provide for a complex statutory ranking in insolvency. German insolvency law recognizes four creditor groups and indirectly protects some other types of creditors, although it does not provide for a class with creditors who are formally granted preferential rights. The national insolvency laws, primarily Dutch and English law, protect some categories of creditors for social reasons, such as employees, some to ensure orderly conduct of the insolvency procedure, such as the insolvency office holder regarding his remuneration, and some because they perform essential public functions, such as tax authorities. Secured creditors enjoy priority treatment to the extent the value of the collateral covers their claim because they have ex-ante bargained for such a treatment.[309]

The bail-in rules create a different system to protect creditors. On the one hand, they recognize the policy of Dutch, German, and English insolvency law by following in bail-in the national insolvency ranking of claims. On the other hand, they derogate from the insolvency law system by also excluding classes of liabilities from the scope of the bail-in mechanism.[310] In particular, the bail-in rules exclude several types of debts that are granted a priority treatment under the national insolvency laws. Examples are debts to secured creditors, which have a priority treatment under Dutch, German, and English insolvency law, financial obligations to employees, which are preferential insolvency claims under Dutch and English law, and liabilities to tax authorities, which have a preferential treatment under Dutch insolvency law. The resolution rules also exclude short-term liabilities with an original maturity of less than seven days to other institutions from the scope of bail-in but these liabilities rank *pari passu* with other senior unsecured

306 Kodek 2014, p. 222; Bauer 2007, p. 188-192; Stürner 2005, p. 597-598. For a discussion of the *par condition creditorum*-principle in German insolvency law, see MünchKomm-InsO/Breuer 2014, section 226, para. 1-6; MünchKomm-InsO/Stürner 2013, Einleitung, para. 1; MünchKomm-InsO/Ganter/Lohmann 2013, section 1, para. 51-52; Ruzik 2010, p. 647 and 666-667.

307 Paulus & Berberich 2016, para. 10.06, 10.51-52

308 Section 53 and 123 InsO; Bauer 2007, p. 190-191.

309 *Cf.* Wessels & Madaus 2017, p. 240; UNCITRAL, Legislative Guide on Insolvency Law Part 2 2004, para. 53.

310 *See* Bliesener 2013, p. 198-209.

liabilities under the national laws of the three jurisdictions. The exclusion ensures that short-term interbank lending which is typically vital to the operation of a bank and provided by other institutions in the banking system is protected from bail-in. Furthermore, the resolution authorities can exclude other types of liabilities in special cirumstances. Thus, the bank resolution rules create a system whereby debt is 'in or out'[311] in addition to the system under which liabilities are 'up or down',[312] i.e., some liabilities have higher priority ranking than other liabilities.

5.3.4 *Leeway left for national legislatures*

The literature has paid much attention to the fact that the differences between the ranking of claims under national insolvency laws may result in differences in the domestic applications of the bail-in mechanism and make it difficult for creditors to assess the likelihood of their claims being bailed-in.[313] Moreover, scholars have argued that the fact that the BRRD refers to national law to determine the bail-in hierarchy of liabilities may create incentives for national legislatures to design their insolvency ranking of claims in a particular way. For example, they may give a more senior ranking to certain types of debt instruments and, accordingly, reduce the chance that these liabilities are bailed-in to persuade investors to invest in banks in their jurisdiction.[314]

An example of a difference that may arise in bail-in under Dutch, German, and English law relates to tax claims. Given that under the BRRD, liabilities to tax authorities are only excluded from the scope of the bail-in mechanism if the liabilities are awarded a preferential treatment under national law, these liabilities do not fall within the scope of the bail-in mechanism under the Wft but are bail-inable under German and English law.[315]

Position of depositors and deposit guarantee schemes
Article 108 BRRD also illustrates the fact that the Dutch, German, and English legislatures and resolution authorities have some discretion in deciding how to design the hierarchy of claims in bail-in and insolvency. The provision aims to align the position of depositors and deposit guarantee schemes in insolvency with their position in bail-in by requiring the insertion of two rungs to the insolvency ranking of claims under national law.

311 Ramos Munoz 2017, p. 270.
312 Ramos Munoz 2017, p. 270.
313 Philippon & Salord 2017, p. 44-45; Wojcik 2016, p. 126. *Cf.* Article 10 Winding-up Directive, which provides that the ranking of claims in an insolvency procedure is one of the aspects that is subject to the determination of the law of the bank's home Member State.
314 Wojcik 2016, p. 126.
315 *Cf.* Article 44(2)(g)(iii) BRRD; Letter of the Dutch Minister of Finance of 4 November 2015 (*Kamerstukken II* 2014/15, 34208, no. E).

If under national insolvency law, covered deposits would rank equally with ordinary, unsecured claims, bail-in may result in creditors being entitled to compensation under the no creditor worse off-principle. Covered deposits are excluded from the scope of the bail-in mechanism and, therefore, the class of ordinary, unsecured claims that potentially has to bear losses in bail-in has become smaller. In an insolvency procedure, by contrast, the depositors, or the deposit guarantee scheme subrogating to their rights and obligations, and the ordinary, unsecured creditors would share equally in the available proceeds.[316] This risk that the no creditor worse-off principle is breached in bail-in justifies granting the deposits of natural persons and of micro, small and medium-sized enterprises that are covered by a deposit guarantee scheme a priority ranking in insolvency which is higher than the position of the ordinary, unsecured claims. A deposit guarantee scheme subrogating to the rights and obligations of covered depositors has the same preferred position as the covered depositors. Article 108 BRRD also provides that the part of these deposits that exceeds the coverage level has a ranking below the ranking of the covered deposits but higher than the ranking of the ordinary, unsecured claims.[317] However, the provision does not stipulate how the priority position of depositors and a deposit guarantee scheme should relate to the priority position of other preferential creditors and secured creditors. The literature has noted that the BRRD leaves this to national law.[318]

Under section 212ra Fw the claims set out in article 108 BRRD have a preferential position (‘*zijn bevoorrecht*’[319]) and are paid from the proceeds available in a liquidation once the preferential insolvency claims listed in section 3:288 BW have been paid. The latter claims include claims of employees for wages relating to the work performed prior to the commencement of the insolvency procedure. As a result, under Dutch law depositors and deposit guarantee schemes can assert a preferential right but stand at the bottom of the class of preferential insolvency claims and are in a liquidation procedure only paid after the administration claims (*boedelvorderingen*) and all other insolvency claims with preferential treatment.

316 Wojcik 2016, p. 123; Schillig 2015, p. 97.

317 Article 108 BRRD also provides that deposits from natural persons, micro, small and medium-sized enterprises that would be eligible for coverage by a deposit guarantee scheme were they not made through branches located outside the EU of institutions established within the EU have the same priority position as the part of the eligible deposits exceeding the coverage level. For a discussion of Article 108 BRRD, *see also* Haentjens 2017, para. 9.17-9.20.

318 Schillig 2016, p. 366-367.

319 Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 128.

Section 46f(4) KWG provides that the claims of depositors and deposit guarantee schemes have priority over the remaining insolvency claims (übrigen Insolvenzforderungen), in the order provided by article 108 BRRD. The present author assumes that the 'remaining insolvency claims' are claims the ordinary insolvency creditors (*Insolvenzgläubiger*) under section 38 InsO. According to the literature, the claims under section 46f(4) KWG should be considered a separate class within the class with claims of insolvency creditors under section 38 InsO and are in a liquidation procedure satisfied after the administration claims under section 53 InsO.[320]

In the consultation procedure on the implementation of the BRRD in the UK, the UK government noted that article 108 BRRD does not prescribe how the position of floating charges in the insolvency ranking of claims should relate to the position of deposits.[321] Some respondents argued that floating charges are typically used by 'sophisticated investors' and should, therefore, not benefit from a more senior ranking than deposits. According to others, however, floating charges are sometimes used by banks for liquidity purposes and providing them a more junior ranking than deposits would deteriorate their value.[322] The legislature decided to create two classes with preferential claims: a class with 'ordinary preferential debts', which include claims of employees, covered deposits and claims of the deposit guarantee scheme, and a class with 'secondary preferential debts', which are the deposits exceeding the amount covered by the deposit guarantee scheme.[323] As a result, in contrast to Dutch and German law, under English law covered deposits and the claims of the deposit guarantee scheme rank equally with other preferential claims, including the preferential claims of employees. Ordinary preferential debts rank above secondary preferential debts. The claims of floating charge holders were not included in the class with secondary preferential debts but rank after this class.

Recent amendments to article 108 BRRD

A new EU directive that amends article 108 BRRD has to be implemented by all EU Member States by 29 December 2018.[324] In the Netherlands a new

320 Skauradszun & Herz 2016, p. 505-508. *See also* Bornemann 2016, para. 49-50.

321 HM Treasury, Transposition of the Bank Recovery and Resolution Directive: response to the consultation, March 2015, para. 2.87-91. *See also* HM Treasury, Transposition of the Bank Recovery and Resolution Directive, July 2014, para. 17.1-9.

322 HM Treasury, Transposition of the Bank Recovery and Resolution Directive: response to the consultation, March 2015, para. 2.87-91. *See also* HM Treasury, Transposition of the Bank Recovery and Resolution Directive, July 2014, para. 17.1-9.

323 Sections 175 and 386 IA 1986 and Schedule 6 to the IA 1986, para. 8-15BB.

324 Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy (OJ L 345, 27.12.2017, p. 96–101). *See also* paragraph 3.2 of chapter 7.

section 212rb Fw has been proposed to implement the amendments.[325] In Germany a new section 46f(6)-(9) KWG entered into force on 21 July 2018.[326] The new article 108(2)-(7) BRRD introduces a specific class of bank debt. The effect is that the class with unsecured, non-preferred bank debt is split into two layers, namely in one lower layer with liabilities meeting the requirements of the new provision and one upper layer with the other senior unsecured liabilities. The lower layer consists of liabilities resulting from debt instruments which contractual documentation and, where applicable, the prospectus explicitly provide that they have the low ranking as defined in article 108(2) BRRD. Accordingly, the resolution authorities can bail-in the financial obligations of a bank that belong to this class immediately after contractually or statutory subordinated liabilities but before the other unsecured, non-preferred claims against a bank. The latter claims include claims that are excluded from bail-in. Because the liabilities in the new class no longer belong to the same class as the excluded liabilities, the authorities can apply their bail-in powers to the new class without treating liabilities in the same class in insolvency unequally in bail-in. The provision also facilitates the compliance of banks with the requirements for a minimum amount of bail-inable debt, i.e., the so-called MREL and TLAC standard, which were discussed in paragraph 3 above.[327] The resolution authorities in the EU require global systemically important banks and may require other banks to meet the requirement for a minimum amount of bail-inable debt with liabilities that rank in insolvency below senior liabilities that are excluded from bail-in or may be excluded from bail-in by the resolution authority.[328]

In September 2018, the UK published a draft version of the Banks and Building Societies (Priorities on Insolvency) Order 2018, which aims to implement the new paragraphs of article 108 BRRD.[329] However, the UK House of Commons' European Scrutiny Committee has indicated that transposition of the directive makes little difference in the UK because the directive does not prevent the BoE from having another preferred approach to the subordination of bank liabilities for the MREL and TLAC requirements, namely structural subordination.[330] Most UK banking groups for

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325 Proposal for the Dutch Act to amend the Fw and implement Directive 2017/2399 (*Kamerstukken II* 2017/18, 34909, no. 2).

326 **Gesetz zur Ausübung von Optionen der EU-Prospektverordnung und zur Anpassung weiterer Finanzmarktgesetze (Bundesgesetzblatt Teil I 2018 Nr. 25 vom 13.07.2018).**

327 *See* paragraph 3 above. The requirements for Total Loss-Absorbing Capacity (TLAC) can be found in the 'Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet' of the Financial Stability Board of 9 November 2015.

328 Article 45b(3) BRRD; Article 12c(1) SRM Regulation; Articles 72a-b and 92a CRR.

329 The draft version of the Order is available at: https://www.gov.uk/government/consultations/draft-banks-and-building-societies-priorities-on-insolvency-order-2018-technical-consultation/technical-consultation-on-the-draft-banks-and-building-societies-priorities-on-insolvency-order-2018

330 European Scrutiny Committee, UK House of Common, Banking reform: risk reduction measures, 27 February 2018.

which bail-in is the preferred resolution strategy have one legal entity within the group, generally a holding company, that issues capital and debt instruments meeting the MREL and TLAC requirements to external investors. The operating subsidiaries within the group, including banks, issue contractually subordinated capital and debt instruments internally to the holding company. The BoE expects to recapitalize the subsidiaries if they experience losses through bail-in of the internally issued instruments. In a winding-up procedure under insolvency law, the claims of the external creditors of the holding company are only satisfied from the proceeds at the subsidiary level after all creditors of the subsidiaries have been paid. Accordingly, these claims at the holding company level are considered to be structurally subordinated to the senior, external liabilities of the operating legal entities, including the liabilities that are excluded from bail-in.[331]

Moreover, although the new article 108(2)-(7) BRRD now aims to harmonize a specific part of the ranking of claims under national insolvency law, the fact that national authorities and legislatures have some leeway in the design of the national bail-in hierarchy of claims is also illustrated by the fact that a similar provision already existed under German law. From 1 January 2017 to 21 July 2018, under the KWG a part of the class of claims of the senior insolvency creditors of banks under section 38 InsO was statutorily subordinated to the remaining claims in the class. The lower layer consisted of claims under certain senior unsecured bank debt instruments, i.e., bearer bonds (*Inhaberschuldverschreibungen*), negotiable registered bonds *(Orderschuldverschreibungen), Schuldscheindarlehen* and non-negotiable registered bonds *(Nahmenschuldverschreibungen)*. Section 46f(5) KWG provided that the payment of these claims in insolvency is conditional on the prior payment of the other claims in the class under section 38 InsO, such as large corporate deposits and claims under derivatives transactions.[332] It is the present author's view that the provision seemed to fit well into German

331 Bank of England, 'The Bank of England's approach to resolution', October 2017, p. 24.

332 The first proposal for Section 46f(5)-(7) KWG of May 2015 explicitly provided for a statutory subordination of the mentioned debt instruments. It provided that the claims are 'als nachrangige Forderungen vor den Forderungen im Rang des § 39 Absatz 1 Nummer 1 der Insolvenzordnung, bei gleichem Rang nach dem Verhältnis ihrer Beträge, berichtigt soweit nicht ein weitergehender Nachrang vereinbart oder gesetzlich vorgegeben ist. Sieht ein vertraglicher Rangrücktritt eine Rangstelle unmittelbar hinter den nicht nachrangigen Insolvenzgläubigern vor, so gilt als vereinbart, dass die Forderungen unmittelbar hinter den Forderungen im Rang des Satzes 1 stehen sollen.' *See* Gesetzentwurf der Bundesregierung, Abwicklungsmechanismusgesetz, Bundesrat, Drucksache 193/15, 1 May 2015, p. 16. Under the provision that entered into force in 2017 the debt instruments are only from an economic point of view treated junior to the other general unsecured claims under Section 38 InsO. Article 46f(5) KWG provides in German that 'Von den Forderungen im Sinne des § 38 der Insolvenzordnung werden zunächst die Forderungen berichtigt, die keine Schuldtitel nach Absatz 6 Satz 1 sind.' *See* Gesetzentwurf der Bundesregierung, Abwicklungsmechanismusgesetz, Deutscher Bundestag, Drucksache 18/5009, 26 May 2015, p. 76-77.

insolvency law, under which several types of claims, including shareholder loans, were already statutorily subordinated by operation of law to the senior unsecured insolvency claims of section 38 InsO.[333] Dutch and English insolvency law, by contrast, do not contain a similar provision under which certain claims are subordinated by operation of law.

Following the entry into force of the BRRD and SRM Regulation, not only Germany but also other EU Member States amended the hierarchy of claims under national insolvency law to facilitate banks to comply with the subordination requirement of the MREL and TLAC standards. The widely accepted view in policy and academic discussions then was that the heterogeneous national approaches to the subordination of bank debt created uncertainty for issuing banks and investors and were likely to complicate the application of the bail-in mechanism to cross-border operating banks. Also, the divergent approaches could cause competitive distortions between banks in the EU internal market. For example, if creditors with otherwise similar debt instruments are treated differently across jurisdictions because of differences in the hierarchy of claims under insolvency law, the costs borne by investors when buying bank debt instruments and costs for banks to meet the subordination requirement are likely to differ.[334] When the EU legislature introduced the harmonized, senior non-preferred debt class, it sought to address these problems.[335]

6 Conclusions

This chapter investigated the objectives, principles, and rules of the national legal frameworks on bail-in established by the BRRD and SRM Regulation. Resolution authorities have the bail-in mechanism at their disposal to write-down and convert into equity capital instruments and liabilities in a certain order, to absorb losses and recapitalize a bank. The paragraphs paid particular attention to the question of how the legal frameworks on bail-in currently interact with and how they have been embedded into private law at the national levels. The sections below summarize the main conclusions of the chapter.

333 Section 39(1) InsO.

334 E.g., Philippon & Salord 2017, p. 44-46; European Banking Authority, Final Report on MREL. Report on the implementation and design of the MREL framework (EBA-Op-2016-21, 14 December 2016), p. 119; Commission staff working document, Impact assessment accompanying the document Proposal amending the CRR, CRD IV, BRRD and SRM Regulation (SWD (2016) 377 final/2, 24.11.2016), p. 24; Valiante 2016, p. 21-24; Council of the European Union, 'Council Conclusions on a roadmap to complete the Banking Union', 17 June 2016, para. 2.7.

335 *Cf.* Recitals 3-10 Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy (OJ L 345, 27.12.2017, p. 96–101).

1. *Do the national legal frameworks on bail-in and the national company and general insolvency laws share some important principles, especially from the perspective of the trend in the EU to introduce corporate restructuring procedures as an alternative to traditional court-centered procedures?*

Common tendencies in national, corporate restructuring and insolvency laws in the EU include that arrangement that is negotiated amongst the creditors can be imposed on a dissenting minority and that a restructuring procedure can be started at an early stage, i.e., earlier than the moment a formal insolvency procedure can be opened. Dutch, German, and English law all provide for corporate restructuring procedures that are initiated by a plan proposal and end with a court confirmation that can bind dissenting creditors and shareholders to a majority vote. Only English law provides for such a corporate procedure outside the context of a formal insolvency procedure, which is mainly the English scheme of arrangement procedure. In the Netherlands, a proposal for a similar procedure is pending, which is the extrajudicial plan (*onderhands akkoord*) procedure. The bail-in mechanism has both of the two characteristics: bail-in takes place outside a traditional, court-centered insolvency procedure and preferably also at an early stage of financial distress, and the bail-in mechanism is a financial restructuring mechanism that can be used to force creditors and shareholders to accept the restructuring measures. Nevertheless, in contrast to the corporate restructuring procedures, in the application of the bail-in, the financial restructuring is not imposed under an arrangement between the debtor and a certain percentage of its creditors and shareholders and confirmed by a court, but by administrative decision.

2. *What is the effect of a reduction of liabilities of a bank by a resolution authority on the liabilities themselves and related guarantees under national law?*

Write-down and conversion are in the BRRD together referred to as 'reduction'. The BRRD provides that if a resolution authority reduces the principal amount of a liability or outstanding amount payable in respect of a liability, that liability and any obligations or claims arising in relation to it that are not accrued at the time when the power is exercised shall be treated as discharged for all purposes. Also, they shall not be provable in any subsequent procedure in relation to the institution under resolution or any successor entity in any subsequent winding-up. The provision suggests that following bail-in both the principal claim against the bank and a possible indemnity claim of a third party against the bank are to be treated as discharged. It does not exclude the possibility that also a claim of a bank's creditor under a related guarantee is to be treated as discharged. It has been shown that under Dutch law, the likely effect of the debt reduction by the resolution authority is that a surety is then no longer liable to the creditor and the co-debtor no longer for the joint and several obligation (*hoofdelijke verbintenis*) to the extent the liability of the bank is reduced. Under German law, such a debt reduction does not affect the rights of the creditors against the bank's

co-debtor, a surety or any other party who is liable for the debtor's obligations. An indemnity claim of these third parties against the bank is treated as discharged to the same extent as the bank's original liability is reduced. Under the UK BA 2009, the BoE seems to have discretion in deciding what are the effects of bail-in on the liability of the bank and related guarantees. However, similar to Dutch law, the general rule under English private law is that the surety is discharged if the principal liability is extinguished by operation of law.

3. *Does conversion of debt into equity under the bank resolution rules follow the formalities and practice for such conversion normally followed in a financial restructuring under national law?*

The BRRD does not prescribe a particular process but requires national law to fill in the technicalities and details of the execution of the conversion. It does require that procedural impediments to the conversion existing under articles of association, contract, or law are removed. Resolution authorities are in principle not subject to requirements to obtain consent or approval from any person, to publish a notice or prospectus, or to file or register a document with an authority. The SAG and its legislative history suggest that the application of the bail-in mechanism under German law follows to a large extent general, national company and insolvency law. The BoE and DNB have both published papers which describe at a high level how the authorities anticipate the conversion process to look like under the BA 2009 and the Wft respectively. The proposed procedures deviate quite significantly from the usual process for conversion of debt to equity under national company and insolvency law and may also differ from the procedures used for bail-in in other jurisdictions. In the procedures, certificates of entitlement or claim rights are provided to the bailed-in creditors, which can be traded until the valuations by the authorities are completed and shares in the capital of the bank can be delivered to the creditors.

4. *How does the hierarchy of claims in bail-in relate to the insolvency ranking of claims under national law?*

The bail-in rules provide for a different system than national insolvency law to protect various types of claims and creditors. The bail-in hierarchy of claims follows to a large extent the hierarchy of claims under national insolvency law. In addition, the resolution rules protect certain types of liabilities of banks by excluding them from the scope of the bail-in mechanism, for example, to avoid that risks spread to other parts of the financial system and enable the bank to continue its daily operations. The rules also empower resolution authorities to exclude other categories of liabilities in exceptional circumstances. Thus, the bank resolution rules combine the system in which some liabilities have higher priority ranking than other liabilities with a policy under which specific types of claims are carved out from bail-in.

6 European bank resolution framework: transfer tools[1]

1 Introduction

After the discussion of the bail-in mechanism in the previous chapter, this chapter takes a detailed look at the other three resolution tools created by the BRRD and SRM Regulation, namely the 'sale of business tool', the 'bridge institution tool' and the 'asset separation tool'. The tools are together called the 'transfer tools'. Paragraph 2 provides a brief discussion of conceptual aspects of the transfer tools from a regulatory perspective and an insolvency law perspective, while paragraph 3 examines the transfer tools as codified in the BRRD and SRM Regulation. Against this background, paragraphs 4 and 5 analyze four prominent relations between the objectives, principles, and rules of the national legal framework on the transfer tools established by the BRRD and SRM Regulation on the one hand, and national private law on the other hand. The paragraphs show how the domestic legal frameworks on the transfer tools interact with and how they have been embedded into private law.

In particular, paragraph 4 investigates the main objectives pursued by the legal framework on the transfer tools on the one hand and by Dutch, German, and English general insolvency law on the other hand. The central question is whether the rules on the transfer tools share objectives with more general national insolvency law. Hence, this paragraph explores the deeper levels of the national legal orders, namely the objectives.

Paragraph 5 then analyzes three sets of rules on the transfer tools. The sections show that the national legislatures closely aligned some of the rules with rules of national private law, that some rules on the transfer tools explicitly depart from national private law, and that the relation of some rules with national private law is unclear. It is also suggested that differences in national private laws interacting with the resolution rules may create diverging outcomes in the interpretation and application of the rules on the transfer tools between jurisdictions.

More specifically, paragraph 5.1 questions how the national legislatures ensured that the transfers ordered by a resolution authority have an immediate effect. The paragraph also examines how the effect and scope of the application of the transfer tools relate to other types of acquisition of assets,

1 This chapter contains and builds on the following work previously published by the author: Janssen 2018a.

rights, and liabilities or shares under national private law. Paragraph 5.2 scrutinizes how the resolution rules protect in case of a partial transfer of assets, rights, and liabilities, security rights under a security arrangement and set-off or netting rights under a set-off or netting arrangement, respectively. Relevant questions in this context are whether creditors also benefit from these rights if an insolvency procedure is opened under national insolvency law and whether other areas of national private law also offer protection against a loss of these rights in case of a partial transfer. Finally, paragraph 5.3 analyzes what is considered a 'normal insolvency proceeding' for a bank under national insolvency law. It discusses as well which role the national resolution authority plays in the opening of such a procedure.

2 Conceptual aspects of the transfer tools from a regulatory and insolvency law perspective

2.1 Transfer tools from a regulatory perspective

A transfer of a failing bank or a part thereof to another party can take many forms.[2] If there is a buyer for the bank as a going concern, a business sale transaction may be the preferred resolution strategy in the resolution procedure. This measure is typically directed towards the continuation of the bank's operations without significant disruptions to payment and clearing and settlements systems. By providing a resolution authority the power to expropriate the existing shareholders' shares in the capital of the failing bank and transfer the shares to a private sector purchaser, a transfer of the bank can relatively easily be accomplished.[3] Moreover, this instrument provides the resolution authority the possibility to transfer the bank's entire business in its present condition.[4] It is recognized, however, that in practice third parties may be unwilling to take over the ownership of the legal entity as a whole or all the assets, rights, and liabilities. For example, there may be only little time available for these parties to analyze the target bank's balance sheet and the acquisition may pass on risks to the purchasing party.[5]

2 *See* Basel Committee on Banking Supervision, 'Guidelines for identifying and dealing with weak banks', July 2015, p. 47-48; Gleeson 2012, p. 16; Asser 2001, p. 143-144; Hüpkes 2000, p. 88-89.

3 Van der Zwet 2011, p. 18-19.

4 Schillig 2016, p. 251; Schelo 2015, p. 147.

5 Schelo 2015, p. 56; Gleeson 2012, p. 16; Asser 2001, p. 145; Hüpkes 2000, p. 89. Cash injections or guarantees of a resolution fund or a reduced purchase price may be necessary to make the business attractive for potential purchasers. *See* Binder 2017a, p. 63; Basel Committee on Banking Supervision, 'Guidelines for identifying and dealing with weak banks', July 2015, p. 47. According to Huertas 2014, p. 93, a sale of a systemically important bank is generally not the preferable resolution strategy. Such a sale can pose concentration risks in the markets as well as contract risks to the buyer, for example, because there is little or no time available to conclude the sale and the acquiring bank may not have a full picture of the problems of the failing bank.

Alternatively, the resolutions authorities reorganize the failing bank through a split up of the business into two or more parts. The reorganization is most often accomplished through a transfer to a buyer of all or a portion of the assets and rights plus all or some of the liabilities.[6] The transferred part typically includes assets, rights, and liabilities that are considered to be systemically relevant and in the public interest to be separated. Other assets, such as a non-performing loan portfolio,[7] and liabilities are left behind and are made subject to an insolvency procedure under insolvency law.[8] According to the literature, this resolution method of separating a balance sheet has laid at the core of several bank resolution regimes around the world for many years.[9] Authorities may prefer to hand over, for instance, the covered deposit portfolio to another bank and ask the deposit guarantee scheme to contribute to cover a deficit between the value of the assets, rights, and liabilities.[10] Such a transfer of deposit accounts can be more efficient than making payments to all depositors. Furthermore, the costs for the deposit guarantee scheme may be lower if the acquiring bank is willing to pay an amount for taking over the failing bank's customers.[11]

Another alternative forms the establishment of a temporary bridge institution. This measure focuses in most cases on the transfer of assets, rights and liabilities that are related to the critical functions of the failing bank. The legal entity serves as a successor of the failing bank until a more permanent solution for the business is found.[12] As such, the bridge institution takes

6 Transfers of banks' assets, rights, and liabilities arranged by authorities in or outside formal resolution procedures have been extensively discussed in literature. Scholars have used theoretical perspectives and have discussed experiences in several jurisdictions. The literature often uses the term 'purchase and assumption transaction'. *See* e.g., Binder 2016, p. 50; Schelo 2015, p. 55-58; Binder 2013b, p. 389-398; Huertas 2012, p. 73-78; Van der Zwet 2011, p. 19-21; Bolzico 2007, p. 16; Seelig 2006, p. 106-114; Asser 2001, p. 144-147; Hüpkes 2000, p. 90-92; Olson 1999, p. 145-148.

7 'Non-performing loans' is a term the literature often uses but it has no uniform definition. In its 'Guidance to banks on non-performing loans' of March 2017 the European Central Bank defines the term as '[l]oans other than held for trading that satisfy either or both of the following criteria: (a) material loans which are more than 90 days past-due; (b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.' For a discussion of the definition of 'non-performing loans' in general, *see* Arner et al. 2017, p. 4-7; Kvarnstroem & Ortwein 2006, p. 1452-1453.

8 *See* Schelo 2015, p. 147; Davies & Dobler 2011, p. 214.

9 Davies & Dobler 2011, p. 214, who discuss that the United States has had a bank resolution authority since 1933 and Canada since 1967 and the powers for authorities to transfer a part or all of a failing bank's business already exist in Italy, Germany, and the United Kingdom for some time as well.

10 *See* Seelig 2006, p. 106-107; Asser 2001, p. 145.

11 Van der Zwet 2011, p. 19. According to Seelig 2006, p. 110, however, the fact that the deposits need to be identified and separated within only a short period can cause operational obstacles.

12 Schelo 2015, p. 141-142; Huertas 2012, p. 75-78; LaBrosse 2009, p. 220-221; Hüpkes 2000, p. 90-91; Olson 1999, p. 147.

over enough assets, rights, and liabilities to be able to operate independently, although the resolution authority is likely to exercise some control over its operations and management.[13] Moreover, the measure gives potential third party purchasers some time to assess the books of the bank and prepare the acquisition.[14] Authorities may also first arrange a transfer of the whole business and transfer certain parts back to the bank under resolution at a later stage. They may prefer to do so if they experience difficulties in quickly determining which assets, rights, and liabilities of the bank under resolution should be included in the transaction.[15]

Nonetheless, the widely accepted view in the literature seems to be that splitting a bank's balance sheet can be complicated, in particular, if the bank operates across borders.[16] The sale of business technique and bridge institution technique can, therefore, generally only be applied to banks with a simple business and assets and liability structure.[17] The BoE, for example, expects to use these techniques only for smaller and medium-sized banks that are large enough to meet the public interest test for the opening of a resolution procedure.[18] For banks with balance sheets of more than £15-25 billion it is said to be unlikely that a buyer is willing to take over the business in case of failure. Furthermore, it may not be practically feasible to split up such a large and interconnected business within a short period to make a sale of business and bridge institution technique possible. For these banks, bail-in is considered to be the preferred resolution strategy.[19]

Finally, a variation on the transfer of shares or 'good' assets, rights, and liabilities to another financial institution or a bridge institution is the transfer of some of the failing bank's liabilities and underperforming assets, such as a non-performing loan portfolio, to a separate vehicle. Such a legal entity is known as a 'bad bank', 'asset management company', and 'asset management vehicle'. The entity, which can be privately or publicly owned, aims to sell the underperforming assets for the best possible price while the failing bank's viable parts stay behind.[20] An advantage of the use of an asset management company is that the entity can, for instance, wait until the market

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13 Schelo 2015, p. 142; Huertas 2012, p. 75; Olson 1999, p. 147. *Cf.* Asser 2001, p. 146.

14 Basel Committee on Banking Supervision, 'Guidelines for identifying and dealing with weak banks', July 2015, p. 49.

15 Schuster & Westpfahl 2011, p. 283-284; Bachmann 2010, p. 467.

16 LaBrosse 2009, p. 221; Mayes 2009, p. 305.

17 Binder 2017a, p. 63; Bank of England, 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)', Responses to consultation and statement of policy, November 2016, p. 21 (which lists several factors that are taken into account to determine whether the use of one of the BoE's transfer powers is the preferred resolution strategy); Binder 2013b, p. 397; Huertas 2012, p. 76-77; Gleeson 2012, p. 16; LaBrosse 2009, p. 221.

18 *Cf.* Section 7 BA 2009.

19 Brierley 2017, p. 469-470.

20 Schelo 2015, p. 57-58; Van der Zwet 2011, p. 20; Seelig 2006, p. 15-16 & 113-114.

conditions for a sale are better than at the time of the bank failure. Also, in practice, such a vehicle often does not have operations that require a banking license, including attracting deposits and issuing loans. In such a case it is not subject to the strict capital requirements that apply to banks.[21] It is believed, however, that the possibility of having underperforming assets ring-fenced into and the related financial burden shifted onto a separate vehicle can be a source of moral hazard.[22] The asset separation technique, therefore, may have to be combined with other resolution tools, including the bail-in mechanism, to allocate losses to the creditors and shareholders of the bank if the assets are sold to the asset management company below the initial book value. As such, the assets can, for example, be transferred to the vehicle at the real economic value while forcing the bank's shareholders and creditors to bear any losses equivalent to the difference with the book value. The measure helps to minimize potential losses for the vehicle.[23] Asset separation methods have been applied many times around the world now, whether it was in the form of the creation of a vehicle that acquires assets, rights, and liabilities of only one bank or several banks.[24] Examples include the German winding-up agencies that were established under the in 2009 adopted section 8a FMStFG, which was discussed in chapter 3.[25] As is further examined in chapter 7,[26] in March 2018 the European Commission presented a package of measures to reduce the level of non-performing loans in the EU, which included a blueprint for national authorities on how they can set-up asset management companies.[27]

21 Commission staff working document AMC Blueprint accompanying the document Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank, Second progress report on the reduction of non-performing loans in Europe (SWD (2018) 72 final, 14.3.2018), p. 17; Schelo 2015, p. 57-58 and 149-152. *See also* Arner et al. 2017, p. 56-58.

22 Avgouleas 2012, p. 414.

23 Commission staff working document AMC Blueprint accompanying the document Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank, Second progress report on the reduction of non-performing loans in Europe (SWD (2018) 72 final, 14.3.2018), p. 50-51. *See also* Schelo 2015, p. 58 & 150; Seelig 2006, p. 16.

24 *See* Demertzis & Lehmann 2017, p. 6-10; Lehmann 2017, p. 7-9; Arner et al. 2017, p. 18-55; Gandrud & Hallerberg 2017; Binder 2016, p. 52; Schelo 2015, p. 57-58; Calomiris et al. 2012, p. 15-17; Günther 2012, p. 141-192; Kvarnstroem & Ortwein 2006, p. 1451-1471. For an analysis of non-performing loans of German banks before 2006 and how these loans could be transferred under German law at that time, *see* Froitzheim et al. 2006. Günther 2012, p. 148 refers to the study of Laeven & Valencia 2008, p. 5 & 23, who identify 124 banking crises in the period 1970 to 2007 and note that asset management companies, in particular, centralized companies, have been set up in 60 percent of the crises.

25 Paragraph 3.2 of chapter 3. *See* Schelo 2015, p. 149; Bornemann 2015, p. 460-462; Günther 2012, p. 177-192.

26 Paragraph 3.2 of chapter 7.

27 Commission staff working document AMC Blueprint accompanying the document Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank, Second progress report on the reduction of non-performing loans in Europe (SWD (2018) 72 final, 14.3.2018).

2.2 Transfer tools from an insolvency law perspective

As paragraph 4 discusses in more detail, from an insolvency law angle the resolution rules on the transfer tools create a legal framework directed towards the distribution of a failing company's assets, which distribution is arranged and supervised by a public authority.[28] Some scholars compare the transfer tools with the instruments an insolvency trustee or administrator may have at its disposal under insolvency law to sell parts of a failing company's business to the benefit of the company's creditors.[29] In many jurisdictions, going concern sales are used in corporate reorganization and liquidation procedures as alternatives to a restructuring of the business in the hands of the existing legal person or a piecemeal liquidation, respectively.[30] In principle, a resolution authority and an insolvency trustee or administrator both aim to agree on a sale price with the purchasing party. Nevertheless, whether it is in a bank resolution or general corporate insolvency procedure, in practice the parts of the failing company are often not sold for the best possible price because the sales are arranged quickly and behind closed doors.[31]

Moreover, the resolution techniques to place certain underperforming assets in an asset management vehicle or transfer shares or well-performing assets temporarily to a bridge institution replicate methods known to reorganize failing, non-financial corporate debtors.[32] Dutch literature, for example, uses the term *sterfhuisconstructie* for the split-up of a company into viable and non-viable business parts.[33] An example from German literature is the temporary transfer of shareholders' shares in a distressed company's capital to a trustee (*Treuhänder*), which shares then serve as security for the loan provided by an investor.[34]

In theory, for creditors of the failing bank the creation of a bridge institution can economically have the same effect as the application of the bail-in mechanism.[35] For example, resolution authorities may transfer assets, rights, and liabilities from the bank under resolution to the bridge institution, while leaving sufficient liabilities behind to ensure that the bridge institution is

28 *Cf.* Binder 2017b, p. 2.
29 Binder 2017b, p. 2; Thole 2016, p. 66; Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 10; Hadjiemmanuil 2015, p. 232; De Weijs 2013, p. 216.
30 Eidenmüller 2018, para. 8.5.1.
31 For a general insolvency law perspective on this issue, *see* Eidenmüller 2018, para. 8.5.1; Hummelen 2016, p. 166-183; Verstijlen 2014, p. 21-29. For a bank resolution perspective, *see* Schelo 2015, p. 148.
32 Schelo 2015, p. 57.
33 Slagter 2000, p. 83.
34 Undritz 2012, p. 1153-1161. *See also* Schelo 2015, p. 57.
35 Schelo 2015, p. 142; Jackson & Skeel 2012, p. 452. *See also* Bornemann 2015, p. 469-470.

well-capitalized. They then put the residual entity in a liquidation procedure.[36] Moreover, they issue shares in the capital of the bridge institution to the creditors who have been left behind, following the ranking of claims under national insolvency law.[37] These measures recapitalize the bridge institution in a similar way as the application of the bail-in mechanism.[38] It has been argued that discrimination between creditors who rank *pari passu* in an insolvency procedure rank is unavoidable in such a separation of the balance sheet of a failing bank.[39] Creditors whose claims are transferred are treated *defacto* senior to the creditors left behind. For instance, the contracts of the former are likely to be continued by the bridge institution or private sector purchaser while the latter become creditors in a liquidation procedure.[40]

3 Transfer tools as codified in the BRRD and SRM Regulation

The BRRD and SRM Regulation incorporate the resolution techniques that the previous paragraph discussed.[41] The Dutch legislature transposed most of the rules of the BRRD on the transfer tools into sections 3a:28-43 Wft[42] and the Decree on Special Prudential Measures, Investor Compensation and Deposit Guarantees pursuant to the Wft (*Besluit bijzondere prudentiële maatregelen, beleggerscompensatie en depositogarantie Wft)*, [43] while in Germany

36 Schelo 2015, p. 142; Jackson & Skeel 2012, p. 452.
37 Schelo 2015, p. 146-147; Jackson & Skeel 2012, p. 452.
38 Jackson & Skeel 2012, p. 452.
39 Binder 2015b, p. 14-15. *See also* Huertas 2012, p. 76; Riethmüller 2010, p. 2301-2302.
40 Binder 2015b, p. 14-15; Binder 2013b, p. 394-395; Thole 2012, p. 234; Huertas 2012, p. 76.
41 *Cf.* Articles 38-42 BRRD; Articles 24-26 SRM Regulation.
42 The Wft uses the term 'transfer of the business' (*overgang van de onderneming*) rather than 'sale of business', as is used by the BRRD. The use of the former term is, according to the legislative history, more in line with the wording used in the provisions on the bridge institution tool and the asset separation tool. *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 18. Moreover, according to the legislative history, the term 'entity for management of assets and liabilities' (*entiteit voor activa- en passivabeheer*) is to be preferred over the BRRD's term 'asset management vehicle' to indicate that assets as well as liabilities can be transferred to the newly created entity. *See* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 102.
43 Chapter 5a Decree on Special Prudential Measures, Investor Compensation and Deposit Guarantees pursuant to the Wft (which heading is 'resolution' (*afwikkeling*)) contains detailed rules on the establishment and termination of an asset management vehicle and bridge institution by DNB. It distinguishes between a bridge institution which can acquire assets, rights, and liabilities of a bank under resolution, which is a so-called bridge company (*overbruggingsonderneming*), and a bridge institution which holds and owns shares (or other instruments of ownership) in the capital of a bank under resolution, bridge company or asset management vehicle, which is a so-called bridge foundation (*overbruggingsstichting*). *See* Explanatory Notes to the Draft Implementation Decree European framework on the recovery and resolution of bank and investment companies (*Stb.* 2015, 433), p. 14-20.

most of the rules can be found in sections 107-135 SAG.[44] The UK BA 2009 provides for most of the rules in its sections 14-48A.

With the 'sale of business tool', the bank under resolution can be wholly or partly sold. Articles 38 BRRD and 24 SRM Regulation provide that this can take the form of a transfer of the shares from the existing shareholders to a private sector purchaser or purchasers. The BRRD and SRM Regulation also allow a transfer of assets, rights, and liabilities, while the failing bank is left behind under its original ownership and license.[45] As is further discussed in paragraph 5.3, article 37(6) BRRD stipulates that after a transfer of only a part of the business of the bank under resolution, the residual entity is 'wound up under normal insolvency proceedings'. The transfer can take place without first obtaining the consent of the shareholders of the bank or any other party and without complying with procedural requirements under company or securities law, such as requirements to file or register a document with an authority.[46] An exception is that the consent of the purchaser is required.[47] The resolution authority has to base its decision as to what is transferred out of the failing bank on the resolution objectives listed in the BRRD and SRM Regulation, including the aim to ensure the continuity of critical functions.[48] Transfers of shares or assets, rights, and liabilities can be made more than once and transferred shares or assets, rights, and liabilities can also be transferred back at a later stage, provided that the purchaser has consented to such a retransfer.[49]

Marketing of the bank is required for the application of the sale of business tool and the sale needs to be made on 'commercial terms', with any consideration paid by the purchaser benefiting either the existing shareholders in case of a share transfer or the bank under resolution in case of a transfer of assets, rights, and liabilities.[50] Moreover, the BRRD stipulates that the resolution authority has to cooperate closely with the competent supervisory

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44 According to the legislative history of the SAG, the 'transfer order' (*Übertragungsanordnung*) in the SAG is regarded an 'umbrella instrument' (*Sammelbegriff*) for the three transfer tools of the BRRD. The general provisions on the transfer order (sections 107-125 SAG) cover common requirements on and features of the three tools. *See* Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 179. *See also* Schillig 2016, p. 261; Binder 2015a, p. 96-97.

45 *See* Schillig 2016, p. 251. *Cf.* IMF & World bank 2009, p. 39.

46 Articles 38(1) and 63(2) BRRD.

47 Article 38(1) BRRD.

48 *See* European Banking Authority, 'Final Draft Guidelines on the minimum services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65(5) of Directive 2014/59/EU', EBA/GL/2015/06, 20 May 2015, p. 4. *Cf.* Article 31 BRRD; Article 14 SRM Regulation.

49 Article 38(5)-(6) BRRD.

50 Article 38(2)-(4) BRRD.

authority. The latter authority needs to check whether the purchaser has the appropriate authorization. The approval of the competent supervisory authority for the acquisition is required if the application of the sale of business tool results in the acquisition of or increase in a qualifying holding in a bank.[51] To allow the purchaser – or the bridge institution or asset management vehicle that are discussed below – to continue the acquired business, under article 65 BRRD the residual legal entity can be required to provide the transferee services or facilities. According to the EBA, these services include services and facilities related to human resources and legal services.[52]

The 'bridge institution tool' is comparable to the sale of business tool. Specific features of the former tool are that it creates only a temporary solution and that the transferee is wholly or partly owned by one or more public authorities, such as the resolution authority, and is controlled by the resolution authority.[53] If the bridge institution pays a consideration, for instance, in the form of shares in the entity's capital, the consideration has to benefit either the former shareholders of the bank under resolution if a share transfer is conducted or the residual entity if assets, rights, and liabilities are transferred.[54] Also, the BRRD requires the resolution authorities to ensure that the total value of transferred liabilities does not exceed the total value of the rights and assets that are either transferred from the bank under resolution or provided by other sources.[55] The BRRD's legislative history suggests that the ultimate objective of the bridge institution tool is to facilitate the sale of the bridge institution, or its assets, rights, and liabilities, as a whole or in part on commercial terms. The management of the entity should be directed towards the preservation of the business and not towards an expansion.[56] Under the BRRD, the resolution authority has to terminate a bridge institution's operations if, within a period of two years, which period can be extended, the entity has not merged with another entity, a third party has not acquired the majority of the shares in the capital or all or almost all the assets, rights, and liabilities, and the assets have not been wound up and the liabilities discharged.[57]

51 Article 38(7)-(9) BRRD. *Cf.* Article 30 SRM Regulation.

52 European Banking Authority, 'Final Draft Guidelines on the minimum services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65(5) of Directive 2014/59/EU', EBA/GL/2015/06, 20 May 2015.

53 Article 40(2) and 41(3)-(5) BRRD.

54 Article 40(4) BRRD. *See* Schelo 2015, p. 144.

55 Article 40(3) BRRD.

56 European Commission, 'Technical details of a possible EU framework for bank recovery and resolution', March 2011, available at ec.europa.eu, p. 53. *Cf.* IMF & World Bank 2009, p. 41-42.

57 Article 41(3)-(8) BRRD.

Articles 42 BRRD and 26 SRM Regulation govern the creation of a vehicle that temporarily manages a part of the assets, rights, and liabilities of a bank under resolution to maximize their value through a sale or wind down. The resolution authorities may only use the 'asset separation tool' in combination with one or more other resolution tools.[58] The BRRD's legislative history indicates that this requirement exists because the fact that the tool allows easy transfers of underperforming assets from the balance sheet of the bank under resolution may otherwise give rise to moral hazard concerns, which concerns were discussed in the previous paragraph.[59] Similar to a bridge institution, an asset management vehicle is to be wholly or partially owned by one or more public authorities, which may include the resolution authority, and is controlled by the resolution authority.[60] The resolution authorities may only use the tool if the liquidation of the assets in a normal insolvency procedure could have adverse effects on the financial markets, the transfer is required to ensure the proper functioning of the bank under resolution or bridge institution, or the transfer is necessary to maximize liquidation proceeds.[61] Article 42(1) BRRD clarifies that not only assets but also rights and liabilities may be transferred to the vehicle. Shareholders and creditors who are left behind with the bank under resolution have no rights over or to the vehicle's assets, rights, and liabilities. The assets, rights, and liabilities of the bank under resolution have to be transferred against a consideration.[62] This consideration may have a nominal or negative value,[63] for instance, if the value of the transferred liabilities exceeds the value of the transferred assets and rights.

4 Parallels between the resolution objectives and insolvency law objectives

4.1 Introduction

The literature has paid attention to the fact that well-known academic theories of the role and function of insolvency law help to understand which trade-offs are made and which goals and objectives can be pursued when dealing with a bank failure.[64] These theories include the creditors' bargain theory, which argues that insolvency is a common pool problem and advocates a coordinated corporate insolvency procedure with the only

58 Article 37(5) BRRD.
59 European Commission, 'Technical details of a possible EU framework for bank recovery and resolution', March 2011, available at ec.europa.eu, p. 54. *Cf*. Article 37(5) BRRD.
60 Article 42(2) BRRD.
61 Article 42(5) BRRD.
62 Article 42(6) and (12) BRRD.
63 Article 42(6) BRRD.
64 Schillig 2016, p. 61-66; De Weijs 2013, p. 201-224 and *see* paragraphs 2.2.1 and 3.2.1 of chapter 2.

objective of maximizing the returns to the creditors.[65] This idea contrasts, for instance, with the view of insolvency law that is offered by Warren, who argues that the goals of insolvency law are broader. Amongst other things, she claims that an insolvency law system should consider the impact of business failure on parties who are not creditors and lack formal legal rights to the assets of the debtor, who may include employees, suppliers, and customers. For instance, insolvency law may indirectly protect the interests of these parties by permitting going concern sales and reorganizations so that the business of a failing company can remain in operation rather than being shut down.[66] These theories were considered briefly in chapter 2.[67]

This paragraph focuses on a dilemma the resolution authorities may be confronted with when applying transfer tools in a resolution procedure. This dilemma mainly deals with the question of whether and how the objective to maximize the satisfaction of creditors' claims should be weighed against other, potentially conflicting goals and objectives that can be pursued, such as the continuation of the debtor's business. Scholars have argued that the primary objectives in a resolution procedure differ significantly from the main objectives pursued by general insolvency law.[68] However, the literature also indicates that national general insolvency laws, in their turn, differ in their approaches on the outcome of the mentioned dilemma. In some jurisdictions, insolvency law focuses only on the joint interests of the insolvency creditors. In other countries, it allows that in some cases the operations of a failing debtor's business are continued because this is in the interest of the preservation of employment, even though this is not the way the creditors' financial interests are best served.[69]

Against this background, the sections below examine the objectives pursued by the national general insolvency laws on the one hand and by the rules on the transfer tools on the other hand. The main question is whether the rules on the transfer tools share objectives with the insolvency laws. It is discussed that under Dutch, German, and English general insolvency law a going concern sale of a part of a corporate debtor's business *en bloc* is often made as an alternative to a piecemeal liquidation of a debtor's assets. The sections investigate to what extent the insolvency laws in such a case also pursue other objectives than serving the joint creditors' financial interests and the former objectives, such as the preservation of employment, can affect the course of an insolvency procedure. This question is especially relevant if the respective interests are not alike. This then leads to the question

65 *See* De Weijs 2013, p. 207-209 and *see* the references to articles of Jackson and Baird provided in paragraph 2.1 of chapter 2.
66 Warren 1993, p. 354-356. *See also* De Weijs 2013, p. 209-210 and paragraph 2.1 of chapter 2.
67 Paragraph 2.1 of chapter 2.
68 Hadjiemmanuil 2015, p. 232. *See also* Tröger 2018, p. 52.
69 Eidenmüller 2018, para. 3.3.2; Verstijlen 1998, p. 154. *See also* Finch & Milan 2017, p. 28-52.

of how these objectives of the national insolvency laws relate to the role the creditors' financial interests and societal interests play in the decision on the application of the transfer tools in a resolution procedure. It is shown that according to case law, Dutch insolvency law permits considering societal-related objectives in insolvency procedures. Nevertheless, in the three jurisdictions, the objective of maximizing the returns to creditors is regarded the primary objective. The paragraph also ascertains that the bank resolution rules define their own primary objectives, which are the resolution objectives. These conclusions about the objectives of national corporate insolvency law and the bank resolution frameworks are further analyzed in the coherence study in chapter 7.

4.2 Objectives of the national general insolvency laws

4.2.1 Going concern sales under Dutch insolvency law

The Fw provides for two types of procedures for insolvent corporate debtors: the bankruptcy procedure (*faillissement*) and the suspension of payments procedure (*surseance van betaling*). When the Dutch legislature introduced the Fw in 1893, the bankruptcy procedure was considered to be oriented towards liquidation, which primary objective was regarded the realization of the debtor's assets for the benefit of the joint creditors (*gezamenlijke crediteuren*).[70] Since then this objective is confirmed by the Dutch Supreme Court and in the literature.[71] To this end, the Fw assigns an important role to the bankruptcy trustee (*curator*), whose task is the management and liquidation of the insolvent estate. According to the generally accepted view in the literature, the task is directed towards maximization of the pro-

70 Vriesendorp 2013, p. 136; Verstijlen 1998, p. 23, who both refer to the legislative history of the Fw in Kortmann & Faber 2016a, p. 7 ('Wenschelijkheid van herziening der oude wetgeving'), arguing that: 'het faillissement is een gerechtelijk beslag op het geheele vermogen des schuldenaars ten behoeve zijner gezamenlijk schuldeischers.' *See also* Kortmann & Faber 2016a, p. 27 ('Opheffing der onderscheiding tusschen den staat der kennelijk onvermogen en dien van faillissement'): 'De instelling van het faillissement beoogt niets anders dan, bij staking van betaling door den schuldenaar, diens vermogen op eene billijke wijze onder al zijne schuldeischers, met eerbiediging van ieders recht, te verdeelen, en het geheele samenstel der bepalingen, welke in eene faillietenwet worden gevonden, heeft geen ander doel dan die billijke verdeeling voor te bereiden, te waarborgen en te bewerkstelligen.'

71 Verstijlen 1998, p. 23, referring, *inter alia*, to HR 28 September 1991, *NJ* 1991, 247 (*Faillissement Suriname*), in which the Supreme Court rules in para. 3.17 that '[d]e faillissementsprocedure strekt tot het leggen van een algemeen beslag op het gehele vermogen van de schuldenaar met het doel dit vermogen te gelde te maken ten voordele van alle crediteuren gezamenlijk', as well as to Molengraaff 1951, p. 31-33, who notes that '[w]èl beschouwd heeft de instelling van het faillissement geen ander doel dan de toepassing, de praktische verwezenlijking van de bepalingen, vervat in art. 1177 B.W. […] Verdeling van de opbrengst van het gehele vermogen onder de gezamenlijke schuldeisers, ziedaar dus wat wordt beoogd. Die verdeling is het einddoel, de slotbehandeling. Het middel daartoe te geraken: het beslag.'

ceeds.[72] If the insolvent debtor and the creditors have conflicting interests, the trustee chooses, in principle, the interests of the joint creditors.[73] In a suspension of payments procedure, by contrast, a deferment of payment is imposed on unsecured, non-preferential claims against a debtor who foresees that it will not be able to pay its creditors.[74] The procedure traditionally aims to provide an instrument that allows a continuation of the debtor's business.[75] In practice, however, it is regarded the 'gateway to bankruptcy' because most suspension of payments procedures have resulted in the commencement of a bankruptcy procedure.[76]

Nevertheless, the bankruptcy procedure under the Fw now seems to serve as an instrument to pursue goals which the Dutch legislature originally did not envisage.[77] The procedure is often used to reorganize and sell a debtor's business or a part thereof on a going concern basis as an alternative to piecemeal liquidation.[78] Such a sale is in most cases effected at an early stage under section 101 Fw rather than under a composition (*faillissementsakkoord*) agreed upon at a later stage in the procedure.[79] Moreover, in practice asset sales in bankruptcy procedures are often prepared and negotiated before the bankruptcy declaration (*faillietverklaring*), generally called 'pre-packed sales' or 'pre-pack', although this practice does not have an explicit foundation in

72 Wessels 2015a, para. 4092-4093; Wessels 2008, p. 3-4; Verstijlen 1998, p. 103-104. *See also* HR 23 December 1994, *NJ* 1996, 628, para. 4.3.2: 'diens taak de belangen van de gezamenlijk bij het faillissement betrokken schuldeisers te behartigen', as also referred to by Hummelen 2016, p. 136; Wessels 2015a, para. 4093 & 4202; Verstijlen 1998, p. 104.

73 Verstijlen 1998, p. 142-148, who notes that the principle of reasonableness and fairness (*redelijkheid en billijkheid*), for instance, may require otherwise.

74 Sections 214, 230, 232 and 233 Fw.

75 *See* Kortmann & Faber 2016b, p. 336 ('Memorie van Toelichting. Van Surséance van Betaling. Algemeene beschouwingen'): 'Terwijl bij faillissement de boedel, voor zooverre geen akkoord tot stand gekomen is, door den curator wordt vereffend en onder de crediteuren verdeeld, is juist het behoud van den boedel en de voortzetting der zaak het doel der surséance. […] Faillissement zal dus in den regel te pas komen daar waar een onherstelbaar verlies en tekort aanwezig is; surséance daarentegen, indien de zaken van den schuldenaar levensvatbaarheid hebben en slechts tijdelijk zijn vastgeraakt. De grondslag van surséance is vertrouwen in de zaak en den persoon des schuldenaars.' *See also* Wessels 2014, para. 8004-8005; Joosen 1998, p. 120; Leuftink 1995, p. 8-9.

76 Wessels 2014, para. 8011; Vriesendorp 2013, p. 61 and 113-114. The suspension of payments procedure is generally considered not a satisfactory instrument because it is mainly oriented towards deferment, as the name implies, rather than a reorganization of the business and the procedure is not applicable to preferential and secured claims. For a critical discussion of the suspension of payments procedure and proposed amendments to the procedure, *see* Van Galen 2015, p. 150-156; Wessels 2014, para. 8011-8016h.

77 Joosen 1998, p. 7.

78 *See* Vriesendorp 2013, p. 137-138; Joosen 1998, p. 3-8. For a discussion of the restart (*doorstart*) of a company's business as part of a bankruptcy procedure, *see also* Grapperhaus 2008.

79 *See* Hummelen 2016, p. 129 & 135; Joosen 1998, p. 179-183. *Cf.* Kortmann & Faber 2016b, p. 63-64 (Explanatory Notes to Section 101 Fw).

the Fw. The search for potential takeover candidates can, for instance, be part of the preparation. A legislative proposal is pending that aims to introduce a statutory basis for the pre-pack.[80] Section 101 Fw currently stipulates that the trustee can sell assets of the debtor before the debtor has entered the 'state of insolvency' (*staat van insolventie*),[81] but only if and to the extent this is necessary to cover the costs of the insolvency procedure or if the assets could not be preserved without loss to the estate. The legislative history of the Fw indicates that the starting point in a bankruptcy procedure should be that as long as the actual liquidation of the estate has not been commenced, the estate is preserved and is not sold by the insolvency trustee. A composition plan may be adopted and the assets should then be returned to the debtor.[82] Based on case law of 1937,[83] however, modern-day legal practice interprets the wording of section 101 Fw broadly and allows the disposal of the debtor's assets by the trustee shortly after the bankruptcy declaration.[84]

From decisions of the Dutch Supreme Court it can be inferred that in a bankruptcy procedure the trustee may also have to consider societal interests involved in the management and liquidation of the estate.[85] Moreover, according to the majority opinion in the literature, it follows from case law that compelling ('*zwaarwegende*') societal interests may even prevail over interests of individual creditors, such as a creditor's interests in its claim under a retention of title. It has been submitted, however, that the Fw leaves only little room for safeguarding societal interests at the expense of the

80 For a discussion of pre-pack sales under Dutch insolvency law, *see* Verstijlen 2014, p. 29-32; Tollenaar 2011. The proposal for the Continuity of Enterprises Act I (*Wet continuiteit ondernemingen I*) was published in 2015, *see Kamerstukken II* 2014/15, 34218, no. 2. At the end of 2017, the handling of the proposal was deferred.

81 Under section 173 Fw the insolvency estate is in the 'state of insolvency' if no composition has been proposed at the creditors' meeting (*verificatievergadering*) or the composition has been dismissed or the confirmation has been denied. Under those circumstances, the liquidation (*vereffening*) of the estate starts. *See* Wessels 2013b, para. 7006 & 7023.

82 Kortmann & Faber 2016b, p. 63-64. *See* Hummelen 2016, p. 135; Wessels 2015a, para. 4390; Joosen 1998, p. 180-182; Van der Burg 1975, p. 38.

83 HR 27 August 1937, Nederlandse Jurisprudentie 1938, 9 (*Nieuw Plancius*). The Supreme Court held that limiting the trustee's competences to a sale of only a part of the assets would be incompatible with the purpose of section 101 Fw. *See* Wessels 2015a, para. 4392; Van der Burg 1975, p. 39.

84 Hummelen 2016, p. 135; Joosen 1998, p. 182.

85 In HR 19 April 1996, *NJ* 1996, 727 (*Maclou*), para. 3.6 the Dutch Supreme Court for instance held that '[v]oorts miskent die stelling dat de curator, anders dan de beoefenaar van een beroep als dat van advocaat, niet in een contractuele betrekking staat tot degenen wier belangen aan hem in zijn hoedanigheid zijn toevertrouwd, alsmede dat hij bij de uitoefening van zijn taak uiteenlopende, soms tegenstrijdige belangen moet behartigen en bij het nemen van zijn beslissingen — die vaak geen uitstel kunnen lijden — óók rekening behoort te houden met belangen van maatschappelijke aard.' *See* Wessels 2008, p. 5-10; Verstijlen 1998, p. 34-40 & 149-163. *See also* Joosen 1998, p. 179-185 and Wessels 2015a, para. 4170-4173.

interests of the joint creditors in the highest possible yield.[86] The societal interests include the continuity of the debtor's business and maintaining of employment.[87] According to the literature, it can also include interests that are linked to business continuity, such as interests in the preservation of capital and know-how, protection of industrial heritage, and protection of the environment.[88] However, this has not been legally enshrined.[89] An important case in this context is the case *Sigmacon II*, in which an individual creditor had attached the debtor's business assets with a view to satisfaction of his tax claims. The Supreme Court held that the mere fact that this creditor advocated alternatives which would have been more favorable for him from a financial point of view than the course of action eventually chosen by the trustee, did not make the trustee's course of action unlawfully. The trustee in the case had aimed to continue the business and preserve jobs through a sale of the debtor's business.[90]

A more recent case of the CJEU sparked a fierce debate in the literature about the use and objectives of pre-packed sales under Dutch law.[91] The case focused on the pre-packed sale of a part of the business of the insolvent company Estro to Smallsteps in a bankruptcy procedure under the Fw. The central question in the case was whether the rights and obligations of employees of the transferor were automatically transferred to the transferee as required by the EU Directive on transfer of undertakings.[92] Under the Directive, the employees do not have to be protected with such an automatic transfer if the transferor is the subject of a bankruptcy or analogous insolvency procedure which is instituted with a view to the liquidation of the assets of the transferor and is under the supervision of a competent

86 Wessels 2015a, para. 4221-4224; Adams 2014, p. 16; Wessels 2008, p. 12; Verstijlen & Vriesendorp 2004, p. 991-997; Verstijlen 1998, p. 152-160. *See also* Vriesendorp 1996, p. 140-145. *Contra* Van Hees 2004, p. 200-203; Van Hees 2015, arguing that case law shows a clear trend and attaches more weight to societal interests in insolvency cases as well as that trustees in practice often rightly give priority to societal interests over the interests of the joint creditors.

87 *See* HR 19 December 2003, *NJ* 2004, 293 (*Curatoren Mobell/Interplan*), para. 3.5.1-3.5.2; HR 19 April 1996, *NJ* 1996, 727 (*Maclou*), para. 3.6; HR 24 February 1995, *NJ* 1996, 472 (*Sigmacon II*), para. 3.5 and *see* for a discussion of the case law Wessels 2015a, para. 4221-4224a; Verstijlen 1998, p. 149-160.

88 Wessels 2015a, para. 4224; Wessels 2008, p. 12; Huydecoper 2007, p. 2; Ophof 1996, p. 205; Wessels 1997a, p. 169-170.

89 *See* Wessels 2016, para. 1066, who argues that it is the task of the Dutch legislature rather than a trustee or administrator to balance the interests in a liquidation procedure.

90 HR 24 February 1995, *NJ* 1996, 472 (*Sigmacon II*), para. 3.5. For a discussion, *see* Wessels 2015a, para. 4222; Verstijlen 1998, p. 155-158.

91 Case C-126/16 *Federatie Nederlandse Vakvereniging e.a./Smallsteps* [2017] ECLI:EU:C:2017:489.

92 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (OJ L 082, 22.03.2001, p. 16-20).

public authority.[93] According to the Court, a procedure focuses on the liquidation of assets if the primary goal is maximizing satisfaction of the collective claims of the creditors.[94] It held that the exception to the protection of employees does not apply – and the protection of workers is thus maintained – if the procedure is aimed at the continuation of the operational character of the undertaking or its viable units.[95] The Court ruled that the pre-pack procedure that was at issue did not fall within the scope of the exception of the Directive since the primary objective of the procedure was safeguarding the activities of the undertaking rather than liquidating the assets.[96] It then referred the case back to the Dutch court which requested the preliminary ruling.

The debate in the literature following the decision has mainly focused on the question of what are the consequences for the Dutch pre-pack practices and other types of procedures, such as a restart (*doorstart*) of a company as part of a bankruptcy procedure which is not a pre-pack restart.[97] For a pre-pack sale or restart to be sucessful, it is often key to leave a part of the employees behind with the transferor entity.[98] Tollenaar expects the consequences of the CJEU decision to be limited. He argues that maximizing satisfaction of the collective claims of the creditors is the primary objective in a bankruptcy procedure under the Fw. Thus, if the business or a part thereof is in a bankruptcy procedure sold as a going concern to a third party, the continuation is not the primary objective but a means to maximize the proceeds.[99] Fliek and Verstijlen, by contrast, have claimed that a restart of a company in a bankruptcy procedure does not, by definition, fall within the scope of the exception of the Directive because it may be considered initiated with the aim to keep the undertaking in business rather than liquidate the assets.[100] One of the first court cases following the CJEU case gave some clarification. The court in that case interpreted the CJEU decision narrowly.

93 Article 5(1) Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (OJ L 082, 22.03.2001, p. 16-20). *See* Case C-126/16 *Federatie Nederlandse Vakvereniging e.a./Smallsteps* [2017] ECLI:EU:C:2017:489, para. 43-44.

94 Case C-126/16 *Federatie Nederlandse Vakvereniging e.a./Smallsteps* [2017] ECLI:EU:C:2017:489, para. 47-48.

95 Case C-126/16 *Federatie Nederlandse Vakvereniging e.a./Smallsteps* [2017] ECLI:EU:C:2017:489, para. 48.

96 Case C-126/16 *Federatie Nederlandse Vakvereniging e.a./Smallsteps* [2017] ECLI:EU:C:2017:489, para. 49-52.

97 E.g., Tollenaar 2018; Fliek & Verstijlen 2018; Spinath 2017; Verstijlen 2017; Vroom & Sperling 2017, p. 397-400; Schaink 2017; Van der Pijl 2017.

98 Vroom & Sperling 2017, p. 400.

99 Tollenaar 2018. *See also* Spinath 2017.

100 Fliek & Verstijlen 2018, para. 5.

It ruled – in line with the opinion of Tollenaar – that the primary objective of a bankruptcy procedure under the Fw is maximization of the satisfaction of the creditors' claims. The sale at issue was not prepared down to the last detail before the bankruptcy declaration but made during a bankruptcy procedure and the insolvency trustee stated that he had wanted to maximize the proceeds through a going concern in bankruptcy. The exception to the protection of employees in the Dutch provisions implementing the Directive on transfer of undertakings, therefore, did apply.[101]

Uncertainty currently still exists about the consequences of the CJEU decision for the Dutch pre-pack practice and restart of a company as part of a bankruptcy procedure under the Fw.[102] It seems fair to say, however, that although case law leaves room to consider other interests than the financial interests of the joint creditors in a bankruptcy procedure, the starting point still is that the primary objective in a bankruptcy procedure is maximizing the payment of the collective claims of the creditors.

4.2.2 *Going concern sales under German insolvency law*

Under the InsO, an insolvency application can lead to a piecemeal liquidation of assets, a so-called asset-deal restructuring (übertragende *Sanierung*) and the opening of an insolvency plan procedure (*Insolvenzplanverfahren*).[103] Upon opening of the insolvency procedure, the debtor's right to manage and transfer the estate's assets is vested in the insolvency trustee (*Insolvenzverwalter*).[104] The InsO requires the trustee to report on the prospects of a continuation of the debtor's business in the creditors' meeting and the creditors decide whether the business is closed down or maintained.[105] The trustee subsequently liquidates the assets if the creditors' meeting decides against preservation of the business as a going concern and the debtor and the trustee have not presented an insolvency plan.[106]

101 Rb. Noord-Holland, 12 October 2017, ECLI:NL:RBNHO:2017:8423 (*Bogra*). *Cf.* Rb. Gelderland, 1 February 2018, ECLI:NL:RBGEL:2018:447 (*Tuunte*).
102 *See* Letter of the Minister for Legal Protection (*Kamerstukken I* 2017/18, 34218, no. J).
103 MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 45.
104 Section 80 InsO.
105 Sections 156-157 InsO. *See* Zimmer 2014, para. 231-244.
106 Section 159 InsO. *See* Zimmer 2014, para. 254-263.

A going concern sale of the business or a part thereof outside an insolvency plan procedure is a favored method in insolvency procedures.[107] In specific cases, the trustee needs the consent of the creditors for such sales, which purpose is according to the literature ensuring a fair market price for the assets to be sold.[108] For example, certain 'transactions of particular importance' (*besonders bedeutsame Rechtshandlungen*) in an insolvency procedure, which includes a sale of the debtor's business, require the prior consent of the creditors' committee. The committee consists of representatives of several groups of creditors.[109] Moreover, a sale to 'insiders', including persons holding a large share of the insolvent company's capital, requires a majority vote in the creditors' meeting.[110] In practice, a preliminary insolvency trustee (*vorläufigen Insolvenzverwalter*) is often appointed by the court to negotiate the asset deal at an early stage, which the creditors' committee then needs to approve once the insolvency procedure has been commenced.[111]

German insolvency law seems to have a more restrictive view than Dutch law regarding the objectives it pursues. Since the introduction of the InsO in 1999, German insolvency law explicitly provides that the primary objective of an insolvency procedure is the collective satisfaction of a debtor's creditors. This objective is pursued by liquidation of the debtor's assets and distribution of the proceeds, or by reaching an agreement in an insolvency plan procedure.[112] According to the literature, German insolvency law is clearly creditor oriented.[113] Nevertheless, early proposals for section 1 InsO provided that – besides the mentioned primary objective – interests of the debtor, the debtor's family and its employees were taken into account in

107 Wessels & Madaus 2017, p. 285-286; MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 91; Undritz 2010, p. 205; Bitter 2010, p. 155-157; Schmerbach & Staufenbiel 2009, p. 459. *Cf.* Brünckmans 2014, p. 1857-1866.

108 Bork 2012a, para. 5.09 and 9.56. *Cf.* Flessner 2003, who notes at p. 330 that '[t]raditionally the role of the German insolvency court is essentially procedural. The court is to open, drive forward, and close the proceeding. But it should not be involved in business decisions nor be called upon to decides in disputes on substantive legal issues. The decisions in managing and liquidating the assets are made by the administrator, and in some important instances, by the creditors.'

109 Sections 160(2)(1) and 67(2) InsO.

110 Sections 162 and 138(2) InsO. *See* Bork 2012a, para. 5.09 and 9.56.

111 Section 22 InsO. *See* Wessels & Madaus 2017, p. 297; Bork 2012a, para. 5.09.

112 Section 1 InsO provides that '[d]as Insolvenzverfahren dient dazu, die Gläubiger eines Schuldners gemeinschaftlich zu befriedigen, indem das Vermögen des Schuldners verwertet und der Erlös verteilt oder in einem Insolvenzplan eine abweichende Regelung insbesondere zum Erhalt des Unternehmens getroffen wird. Dem redlichen Schuldner wird Gelegenheit gegeben, sich von seinen restlichen Verbindlichkeiten zu befreien.' *See* MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 20.

113 Eidenmüller 2018, para. 3.3.2 notes that German insolvency law 'is debt collection law and nothing else', which 'philosophy' is according to Eidenmüller different than the 'philosophies' of French, English and US insolvency law.

the procedure.[114] Whether the reorganization and continuation of the operations of the debtor's business is now a secondary objective,[115] an equivalent objective[116] or only a means[117] to ensure the satisfaction of the creditors' claims is debated in the literature.[118] Most scholars seem to agree that societal interests such as the protection of the environment should not have direct effect on the course of an insolvency procedure and a German court does not reject an insolvency plan only because it fails to protect the preservation of jobs.[119] They maintain that insolvency law does not interfere with existing market mechanisms.[120] This is justified by the fact that economic and social issues are addressed by other areas of law.[121] In that view, the decision whether the debtor's business is liquidated on a piecemeal basis, or continued through a going-concern sale or financial restructuring, or a com-

114 MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 1-4, refer to a proposal for section 1 InsO (Gesetzentwurf der Bundesregierung, Entwurf einer Insolvenzordnung (InsO), Deutscher Bundestag, Drucksache 12/2443, 15 April 1992), which provided that: '(1) Das Insolvenzverfahren dient dazu, die Gläubiger eines Schuldners gemeinschaftlich zu befriedigen, indem das Vermögen des Schuldners verwertet und der Erlös verteilt wird. (2) Die Interessen des Schuldners und seiner Familie sowie die Interessen der Arbeitnehmer des Schuldners werden im Verfahren berücksichtigt. Dem redlichen Schuldner wird Gelegenheit gegeben, sich von seinen restlichen Verbindlichkeiten zu befreien. Bei juristischen Personen und Gesellschaften ohne Rechtspersönlichkeit tritt das Verfahren an die Stelle der gesellschafts- oder organisationsrechtlichen Abwicklung. (3) Die Beteiligten können ihre Rechte in einem Insolvenzplan abweichend von den gesetzlichen Vorschriften regeln. Sie können insbesondere bestimmen, daß der Schuldner sein Unternehmen fortführt und die Gläubiger aus den Erträgen des Unternehmens befriedigt werden.' The Explanatory Notes to the draft section indicate at p. 108-109 that the satisfaction of creditors was the primary objective.

115 Smid 2012, Section 1 InsO, para. 13-17.

116 Bork 2012b, para. 356.

117 Bitter 2010, p. 152; JaegerKomm-InsO/Henckel 2004, Section 1, para. 2; Eidenmüller 1999, p. 26-27.

118 MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 85; Paulus & Berberich 2012, p. 315.

119 Von Wilmowsky 2016, p. 246-247; Smid 2012, Section 1 InsO, para. 16-17; Bork 2012a, para. 3.21. *Cf.* Gesetzentwurf der Bundesregierung, Entwurf einer Insolvenzordnung (InsO), Deutscher Bundestag, Drucksache 12/2443, 15 April 1992, p. 76: 'Das Insolvenzrecht soll auch nicht mit der Aufgabe einer gesamtwirtschaftlich orientierten – etwa auf Ziele der Industrie-, Regional-, Arbeitsmarkt- oder Stabilitätspolitik gerichteten – Prozeßsteuerung belastet werden. Es kann die Wirtschafts-, Sozial- und Arbeitsmarktpolitik nicht ersetzen. Insbesondere dient das gerichtliche Insolvenzverfahren auch nicht dazu, das Arbeitsplatzinteresse der Arbeitnehmer gegenüber Rentabilitätsgesichtspunkten durchzusetzen.'

120 *See* MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 43, who note that '[n]ach der Vorstellung des Gesetzgebers hat, wenn es zur Insolvenz kommt, nicht der Markt versagt, sondern der Schuldner. Die Insolvenz ist deshalb kein Anlass, die Marktmechanismen durch hoheitliche Wirtschaftsregulierung zu verdrängen. […] Das öffentliche Interesse an der Erhaltung insolventer Unternehmen oder an der Kontinuität ihrer Unternehmensträger darf nicht gegen die Marktgesetze durchgesetzt werden.'

121 Von Wilmowsky 2016, p. 246-247; Paulus & Berberich 2012, p. 315; Häsemeyer 2003, para. 2.19-20.

bination, depends on how the most value is obtained for the creditors.[122] Smid notes in this context about the role of the insolvency trustee under the InsO that:

> '[i]n Europa trifft man auch „etatistische" Modelle des Insolvenzrechts an; so wird Insolvenzrecht in Frankreich herkömmlich auch von wirtschaftsplanerischen Zwecken her verstanden; in Italien kennt man das Verfahren der amministrazione straordinaria, dessen Auslösung in den Händen der Wirtschaftsverwaltung liegt. Hiervon unterscheidet sich das deutsche Insolvenzrecht: §1 Satz 1 InsO statuiert gegenüber allen möglichen hoheitlichen Zwecken (des Steuer-, Umwelt- oder des europäischen Beihilferechts) die Rigidität des Insolvenzrechts. […] Gegenüber der Forderung nach dem Erhalt von Arbeitsplätzen, dem Schutz der Umwelt oder der Wahrung des Wirtschaftsstandorts eines Industrieunternehmens kann sich daher der Verwalter aufgrund §1 InsO darauf berufen, sein Handeln bewege sich in dem durch den Gesetzgeber abgesteckten Spielraum und löse daher nicht als pflichtwidriges Handeln Schadenersatzpflichten aus.'[123]

It has been argued that section 251 InsO illustrates that under the InsO a reorganization under an insolvency plan may not take place at the expense of the insolvency creditors. It provides that the approval of an insolvency plan in an insolvency plan procedure is to be refused on the application of a creditor or shareholder if this creditor or shareholder voted against the proposal and he shows the court that he is likely to be placed in a worse position under it than without the plan.[124]

4.2.3 Going concern sales under English insolvency law

The primary objectives of English insolvency law have been considered to be: maximizing the returns to the creditors, creating a system to distribute the proceeds in a fair and equitable manner, and investigating the causes

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122 Von Wilmowsky 2016, p. 245-254; MünchKomm-InsO/Ganter/Lohmann 2013, Section 1, para. 44-45; Thole 2010, p. 56-57; Eidenmüller 1999, p. 25-27. Thole 2010, p. 58 argues that '[o]bwohl sich jedes Insolvenzverfahren den sozialen, politischen und ökonomischen Realitäten stellen muss, steht immer – unter Berücksichtigung legitimer schuldnerinteressen und rechtsstaatlich geforderter Beteiligungsrechte – die gemeinschaftliche Gläubigerbefriedigung als Verfahrensziel im Vorgrund.'

123 Smid 2012, Section 1 InsO, para. 16-17. Free translation by the present author: In Europe there are also 'statist' insolvency law models; insolvency law in France is traditionally considered to have economic purposes; in Italy, the amministrazione straordinaria procedure is placed in the hands of the economic administration. This contrasts with German insolvency law: section 1 sentence 1 InsO lays down the rigidity of insolvency law by opposing all possible public objectives (tax, environmental or European state aid). [...] Instead of pursuing the objective to preserve jobs, to protect the environment or to preserve the business location of an industrial company, the administrator can claim that his actions are within the scope of the InsO created by the legislature and, therefore, he cannot be held liable to pay damages because of a breach of his duty.

124 Verstijlen 1998, p. 154. *See also* Bork 2012a, para. 17.60-17.62.

of failure and, where relevant, holding those to account who conducted mismanagement.[125] Similarly, following its review of English insolvency law in 1982, the Review Committee on Insolvency Law noted that the law aims to distribute the proceeds of the assets of an insolvent debtor amongst the creditors. Two other important insolvency law objectives laws were, according to the Committee, to serve 'as a weapon in persuading a defaulting debtor to pay or make proposals for the settlement of debt' and 'through their investigation processes, [to serve as, LJ] the means by which the demands of commercial morality can be met.'[126]

The Review Committee on Insolvency Law, whose report is known as the Cork Report, also advocated a major reform of English insolvency law. Disposal of the business through liquidation had long dominated English insolvency law.[127] The Cork Report recommended, amongst other things:

> '[t]o encourage, wherever possible, the continuation and disposal of the debtor's business as a going concern and the preservation of jobs for at least some of the employees, and to remove obstacles which tend to prevent this.'[128]

Although liquidation continued to be a centerpiece of English insolvency law, the publication of the Cork Report has been considered an important step towards the growth of a so-called 'rescue culture'.[129] The literature defines it is 'a philosophy of reorganising companies so as to restore them to profitable trading and enable them to avoid liquidation.'[130] The instruments that have been provided by the IA 1986 and the reforms in the Enterprise Act 2002 to implement this culture following the publication of the Report include the administration procedure.[131] In this procedure, an administrator takes over the management and has broad statutory powers[132] to do 'anything necessary or expedient for the management of the affairs, business and property of the company', in accordance with proposals approved by the creditors' committee and directions given by the court.[133] In practice,

125 Goode 2011, para. 2.01.
126 Cork Report 1982, para. 235.
127 Xie 2016, p. 36; Goode 2011, para. 11.02.
128 Cork Report 1982, para. 1980. *Cf.* Cork Report 1982, para. 1734, which starts the Chapter with the heading 'The Public Interest'. The paragraph states that '[i]nsolvency proceedings have never been treated in English law as an exclusively private matter between the debtor and his creditors; the community itself has always been recognised as having an important interest in them.' The chapter then discusses, inter alia, the liability of directors.
129 Goode 2011, para. 11.03. For a discussion of the 'rescue culture' and its legal framework, *see* e.g., Armour 2012, p. 43-78; Finch 2008, p. 756-777; Frisby 2004.
130 Goode 2011, para. 11.03.
131 Goode 2011, para. 11.03.
132 *Cf.* the list in Schedule 1 to the IA 1986.
133 Schedule B1 to the IA 1986, para. 53, 59(1) and 68, as also referred to by Finch & Milan 2017, p. 315.

the procedure is often used to arrange a going concern sale of substantially all the assets.[134] Furthermore, the literature notes that almost one-third of all administrations are pre-packaged administrations. Similar to the pre-pack practices under Dutch and German law, in a pre-packaged administration the arrangement on the sale is negotiated before the appointment of the administrator, who concludes the deal immediately after his appointment. [135]

Notwithstanding the growth of this 'rescue culture', the IA 1986 explicitly provides that the function of a liquidator in a winding-up by the court is to realize and distribute the assets amongst the creditors.[136] He only has the power to continue the business of the debtor if this is beneficial to the liquidation.[137] Scholars consider liquidation to be a collective mechanism that is not intended to serve social interests.[138] Nevertheless, case law shows that societal goals can play an important role in the procedure. For example, in *Re Mineral Resources Ltd, Environmental Agency v Stout* the High Court judge held that there is a significant public interest in maintaining a healthy environment. In the case the continued compliance with an environmental license by the company was considered to have priority over the interests in a fair and orderly winding up.[139] As Goode has discussed, this decision was later overturned in *Re Celtic Extraction Ltd*, in which the Court of Appeal decided that the liquidator could disclaim the environmental license of the company, with the effect that the obligations under the license ceased. The Court stated that it was not desirable that assets were used to cover the costs of compliance rather than being equally divided amongst the unsecured creditors.[140]

In contrast to the liquidator in a winding-up procedure, the administrator in an administration procedure is provided a more extended list with specific objectives. He must perform his functions with the aim of (a) rescuing the company as a going concern, or (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or (c) realizing property in order to make a distribution to one or more secured or preferential creditors.[141]

134 Wessels & Madaus 2017, p. 287; Goode 2011, para. 11.17.

135 Goode 2011, para. 11.37. For a discussion of the pre-packaged administration, *see* Finch 2011.

136 Section 143(1) IA 1986. *See* Fletcher 2017, para. 22.080.

137 Schedule 4 to the IA 1986, para. 5. *See* Goode 2011, para. 1.39.

138 E.g., McCormack 2012, p. 235.

139 *Re Mineral Resources Ltd, Environmental Agency v Stout* [1999] Env. L.R. 407. *See* Goode 2011, para. 2.25.

140 *In Re Celtic Extraction Ltd* [2001] Ch. 475. *See* Goode 2011, para. 2.25 & 8.30.

141 Schedule B1 to the IA 1986, para. 3(1).

He pursues objective (a) unless he thinks that (1) it is not reasonably practicable to achieve that goal, or (2) objective (b) would achieve a better result for the company's creditors as a whole.[142] Objective (c) is only pursued if he thinks that it is not reasonably practicable to achieve aims (a) and (b) and he does not unnecessarily harm the interests of the creditors of the company as a whole.[143] Although the structure of this provision is complicated, it is clear that the administrator does not have to save the company at all costs. The IA 1986 allows him to make arrangements to rescue the business rather than the company if he can achieve a better result for the creditors in that way.[144] Moreover, Fletcher notes that by explicitly providing that the overall objective of the administrator is to perform his functions in the interests of the creditors as a whole, the IA 1986 underlines the traditional approach of English insolvency law. This approach is that the interests of creditors are given priority to any other interests, including interests in the preservation of employment and interests of individual creditors.[145]

4.3 Objectives of going concern sales under bank resolution law

The BRRD and SRM Regulation provide the resolution authorities with the three transfer tools to enable them to deal with the insolvent or near-insolvent business of the bank.[146] They suggest that the objective to maximize the returns to the creditors of the insolvent debtor, which is recognized as the primary objective of Dutch, German, and English insolvency law, can play a role in the application of one of the three transfer tools.

For example, as was shown previously, the application of the sale of business tool under the BRRD and SRM Regulation requires marketing of the shares or assets, rights, and liabilities that the resolution authority intends to transfer and the transfer is to be made on commercial terms.[147] Requirements for the marketing process include that it is transparent, that it does

142 Schedule B1 to the IA 1986, para. 3(3).

143 Schedule B1 to the IA 1986, para. 3(4).

144 Finch & Milan 2017, p. 315. *See also* Fletcher 2017, para. 16.022-24; Goode 2011, para. 11.23. For a detailed discussion of the purpose of administration under Schedule B1 to the IA 1986, para. 3, *see* Armour & Mokal 2005, p. 41-49; Frisby 2004, p. 260-263.

145 Fletcher 2017, para. 16.024. *See also* Frisby 2004, p. 261, who refers to a remark of Lord McIntosh of Harringey about the function of the administrator in a debate on the Enterprise Bill: 'there may be times when company rescue is not the best option, when the medium to longer-term viability of the business is poor. We do not want the administrator to be constrained to attempting to rescue every company irrespective of whether there is a business worth preserving. We do not want an administrator to have to pursue a company rescue that may be reasonably practicable but would result in a lower return to creditors as a whole'. Hansard, House of Lords, Vol 639, 1101, 21 October 2002.

146 *See* De Weijs 2013, p. 216.

147 *See* paragraph 3 above and *see* Article 38(2)-(3) and 39(1) BRRD; Article 24(2) SRM Regulation.

not unduly favor or discriminate between potential purchasers and that it aims at maximizing, as far as possible, the sale price.[148] Paragraph 3 above also noted that a bridge institution can be created to maintain access to critical functions and to sell the entity under resolution.[149] If the resolution authority then seeks to sell the bridge institution or its assets, rights, and liabilities, the institution is, or the assets, rights, and liabilities are to be marketed openly and transparently, and the sale is to be made on commercial terms.[150] Article 41 BRRD allows authorities to postpone a bridge institution's termination, not only if this is necessary to ensure continuity of essential banking and financial services, but also if this supports the sale of the business or the liquidation of assets and discharge of liabilities.[151] Moreover, the BRRD provides that an asset management vehicle is created to maximize the value of the transferred assets and rights through a sale or orderly wind down.[152] Hence, the resolution authorities apply the three tools to achieve a sale for the best possible price. After a transfer of the assets, rights, and liabilities with one of the three transfer tools, any consideration paid is to benefit the entity under resolution, and hence indirectly its creditors and shareholders.[153] If the sale of business tool or bridge institution tool is applied by transferring shares or other instruments of ownership, the resolution authorities have to distribute any proceeds amongst the former owners of the instruments.[154]

However, value maximization is not the only objective of the rules on the transfer tools. As chapter 2 briefly discussed, the BRRD and SRM Regulation provide a list of five resolution objectives that have to be taken into account by the resolution authorities when applying their resolution tools.[155] The objectives underline that the resolution regime is primarily designed to protect the functioning of the financial system and depositors of the bank, and to minimize moral hazard.[156] Chapter 2 showed that the policymakers and scholars justify these objectives by referring to the 'specialness' of a banking business. The resolution objectives are:

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148 Article 39(2) BRRD; Article 24(2) SRM Regulation. *Cf.* Roe & Adams 2015, p. 363 who argue that '[f]or bankruptcy to handle a systemically important financial institution successfully, it must be able to market those parts of the failed institution's financial contracts portfolio that are saleable at their fundamental value, i.e., other than at fire sale prices. [...] Bankruptcy needs authority, first, to preserve the failed firm's overall portfolio value, and, second, to break up and sell a very large portfolio that is too large to sell intact.'

149 Article 40(2) BRRD; Article 25(2) SRM Regulation.

150 Article 41(4) BRRD; Article 25(2) SRM Regulation.

151 Article 41(6) BRRD.

152 *See* paragraph 3 and *see* Article 42(3) BRRD; Article 26(2) SRM Regulation.

153 Articles 38(4), 40(4) and 42(7) BRRD.

154 Articles 38(4) and 40(4) BRRD.

155 Article 31(2) BRRD; Article 14(2) SRM Regulation; Paragraphs 2.2.3 and 3.2.1 of chapter 2.

156 *See* Sjöberg 2014, p. 194 and *see* Paragraph 2.2.3 of chapter 2.

> '(a) to ensure the continuity of critical functions;
> (b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline;
> (c) to protect public funds by minimising reliance on extraordinary public financial support;
> (d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC;
> (e) to protect client funds and client assets.'

The BRRD provides that these five 'resolution objectives are of equal significance, and resolution authorities shall balance them as appropriate to the nature and circumstances of each case.'[157] The Impact Assessment accompanying the proposal for the BRRD suggests that two of them are especially of importance, but it is the present author's view that they are closely intertwined with the other three resolution objectives.[158] The Impact Assessment notes that:

> '[i]nsolvency procedures may take years, and the objective of authorities is to maximise the value of assets of the failed firm in the interest of creditors. In contrast, the primary objective of a resolution is to maintain financial stability and minimise losses for the society, in particular taxpayers. For this reason, certain critical stakeholders and functions (such as depositors, payment systems) need to be protected and maintained as operational, while other parts, which are not considered key to financial stability, may be allowed to fail in the normal way.'[159]

Under article 39 BRRD the above-mentioned requirements of marketing the shares or assets, rights, and liabilities of a bank and selling them for the best possible price, may have to give way for the five resolution objectives. It provides that the marketing requirements in the application of the sale of business tool may be waived if compliance with the requirements would undermine the resolution objectives. They can be waived, in particular, if there is a material threat to financial stability and compliance would under-

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157 Article 31(3) BRRD.

158 *See also* Sjöberg 2014, p. 196, who notes that '[l]isting so many different items and suggesting they are equally important objectives is at best confusing and could, in the worst case scenario, paralyze the resolution authority. In my view, the existence of two overriding objectives of sufficient, these being to preserve systemic stability and at the same time uphold market discipline.'

159 Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM(2012) 280 final, 6 June 2012, SWD(2012) 166 final, p. 11, as also referred to by De Weijs 2013, p. 216.

mine the effectiveness of the tool in addressing the threat or achieving the resolution objectives.[160] Articles 31 BRRD and 14 SRM Regulation add that if it is necessary to achieve the resolution objectives, a resolution authority is also not required to comply with the requirement to seek to minimize the cost of resolution and avoid destruction of value. The provisions do not clarify for whom the costs are otherwise to be minimized.[161] It is the present author's view that the exception allows a resolution authority, for instance, to apply a resolution tool and ask the Single Resolution Fund or the national resolution financing arrangement to contribute. It may be justified to apply a particular resolution tool to ensure that depositors have continued access to their deposits in the bank under resolution, even though other resolution measures would not require a contribution from a resolution fund or from a deposit guarantee scheme.[162] Moreover, the above-mentioned exception in article 39 BRRD may provide a resolution authority a legal basis to sell the business of the bank under resolution without openly marketing the business, and to do this in a short period and for a low or negative price. The authority may for example do so if this is necessary to avoid adverse effects on the financial system.[163] In June 2017 the SRB decided that the sale of business tool had to be applied to sell a bank to a private sector purchaser overnight and for only EUR 1. Even though this bank was marketed, the case shows that a resolution authority may consider contacting only a few bidders to be

160 Article 39(3) BRRD. *Cf.* Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 183, which notes that section 126(2)(5) SAG 'zielt auf eine möglichst hohe Gegenleistung ab, wobei gleichzeitig die Abwicklungsziele und, wie die Formulierung „soweit möglich" verdeutlicht, andere Restriktionen (z. B. die Eilbedürftigkeit) zu beachten sind.'

161 An early working document on the resolution framework of the European Commission of 2011 notes that an authority should, in addition to the current requirements in Article 38 BRRD, be required to establish that the application of the sale of business tool is less costly compared to alternative options like partial or total liquidation. *See* European Commission, 'Technical details of a possible EU framework for bank recovery and resolution', March 2011, available at ec.europa.eu. The Commission does not clarify for whom the measure should be less costly, such as for the creditors of a bank under resolution, the resolution fund or the deposit guarantee schemes. According to Lastra, Olivares-Caminal & Russo 2017, p. 7 '[l]east cost is a test mandated by law in the US, while it is an important consideration in the choice of resolution procedures in the EU. The 'cost' in the EU context is not the cost to the resolution authorities (like the FDIC in the US) but costs to taxpayers. In the context of the BRRD and SRMR there must be a minimum impact on public finances, financial stability and the real economy. This must be assessed against the 'value' given to the continuity of critical banking functions.'

162 *Cf.* Articles 101 and 109 BRRD; Articles 76 and 79 SRM Regulation.

163 *Cf.* Schelo 2015, p. 148.

> '[j]ustified on the basis of financial stability grounds and the substantial risk that marketing of a wider circle of potential purchasers and the disclosure of risks and valuations or the identification of critical and non-critical functions in respect of the Bank may result in additional uncertainty and in a loss of market confidence. Moreover, contacting a wider number of purchasers might increase the probability of leakage and thus, the risk that the Bank may enter resolution within an extremely short timeframe.'[164]

It has been argued that the fact that the resolution rules require the resolution authorities to pursue a wide range of societal-oriented objectives, namely the resolution objectives, can be considered a victory of the above-mentioned theory of insolvency law advocated by Warren.[165] It is the present author's view that it indeed contrasts with the primary objectives pursued by Dutch, German, and English insolvency law, under which insolvency trustees and administrators seem to be left hardly any room for prevailing societal interests over the financial interests of the joint creditors.

The fact that the resolution objectives are the primary objectives in a bank resolution procedure does not entail, however, that a resolution authority does not consider the objectives of insolvency law in its assessment of how the shareholders and creditors should be treated.[166] The transfer tools offer an alternative means to distribute the value of the common pool of assets and the no creditor worse off-principle requires that in such distribution, shareholders and creditors are not made worse off than in an insolvency procedure.[167] As noted in Chapter 2,[168] the results of the resolution procedure have to be compared with the outcome of a hypothetical insolvency procedure for the bank. Shareholders and creditors are entitled to compensation if they have incurred greater losses in resolution than in such an insolvency procedure. As paragraph 5.3 below discusses, under Dutch and German law, the collective satisfaction of the claims of the creditors is the primary objective in the liquidation of a bank's business. In the bank-specific insolvency procedure under the BA 2009, a liquidator is also required to pursue the objective of achieving the best result for the bank's creditors as a whole if the primary statutory objective is achieved. The primary statutory objective is ensuring that either the deposit portfolio of the bank is transferred to another bank or depositors receive payments from the deposit guarantee scheme.[169]

164 Single Resolution Board, 'Decision of the Executive Session of the Board of 3 June 2017 concerning the marketing of Banco Popular Español (hereinafter the "Bank"). Addressed to the Fund for Orderly Bank Restructuring (hereinafter "FROB")' (SRB/EES/2017/06).

165 De Weijs 2013, p. 216.

166 *See* De Weijs 2013, p. 216-217.

167 De Weijs 2013, p. 216.

168 Paragraph 3.2.1 of chapter 2.

169 Section 99 BA 2009.

5 Implementation of the rules on the transfer tools into national law

5.1 Effect and scope of the application of the transfer tools

5.1.1 Introduction

This paragraph further investigates the alignment of the legal framework on the transfer tools with Dutch, German, and English private law. The BRRD requires that resolution authorities have the power to transfer shares issued by a bank under resolution or bridge institution, and that they have the power to transfer assets, rights, and liabilities of a bank under resolution, bridge institution or asset management vehicle.[170] Member States have to make sure that legal barriers to the transfers created by requirements that apply under law or contract or otherwise apply are removed. These barriers include, for instance, requirements to first obtain the consent of the shareholders or to file or register a document with an authority.[171] As stated in paragraph 3, an exception is that the consent of the purchaser is required if the sale of business tool is used.[172] Article 38(8)-(9) BRRD provides another example of an exception by stipulating that the approval of the competent supervisory authority is required if the application of the sale of business tool results in the acquisition of or increase in a qualifying holding in a bank.

The sections below discuss in more detail how Dutch, German, and English law ensure that the transfers ordered by the resolution authority have an immediate effect, and what can be included in the authority's transfer decision. Although important differences exist between the application of the transfer tools and a merger or division of a company under national law, similarities regarding the scope and effect of the measures under Dutch law seem to justify a cautious comparison. The sections also show that the English legal framework on the transfer tools, by contrast, forms a framework separated from the private law framework normally applicable to transfers of shares or assets, rights, and liabilities. The German legislature considers the application of the transfer tools to effectuate a transfer *sui generis*, but it remains unclear what this means in private law terms.

170 Articles 37(1), 38(1), 40(1) and (7), 42(1) and (10) and 63(1) BRRD.

171 Articles 38(1), 40(1), 42(1) and 63(2) BRRD. *Cf.* Articles 119-122 BRRD and Recital 120 BRRD: 'Union company law directives contain mandatory rules for the protection of shareholders and creditors of institutions which fall within the scope of those directives. In a situation where resolution authorities need to act rapidly, those rules may hinder effective action and use of resolution tools and powers by resolution authorities and appropriate derogations should be included in this Directive.'

172 Section 38(1) BRRD.

5.1.2 Application of the transfer tools under Dutch law

Section 3:80(2) BW provides that assets (*goederen*)[173] are acquired under universal title (*algemene titel*) through hereditary succession (*erfopvolging*),[174] joining of estates under matrimonial property law (*boedelmenging*),[175] merger (*fusie*) of two or more legal persons,[176] and division (*splitsing*) of a legal person.[177] Moreover, assets are acquired under universal title through the application of a transfer tool for a failing insurance company, bank or other type of financial institution as set out in Part 3a Wft.[178] In contrast to acquisition under particular title (*bijzondere titel*), in which case one or more specific assets, liabilities, or legal relationships are acquired,[179] acquisition under universal title is traditionally considered to be the acquisition of a whole estate (*vermogen*) or a proportional part thereof. The acquirer continues the position of the legal predecessor and formal delivery (*levering*), assumption of individual debts (*schuldoverneming*) and takeover of contracts (*contractsoverneming*) are not required for the acquisition.[180]

173 Sections 3:1, 3:2 and 3:6 BW.
174 Section 4:182 BW.
175 Section 1:94 BW.
176 Section 2:309 et seq. BW.
177 Section 2:334a et seq. BW. Section 2:334a BW provides that a division includes a split-up (*zuivere splitsing*) and a split-off (*afsplitsing*). In the former case the company that is to be divided ceases to exist on the division, while in the latter case this company does not cease to exist.
178 Sections 3:a2, 3a:28, 3a:37, 3a:41 Wft (banks, investment firms and several other types of financial institutions), 3a:78, 3a:104, 3a:112 and 3a:117 Wft (insurance companies).
179 Section 3:80(3) BW. *See* Pitlo/Reehuis & Heisterkamp 2012, para. 91 and 93.
180 This definition of acquisition under universal title is based on the description provided in Dutch in Van Zeben et al. 1981 (legislative history Book 3 BW), p. 307 (Toelichting-Meijers): 'De wet stelt voorop de onderscheiding van verkrijging van goederen onder algemene titel en die onder bijzondere titel. De onderscheiding is van belang voor de vraag of de verkrijger de positie van een derde inneemt of als de voorzetter van de volledige rechtspositie van zijn voorganger moet worden beschouwd. In verband met dit rechtsgevolg vindt verkrijging onder algemene titel alleen plaats, wanneer een gans vermogen op een ander overgaat. Een zodanige overgang voltrekt zich in het ontwerp evenals in het tegenwoordige recht alleen krachtens wettelijk voorschrift zonder dat een bijzondere rechtshandeling daartoe nodig is.' *See also* Verstappen 1996, p. 77-78, who defines acquisition under universal title under Dutch law as: 'de opvolging in of de verkrijging van een onbepaald aantal goederen, schulden en/of rechtsbetrekkingen, welke opvolging of verkrijging is gebaseerd op één titel, de rechtsgrond of rechtvaardiging voor de opvolging of de verkrijging, zonder dat voor de verkrijging van de afzonderlijke goederen, schulden en/of rechtsbetrekkingen levering, schuld- dan wel contractsoverneming is vereist.' According to Wessels 1997b, p. 176, the term 'indefinite' (*onbepaald*) in Verstappen's definition is not concrete enough. Moreover, Wessels 1997b, p. 176 does not agree with Verstappen that the term '*goederen*' in Dutch private law does not include liabilities (*schulden*). Verstappen 2002, p. 103-104, changes his definition of acquisition under universal title by excluding the term 'an indefinite number of' ('*een onbepaald aantal*').

Some authors, however, have claimed that the traditional understanding of acquisition under universal title is outdated.[181] Since the entry into force of the rules on the division of a company in 1998 it may also concern the acquisition of a specific set of assets, liabilities, and legal relationships. In contrast to, for example, hereditary succession and joining of estates under matrimonial property law, a division requires a specification of the assets, liabilities, and legal relationships that pass to the acquiring party.[182] Against this background, Buijn maintains that the Dutch legislature needs to exercise some restraint in allowing more types of acquisition under universal title as it now bears a strong likeness with acquisition under particular title.[183] It has also been argued that for dogmatic reasons the acquisition through division of a company under the BW or approval of a transfer plan for a bank or insurance company under the Wft[184] – which is since the entry into force of Part 3a Wft the application of a transfer tool – should rather be considered a special type of acquisition which does not require formal delivery, debt assumption or contract takeover on the basis of the BW.[185]

It is the present author's view that by referring to the application of the transfer tools under Part 3a Wft, section 3:80(2) BW confirms the view that acquisition under universal title under Dutch law is no longer limited to the passing of a whole estate or a proportional part thereof. Under Part 3a Wft and the SRM Regulation relevant instruments, assets, rights, and liabilities

181 Pitlo/Reehuis & Heisterkamp 2012, para. 91; Verstappen 2002, p. 103-104. *Cf.* Verstappen 1996, p. 34.

182 *See* Pitlo/Reehuis & Heisterkamp 2012, para. 91; Verstappen 2002, p. 103-104. *Cf.* Section 2:334f(2)(d) BW.

183 Buijn 1996, p. 18.

184 The Intervention Act introduced a transfer regime for insurance companies and banks in the Wft in 2012. Banks are now subject to the resolution regime in Part 3a Wft. The currently pending proposal for the Act recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) is intended to abolish the existing transfer regime for insurance companies under the Intervention Act and to introduce a resolution regime for insurance companies in Part 3a Wft. *See* paragraphs 2.2 and 2.3 of chapter 3.

185 Van Es 2012 (GS Vermogensrecht), para. 20-21, who claims that acquisition under universal title through division of a company under the BW or through approval of a transfer plan under the Wft is an 'atypical' type of acquisition under universal title. Van Es refers to Verstappen 1996, p. 33-34 for the discussion of the division as special type of acquisition ('overgang heeft meer kenmerken van een bijzondere wijze van overgang van goederen en schulden waarvoor geen levering, schuld-, dan wel contractsoverneming is vereist') and to De Serière 2012, p. 6, who considers the acquisition through approval of the transfer plan under section 3:159l, 3159p and 3:159s Wft, acquisition under particular title by operation of law. *See also* Van den Hurk & Strijbos 2012, para. 6 and footnote 41; Verstappen 2002, p. 103-104.

of a bank under resolution can pass promptly and *en bloc*.[186] The SRM Regulation requires the SRB's resolution scheme to provide for the details on the application of the resolution tools, including, where relevant, a specification of the instruments, assets, rights, and liabilities to be transferred by a national resolution authority to a private sector purchaser, bridge institution or asset management vehicle.[187] Although this is not explicitly required by Part 3a Wft, it is assumed here that if the business of a bank under resolution is divided, DNB's decision on the application of the transfer tools, similar to a proposal on a division in accordance with section 2:334f(2) BW, also includes a description on the basis of which can be determined which part of the bank's business passes and which part stays behind.[188]

Part 3a Wft also does not provide what happens with assets, rights, and liabilities which would not be allocated by DNB's decision in such a case because certain assets were, for instance, not known at the time the decision was taken. It is the present author's view that the application of section 2:334s BW by analogy may provide a solution in that case. Accordingly, these assets would be allocated to the recipient company or companies if the whole business of the bank under resolution is acquired by another

186 *Cf.* Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 48: '[i]n het voorstel is gekozen voor een regeling die met zich brengt dat de deposito-overeenkomsten waarop het overdrachtsplan betrekking heeft, snel en eenvoudig kunnen overgaan op de overnemer, zonder dat toestemming of medewerking van derden nodig is en zonder dat per actief of passief afzonderlijk de voor levering of contractsoverdracht benodigde formaliteiten behoeven te worden vervuld. Medewerking van elke individuele depositohouder zou in de situatie waarop het wetsvoorstel betrekking heeft ondoenlijk zijn. Het zou te veel tijd vergen. Bovendien zou de situatie waarin een deel van de depositohouders wel toestemming geeft en een ander deel niet, onpraktisch zijn.'

187 Articles 23, 24(2), 25(2) and 26(2) SRM Regulation.

188 *Cf.* Section 2:334f(2)(d) BW; Article 3(2)(h) Sixth Council Directive of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies (82/891/EEC) (OJ L 378, 31.12.82, p. 47-54). The Explanatory Notes to the Draft Law concerning the division of a company (*Kamerstukken II* 1995/96, 24702, no. 3), p. 10 note that '[h]oe gedetailleerd de beschrijving moet zijn om de vereiste mate van nauwkeurigheid te bieden, zal afhangen van de omstandigheden van het geval. Soms zullen vermogensbestanddelen precies moeten worden aangeduid («de grond met opstallen, plaatselijk bekend als ..., kadastraal bekend als ...»; «de rekening-courantverhouding met ...»), maar in andere gevallen kan een meer globale omschrijving voldoende zijn, bijvoorbeeld een aanduiding van vermogensbestanddelen naar de plaats waar zij zich bevinden of de aard ervan («alle vorderingen op handelsdebiteuren»). Als bepaalde vermogensbestanddelen overgaan op de ene verkrijgende rechtspersoon en het overige vermogen op de andere, zal ten aanzien daarvan vaak met die aanduiding («het overige vermogen») kunnen worden volstaan. De beschrijving moet zodanig zijn dat niet alleen de betrokken rechtspersonen zelf maar ook belanghebbende derden aan de hand daarvan kunnen vaststellen waar het vermogen terecht zal komen.' For a discussion of this requirement, *see* Verstappen 2002, p. 104-108; Wessels 1997b, p. 176; Buijn 1996, p. 54-55.

party or parties, who would then also made be jointly and severally liable for liabilities that are not allocated, and to the bank under resolution if only a part of the business passes.[189]

It is a general rule of Dutch law that companies are prohibited from entering into a merger or being party to a division during bankruptcy or suspension of payments procedure.[190] The Dutch legislature created an exception to this rule if the company being divided during such a procedure becomes the sole shareholder of the newly established company.[191] The legislative history explicitly indicates that a division is an excellent means to ensure a separation of the viable parts of a failing company's business so that these parts are not involved in the liquidation.[192] Some scholars, however, maintain that the legislature's view on the use of a division in bankruptcy and suspension of payments procedures is too optimistic and several requirements to the division create obstacles to the use of the concept.[193] These include the requirement that the recipient companies and the company being divided remain liable for the performance of the latter company's obligations at the time of the division, and the procedural requirements that a detailed proposal to the division has to be written. This proposal is then filed at the commercial register and the filing is published in a newspaper.[194]

By contrast, to enable the resolution authority to act rapidly, the application of the transfer tools under Part 3a Wft derogates on important points from the BW. Section 3a:6 Wft provides, for example, that the resolution authority's decision on the transfer supersedes any approval, notification,

189 *Cf.* Buijn 1996, p. 90-95; Wessels 1997b, p. 185; Article 3(3) and 22(1) Sixth Council Directive of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies (82/891/EEC) (OJ L 378, 31.12.82, p. 47-54).

190 Sections 2:310(6) and 2:334b(6) BW.

191 Section 2:334b(7) BW. The transferee must also be a public limited liability company (*naamloze vennootschap*) or private company with limited liability (*besloten vennootschap*).

192 Explanatory Notes to the Draft Law concerning the division of a company (*Kamerstukken II* 1995/96, 24702, no. 3), p. 6: '[e]lke splitsing in faillissement of surseance te verbieden, zou tot een te starre opzet leiden. Splitsing is juist een bij uitstek geschikt middel om van een rechtspersoon in financiële moeilijkheden levensvatbare onderdelen af te scheiden, zodat deze niet in de deconfiture worden meegesleurd. Vanzelfsprekend moet de afscheiding wel zodanig geschieden, dat schuldeisers daardoor niet worden geschaad. Artikel 334b lid 7 beperkt de splitsing in faillissement of surseance daarom tot rechtspersonen die bij de splitsing enig aandeelhouder worden van alle verkrijgende rechtspersonen. Het verlies dat de rechtspersoon door de overgang van (een deel van) haar vermogen lijdt, wordt in dat geval gecompenseerd door de aanwas die zij geniet doordat zij de aandelen in de verkrijgende vennootschappen verwerft. Per saldo blijft de vermogenspositie van de splitsende rechtspersoon gelijk.' *See* Slagter 2000, p. 86; Joosen 1998, p. 40; Buijn 1996, p. 29-30. *See also* Raaijmakers 1980, p. 122.

193 Slagter 2000, p. 86-88; Joosen 1998, p. 39-45; Van Zadelhoff 1998, p. 151-152.

194 Sections 2:334h and 2:334t BW. *See* Slagter 2000, p. 86-88; Joosen 1998, p. 39-45; Buijn 1996, p. 29-30; Van Zadelhoff 1998, p. 151-152.

or other procedural requirements that would otherwise apply by virtue of law, articles of association, or internal regulations.[195] The requirements include the requirements of the BW on the approval of the general meeting of shareholders,[196] to register newly established companies in the commercial register[197] and the rights of creditors to state their opposition to a proposed merger or division.[198] Hence, although the effects can be similar under section 3:80(2) BW, from a procedural point of view this new type of acquisition under universal title clearly distinguishes itself from the division and merger under the BW.

The question arises what can exactly be included in DNB's decision on the application of the transfer tools.[199] According to the relevant provisions in Part 3a Wft, DNB has the authority to decide on the passing (*overgang*) of instruments of ownership as well as assets and liabilities.[200] When presenting the Draft Intervention Act,[201] the Dutch government stated that the term 'assets and liabilities' used in the provisions in the Wft on DNB's transfer plan for a failing bank can include 'all transferable rights and liabilities' (*alle overdraagbare rechten en verplichtingen*), whether they are included in the bank's balance sheet or not.[202] Section 3:83 BW provides in this context that ownership, limited rights and claims are transferable, unless this is precluded by law or the nature of the right. The transferability of claims can be contractually excluded by the creditor and debtor and other rights are only transferable if this is provided by law. According to the Dutch doctrine, however, the fact that a legal relationship is non-transferable under section 3:83 BW does not necessarily mean that it cannot be acquired under universal title.[203] It has been argued, for instance, that the contractual non-transferability of a claim in accordance with section 3:83(2) BW or restrictions in the power of disposition (*beschikkingsbevoegdheid*), including for shares under section 2:87 BW, does not preclude acquisition under universal title.[204]

195 *See* Explanatory Notes to the Draft Financial Markets Amendment Act 2017 (*Herstelwet financiële markten 2017*, *Kamerstukken II* 2016/17, 34634, no. 3), p. 13-15; Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 80-82. *Cf.* Recitals 120-124 and Articles 63(2) and 119-122 BRRD.

196 *Cf.* e.g., Section 2:107a BW.

197 *Cf.* Section 2:69 BW.

198 *Cf.* Sections 2:316, 2:334k and 2:334l BW.

199 *Cf.* Articles 24-26 SRM Regulation; Sections 3a:28-43 Wft.

200 Sections 3a:28, 3a:37 and 3a:41 Wft.

201 *See* paragraph 2.2 of chapter 3.

202 Explanatory notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 12.

203 Zaman 2004, p. 128; Verstappen 1996, p. 249-250.

204 Verstappen 1996, p. 249-250.

The general rule is that assets, liabilities as well as legal relationships qualifying as proprietary rights (*vermogensrechtelijke rechtsverhoudingen*),[205] including certain agreements,[206] can be acquired under universal title.[207] Thus, in principle, non-proprietary legal relationships (*niet-vermogensrechtelijke rechtsverhoudingen*) do not pass to another party under universal title.[208] Examples of these relationships discussed in the literature include the right of the company to appointment a director or a supervisory director (*benoemingsrecht*), a company's two-tier board structure (*structuurregime*)[209] and a running power of attorney (*volmacht*) which is not connected to a specific asset.[210] Moreover, certain legal relationships cannot be acquired under universal title because of their 'person-related nature'.[211] As is further discussed in paragraph 5.2.2, an example is all monies security (*bankzekerheid*) for which the parties contractually agreed that it is person-related.[212] It is also a general rule of Dutch private law that a person who succeeds to the possession of another under universal title continues an already running prescription (*lopende verjaring*)[213] and this person also succeeds to the transferor's rights of possession (*bezit*) and detention (*houderschap*).[214] Also, an agreement's legal effects bind a successor under universal title, unless the agreement provides otherwise.[215]

It is less clear which public-law legal relationships, including licenses, can be acquired under universal title. According to Verstappen, the starting point is that if a license can be acquired under particular title, it can also be acquired under universal title. Nevertheless, the nature of the license or the law may provide whether a specific type can be acquired under universal

205 *Cf.* Section 3:6 BW, which defines 'proprietary rights' (*vermogensrechten*) as '[r]echten die, hetzij afzonderlijk hetzij tezamen met een ander recht, overdraagbaar zijn, of er toe strekken de rechthebbende stoffelijk voordeel te verschaffen, ofwel verkregen zijn in ruil voor verstrekt of in het vooruitzicht gesteld stoffelijk voordeel'.

206 *See* Verstappen 1996, p. 267-269.

207 *See* Verstappen 2002, p. 64-65; Verstappen 1996, p. 267 et seq.

208 *See* Zaman 2004, p. 131; Verstappen 2002, p. 64-65; Wessels 1997b, p. 179; Verstappen 1996, p. 149-150.

209 Section 2:164 BW.

210 Schoonbrood & Klaver 2017, p. 313-322 (on the two-tier board structure) and Zaman 2004, p. 131-132; Wessels 1997b, p. 179 (on the right of appointment and power of attorney). *See also* Memorandum of Reply to the Draft Law concerning the division of a company (*Kamerstukken II* 1995/96, 24702, no. 6), p. 4 & 15-16.

211 Zaman 2004, p. 133; Verstappen 2002, p. 67-71; Wessels 1997b, p. 182-183. *See also* Verstappen 1996, p. 279.

212 Asser/Van Mierlo 3-VI 2016, para. 55; Overes, in: Raaijmakers et al. 2005, Section 2:334j BW, para. 5, both referring to Explanatory Notes to the Draft Law concerning the division of a company (*Kamerstukken II* 1995/96, 24702, no. 6), p. 9-10.

213 Section 3:102 BW.

214 Section 3:116 BW. *Cf.* Wessels 1997b, p. 177.

215 Section 6:249 BW.

title.[216] For a banking license a specific rule in the Wft applies, which indicates that such a license is closely connected to the whole banking business (it is *persoonlijk)* and cannot be acquired under particular title.[217] However, according to the legislative history of this section, a banking license passes by operation of law to the acquiring party who acquires the bank's business under universal title, such as through a merger under the BW. It adds that the license may have to be assessed again and amended if changes are made to the activities that are acquired by the party.[218] The present author assumes that this rule also applies if the application of the transfer tools results in a merger of the bank under resolution with another company or split-off of activities for which a license was granted.

5.1.3 Application of the transfer tools under German law

The German legal doctrine makes a distinction between the singular succession (*Singularsukzession*, also called *Einzelrechtsnachfolge*) and the universal succession (*Universalsukzession*, also called *Gesamtrechtsnachfolge*).[219] The former refers to the transfer of a particular asset, liability or legal relationship in accordance with the applicable requirements of the BGB, such as an agreement on the assignment of a claim between the former and the new creditor under section 398 BGB.[220] In case of universal succession, by contrast, assets, liabilities, and legal relationships pass as a whole ('*zum Vermögen gehörenden Gesamtheit von Rechten und Plichten*'[221]) to another party *uno actu*. It includes a whole estate or a specified part thereof.[222] This type of transfer is only possible if explicitly provided for by law. A traditional example is universal succession under the law of inheritance (*Erbrecht*). Under the Transformation Act (*Umwandlungsgesetz*, UmwG), a merger (*Verschmelzung*) or division (*Spaltung*) of a company also entails universal succession.[223] Hence, universal succession under German law shows strong similarity to acquisition under universal title under Dutch law.

The literature indicates that in insolvency procedures under the InsO, the fact that certain legal relationships cannot be easily transferred can form a substantial obstacle to an asset-deal restructuring (übertragende *Sanierung*). For example, third party may not be able to acquire a contractual position without the cooperation of the counterparty, such as in case of a debt

216 Verstappen 2002, p. 74-75 & 131-134. *See also* Zaman 2004, p. 136-139; Wessels 1997b, p. 182; Verstappen 1996, p. 199-206.
217 Section 2:1 Wft.
218 Explanatory Notes to the Draft Wft (*Kamerstukken II* 2005/06, 29708, no. 19), p. 427.
219 Lieder 2015, p. 33-37.
220 *See* Lieder 2015, p. 112.
221 Lieder 2015, p. 716.
222 *See* Lieder 2015, p. 716-719.
223 *See* Lieder 2015, p. 36-37 and 714-718.

assumption (*Schuldübernahme*) under section 415 BGB.[224] Since the reform of the InsO in 2012, the InsO explicitly provides that all measures allowed under company law can be included in an insolvency plan,[225] such as a merger or division under the UmwG.[226] Consensus exists that the possibility to use (partial) universal succession in an insolvency plan procedure offers many practical advantages.[227] It is a matter of debate, however, whether the provisions of the UmwG on creditor protection are applicable in such a procedure. The provisions include the rule that involved companies are jointly and severally liable for the obligations of a divesting company at the time of a division.[228] It has been argued that such applicability makes the usefulness of the measures under the UmwG questionable.[229]

Against this background, the German bank resolution rules that have been introduced since 2008 have offered authorities more and more flexibility in the implementation of the measures. As discussed in chapter 3,[230] since 2009 section 8a FMStFG provides that a bank's[231] risk exposures[232] and non-core business divisions can be transferred to a winding-up agency in two

224 Thole 2015, p. 100; Bitter 2010, p. 155-161; Bitter & Laspeyres 2010, p. 1157-1158. *See also* Eidenmüller & Engert 2009, p. 542. The issue is also recognised in the legislative history of the InsO (Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen, Deutscher Bundestag, Drucksache 17/5712, 4 May 2011, p. 30): '[i]n der Rechtswirklichkeit ist die übertragende Sanierung aber nicht immer ein gleichwertiger Ersatz für die Sanierung des Unternehmensträgers durch einen Insolvenzplan. [...] Das insolvente Unternehmen kann Inhaber von Rechtspositionen sein, die nicht oder nur mit Schwierigkeiten und Kosten übertragen werden können; Beispiele sind Lizenzen, Genehmigungen und günstige langfristige Verträge.'

225 Section 225a(3) InsO.

226 *See* Thole 2015, p. 100-102; Bork 2012a, para. 15.16; MünchKomm-InsO/Eidenmüller 2014, Section 225a, para. 23 and 97-98. Section 123 UmwG distinguishes three types of divisions: a split-up (*Aufspaltung*), spin-off (*Abspaltung*) and hive-down (*Ausgliederung*). In the first case assets of the transferring company are divided and the transferring company is dissolved. Both in case of a spin-off and a hive-down, a part of a company's assets is transferred but in the first case the owners of the shares in the transferring company receive shares in return while in the latter case the transferring company receives the shares in the recipient company or companies in return. Section 174 UmwG provides that another type of consideration than shares can be provided. On the universal succession and its effects under the UmwG, *see* Schmitt/Hörtnagl/StratzKomm-UmwG/Stratz 2016, Section 20 UmwG, para. 23-31; Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, Section 131 UmwG, para. 4-8; Froitzheim et al. 2006, p. 115-124.

227 Thole 2015, p. 100 and 103-104; Kahlert & Gehrke 2013, p. 976; Drouwen 2009, p. 1053.

228 Section 133 UmwG. *See* Thole 2015, p. 104-105 and *see* Kahlert & Gehrke 2013, p. 977-978, who argue that section 133 UmwG does not apply in an insolvency plan procedure, and MünchKomm-InsO/Eidenmüller 2014, Section 225a, para. 100; Bork 2012a, para. 15.16, who hold the view that the provision does apply.

229 Bork 2012a, para. 15.14.

230 Paragraph 3.2 of chapter 3.

231 *Cf.* Section 8a(2) FMStFG.

232 According to Günther 2012, p. 179 the risk positions include claims, securities, derivatives, rights and duties from loan commitments or guarantees and equity participations, together with the relevant collateral. *Cf.* Section 8(1) FMStFG.

ways.[233] It can be carried out through a legal transaction (*Rechtsgeschäft*), including the assignment of claims under section 398 BGB and debt assumption under section 414 BGB. It can also be carried out through a division under the UmwG.[234] With a view to a simplification of the procedure (*'einer Vereinfachung des Umwandlungsverfahren'* and *'Verfahrenserleichterung'*),[235] section 8a(8) FMStFG excludes several formalities and provisions that would otherwise be applicable in case of a division under the UmwG. Audit requirements are, for instance, excluded.[236] Nonetheless, a division can still be a complex procedure. The UmwG requires, inter alia, a division and takeover agreement that contains comprehensive information about the division, a shareholder resolution, and the entry of the division into the commercial register.[237]

Section 48a et seq. KWG and the KredReorg, which both entered into force in 2010, rely only to a limited extent on the framework for universal succession created by the UmwG. Section 48f KWG stated that a transfer decision of the BaFin in accordance with section 48a et seq. KWG was directed towards a transfer by way of a hive-down (*Ausgliederung*). In a hive-down one or more parts of the assets of the bank are transferred to one or more

233 Besides the establishment of a winding-up agency governed by Federal law (*Bundesrechtliche Abwicklungsanstalt*) under section 8a FMStFG, section 8b FMStFG provides that a winding-up agency can be established under the laws of the states (*Landesrechtliche Abwicklungsanstalt*). The latter type of winding-up agency is not further discussed here.

234 Section 8a(1) FMStFG. *See* Pannen 2010, p. 108-109; Günther 2012, p. 193 et seq; Explanatory Notes to the draft Financial Market Stabilisation Fund Act (Gesetzentwurf der Bundesregierung, Bericht des Haushaltsausschusses, Entwurf eines Gesetzes zur Fortentwicklung der Finanzmarktstabilisierung, Deutscher Bundestag, Drucksache 16/13591, 2 July 2009), p. 10. Under section 8a(1)(4) FMStFG, the risk positions or business divisions can also be hedged without a transfer, for instance by way of guarantees or sub-participations (*Unterbeteiligungen*). The Explanatory Notes to the draft Financial Market Stabilisation Fund Act (Gesetzentwurf der Bundesregierung, Bericht des Haushaltsausschusses, Entwurf eines Gesetzes zur Fortentwicklung der Finanzmarktstabilisierung, Deutscher Bundestag, Drucksache 16/13591, 2 July 2009), p. 10 indicate that this option may for instance be of relevance if risk positions are subject to foreign law and cannot be easily transferred. *See* Günther 2012, p. 217; Wolfers & Rau 2009, p. 2405.

235 Explanatory Notes to the draft Financial Market Stabilisation Fund Act (Gesetzentwurf der Bundesregierung, Bericht des Haushaltsausschusses, Entwurf eines Gesetzes zur Fortentwicklung der Finanzmarktstabilisierung, Deutscher Bundestag, Drucksache 16/13591, 2 July 2009), p. 14.

236 Section 8a(8)(3) FMStFG. *Cf.* Sections 9-12 and 125 UmwG. *See* Explanatory Notes to the draft Financial Market Stabilisation Fund Act (Gesetzentwurf der Bundesregierung, Bericht des Haushaltsausschusses, Entwurf eines Gesetzes zur Fortentwicklung der Finanzmarktstabilisierung, Deutscher Bundestag, Drucksache 16/13591, 2 July 2009), p. 12-14.

237 *See* Section 125 in conjunction with sections 4, 6, 13 and 61, and sections 126 and 131 UmwG. *Cf.* Section 8a(8) FMStFG; Explanatory Notes to the draft Financial Market Stabilisation Fund Act (Gesetzentwurf der Bundesregierung, Bericht des Haushaltsausschusses, Entwurf eines Gesetzes zur Fortentwicklung der Finanzmarktstabilisierung, Deutscher Bundestag, Drucksache 16/13591, 2 July 2009), p. 13-15; Günther 2012, p. 220 et seq.

companies as a whole and the shares in the transferee entities are allocated to the transferring entity.[238] Although the regime was based on and followed in terms of its effects to a certain extent the provisions of the UmwG, the legislative history indicates that the measures were executed under sections 48f-k KWG.[239] For example, the KWG explicitly provided that the BaFin's transfer decision (Übertragungsanordnung) and the consent of the transferee entity rather than a shareholder resolution were required for the transfer to become effective.[240] Section 11 KredReorg provides that a hive-down under the UmwG can be included in a reorganization plan for a bank. The literature argues that the German legislature promoted the usefulness of the measures available under the KredReorg. It limited the liability of the transferee company for the existing obligations of the transferor to the hypothetical recovery rate the creditors would have received without the hive-down. Accordingly, the KredReorg derogates from section 133 UmwG, which requires full joint and several liability for all transferor's obligations.[241] Similar provisions were applicable for the transferor bank as well as the transferee entity after a transfer under sections 48a et seq. KWG.[242]

When the German government presented the draft SAG in 2014, it stated that the decision of the resolution authority on the application of the transfer tools results in a transfer *sui generis*.[243] While section 48a et seq. KWG referred to the UmwG several times, for a transfer under the SAG only the

238 Section 123(3) UmwG.

239 Explanatory Notes to the draft Restructuring Act (Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur Restrukturierung und geordneten Abwicklung von Kreditinstituten, zur Errichtung eines Restrukturierungsfonds für Kreditinstitute und zur Verlängerung der Verjährungsfrist der aktienrechtlichen Organhaftung (Restrukturierungsgesetz), Deutscher Bundestag, Drucksache 17/3024, 27 September 2010), p. 65. *See also* Beck/Samm/Kokemoor/Bornemann 2013, Section 48a KWG, para. 64-67 and 136-139; Schuster & Westpfahl 2011, p. 284-285; Bachmann 2010, p. 467-468. *Cf.* Sections 48a (1) and 48g KWG; Section 123(1)(3) UmwG.

240 Section 48f(1) KWG. *See* Explanatory Notes to the draft Restructuring Act (Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur Restrukturierung und geordneten Abwicklung von Kreditinstituten, zur Errichtung eines Restrukturierungsfonds für Kreditinstitute und zur Verlängerung der Verjährungsfrist der aktienrechtlichen Organhaftung (Restrukturierungsgesetz), Deutscher Bundestag, Drucksache 17/3024, 27 September 2010), p. 65-66; Bliesener 2012, p. 141; Beck/Samm/Kokemoor/Bornemann 2013, Section 48a KWG, para. 138.

241 Section 11(4) KredReorg; Bork 2012a, para. 15.14-15.15.

242 *See* Sections 48h(1), 48j(4) and 48k(3) KWG. In contrast to section 11 KredReorg, sections 48h(1), 48j(4) and 48k(3) KWG provided that the liability for the transferor bank only existed to the extent the creditors were not paid off by the transferee company and vice versa. For a discussion of the provisions, *see* Bliesener 2012, p. 142; Boos/Fischer/Schulte-Mattler/Komm-Kreditwesengesetz/Fridgen 2012, Section 48h KWG, para. 1, Secion 48j KWG, para. 22, Section 48k KWG, para. 7; Riethmüller 2010, p. 2302.

243 Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181. *See* Schillig 2016, p. 261.

resolution decision (*Abwicklungsanordnung*) and the SAG are decisive.[244] Section 113 SAG provides that the decision supersedes any statutory or contractual procedural requirement that would normally apply to the transfer, such as shareholders' resolutions.[245] This also entails that the provisions of the UmwG that aim to protect creditors involved in a merger or division do not apply to a transfer order under the SAG. An example is the provision requiring that creditors is to be provided security if they can demonstrate that the satisfaction of their claims is endangered because of the merger or division.[246] However, if the transferor receives shares in the transferee as compensation and a resolution of the transferee's shareholders is required for the capital increase, under section 109(2) SAG the transfer order is only issued once the shareholder resolution has become unchallengeable. The literature argues that this requirement in the SAG may be 'problematic', especially in a resolution procedure in which time is of the essence.[247]

The legislative history does not clarify what the effect of the application of the transfer tools is in private law terms. It is the present author's view that section 114 SAG suggests that the resolution decision effectuates a (partial) universal succession, provided that, where relevant, consent (*Einwilligung*) of the purchaser has been obtained[248] and the decision has been published.[249] The section provides that when the transfer becomes effective, the objects covered by the resolution order are transferred to the acquiring legal entity ('[m]*it Wirksamwerden der Übertragung gehen die von der Abwicklungsanordnung erfassten Übertragungsgegenstände auf den übernehmenden Rechtsträger über*'). Although the SAG requires a registration of the transfer

244 *See* Engelbach & Friedrich 2015, p. 666; Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181. *Cf.* Section 136 SAG.

245 *See* Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181; Schillig 2016, p. 261. Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181: 'Außerhalb dieses Gesetzes oder einzelvertraglich geregelte Verfahrensschritte, (z. B. arbeitsrechtlicher) Beteiligungs- und Zustimmungserfordernisse, Übertragungshindernisse, Eintragungen und Formvorschriften hindern nach den Absätzen 1 und 2 die Rechtwirkungen der Abwicklungsanordnung nicht. Die Ersetzungswirkungen des Absatz 2 sind allerdings begrenzt: Insbesondere gelten nur diejenigen gesetzlichen oder vertraglichen Beteiligungs- und Zustimmungserfordernisse als erfüllt, die sich auf die Übertragung als solche beziehen.'

246 *See* Sections 22 and 125 UmwG; Engelbach & Friedrich 2015, p. 666. *Cf.* Section 68 SAG on the no creditor worse off-principle.

247 Schillig 2016, p. 261-262.

248 Section 109 SAG; Section 183 BGB. *See* Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181.

249 Section 137 SAG.

of assets, rights, and liabilities or shares in the commercial register to ensure clarity for the markets about the resolution measures taken,[250] section 136(4) SAG indicates that such a registration only has a declaratory character.[251]

Although the prevailing opinion in German literature used to be that the rules on hereditary succession applied by analogy to the merger of a company, it is generally accepted now that a company merges or divides under the UmwG on the basis of a legal act (*Rechtsgeschäft*) and as specified in the agreement rather than by operation of law.[252] By contrast, the SAG's transfer tools are applied on the basis of an administrative act (*Verwaltungsakt*).[253] Based on section 48e KWG,[254] the SAG requires the resolution decision to specify the objects subject to the transfer (Übertragungsgegenstande), which can include shares, assets, liabilities and legal relationships.[255] Although this is not discussed in the legislative history, the present author assumes that,

250 *See* Explanatory Notes to the draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181. *Cf.* Section 48f(3) KWG; Section 171 UmwG as well as the Notes of the Bundesrat to the draft SAG (Bundesrat, Empfehlungen der Ausschüsse, BRRD-Umsetzungsgesetz, Drucksache 357/1/14, 8 September 2014), p. 13: [d]a die Abwicklungsanordnung in diesem Fall einen Übernahmevertrag zwischen über nehmendem und übertragendem Rechtsträger ersetzen kann (§ 107 Absatz 1 Satz 1 SAG-E), muss der Anordnungsinhalt – trotz der im Fall ihres Erlasses gebotenen besonderen Eile – dem Gebot der Bestimmtheit der übertragenen Gegenstände und Rechte genügen, um die Reichweite der Rechtsnachfolge und die Anteile an dem übernehmenden Rechtsträger hinreichend sicher bestimmen zu können. Deshalb wird gebeten, im weiteren Gesetzgebungsverfahren sicherzustellen, dass durch gesetzliche Vorgaben die Abwicklungsanordnung ein Mindestmaß an inhaltlichen Vorgaben enthält, um eine genaue Bezeichnung und Aufteilung aller Gegenstände und Rechte des Aktiv- und Passivvermögens zu ermöglichen. Solche Mindestvorgaben erscheinen auch deshalb von besonderer Bedeutung, als aus weislich der Einzelbegründung zu § 115 SAG-E mit Erlass der Anordnung bei den Marktteilnehmern Klarheit über die Vermögenszuordnung bestehen soll und spätere Streitigkeiten über Inhalt und Tragweite der Anordnung vermieden werden sollen'.

251 *See* Schillig 2016, p. 261.

252 *See* Rieble 1997, p. 303: '[d]er Vergleich mit dem Tod natürlicher Personen war stets nur ein Notbehelf. Denn der Verschmelzungsvertrag als Rechtsgeschäft führt nicht wie der Tod zuerst das Erlöschen des übertragenden Rechtsträgers herbei, so dass dann als gesetzliche Nebenfolge notwendig eine Universalsukzession eintreten muss, um subjektlose Rechte und Pflichten zu verhindern. Der Rechtsgeschäftswille der Parteien des Verschmelzungsvertrages ist zuerst auf die Vermögensübertragung gerichtet. Und nur weil die Universalsukzession den Rechtsträger aller Rechte und Pflichten entledigt, ihn „entleert", kann dann als logisch zweiter Schritt der Rechtsträger, der im Wortsinne keiner mehr ist, erlöschen. Die Universalsukzession ist nicht Folge der Verschmelzung, sondern ihr Ziel.' *See also* Lieder 2015, p. 722-724.

253 *Cf.* Section 136 SAG; Beck/Samm/Kokemoor/Bornemann 2013, Section 48a KWG, para. 64; Bliesener 2012, p. 141.

254 *Cf.* Boos/Fischer/Schulte-Mattler/Komm-Kreditwesengesetz/Fridgen 2012, Section 48e KWG, para. 6-9.

255 Sections 107(2) and 136(1) SAG.

similar to a transfer under section 48g KWG,[256] the principles as to what can be subject to universal succession under the UmwG also apply to universal succession under the SAG. This means, for example, that the transferee entity succeeds to the transferor's right of possession (*Besitz*),[257] and a contractually agreed prohibition of assignment under section 399 BGB does not preclude the passing of a claim under the SAG.[258] Legal relationships with a 'personal character' (*höchstpersönliche Rechte und Plichten*) are not acquired, which arguably include many types of public-law legal relationships.[259] For example, according to the literature, a banking license is granted to the bank itself and, in contrast to the view of the Dutch legislature, cannot be acquired through universal succession.[260] Section 118 SAG provides that a transferee entity may need to be granted appropriate authorization for the business it acquires.[261]

5.1.4 Application of the transfer tools under English law

In contrast to Dutch and German law, under English law the concept of universal succession does not exist. Under English law, a transfer of assets, rights, and liabilities of, or a transfer of shares in a company to another company is in principle effected by agreement. For a transfer of assets, rights, and liabilities, a sale is to be arranged in accordance with the legal formalities applicable under contract and property law.[262] An administrator who aims to transfer a business in an administration procedure under the IA 1986 may want to transfer rights under loan agreements by way of

256 *See* Bliesener 2012, p. 149; Explanatory Notes to the draft Restructuring Act (Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur Restrukturierung und geordneten Abwicklung von Kreditinstituten, zur Errichtung eines Restrukturierungsfonds für Kreditinstitute und zur Verlängerung der Verjährungsfrist der aktienrechtlichen Organhaftung (Restrukturierungsgesetz), Deutscher Bundestag, Drucksache 17/3024, 27 September 2010), p. 66.

257 *Cf.* Schmitt/Hörtnagl/StratzKomm-UmwG/Stratz 2016, Section 20 UmwG, para. 83; Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, Section 131 UmwG, para. 24. *Cf.* Section 857 BGB.

258 *Cf.* Schmitt/Hörtnagl/StratzKomm-UmwG/Stratz 2016, Section 20 UmwG, para. 74; Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, Section 131 UmwG, para. 31. Cf. also Rieble 1997, p. 302-303.

259 *Cf.* Schmitt/Hörtnagl/StratzKomm-UmwG/Stratz 2016, Section 20 UmwG, para. 84-86 and 88-90; Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, Section 131 UmwG, para. 69 and 76.

260 Schmitt/Hörtnagl/StratzKomm-UmwG/Stratz 2016, Section 20 UmwG, para. 90; Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, Section 131 UmwG, para. 69. *See* Günther 2012, p. 225.

261 *Cf.* Articles 38(7) and 41(1)(e) BRRD. In contrast to section 118 SAG, section 48g(6) KWG provided that the authorization for the acquired business was granted by the transfer order. *See* Beck/Samm/Kokemoor/Bornemann 2016, SAG, para. 129.

262 *See* Kershaw 2016, para. 2.01-2.31.

assignment. However, if the contracts contain a non-assignability clause, the assignment of the rights under the contracts will be ineffective in the sense that it does not provide the assignee any rights against the borrower or will only be effective with the consent of the latter contracting party.[263] This is, according to the literature, justified by the importance of private autonomy in English law.[264]

English law does not provide for a statutory mechanism to effectuate a merger or acquisition by operation of law if required board and shareholder approvals have been obtained and documents have been filed. This contrasts with the Dutch and German statutory merger and acquisition regimes.[265] However, a merger or division of a company and other types of reorganizations can take place through a scheme of arrangement under the CA 2006.[266] As noted in paragraph 4 of chapter 5, under the Act the court may sanction a scheme if a majority in number representing 75 percent in value in each relevant class of creditors or shareholders approved it.[267] The court also assesses the fairness and reasonableness of the scheme.[268] After the delivery of the court order to the Companies Register, the scheme is binding on all shareholders and creditors who voted on the scheme.[269] Thus, if the scheme provides for a transfer of the shares in the target company to a bidder and the scheme becomes legally effective, the bidder becomes 100 percent shareholder even though some of the former shareholders voted against the scheme.[270] For mergers and divisions of public companies through a scheme and cross-border mergers additional requirements are to be met, but they remain court-controlled processes.[271] If a scheme is used to effect a transfer of a company or its business as a whole or in part to another company, section 900 CA 2006 may be relevant. The section provides the court specific powers to effectuate the measures, including the power to transfer the property and liabilities of any transferor company, in which case the property and liabilities are transferred by virtue

263 *See Helstan Securities Ltd v Hertfordshire CC* [1978] 3 All E.R. 262; Peel 2015, para. 15.050; Kershaw 2016, para. 2.17; Barratt 1998, p. 52.

264 Bork 2011, para. 12.30.

265 *See* Kershaw 2016, para. 2.33.

266 *See* Kershaw 2016, para. 2.33.

267 Section 899 CA 2006.

268 See paragraph 4 of chapter 5 and *see* Payne 2014a, p. 73-78.

269 Section 899(4) CA 2006. *See also* Kershaw 2016, para. 2.63.

270 *See* Payne 2014a, p. 87; Kershaw 2016, para. 2.35.

271 Part 27 CA 2006 applies to mergers and divisions of public companies through a scheme of arrangement. For a discussion, *see* Kershaw 2016, para. 2.68-2.70. Cross-border mergers are governed by the Companies (Cross-Border Mergers) Regulation 2007. *See* Kershaw 2016, para. 2.71-76.

of the order.[272] Nevertheless, in such a case the court order cannot override the contractual rights of a third party.[273]

The legislative history of the BA 2009 explicitly indicates that the above-mentioned general private law framework and the framework created by Part 7 of the FSMA 2000 are not considered appropriate legal frameworks for transferring shares in or the business of a failing bank. They may not always enable quick transfers.[274] The banking business transfer scheme under Part 7 FSMA 2000 can be used to transfer the whole or a part of the business of a bank to another legal entity *en bloc* by court order.[275] However, the FSMA 2000 requires that a strict procedure is followed, including the hearing of any person who believes that he would be adversely affected by the transfer.[276]

Under the BA 2009, the BoE can make a share transfer instrument and a property transfer instrument. The former instrument effectuates a transfer to a private sector purchaser or a bridge institution of securities specified in the instrument and falling within the classes of securities listed in section 14 BA 2009, such as shares, debentures, and warrants.[277] The property transfer instrument is used to effectuate a transfer of some or all the specified prop-

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272 Section 900 CA 2006.

273 Davies & Worthington 2016, para. 29-12; Kershaw 2016, para. 2.67, all referring to the case *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014. In this case, the House of Lords held that without the consent of the employee the employee's contract could not be transferred to another company by the court under the Companies Act 1929.

274 I. Pearson, comments on Banking Bill, Clause 10, Public Bill Committee, 6 November 2008 argued that: '[t]he means to transfer the ownership and business of deposit takers already exists but commercial transfer mechanisms are not appropriate for dealing with failing banks. They are often too slow and do not provide sufficient certainty for parties involved in the transaction. The same is true of the part 7 procedure in the Financial Services and Markets Act 2000. The private sector purchaser tool in the clause provides for swift and certain transfer of some or all of the banking business from a failing bank to a private sector purchaser.'

275 Section 106 and 111 FSMA 2000. *See also* Lord McIntosh of Haringey, comments on Financial Services and Markets Bill, Amendment no. 202, Column 202, 21 March 2000, who noted that '[t]he Committee will wish to note that the problems that are addressed by this part are specific to the insurance and banking industries. […] It might be helpful if I clarify that we are talking about transfer of a business from one company to another — often, though not always, when two companies within a group are being restructured. It is not directly linked to mergers and take-overs, where the ownership of the company may change, although where a take-over has occurred the new parent company may subsequently decide to amalgamate or restructure the business of its subsidiaries. Another situation where such transfers occur is when a company is failing and, in order to protect the interests of its creditors or customers, another company agrees to take over part of the business of the failing firm. […] It will be for the courts to decide whether to sanction a business transfer.'

276 Section 110(1) FSMA 2000.

277 Sections 11-12, 14-15 BA 2009.

erty, rights or liabilities to a private sector purchaser, bridge institution or asset management vehicle.[278]

Although the BA 2009 provides which types of instruments are considered 'securities' that can be transferred with a share transfer instrument,[279] it does not provide a definition of the term 'property'.[280] It is the present author's view that the definition of the term 'property' in English general insolvency law may be relevant in this context. Under the IA 1986 it has a broad meaning and includes

> 'money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.'[281]

According to case law, rights or interests are considered 'property' if they are 'definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence and stability',[282] to which definition Goode adds the element 'capable of possessing realisable value.'[283] Thus, to determine whether it is 'property' under the IA 1986, one has to determine:

> 'whether the right is of a kind having a value which is realizable by the insolvent company, as opposed to a right of a kind which is of value only to the company itself. Where the right is truly non-transferable in the sense that it is of a kind having value only in the hands of the company in liquidation and cannot be sold or otherwise disposed of for value, then it is not property for the purposes of the Insolvency Act.'[284]

The literature notes it was on this ground that the Court of Appeal ruled that a secure period tenancy cannot be considered 'property' under the IA 1986 as it is by its nature personal to the tenant and cannot be realized by the trustee for the benefit of the creditors.[285] Hence, the English doctrine makes a distinction between things that are considered 'purely personal to

278 Sections 11-12ZA, 33 BA 2009.
279 Section 14 BA 2009.
280 *Cf.* however section 35 BA 2009 on 'transferable property', which states that the property, rights and liabilities that can be transferred include those acquired or arising between the making of the instrument and the transfer date, rights and liabilities arising on or after the transfer date in respect of matters occurring before that date, property in another jurisdiction, and rights and liabilities under the law of another jurisdiction or under enactment.
281 Section 436 IA 1986.
282 *National Provincial Bank Ltd v Hasting Car Mart Ltd* [1965] A.C. 1175.
283 Goode 2011, para. 6.07.
284 Goode 2011, para. 6.09
285 *City of London Corporation v Bown* [1990] 22 H.L.R. 32; Goode 2011, para. 6.14.

the company' and things that are not to ascertain what is property.[286] It is the present author's view that these analyses of the concept of property may be relevant to determine what is considered 'property' under the BA 2009.

It cannot be inferred from the BA 2009 that general private law requirements for a transfer of shares or assets, rights, and liabilities apply to the transfers under the BA 2009. It is the present author's view that the BA 2009 instead provides for its own regime to transfer property, rights, and liabilities or shares and other instruments, and derogates from the legal framework normally applicable to such transfers.[287] It gives the resolution authority flexibility in applying the transfer tools. For example, the BA 2009 explicitly provides that the transfers take effect despite any restriction arising by virtue of contract or legislation or in any other way. Such a restriction includes any restriction relating to what can and cannot be assigned and to a requirement for consent.[288] The transfers take effect by virtue of the instrument of the resolution authority and in accordance with its provisions as to the timing or other ancillary matters.[289] According to the Explanatory Notes, it means that the transfer takes place by operation of law.[290] The BA 2009 provides that the resolution authority can make additional provisions to specify the effects of the transfers. For example, both types of instruments may provide that the transferee is treated as the same person as the transferor, and that agreements made or other things done by or in relation to a transferor are treated as made or done by or in relation to the transferee. Also, legal proceedings that relate to something transferred may be required to be continued in relation to the transferee, and the terms of a trust on which property or shares that are transferred are held may be removed or altered.[291] Under section 36 BA 2009 the property transfer instrument may provide that the transfer is to be treated as a succession and that contracts of employment are continued. Accordingly, contracts entered into by the transferor can be easily continued by the transferee.[292]

The BA 2009 contains a specific provision on the effect of the application of a property transfer instrument on licenses. The starting point is that a license, which includes permission and approval and any other permis-

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286 Goode 2011, para. 6.09 and 6.14, referring to the analysis in Penner 2000.

287 *Cf.* Davies & Dobler 2011, p. 215: '[t]he SRR is an 'administrative' rather than 'judicial' process; the Bank of England does not need court approval to exercise its transfer powers and can do so once the SRR has been triggered simply by issuing a written transfer document (the 'transfer instrument'). The transfer instrument sets out the terms of the transfer and the time at which the transfer becomes automatically effective.'

288 Sections 17(3) and 34(3) BA 2009.

289 Section 17(2) and 34(2) BA 2009.

290 Explanatory Notes BA 2009, p. 8, para. 53.

291 Sections 17(5), 18, 34(7)-(8) and 36 BA 2009.

292 *Cf.* Sections 18 and 36 BA 2009; Explanatory Notes BA 2009, p. 8, para. 54-57 and p. 12, para. 93-101.

sive document in respect of anything transferred, continues to have effect despite the transfer. The instrument may divide responsibility for exercise and compliance between the transferor and transferee. Nevertheless, the BoE also has the power to determine that a license is discontinued.[293]

5.2 Protection against cherry-picking

5.2.1 Introduction

This paragraph takes a detailed look at the 'safeguards' in a resolution procedure provided by articles 76-79 BRRD, which were in the Netherlands implemented in sections 3a:60-3a:61 Wft and in Germany in section 110 SAG. In the UK, sections 47-48 BA 2009 and the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 provide for the safeguards.

Article 76 BRRD requires in two circumstances 'appropriate protection' for six types of arrangements[294] and the counterparties to these arrangements. The arrangements are security arrangements, title transfer financial collateral arrangements, set-off arrangements, netting arrangements, covered bonds, and structured finance arrangements. Which form of protection is considered 'appropriate' for each type of arrangement is specified in articles 77-79 BRRD. For the safeguards to apply, it does not matter how many parties are involved in the arrangement and whether the arrangement is created by contract, trust, or other means, or arises by operation of law.[295] The safeguards do not affect a resolution authority's power to suspend certain contractual obligations and rights in a resolution procedure under of articles 69-71 BRRD, including the powers to temporarily restrict the enforcement of security interests and temporarily suspend termination rights.[296]

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293 Section 37 BA 2009.

294 It is worth noting that the English and Dutch language versions of articles 76-79 BRRD use the terms 'arrangements' and 'agreements' inconsistently. For example, in the English version, the heading of article 77 BRRD is 'Protection for financial collateral, set off and netting agreements' (emphasis added), while the article itself and the other four articles in the BRRD use the term 'arrangements'. In the Dutch version of the articles, including article 76(2) BRRD, the terms 'zekerheidsregelingen', 'financiëlezekerheidsovereenkomsten', 'verrekeningsovereenkomsten', 'salderingsovereenkomsten' and 'gestructureerde financieringsregelingen' (emphasis added) are used. This makes the scope of article 76(3) BRRD unclear because the paragraph provides that the 'appropriate protection' requirement under article 76(2) BRRD is applicable 'ongeacht het aantal partijen bij de regelingen en ongeacht of de regelingen: a) bij overeenkomst, trust, of andere middelen zijn opgezet, dan wel van rechtswege automatisch zijn ontstaan' (emphasis added). The German language version, by contrast, seems to be more consistent in those cases by only using the term 'Vereinbarungen'.

295 Article 76(3) BRRD.

296 For a discussion of the resolution powers provided by articles 69-71 BRRD, *see* Haentjens 2017, para. 7.86-99; Garcimartín & Saez 2015, p. 341-343.

The first case in which the safeguards apply is a transfer of some but not all assets, rights, and liabilities of a bank under resolution, a bridge institution or an asset management vehicle to another entity. In such a case, in principle, a resolution authority cannot selectively choose or 'cherry-pick' which assets, rights, and liabilities falling within one of these types of arrangements are transferred and which stay with the residual entity. If the safeguards are applicable, the resolution authority should either transfer all linked contracts within a protected arrangement or leave them all behind.[297] Accordingly, a counterparty does not run the risk that he loses the set-off or netting rights under the protected set-off or netting arrangement respectively because the transfer does not result in the splitting of claims and liabilities under the arrangement.[298] The safeguards also aim to prevent that a claim against a transferor, such as a bank under resolution, is transferred without the assets against which the transferor's liability is secured, and vice versa.[299] Hence, they aim to minimize uncertainty as to whether a counterparty of the bank under resolution can still exercise his security rights under the protected security arrangement after the transfer.

Similar safeguards apply if the resolution authority uses its power to cancel or modify the terms of a contract to which the bank under resolution is a party, or substitute the transferee entity as a party, as specified in article 64(1)(f) BRRD. With this power, the authority may, for example, amend the terms and conditions of an agreement or substitute the transferee as a party to a contract so as to enable the transferee to operate the transferred business. However, under articles 76-79 BRRD, a resolution authority cannot,

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297 Recital 95 BRRD. The safeguards closely resemble the safeguard provided by section 2:334j BW, which protects creditors involved in a division of a company by requiring that a legal relationship to which the company is a party may in principle only be transferred in its entirety. However, in contrast to the BRRD, the section allows an exception to the rule by a separation of the legal relationship on a proportional basis if the relationship is connected to assets, rights, and liabilities that are transferred to several transferees or it is also connected to assets, rights, and liabilities that remain with the transferor. According to the legislative history (Explanatory Notes to the Draft Act on the amendments to the BW and several other acts regarding the act on the division of a company (*Kamerstukken II* 1995/96, 24702, no. 3), p. 12-13), this means, for instance, that a building maintenance agreement can be split up into two agreements if two transferees acquire a transferor's building. Similarly, under section 93 BGB, assets cannot be separated from their 'essential parts' (*wesentlichen Bestandteile*). This means, according to Lieder 2015, p. 729, that in case of a division of a company a building is to be transferred to the same transferee as the plot on which it is built.

298 Article 77 BRRD. *Cf.* Zerey/Fried 2016, part 3, section 17, para. 49; Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 113; Explanatory Notes to the Draft Financial Markets Amendment Act 2015 (*Wijzigingswet financiële markten 2015*, *Kamerstukken II* 2013/14, 33918, no. 3), p. 20-22; Rank & Diamant 2014.

299 Article 78 BRRD. *Cf.* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 115.

for instance, cancel or modify rights and liabilities under a protected set-off arrangement if the parties then lose their set-off rights, or cancel or modify a security arrangement if this means that the debt is no longer secured.[300]

Contravening the restrictions
It cannot be immediately inferred from the BRRD what happens if a decision of a resolution authority on the application of the transfer tools is not in accordance with the specific forms of protection for the arrangements required by articles 77-79 BRRD.

Conversely, section 3a:61(6) Wft explicitly provides that a transfer, termination or modification in conflict with the protection required by that section is not void or voidable. According to its legislative history, the structures of the relevant parts of the BRRD and Part 3a Wft suggest what are the implications if a transfer order does not protect arrangements in the specific forms required by articles 77-79 BRRD and section 3a:61 Wft. In such a case, one should rely on the general rules of article 76 BRRD and section 3a:60 Wft.[301] The general rule of the former article is that there has to be some form of protection for the arrangements and the counterparties to the arrangements. Section 3a:60 Wft requires that the rights arising from the arrangements are not affected. As can be inferred from the Explanatory Notes to the Draft Part 3a Wft, this means, for instance, that parties should have the opportunity to exercise their set-off rights under a protected set-off arrangement or security rights under a protected security arrangement. The partial transfer, termination or modification itself is not void or voidable.[302]

Three sections of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 contain more detailed provisions on the consequences of a breach of its safeguards for the above-mentioned arrangements. The sections exist 'to provide certainty to the market as to the outcome should the safeguards be inadvertently contravened.'[303] Section 10 provides for the consequences if the resolution authority exercises its powers to cancel or modify the terms of an arrangement, or to substitute the transferee as a party. In such a case, the partial property transfer is void in so far as it is made in contravention of the safeguards that the rights or liabilities under a protected arrangement may not be terminated or modified in the exercise of these powers. Section 11 sets out the consequences if the authority

300 Articles 77(1) and 78(1) BRRD.
301 Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 112 and 117.
302 Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 117.
303 HM Treasury, 'Banking Act 2009: special resolution regime code of practice', March 2017, para. 8.13-14. *See also* Gleeson & Guynn 2016, para. 14.105-107.

partially transfers assets, rights, and liabilities and the transfer contravenes the provision that the transfer may not include only some, but only all, the protected rights and liabilities under a protected set-off or netting arrangement. In that case, the transfer does not affect the exercise of the rights to set-off or net. Finally, section 12 of the Order applies if sections 10 and 11 do not apply. This may be the case, for instance, if a partial property transfer instrument contravenes the rule that the benefit of the security may not be transferred without the secured liability under a protected security arrangement.[304] Moreover, the section only applies if a person, such a creditor, considers a property transfer to be in breach of the safeguards and that as a result his property, rights or liabilities have been affected. Under those circumstances, the person may notify the resolution authority. The authority must then either take steps to remedy the breach by, for example, transferring property, rights or liabilities to the transferee, or explain why no safeguard has been contravened.[305]

Section 110 SAG does not contain a paragraph equivalent to section 3a:61(6) Wft and sections 10-12 Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009. However, literature discussing section 48k KWG may provide a solution. Until the entry into force of the SAG, section 48k KWG contained safeguards for partial transfers similar to the safeguards of articles 76-79 BRRD. According to Fridgen, under sections 134 and 139 BGB only the part of the resolution authority's decision on the partial transfer violating the statutory 'appropriate protection' requirements can be considered void.[306] The sections specify the consequences if a legal transaction violates a statutory prohibition.[307] Whether these consequences also apply in case of breach of the safeguards of the SAG is not evident from the SAG or literature.

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304 *See* Gleeson & Guynn 2016, para. 14.110.

305 Section 12 Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009.

306 Boos/Fischer/Schulte-Mattler/Komm-Kreditwesengesetz/Fridgen 2012, Section 48k KWG, para. 6, who notes that: '[s]oweit jedoch Ausgliederungsgegenstände nach Abs. 2 Satz 1 oder 2 betroffen sind und nicht vollständig übertragen werden, sieht das Gesetz keine Fehlerfolge vor. In Betracht kommt hier die Annahme der Nichtigkeit wegen Verstoßes gegen ein gesetzliches Verbot entsprechend § 134 BGB, das sich i. S. v. § 139 auf diejenigen Gegenstände beschränkt, die nur insgesamt übertragen hätten werden sollen. Die partielle Übertragungsanordnung wird aber nicht insgesamt unwirksam, wenn von ihr noch weitere – von der Unwirksamkeit nicht betroffene – Ausgliederungsgegenstände erfasst sind.'

307 Section 134 BGB provides that '[e]in Rechtsgeschäft, das gegen ein gesetzliches Verbot verstößt, ist nichtig, wenn sich nicht aus dem Gesetz ein anderes ergibt' and section 139 BGB that '[i]st ein Teil eines Rechtsgeschäfts nichtig, so ist das ganze Rechtsgeschäft nichtig, wenn nicht anzunehmen ist, dass es auch ohne den nichtigen Teil vorgenommen sein würde.'

Existing safeguards under EU legislation

The safeguards of the BRRD in partial transfers of assets, rights, and liabilities build on existing insolvency law safeguards law for several types of transactions and contracts of banks under EU legislation. The Financial Collateral Directive, for instance, aims to facilitate the provision of financial collateral under so-called financial collateral arrangements of certain parties, such as repos.[308] The financial collateral may consist of financial instruments, such as shares, cash or credit claims. For example, the Directive requires that a collateral taker can use and dispose of financial collateral provided under a security financial collateral arrangement, and that title financial collateral arrangements and close-out netting provisions in financial collateral arrangements can take effect in accordance with their terms. Moreover, the Financial Collateral Directive provides that several provisions of insolvency law are to be dis-applied. A collateral arrangement and the provision of collateral under it may not be affected by the retroactive effects of a declaration of insolvency. Title transfer financial collateral arrangements now form one of the classes of arrangements listed in article 76 BRRD, while security financial collateral arrangements can qualify as security arrangements that are protected under this article. Also, article 80 BRRD requires that if the resolution authorities partially transfer assets, rights, and liabilities or use their contract modification or cancellation powers, this may not affect the operation of payment and securities settlement systems covered by the Settlement Finality Directive. Hence, these systems need to be allowed to operate unaffected, as is also required under the Settlement Finality Directive in the event of insolvency of a system participant.[309]

However, exceptions to the safeguards of articles 77-79 BRRD are allowed 'where necessary' to ensure the availability of deposits covered by a deposit guarantee scheme, which coverage the Deposit Guarantee Scheme Directive requires.[310] Authorities may transfer covered deposits without transferring the assets, rights, and liabilities that are part of the same financial collateral, set-off, netting or security arrangement. Furthermore, the BRRD allows the authorities to transfer, modify or terminate these assets, rights, or liabilities without transferring the covered deposits.[311]

308 *See* Schillig 2016, p. 381-382; Sumpter & Blundell 2016, p. 81-84. For an in-depth discussion of the Financial Collateral Directive, *see* Diamant 2015; Keijser 2006.

309 Haentjens 2017, para. 7.108; Schillig 2016, p. 380-381.

310 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173 12.6.2014, p. 149).

311 Article 77(2), 78(2) and 79(2) BRRD. *See also* Sumpter & Blundell 2016, p. 82-83.

Delegated Regulation on partial transfers
A Commission Delegated Regulation on partial transfers,[312] which is based on an opinion of the EBA,[313] limits the scope of the safeguards provided by articles 76-79 BRRD. It was adopted under article 76(4) BRRD to further specify the types of arrangements to which the safeguards apply. Its recital 4 indicates that the Regulation aims to enhance certainty in terms of the scope of the safeguards.[314]

Article 5 Delegated Regulation, however, allows resolution authorities to derogate from the limitations provided in the Regulation by protecting 'any type of arrangement which can be subsumed under one of the classes in points (a), (c), (d) and (f) of article 76(2) of Directive 2014/59/EU [BRRD, LJ]',[315] which are security arrangements, set-off arrangements, netting arrangements and structured finance arrangements, or 'any type of arrangements which do not fall within the scope of article 76(2) of Directive 2014/59/EU'.[316] The protection is allowed if the arrangements are 'protected in normal insolvency proceedings against a temporary or indefinite separation, suspension or cancellation of assets, rights, and liabilities falling under the arrangements under their national insolvency law including the national transposition of Directive 2001/24/EC [the Winding-up Directive, LJ].' According to recital 8, this is the case if a creditor would still benefit from the rights arising under the arrangement once an insolvency procedure is initiated, unless the whole transaction was made void under national insolvency law, and it particularly applies to security arrangements and set-off and netting arrangements.[317] It is the present author's view that the European Commission has introduced the derogation in article 5 Delegated Regulation to allow resolution authorities to comply with the principle of the BRRD that no creditor shall incur greater losses in the resolution procedure than he would have been incurred if the bank had been wound up under a normal insolvency procedure, i.e., the no creditor

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312 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, 20.5.2017, p. 15-19) ('Delegated Regulation on partial transfers').

313 European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015.

314 Recital 4 Commission Delegated Regulation on partial transfers.

315 Article 5(1)(a) Commission Delegated Regulation on partial transfers.

316 Article 5(1)(b) Commission Delegated Regulation on partial transfers.

317 Recital 8 Commission Delegated Regulation on partial transfers. *See also* European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015, p. 8.

worse off-principle.[318] The provision ensures that resolution authorities can protect security arrangements, set-off arrangements, netting arrangements and structured finance arrangements notwithstanding the limitations to the safeguards provided by the Delegated Regulation. According to the present author, it is unclear which other types of arrangements 'which do not fall within the scope of article 76(2) of Directive 2014/59/EU' the resolution authorities may prefer to protect.

The Delegated Regulation, including its article 5 and recital 8, gives rise to the questions what type of security arrangements and set-off and netting arrangements are protected by articles 76-79 BRRD. Moreover, the question arises how these arrangements are protected in insolvency procedures under national insolvency law. Sections 5.2.2 and 5.2.3 discuss these questions for Dutch, German, and English law. The sections investigate as well if other areas of national private law also offer safeguards in case of a partial transfer of assets, rights, and liabilities against a loss of security rights under a security arrangement or a loss of set-off or netting rights under a set-off or netting arrangement.

5.2.2 Security arrangements

The safeguards for 'security arrangements'

According to article 76(2) BRRD, its 'appropriate protection' requirement is applicable to security arrangements 'under which a person has by way of security an actual or contingent interest in the assets or rights that are subject to transfer, irrespective of whether that interest is secured by specific assets or rights or by way of a floating charge or similar arrangement.'[319] Article 78 BRRD clarifies that 'appropriate protection' of these arrangements means that a resolution authority prevents

> '(a) the transfer of assets against which the liability is secured unless that liability and benefit of the security are also transferred;
> (b) the transfer of a secured liability unless the benefit of the security are also transferred;
> (c) the transfer of the benefit of the security unless the secured liability is also transferred; or
> (d) the modification or termination of a security arrangement through the use of ancillary powers, if the effect of that modification or termination is that the liability ceases to be secured.'

318 Article 34(1)(g) BRRD. *Cf.* European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015, p. 7-8.

319 *Cf.* the similar definitions in sections 3a:1 Wft and 48(1)(a) BA 2009. The SAG does not provide for a definition of the term 'security arrangements'.

While the Dutch and UK legislatures transposed these sections of article 78 BRRD almost literally into section 3a:61(2) Wft and section 5 BA 2009 (Restriction of Partial Property Transfers) Order 2009 respectively, section 110 SAG implements this requirement into German law, under which

> 'die Übertragungsgegenstände nur zusammen mit den bestellten Sicherheiten übertragen werden [können, LJ] und können Sicherheiten nur zusammen mit den Übertragungsgegenständen, für welche die Sicherheiten bestellt sind, übertragen werden.'[320]

The above-mentioned definition in article 76(2) BRRD seems to refer to *in rem* security, i.e., security in a tangible or intangible asset of the debtor or a third party.[321] This type of security is traditionally distinguished from personal security, which the literature defines as a security in the form of a personal undertaking, typically provided by a third party, to reinforce the primary obligation of the debtor.[322] The legislative history of section 3a:61 Wft also only discusses the protection of *in rem* security, which under Dutch law typically takes the form of a pledge (*pandrecht*) or mortgage (*hypotheekrecht*), and does not mention personal security, such as suretyship (*borgtocht*) under sections 7:850 et seq. BW. Similarly, in its opinion on the safeguards provided by articles 76-79 BRRD, the EBA defines 'security rights' as

> 'any contractual arrangement that permits one party to seize or appropriate, sell or have sold assets of the other party upon the occurrence of a certain event (enforcement event), typically a default or non-payment of an obligation of that party, to use the proceeds to pay a specified liability. However, security rights can also result by virtue of law from another legal relationship without an explicit security arrangement, for example a property lease may imply a right of lien over assets of the lessee in the property.'[323] (Emphasis added)

Conversely, the first paragraph of article 2 Delegated Regulation on partial transfers uses a broader definition of the term 'security arrangements' in article 76(2)(a) BRRD by providing that these arrangements include

320 Translation by the present author: the items that are transferred can only be transferred together with the created security rights, and security rights can only be transferred together with the items for which the rights have been created.

321 This definition is based on the definition provided by Gullifer 2013, para. 1.06. *Cf*. Wood 2007a, para. 1.001 and 2.001; Ali 2002, para. 2.33-34.

322 Gullifer 2013, para. 1.06. *See also* Weber 2012, p. 7.

323 European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015, p. 8.

'(1) arrangements stipulating guarantees, personal securities and warranties;
(2) liens and other real securities interests;
(3) securities lending transactions which do not imply a transfer of full ownership of the collateral and which involve one party (the lender) lending securities to the other party (the borrower) for a fee or interest payment and in which the borrower provides the lender with collateral for the duration of the loan.'

Hence, this paragraph does not only require a resolution authority to protect security financial collateral arrangements, under which security over financial collateral is typically provided to a creditor,[324] and other *in rem* security arrangements but also personal security arrangements. It means that article 78 BRRD now prevents a resolution authority in a partial transfer from modifying or terminating a personal security arrangement to which the bank under resolution is a party if the effect would be that the liability would otherwise no longer be secured.[325] Also, if another legal entity in the same group guarantees a liability of the bank, the guarantee has to be transferred to another party together with the liability.

Unclear in this context is, however, why the second paragraph of article 2 Delegated Regulation on partial transfers provides that

'[s]ecurity arrangements shall qualify as security arrangements pursuant to Article 76(2)(a) of Directive 2014/59/EU [BRRD, LJ] only if the rights or assets to which the security interest is attached or would attach upon an enforcement event are sufficiently identified or identifiable in accordance with the terms of the arrangement and the applicable national law.' (Emphasis added)

A possible interpretation is that according to this paragraph 'guarantees, personal securities and warranties' qualify as 'security arrangements' if the obligations of the principal debtor are sufficiently identified or identifiable. The better view seems to be that the term 'security arrangements' in this second paragraph only refers to *in rem* security interests, because only this type of security is typically attached or attaches upon an enforcement event to assets or rights, and that the paragraph leaves section (1) of article 2 unaffected.

324 *Cf.* the definition of 'security financial collateral arrangements' in article 2(1) Financial Collateral Directive: 'an arrangement under which a collateral provider provides financial collateral by way of security in favour of, or to, a collateral taker, and where the full ownership of the financial collateral remains with the collateral provider when the security right is established.'

325 *Cf.* Articles 64(1)(f), 76(1)(b) and 78(1)(d) BRRD.

According to the EBA, the 'appropriate protection' requirement of article 78 BRRD should not always be identical to a prohibition of separation of secured liabilities from the related collateral. It stressed in its above-mentioned opinion that the definition of 'security arrangements' provided in article 76(2)(a) BRRD significantly reduces the flexibility of resolution authorities to implement partial transfers of assets, rights, and liabilities because the definition explicitly includes floating charges.[326] Under English law, a floating charge is a security interest in a potentially constantly changing fund of assets rather than in specific assets. It attaches to the relevant assets by converting into a fixed charge upon the occurrence of an event, which may include the failure to pay the sum due under the charge.[327] Accordingly, if such a security interest extends to, for instance, all assets of the bank, it may not be possible for a resolution authority to transfer the secured liability without these assets or to transfer only a few of these assets. By contrast, the UK government noted in 2008 that it did not intend to carve out floating charges from the safeguards included in the draft version of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009. It added that, in practice, banks rarely grant such charges over all or substantially all their assets, although these types of charges may be granted if a bank receives emergency liquidity assistance from the BoE.[328] Banks create floating charges more often over a specific pool of assets, such as securities.[329]

The question arises if the above-mentioned second paragraph of article 2 Delegated Regulation on partial transfers follows the opinion of the EBA by excluding floating charges and similar security interests from the scope of the protection offered to security arrangements under articles 76 and 78 BRRD. The paragraph requires the assets to be 'sufficiently identified or identifiable'. It is the present author's view that this is not the case because the paragraph adds the phrase 'in accordance with the terms of the arrangement and the applicable national law'. In contrast to Dutch and German law,[330] English law does not require specificity of assets for the purpose of security interests at the time of the agreement. A debtor may grant a security interest over a specific asset, but a security arrangement may also cover a cluster of assets and even all present and future assets that will become

326 European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015, p. 9.
327 Gullifer 2013, para. 4.03-4.04 and 4.32-4.60.
328 HM Treasury, 'Special resolution regime: safeguards for partial property transfers', CM 7497, November 2008, para. 3.2-3.7.
329 The City of London Law Society, Transposition of the Bank Recovery and Resolution Directive, 2014.
330 *See* Thiele 2003, para. 75 and 402.

identifiable as falling within the terms of the agreement, without providing a specification.[331] According to the present author, the second paragraph of article 2 Delegated Regulation on partial transfers, therefore, does not aim to exclude floating charges under English law from the scope of the safeguards. This view seems to be supported by section 5(1) Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009, which requires the resolution authority to protect security arrangements under which 'the liability is secured against all or substantially all of the property or rights of a person'. In a resolution procedure, the resolution authority and the creditor, which is in the above-mentioned case of emergency liquidity assistance the BoE itself, may agree on termination or modification of the floating charge.

The protection offered by national insolvency law
The question arises which insolvency-specific privileges the creditors with *in rem* security rights enjoy in insolvency procedures under national insolvency law. As a general rule, if a company enters an insolvency procedure, the secured creditors have claims against specific corporate assets.

It can be argued that the approach taken by the BRRD to require resolution authorities to protect parties' *in rem* security rights differs from the Fw's approach to secured creditors, although these creditors are offered protection by both the resolution rules and Dutch insolvency law. In bankruptcy procedures under the Fw, creditors whose claims are secured by a pledge or mortgage over one or more assets of the debtor, in principle, take care of their own interests and the trustee is only required to respect their interests.[332] These creditors can exercise their security rights as if the procedure was not opened.[333] One exception is that the trustee can require creditors with a pledge or mortgage to perform the execution within a reasonable period and he can realize the relevant assets if the creditors have not done so within that period.[334] Similarly, in the winding-up of a company under the IA 1986, creditors whose claims are fully secured can realize their secu-

331 Goode 2017, para. 23.12; Gullifer 2013, para. 2.05-2.06, who note that an exception applies in case of contracts of sale. *See also* Wood 2007a, para. 7.005-7.012.

332 Verstijlen 1998, p. 197-198.

333 Section 57 Fw. *Cf.* Section 232 Fw, under which the suspension of payments procedure is not applicable to secured creditors.

334 Section 58 Fw. *See also* HR 20 December 2013, *NJ* 2014, 151 (*Glencore AG/Curatoren Zalco*), para. 4.6.2; HR 19 June 2008, *NJ* 2008, 222 (*Cantor/Arts q.q.*), para. 3.6.

rity to satisfy what is due and are largely unaffected by the procedure.[335] An exception applies to the position of floating charge holders. Under section 176A IA 1986 a liquidator has to make a prescribed part of the property of the company that would otherwise be available for the satisfaction of the floating charge holders available for the satisfaction of unsecured debts. He may not distribute that part to a floating charge holder except in so far as it exceeds the amount required for the satisfaction of unsecured debts.[336]

Under the InsO, by contrast, secured creditors are more involved in insolvency procedures.[337] After the creditors' meeting, the trustee rather than the secured creditor, in principle, liquidates all movable assets that are in the trustee's possession (*Besitz*) and to which the creditor has a right to separate satisfaction (*Absonderungsrecht*), such as in case of a so-called transfer of title for security purposes (*Sicherungsübereignung*). Such a security transfer allows the debtor-transferor to keep the assets in his possession while the legal title to the assets is transferred to the creditor transferee. Moreover, the trustee collects or in another way disposes of claims assigned by the debtor to secure a claim, such as in the event of an assignment for security purposes (*Sicherungsabtretung*). [338] The trustee then distributes the proceeds to the secured creditors, after deduction of the costs of determining and disposing of the assets.[339] This rule does not apply to immovable assets, which can be realized by the secured creditor as well as the trustee, and to assets which are not in possession of the trustee, such as a pledged asset which is as a general rule realized by the secured creditor himself.[340]

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335 Goode 2011, para. 8.47 and 8.49. Anderson 2017, para. 21.04 refers to *Buchler v Talbot* [2004] UKHL 9, para. 51, in which case Lord Millett explained the position of secured creditors in the following way: '[Liquidation is] not concerned with assets which have been charged to creditors as security, whether by way of fixed or floating charge. Secured creditors can resort to their security for the discharge of their debts outside the bankruptcy or winding up. Assets subject to a charge belong to the charge holder to the extent of the amounts secured by them; only the equity of redemption remains the property of the chargor and falls within the scope of the chargor's bankruptcy or winding up. As James LJ observed in In re Regents Canal Ironworks Co, Ex p Grissell (1877) 3 Ch. D. 411, 427 charge holders are creditors "to whom the [charged] property belong[s] with a specific right to the property for the purpose of paying their debts". Such a creditor is a person who "… is to be considered as entirely outside the company, who is merely seeking to enforce a claim, not against the company, but to his own property" per James LJ in In re David Lloyd & Co.'

336 The IA 1986 (Prescribed Part) Order 2003 sets out how the prescribed part is calculated. In contrast to the rights of the other secured creditors, the rights to the proceeds of a floating charge security are subject to the prior payment of expenses of the procedure as well as of preferential creditors. *Cf.* section 175(2) IA 1986.

337 Verstijlen 1998, p. 192-194.

338 Section 166 InsO. *See* MünchKomm-InsO/Tetzlaff 2013, Section 166, para. 6.

339 Sections 170-171 InsO.

340 Sections 49, 50, 165 and 173 InsO. *See* MünchKomm-InsO/Tetzlaff 2013, Section 165, para 2 and Section 173, para. 6

The protection offered by other areas of national private law
Can other areas of national private law also prevent that claims of parties cease to be secured in the event of a partial transfer of assets, rights, and liabilities in a resolution procedure? The sections below show that articles 76(2)(a) and 78 BRRD required transposition into the Wft, the SAG, and the BA 2009 because their safeguards are broader in scope than the protection provided under Dutch, German, and English private law, respectively.

The Explanatory Notes to the draft Part 3a Wft suggest that articles 76(2)(a) and 78 BRRD were only implemented into Dutch law to ensure that the safeguards required by the articles are applicable if a transfer in a resolution procedure involves assets and security arrangements that are governed by non-Dutch law. According to the Notes, Dutch private law provides for appropriate protection of security arrangements if the assets encumbered by a pledge or mortgage are transferred, or the bank's claim for which *in rem* security is provided is transferred to a new creditor.[341] Indeed, as a general principle of property law, the principle of *droit de suite* ensures that a debtor's/security giver's counterparty can assert his right of pledge or mortgage against a third party to which the encumbered asset is transferred.[342] Moreover, according to the Dutch doctrine a pledge and mortgage are so-called 'dependent rights' (*afhankelijke rechten*). The BW defines this term as rights that can only exist in conjunction with the claim which they secure and that follow this claim by operation of law if the claim passes to a transferee.[343] Section 6:142 BW provides that pledge and mortgage are also 'ancillary rights' (*nevenrechten*). Accordingly, if a bank's claim would be acquired by a new creditor under universal title (*algemene titel*) under section 3:80(2) BW and Part 3a Wft, in principle, this creditor automatically also receives the corresponding pledge or mortgage.[344]

Similarly, the German doctrine classifies the pledge (*Pfand*) and mortgage (*Hypothek*) that are established under the BGB as security rights which are by their nature accessory (*akzessorisch*) to the secured claim.[345] This legal nature entails that they only exist if the secured claim exists, cease to exist when the secured claim is discharged, and automatically pass to a trans-

341 Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 115-116.
342 *Cf*. Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 115; Snijders & Rank-Berenschot 2017, para. 67.
343 Sections 3:7 and 3:82 BW. *See* Achterberg 1994a, p. 297.
344 *Cf*. Section 6:142 BW; Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 115-116; Asser/Hartkamp & Sieburgh 6-II 2013, para. 257; Asser/Van Mierlo 3-VI 2016, para. 52; Achterberg 1994a, p. 297.
345 Swinnen 2014, p. 11, who refers, inter alia, to Baur & Stürner 2009, para. 36, no. 74-76 and para. 55, no. 4. *See also* Wilhelm 2010, para. 2198-2207.

feree together with the secured claim.[346] The literature calls such a security right an 'addition' (*Anhängsel*) to the claim.[347] A contractual agreement to transfer a claim without the corresponding mortgage or vice versa does not have any effect (*Wirkungslos*).[348] The BGB itself uses the term 'ancillary rights' (*Nebenrechten*) to explicitly indicate that a pledge and mortgage pass to a new creditor together with the corresponding passed claims, whether it concerns singular succession or universal succession.[349]

By contrast, the English doctrine does not recognize a concept of accessoriness of *in rem* security rights to the secured claim in the same way as the Dutch and German doctrine do. The English legal literature uses the term 'accessory' when discussing a suretyship guarantee as a type of personal security.[350] While scholars maintain that a security interest in an asset cannot exist if there is no obligation of the debtor to the creditor,[351] they do not refer to accessoriness in the context of *in rem* security rights.[352] A security interest in an asset can, in principle, be transferred without the underlying secured debt.[353] In contrast to the Dutch literature as regards Dutch law,[354] in the English literature, no doubt exists that under English law the security holder and creditor do not necessarily have to be the same person and that a security trustee can hold the security for the benefit of the secured creditors.[355] McKendrick, however, argues that a transfer of a mortgage, and presumably also of a charge, without reference to the secured debt or other obligation nevertheless carries with it by necessary implication of law a transfer of the underlying secured obligation.[356]

346 MünchKomm-BGB/Lieder 2017, Section 1153, para. 1-5; MünchKomm-BGB/Roth/Kieninger 2016 BGB, Section 401, para. 1, 3-4; MünchKomm-BGB/Damrau 2017, Section 1250, para. 1; Baur & Stürner 2009, para. 36, no. 75-76 and para. 55, no. 4. *Cf.* Sections 401, 1153 and 1250 BGB.

347 Baur & Stürner 2009, para. 36, no. 75.

348 Von StaundingersKomm-BGB/Wolfsteiner 2015, Section 1153, para. 11-12.

349 Section 401 BGB; Lieder 2015, p. 755-756; Von StaundingersKomm-BGB/Busche 2015, Section 401, para. 1, 12, 16.

350 *Cf.* e.g., McKendrick 2016, para. 30.05: 'a guarantee is […] an accessory engagement.' Also referred to by Steven 2009, p. 390-391. *Cf. also* Gullifer 2013, para. 8.02: 'a suretyship guarantee is an accessory contract, not a primary contract. That is to say, the surety's obligations are co-terminous with those of the principal debtor, his liability does not arise until the principal debtor has made default and anything which nullifies, reduces or extinguishes the liability of the principal debtor has the same effect on the liability of the surety.'

351 McKendrick 2016, para. 23.15-23.17; Gullifer 2013, para. 1.47.

352 Steven 2009, p. 390-391.

353 Gullifer 2013, para. 1.47; Wibier 2009, p. 23.

354 Meijer Timmerman Thijssen 2009, p. 133-136.

355 *Cf.* e.g., Wood 2008, para. 17.15 and *see* Wibier 2009, p. 23.

356 McKendrick 2016, para. 23.55, who refers to *Jones v Gibbons* (1804) 9 Ves 407.

The Explanatory Notes to the draft Part 3a Wft do not adequately discuss what happens with *in rem* security interests that secure a bank's liability rather than its claim if the resolution authority's decision only states that this liability is acquired by a new debtor.[357] As a general rule, section 6:157 BW provides that a pledge or mortgage granted for debt assumed by a new debtor under sections 6:155 et seq. BW remains effective, as do the other ancillary rights connected to the claim. However, a pledge or mortgage over assets that do not belong to either the former or new debtor ceases by the assumption, unless the security provider previously consented to the preservation.[358] Assuming that this provision can be applied by analogy to acquisition under universal title through the application of one of the transfer tools under Part 3a Wft, it ensures that *in rem* security rights over assets of the bank or the new debtor remain in place. Nonetheless, it does not offer this protection if the assets subject to the security interest stay behind with a third-party security provider.[359] As suggested by Rank, the resolution authority's transfer decision can offer a solution in such a case, for instance, by explicitly providing that a pledge converts into a third-party pledge for the debts of the new debtor.[360] However, relevant views in this context can also be found in the literature on the acquisition under universal title through a merger under Book 2 BW. Most legal scholars agree that section 6:157 BW is not applicable to such an acquisition under universal title because, in contrast to a debt assumption under sections 6:155 et seq. BW, the transfer of liabilities to a new debtor through a merger is not dependent on the consent of the involved creditors. They argue that a pledge, including a third-party pledge, should, therefore, remain in effect.[361] According to the present author, the same argument can be used as regards the application of the transfer tools under Part 3a Wft, because this also results in acquisition under universal title which does require the involved creditors' consent.

Similar conclusions can be drawn from a German law perspective. Section 418 BGB applies if a bank's debt rather than claim is assumed by a third party under section 414 BGB. The provision stipulates that in the interest of the security provider, a security right created for the claim against the original debtor ceases to exist. However, this rule does not apply if the party to which the secured assets belong ('*derjenige welchem der verhaftete Gegenstand zur Zeit der Schuldübernahme gehört*') has consented to the preservation of the

357 *Cf.* Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 115-116.

358 Section 6:157(2) BW. *See* Asser/Hartkamp & Sieburgh 6-II 2013, para. 304-305; Achterberg 1994b, p. 312.

359 *Cf.* Rank 2015, p. 33-34.

360 Rank 2015, p. 34. *Cf.* Asser/Van Mierlo 3-VI 2016, para. 66; Snijders & Rank-Berenschot 2017, para. 513.

361 Raaijmakers & Van der Sangen in: Raaijmakers et al. 2005, Section 2:316 BW, para. 2b; Achterberg 1994b, p. 312.

security right.[362] Assume that a German court allows application of section 418 BGB by analogy in case of universal succession through the application of a transfer tool under the SAG. Security arrangements can in such a case be protected if the new debtor acquires a bank's liability by asking the creditor or third-party security provider his consent for the preservation of the pledge. However, similar to the arguments used in Dutch literature, the prevailing opinion in German literature is that section 418 BGB is not applicable in case of universal succession through a merger or division under the UmwG. German legal scholars maintain that the divided company's creditors do not consent to the passing of the company's debt to a new debtor.[363] This view may serve as an argument that also under German law a pledge remains in existence if the corresponding liability is acquired through the application of a transfer tool under the SAG.

English law does not provide for the concept of debt assumption in the same way as Dutch and German law do and, therefore, does not contain a provision similar to sections 6:157 BW and 418 BGB. While rights under a contract can be transferred through assignment, the obligations under a contract cannot.[364] Obligations can be novated from one party to another. The original liability extinguishes and is replaced by a new liability in the same amount in favor of the new debtor.[365] It is the prevailing view in the literature that the new party should not be considered a legal successor of the former debtor and that any security comes to an end. New security rights would need to be created by the new debtor.[366] It is unclear if these standards would also apply if the BoE transfers a liability of a bank under resolution by operation of law.

From a Dutch law perspective, the implementation of articles 76(2)(a) and 78 BRRD seems to be especially relevant in the context of a pledge or mortgage that does not secure only one claim but extends to all existing and future claims of the bank against a debtor (known as *bankzekerheid* or all monies security).[367] Consensus exists in the Dutch literature that under section 6:142 BW a new creditor receives such security interest if he acquires the entire credit relationship between the original creditor and the debtor under universal title. He obtains the security interest for all claims arising from the credit relationship, provided that the original parties did

362 MünchKomm-BGB/Bydlinksi 2016, Section 418, para. 1.
363 Von StaundingersKomm-BGB/Rieble 2012, Section 418, para. 5; Rieble 1997, p. 309.
364 *See* Smith & Leslie 2013, para. 21.01; Barratt 1998, p. 51.
365 Thiele 2003, p. 151; Burgess 1996, p. 247.
366 Wood 2008, para. 10.30-10.3232; Thiele 2003, p. 152-153.
367 *Cf.* Section 3:231 BW and *see* Snijders & Rank-Berenschot 2017, para. 511; Asser/Van Mierlo 3-VI 2016, para. 47.

not explicitly provide that the security has a person-related nature.[368] It has been a matter of debate, however, if the security interest also passes by operation of law to a new creditor if this creditor obtains only one or a few claims against the debtor out of all the existing and future claims covered by the security interest. Some authors hold the view, for instance, that this is not the case because the security interest is bound to the credit relationship between the original creditor and debtor and it can only pass together with the claim if the original credit relationship is terminated.[369] The majority opinion in literature now seems to be that the new creditor can acquire the security interest, provided that it does not seek to secure the final net claim between the original creditor and debtor.[370] Nonetheless, this has not been confirmed in case law and, therefore, uncertainty still exists about the transfer of the *bankzekerheid* if not the entire credit relationship is taken over.[371] Most scholars maintain that a transfer of one or a few claims results in one security interest that belongs jointly to both the transferor and transferee.[372] To ensure that the new creditor acquires the security right if the credit relationship with the original creditor is continued, in practice the original creditor often renounces (*doet afstand*) or terminates (*zegt op*) his security rights to the extent it relates to claims that were not transferred to the new creditor.[373] In sum, if the safeguards under articles 76(2)(a) and 78 BRRD did not exist, under Dutch law uncertainty would exist as to whether the *bankzekerheid* is transferred to a successor creditor who does not take over the entire credit relationship which the bank under resolution has with its debtor.[374]

By contrast, the German literature and English literature have not fiercely debated the question what happens with a security interest that covers all existing and future claims that the debtor owes to a creditor, such as a bank, under any arrangement if a new creditor acquires a part of the secured claims. The literature indicates that a security interest is not non-transferable under German law or English law only because it secures all claims against a debtor.[375] Case law has clarified that unless otherwise agreed, under English law the security would not cover the claims of a transferee

368 Asser/Van Mierlo 3-VI 2016, para. 55; Overes, in: Raaijmakers et al. 2005, Section 2:334j BW, para. 5, both referring to Explanatory Notes to the Draft Law concerning the division of a company (*Kamerstukken II* 1995/96, 24702, no. 6), p. 9-10.

369 *See* Swinnen 2014, p. 360; Thiele 2003, p. 65, who refer to, amongst others, Vriesendorp 1988, p. 315-317.

370 Asser/Van Mierlo 3-VI 2016, para. 54, who discusses the views in literature, and Bergervoet 2014, p. 84-89.

371 *See* Asser/Van Mierlo 3-VI 2016, para. 54; Thiele 2003, p. 66.

372 *See* Swinnen 2014, p. 11, who refers, inter alia, to Derksen 2010, p. 796; Bos 2010, p. 59.

373 *See* Thiele 2003, p. 66-67.

374 *Cf.* Thiele 2003, p. 64.

375 Thiele 2003, p. 150 and 216. *Cf.* Sections 1113(2) and 1204(2) BGB, providing that a mortgage or pledge can secure existing as well as future claims.

other than the transferred claims.[376] Moreover, in principle, the all monies security continues to secure also the claims that may arise between the debtor and the transferor creditor.[377] German legal scholars agree that if only one claim passes to a new creditor while a pledge secures a large number of claims, under German law the pledge does not pass with the claim to the new creditor by operation of law if the credit relationship for which the pledge was created remains in existence. Accordingly, in such a case the pledge only follows the claim under section 1250 BGB if the new creditor acquires the entire creditor relationship from which the claim arises. [378] It is a matter of debate in German literature, however, if the transfer of one claim to several creditors leads to a division of the pledge. Hence, it is unclear whether such a transfer results in a joint security right or several independent security rights.[379]

From the perspective of German law, the safeguards provided by section 110 SAG are especially relevant in the context of the several types of security rights which are not connected to the secured claim by operation of law (*nicht akzessorische Sicherung*).[380] The land charge (*Grundschuld*),[381] the transfer of title for security purposes (*Sicherungsübereignung*) and the assignment for security purposes (*Sicherungsabtretung*) all create non-accessory security interests, although only the former has an explicit legal basis in the BGB. The latter two were developed in legal practice as alternatives to pledges and are recognized by German courts.[382] If section 110 SAG does not exist and a resolution authority decides to transfer only the secured claims to a new creditor, the non-accessory character of these security rights could cause a separation of these rights and the claims.[383]

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376 Thiele 2003, p. 150; Burgess 1996, p. 249, who both refer to *Re Clark's Refriferated Transfport Pty Ltd* [1982] VR 989.

377 Thiele 2003, p. 150.

378 Von StaundingersKomm-BGB/Wiegand 2009, Section 1250, para. 6; Baur & Stürner 2009, para. 55, no. 33; Westermann 1998, para. 132, no. I.1.

379 Von StaundingersKomm-BGB/Wolfsteiner 2015, Section 1153, para. 9; Von StaundingersKomm-BGB/Wiegand 2009, Section 1250, para. 5, arguing that a partial transfer of a claim or a transfer of a claim to several creditors results in a joint mortgage or pledge for the creditors. *Contra* MünchKomm-BGB/Damrau 2017, Section 1250, para. 2, arguing that a partial transfer of the claim to another creditor results in a division of a pledge between the creditors.

380 *See* MünchKomm-BGB/Roth/Kieninger 2016, Section 401, para. 3, 14-15; Von StaundingersKomm-BGB/Busche 2012, Section 401, para. 37, 40-41; Wilhelm 2010, para. 1339-1355, 2218-2231.

381 *See* Swinnen 2014, p. 49-53. *Cf.* Section 1191 BGB.

382 Sections 1192 et seq. BGB (land charge). For a discussion of the security transfer and security assignment, *see* Wilhelm 2010, para. 2223-2228; Weber 2012, p. 132-151, 241-256.

383 *Cf.* Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, 2016, Section 131 UmwG, para. 23.

The fact that several types of non-accessory security rights have been developed and increasingly used in legal practice as alternatives to accessory security rights shows, according to Swinnen, that over the years there has been a development in the direction away from the use of accessory security rights (*'evolutie weg van accessoriteit'*) in national laws of security.[384] As mentioned above, the non-accessory security rights include the transfer of title for security purposes under German law. Moreover, Dutch, German, and English private law distinguish accessory and non-accessory personal security. While both the independent guarantee (*onafhankelijke garantie, selbstständige Garantie*) and suretyship guarantee (*borgtocht, Bürgschaft*) are considered personal security under Dutch, German, and English law, according to the national doctrine only the former creates an independent, non-accessory commitment.[385] The literature indicates that an independent guarantee may be preferred in legal practice precisely because parties can agree that the guarantor's obligations are not dependent on the underlying relationship.[386]

These characteristics of *in rem* security under national law contrast with the safeguards under articles 76(2)(a) and 78 BRRD under which security rights are protected in a partial transfer of assets, rights, and liabilities, whether they are accessory security rights or not. Furthermore, the distinction between accessory and non-accessory personal security contrasts with the Commission Delegated Regulation, under which personal security arrangements have now also been included in the scope of the safeguards in resolution procedures. In sum, the provisions on the safeguards required transposition into national law because national contract and property law derogates in its protection to parties with *in rem* or personal security in partial transfers from the protection offered by the resolution rules.

384 Swinnen 2014, p. 5. *See also* Van Erp & Akkermans 2012, p. 433-434 and 539, who note that 'several developments in the legal systems and in international instruments demonstrate that the accessory nature of property security rights in general is in decline.' They discuss the land charge under German law as an example.

385 *Cf.* Section 7:851 BW, providing that the existence of a suretyship guarantee is dependent on the existence of the obligation of the primary debtor, and section 767 BGB, which limits a surety's obligation to the amount of the principal debtor's debt. For a discussion of the English law perspective, *see* McKendrick 2016, para. 30.14 and 35.153.

386 Swinnen 2014, p. 5; Bergervoet 2014, p. 60. *See also* Weber 2012, p. 8; Snijders & Rank-Berenschot 2017, para. 483. *Cf.* Bertrams 2013, p. 4-5 for a discussion of the use of the term 'guarantee' in several jurisdictions.

5.2.3 Set-off and netting arrangements

The safeguards for 'set-off arrangements' and 'netting arrangements'

The safeguards for set-off arrangements and netting arrangements, which include close-out netting arrangements, can be found in article 77 BRRD.[387] The Commission Delegated Regulation on partial transfers limits the scope of these safeguards to specific qualifying set-off arrangements and netting arrangements. It provides, for example, that set-off arrangements and contractual netting agreements, which is a term defined in the CRR,[388] of the bank under resolution and a single counterparty qualify as set-off arrangements or netting arrangements under articles 76 and 77 BRRD if they relate to rights and liabilities arising under financial contracts or derivatives.[389] Financial contracts include securities, commodities and swap contracts.[390]

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387 In Article 2(1)(99) BRRD the term 'set-off arrangement' is defined as 'an arrangement under which two or more claims or obligations owed between the institution under resolution and a counterparty can be set off against each other'. Article 2(1)(98) BRRD defines the term 'netting arrangement' as '[...] an arrangement under which a number of claims or obligations can be converted into a single net claim, including close-out netting arrangements under which, on the occurrence of an enforcement event (however or wherever defined) the obligations of the parties are accelerated so as to become immediately due or are terminated, and in either case are converted into or replaced by a single net claim, including 'close-out netting provisions' as defined in point (n)(i) of Article 2(1) of Directive 2002/47/EC and 'netting' as defined in point (k) of Article 2 of Directive 98/26/EC'. According to article 2(1)(n) Financial Collateral Directive, a 'close-out netting provision' is '[…] a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise'. Article 2(k) Settlement Finality Directive defines 'netting' as: 'the conversion into one net claim or one net obligation of claims and obligations resulting from transfer orders which a participant or participants either issue to, or receive from, one or more other participants with the result that only a net claim can be demanded or a net obligation be owed'. The literature and EU legislation provide various definitions of the terms 'netting' and 'set-off'. *Cf.* e.g., Zerey/Fried 2016, part 3, section 17, para. 51; Garcimartín & Saez 2015, p. 331-333. Berger 1996, p. 19-20 notes in this context: 'dass sich der Nettingbegriff sowohl im operativen als auch im bankbetriebswirtschaftlichen und bankrechtlichen Bereich zu einem abstrakten Schlagwort mit diffuser Begrifflichkeit entwickelt hat. Er gehört dabei seit längerem zum festen Bestandteil der Nomenklatur des Bankaufsichtsrecht, hat jedoch auch dort keine festen Konturen.' The SAG only defines 'Saldierungsvereinbarung' and does not define 'Aufrechnungsvereinbarung', although the definition of the former also refers to 'Aufrechnungen'. The Bankenverband argued in its consultation reaction on the Draft SAG of 9 September 2014 that only the term 'Aufrechnungsvereinbarung' should be used, to cover both netting arrangements and set-off arrangements, because this is more in line with the terminology used in practice.

388 *See* Article 1(2) Delegated Regulation on partial transfers; Article 295 CRR, under which 'contractual netting agreements' are in particular bilateral agreements between a bank and its counterparty which meet the provided requirements, including that they are recognised by the competent supervisory authority.

389 Article 2(1)(100) BRRD.

390 Article 2(1)(65) BRRD.

The same applies if the set-off arrangements and contractual netting agreements are linked to the counterparty's activity as a central counterparty or they are related to rights and obligations towards payment or securities settlement systems. Finally, authorities have the option to include other types of set-off and netting arrangements if their protection is required for the recognition of the arrangements' risk mitigation effects under prudential rules.[391]

Set-off and netting arrangements do not fall within the scope of the safeguards if they contain so-called 'catch all' or 'sweep up' clauses, extending to, for example, all rights and liabilities between the parties, because such a clause could hinder the feasibility of a partial transfer of a bank's assets, rights, and liabilities.[392] Moreover, resolution authorities may exclude from the protection arrangements containing so-called 'walk away' clauses, permitting a non-defaulting counterparty to make only limited payments or no payment at all to the estate of the defaulter, even if the defaulting party is a net creditor.[393] This provision was added to the Delegated Regulation, inter alia, because arrangements containing such a clause are not recognized for the purpose of calculating capital requirements under the CRR.[394]

Nonetheless, as indicated in paragraph 5.2.1 above, article 5 of the Commission Delegated Regulation allows resolution authorities to derogate from these limitations provided in the Delegated Regulation by protecting any type of set-off or netting arrangement. Such protection is allowed if the arrangement is protected in an insolvency procedure under insolvency law 'against a temporary or indefinite separation, suspension or cancellation of assets, rights and liabilities falling under the arrangements'. According to its recital 8, this is the case if a creditor would still benefit from the rights arising under the arrangement once an insolvency procedure is initiated. The sections below analyze how set-off and netting rights are treated in insolvency procedures under national insolvency law.

The protection offered by national insolvency law

Article 77 BRRD aims to ensure that parties do not lose their set-off or netting rights when a partial transfer is conducted or when contracts are modified or terminated in a resolution procedure. By contrast, the provisions on set-off in Dutch, German, and English insolvency law mainly focus on the

391 Articles 3 and 4 Delegated Regulation on partial transfers. *See* European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015, p. 14-15.

392 Recital 5 Delegated Regulation on partial transfers.

393 Article 5 Delegated Regulation on partial transfers.

394 *See* European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015, p. 15. *Cf.* Article 296(2) CRR.

question of whether claims can be set-off notwithstanding the commencement of an insolvency procedure in which the debtor's estate is traditionally protected against the enforcement of claims by individual creditors.[395]

As a general rule, both the Dutch and German insolvency laws do not affect parties' statutory or contractual set-off positions gained before insolvency.[396] Notwithstanding the special rules on set-off and netting added to the Fw by the Settlement Finality Directive and the Financial Collateral Directive,[397] section 53 Fw provides that in a bankruptcy procedure a debtor/creditor of a bankrupt may set-off his liability and claim provided that the liability and claim both date from before the date of bankruptcy or result from acts with the bankrupt that took place prior to the bankruptcy. This provision has led to much case law clarifying that the rule has to interpreted narrowly.[398] The Fw allows claims that are not due and payable to be set-off.[399] It does not allow set-off if the bankrupt's debtor/creditor acquired the liability or claim after the bankruptcy or if an assignee did not acquire his liability or claim in good faith.[400] Similarly, under section 94 InsO a creditor's statutory or contractual set-off right which existed at the time the insolvency procedure was opened is not affected by the procedure.[401] If set-off is not yet possible at the start of the procedure because, for instance, the claims are of different types or a claim is not yet due, the InsO protects the potential set-off

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395 *Cf.* Fletcher 2007, para. 7.97 who notes about insolvency set-off under national laws that '[t]he laws of the Member States diverge sharply over the operation of set-off in the event of a debtor's insolvency. In the United Kingdom, set-off is treated as a mandatory process which must be applied, as a matter of public policy, in both individual and corporate insolvencies in which the necessary requirement of mutuality is present. In most Civil law systems, on the other hand, the prevailing view is that set-off constitutes a violation of the principle of pari passu distribution, and that as a matter of public policy it must be confined to the most carefully limited circumstances, as where the cross-border liabilities arise out of one and the same contract or obligation. Therefore, in a cross-border insolvency, the outcome for any creditor who is also a debtor to the estate can be drastically affected by the way in which the issue of the applicable law is resolved, if the competing laws happen to belong to the different schools of opinion with regard to set-off.'

396 The general rules on statutory set-off can be found in sections 6:127 et seq. BW and 387 et seq. BGB respectively but contractual set-off is recognised as as being valid and enforceable. Sections 53 Fw and 94 InsO apply to both statutory and contractual set-off. *See* Rank & Silverentand 2018, para. 22.09-22.11; Verstijlen 2016 (T&C Insolventierecht), section 53 Fw, para. 1; MünchKomm-InsO/Brandes/Lohmann 2013, Section 94, para. 44-48; Rosskopf 2008, p. 189-200; Nijenhuis & Verhagen 1994, para. 2. For an analysis of contractual set-off under German law, *see* Berger 1996.

397 Sections 63e(2) and 212b(3) Fw.

398 *See* Verstijlen 2016 (T&C Insolventierecht), section 53 Fw.

399 Sections 53(2), 130 and 131 Fw. *See* Verstijlen 2016 (T&C Insolventierecht), section 53 Fw, para. 4; Faber 2005, p. 452-453.

400 Section 54 Fw.

401 Exceptions to the provisions on insolvency set-off were added to the InsO to implement the Settlement Finality Directive and the Financial Collateral Directive, *see* Sections 96(2) and 104(2)(6) InsO. For a discussion of the implementation of these directives into German law, *see* Ruzik 2010, p. 235-251 and 364-618.

position but only if the insolvent debtor's claim is not enforceable earlier than the creditor's claim.[402] The InsO does not permit set-off, however, if the creditor becomes a debtor of the insolvent estate or is assigned a claim of a third party only after the opening of the procedure, or he acquired the opportunity to set-off by a voidable transaction.[403] Under both the Fw and the InsO, a contractual exclusion or limitation of set-off remains in effect after the opening of the insolvency procedure.[404]

Under English insolvency law, by contrast, insolvency set-off is mandatory, operates automatically and cannot be waived by contractual agreement.[405] According to the Insolvency (England and Wales) Rules 2016 (IR 2016), '[a]n account must be taken of what is due from the company and the creditor to each other in respect of their mutual dealings and the sums due from the one must be set off against the sums due from the other.'[406] The substance of the provision is similar for administration and winding-up procedures. For the claims to be included they do not have to be due and payable.[407] They may be present or future claims, and certain or contingent claims.[408] However, the claims must exist between the same parties in the same right ('mutual') and must both result in a pecuniary liability ('commensurable').[409] If there is a balance owed to the creditor, only that balance is provable in the winding-up or administration procedure. If there is a balance owed to the company, that balance must be paid to the liquidator or administrator, respectively.[410] Claims of the company or the creditor that are not eligible to be set-off include claims arising from obligations incurred at the time when the creditor had notice that a petition for the winding-up of the company was pending or after the company went in administration.[411]

Although the Fw does not explicitly provide that contractual netting provisions can be validly invoked after the declaration of bankruptcy, in the literature consensus seems to exist that these provisions are enforceable only to the extent that they are within the boundaries created by the Fw.[412]

402 Section 95(1) InsO; Bork 2012a, para. 11.52-54.
403 Section 96(1) InsO.
404 *See* Verstijlen 2016 (T&C Insolventierecht), section 53 Fw, para. 1; Wessels 2015b, p. 238; MünchKomm-InsO/Brandes/Lohmann 2013, Section 94, para. 39-41; Rosskopf 2008, p. 192-193, 199-200.
405 *See Stein v Blake* [1996] A.C. 243; *Westminister Bank Ltd v Halesowen Presswork and Assemblies Ltd* [1972] A.C. 785 and *see* Fletcher 2017, para. 9.056 and 23.020; Gullifer 2013, para. 7.78-7.79.
406 Sections 14.24(2) and 14.25(2) IR 2016.
407 Fletcher 2017, para. 23.022.
408 Sections 14.24(7) and 14.25(7) IR 2016.
409 Fletcher 2017, para. 23.021; Gullifer 2013, para. 7.83 and 7.86.
410 Sections 14.24(3)-(4) and 14.25(3)-(4) IR 2016.
411 Sections 14.24(6) and 14.25(6) IR 2016.
412 *See* Rank 2010, p. 322; Keijser 2006, p. 295; Nijenhuis & Verhagen 1994, para. 2-4.

According to legal scholars, the fact that the Dutch legislature did not add any provision to the Fw to guarantee the enforceability in insolvency of close-out netting provisions in financial collateral arrangements, as required by the Financial Collateral Directive, confirms this view.[413] Close-out netting is likely to be considered enforceable by a Dutch court if its effect complies with the requirements for insolvency set-off listed in sections 53 and 54 Fw.[414] However, some Dutch scholars argue that sections 37 and 37a Fw apply to contractual close-out netting.[415] Section 37 Fw applies to a mutual agreement has not or has not been fully performed by both the debtor and the counterparty at the time of the bankruptcy declaration. It stipulates that the bankruptcy trustee loses his right to demand performance of the agreement if the trustee does not declare within a reasonable period of time, as specified in writing by the counterparty, that he is prepared to perform the agreement. If the counterparty then rescinds the mutual agreement (*ontbinding* or *vernietiging*), he may file his claim for damages in the insolvency procedure under section 37a Fw. The better view seems to be that sections 37 and 37a Fw do not necessarily overrule close-out netting provisions and do not require that these sections' procedure is followed.[416] Arguably, section 37 Fw aims to create the same result as contractual close-out netting, namely to provide the non-defaulting counterparty clarity about the performance of the reciprocal obligations under the agreement.[417] There has also been some debate about the exact scope of section 38 Fw. The section provides that mutual agreements which relate to the delivery of goods traded in the commodities market are automatically terminated (*ontbonden*) as a result of the bankruptcy order if the agreed period for delivery of the goods expires or the date of delivery falls after the declaration of bankruptcy. The counterparty may then lodge a claim for damages in the insolvency procedure. While some authors argue that this provision also applies to derivatives agreements and perhaps even to agreements involving financial collateral,[418] the majority opinion in literature seems to be that close-out

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413 Rank 2010, p. 322; Keijser 2006, p. 295. *See also* Rank & Silverentand 2018, para. 22.23.

414 *See* Rank 2010, p. 325; Keijser 2006, p. 295.

415 Nijenhuis & Verhagen 1994, para. 4. *See also* Wessels 1997c, para. 5; Wessels 1997d, p. 94-95.

416 Rank 2010, p. 325.

417 Rank 2010, p. 325. *Cf.* Van Zanten 2013 (GS Faillissementsrecht), section 37 Fw, para. A2, who argues that section 37 Fw 'is bedoeld om de wederpartij een instrument te bieden om een einde te maken aan de onzekere situatie waarin zij als gevolg van het faillissement van haar contractpartij kan komen te verkeren, doordat zij niet weet of de curator bereid zal zijn de overeenkomst na te komen.'

418 Keijser 2006, p. 307 (arguing that the possibility that a Dutch court rules that section 38 Fw is applicable to derivatives agreements cannot be excluded and that it is even more likely that the section applies to repurchase and securities lending agreements); Nijenhuis & Verhagen 1994, para. 4 (arguing that section 38 Fw may also be applicable to certain derivatives agreements).

netting is upon insolvency under most types of agreements not likely to be affected by section 38 Fw.[419]

In the German literature, there has also been some debate about the precise nature of contractual close-out netting. Most authors agree that close-out netting results in set-off by agreement (an *Aufrechnungsvertrag*).[420] After the commencement of an insolvency procedure, set-off of the compensation amounts for the outstanding transactions takes place, provided that this complies with sections 94, 95 and 96 InsO.[421] Similar to section 38 Fw, section 104 InsO indicates that certain types of agreements are terminated by operation of law if the agreed period for performance expires, or the performance date falls after the date the insolvency procedure is opened. It explicitly provides that in such a case only a compensation amount can be claimed. However, the scope of section 104 InsO is broader than the scope of section 38 Fw.[422] Section 104 InsO applies to goods (*Waren*) and financial performances (*Finanzleistungen*) with a market or stock exchange price. Its non-exclusive list with financial performances contains, for example, options and – since the implementation of the Financial Collateral Directive[423] – financial collateral. Moreover, section 104 InsO provides how the claim for non-performance is determined, although parties may deviate from the provisions, including from the valuation standards.[424] Thus, although contractual netting provisions are generally enforceable upon insolvency if they are within the parameters of the InsO, this provision creates a statutory netting regime for certain types of agreements.

From an English law perspective, two principles of English insolvency law are relevant in the discussion of whether contractual netting on insolvency is enforceable.[425] The first is the anti-deprivation principle, under which

419 *See* Nijenhuis 1998, p. 612-613; Wessels 1997c, para. 5; Wessels 1997d, p. 94; Meesters 1994, p. 35 (all arguing that section 38 Fw is unlikely to be applicable to derivatives agreements) and *see* Rank 2010, p. 324 (arguing that even if section 38 Fw applies to repurchase and securities lending agreements, a Dutch court is likely to rule that parties can validly agree on the method of calculating the damages in the insolvency procedure).

420 Fuchs 2013, p. 46; Binder 2005, p. 439; Böhm 1999, p. 118-119; Berger 1996, p. 34. *Contra* Zerey/Behrends 2016, part 2, section 6, para. 54-55, who argues that contractual close-out netting does not result in set-off on the basis of a set-off arrangement (*Aufrechnungsvertrag*) but on the basis of an arrangement on the conditions for set-off (*Vertrag über die Voraussetzungen der Aufrechnung*). The arrangement ensures that the conditions for set-off are present. Comparable to set-off under sections 387-388 BGB, set-off requires a declaration to the other party. *Cf.* Von StaundingersKomm-BGB/Gursky 2011, Vorbemerkungen zu Section 387, para. 83.

421 Zerey/Behrends 2016, part 2, section 6, para. 56-57.

422 For a discussion of section 104 InsO, *see* Braun/Kroth 2017, InsO § 104; Ruzik 2010, p. 553 et seq. For a comparison of sections 38 Fw and 104 InsO, *see also* Keijser 2006, p. 308-310.

423 *See* Ruzik 2010, p. 575.

424 Section 104(2) and (4) InsO.

425 *See* Murray 2017, para. 11.12.1.4-11.12.2.8; Gullifer 2013, para. 7.90-7.93.

an arrangement is void if its effect is depriving an insolvent entity of its assets that would otherwise have been available for distribution amongst the creditors.[426] In *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* the Supreme Court held that clauses do not violate the principle if they are part of a 'commercial transaction entered into in good faith' and they 'do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties.'[427] The accepted view in the literature seems to be that based on these grounds, close-out netting provisions do not violate the anti-deprivation rule. The purpose of the provisions can be considered to be the increase of certainty and reduction of credit risk.[428] The second relevant principle is the *pari passu* principle. A leading House of Lords decision indicates that an English court may avoid an arrangement as a matter of public policy if it creates a method that alters and is intended to alter the *pari passu* distribution amongst the creditors in an insolvency procedure under the IA 1986.[429] The accepted view in literature seems to be that the principle does not invalidate contractual netting as long as the contractual netting does not give better rights than those provided by the provisions on insolvency set-off in the IR 2016. Close-out netting can be said to achieve the same result as the operation of insolvency set-off.[430] Furthermore, special statutory provisions exist that aim to safeguard the validity of netting arrangements on insolvency. These include, in addition to the special provisions introduced by the Settlement Finality Directive and the Financial Collateral Directive, the provisions in Part 7 of the Companies Act 1989. The provisions preserve the validity of netting provisions in contracts entered into on, or subject to the rules of, an exchange or through a recognized clearing house.[431]

In sum, in the investigated jurisdictions, counterparties to set-off and netting arrangements still benefit from their rights arising under the arrangements once an insolvency procedure is initiated, provided that the set-off or netting is within the boundaries created by national insolvency law. In principle, the scope of the set-off and netting arrangements which national insolvency law protects is broader than the scope of the arrangements protected by the safeguards under article 77 BRRD and articles 3-4 Commission Delegated Regulation on partial transfers. Nevertheless, article 5 Delegated Regulation allows resolution authorities to protect all set-off and netting

426 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383, para. 104.
427 *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383, para. 104 and 108. *See* Murray 2017, para. 11.12.2.3.
428 Murray 2017, para. 11.12.2.4-11.12.2.6; Gullifer 2013, para. 7.90-7.93.
429 *British Eagle International Airlines v Cie Nationale Air France* [1975] 1 WLR 758. *See* Derham 1991.
430 Murray 2017, para. 11.12.2.7-11.12.2.8; Gullifer 2013, para. 7.93; Paech 2014, p. 12-13.
431 *See* Gullifer 2013, para. 7.94.

arrangements under which counterparties still benefit from their set-off and netting rights upon opening of an insolvency procedure.

The protection offered by other areas of national private law

If the Commission Delegated Regulation on partial transfers, articles 76 and 77 BRRD and the national implementing legislation did not exist, can other areas of national private law also safeguard the enforceability of parties' set-off or netting rights in case of a partial transfer of assets, rights, and liabilities in a resolution procedure? The sections below show that the safeguards provided by the bank resolution rules are broader than the protection offered to set-off or netting rights in such a case under Dutch, German, and English contract law.

It has been investigated in the Dutch literature what the relevant provisions in Dutch law would be in such a case.[432] As a general rule of private law, an agreement's legal effects bind a successor under universal title, unless the agreement provides otherwise.[433] To this end, following acquisition under universal title through the application of a transfer tool under Part 3a Wft, the transferee is, in principle, brought into the same legal relationships as the transferor.[434] Nonetheless, the provision is of minor importance as regards legal relationships that stay behind. Accordingly, it may not prevent that parties lose their set-off or netting rights in a resolution procedure.[435] As discussed by Rank, in theory, section 6:130(1) BW may offer a solution in specific cases.[436] The section provides that

> '[i]s een vordering onder bijzondere titel overgegaan, dan is de schuldenaar bevoegd ondanks de overgang ook een tegenvordering op de oorspronkelijke schuldeiser in verrekening te brengen, mits deze tegenvordering uit dezelfde rechtsverhouding als de overgegane vordering voortvloeit of reeds vóór de overgang aan hem is opgekomen en opeisbaar geworden.'[437]

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432 Rank 2015, p. 25-35. The immediate reason for Rank's analysis in 2013 (published in 2015) was the fact that at that moment the Dutch Intervention Act did not contain safeguards comparable to the safeguards in articles 76-79 BRRD.

433 Section 6:249 BW.

434 *Cf.* Valk 2017 (T&C Burgerlijk Wetboek), Section 6:249 BW, para. 1.

435 *See* Rank 2015, p. 25-26.

436 Rank 2015, p. 26-28.

437 Translation of section 6:130(1) BW by the present author: [a] debtor has a right to set-off a counterclaim against the original creditor if the original creditor's claim is transferred under particular title but only if the counterclaim resulted from the same legal relationship as the transferred claim or the counterclaim existed and was due and payable before the transfer. For a general discussion of the requirements and examples of the application of section 6:130 BW, *see* Asser/Hartkamp & Sieburgh 6-II 2013/233-236; Van Gaalen 1996, p. 39-58.

Thus, if a creditor acquires a claim of a bank against a counterparty of the bank under section 6:159 BW (contract takeover, *contractsoverneming*), the counterparty of the bank is, in principle, allowed to set-off his counterclaim against the bank.[438] Section 6:130 BW is of non-mandatory law, and contracting parties may deviate from its requirements before the transfer takes place.[439] However, the section does not provide that the counterparty can set-off the amounts due to the bank with his claim against the bank, such as a deposit claim, if the liability of the bank – rather than a claim of the bank – is assumed by a new debtor under sections 6:155 et seq. BW.[440] Furthermore, it is uncertain if a Dutch court allows the application of section 6:130 BW by analogy in case of acquisition under universal title. It has been argued that the provision is only applicable to acquisition under particular title and is not relevant in case of acquisition under universal title because a successor under universal title is traditionally bound by all rights and obligations of his legal predecessor.[441] However, as was argued in paragraph 5.1, acquisition under universal title is under Part 3a Wft not necessarily limited to the passing of a whole estate or a proportional part thereof. It is the present author's view that above-mentioned argument in literature supports the view that the provision should apply if a third party acquires only a few rather than all rights and obligations under universal title. Nonetheless, even if section 6:130 BW is applied by analogy, the enforceability of netting rights may not be fully safeguarded.[442] Close-out netting, for instance, requires the termination of the outstanding transactions and the valuation of the resulting obligations before a set-off can take place.[443]

Uncertainty may also exist as to whether the claim of a bank under resolution and a counterparty's claim falling within one set-off or netting arrangement can be considered to result from the same legal relationship as required in section 6:130 BW.[444] If follows from case law that the sole fact that a claim and counterclaim are provided for by the same document does not necessarily mean that they arise from the same legal relationship, although this can be an indication for the required sufficient close relationship.[445] Moreover, section 6:130 BW would not protect a counterparty if the whole bank is split-up and, accordingly, the 'original creditor' does no longer exist.

438 *Cf.* Faber 2005, p. 247-248.
439 *See* Faber 2005, p. 300; Van Gaalen 1996, p. 56-57.
440 Rank 2015, p. 26. *Cf.* Faber 2005, p. 246; Van Gaalen 1996, p. 49.
441 Faber 2005, p. 248.
442 Rank 2015, p. 27.
443 *See* Wood 2007b, para. 1.004-5 and 1.029-30.
444 *See* Rank 2015, p. 26-27.
445 *See* Rank 2017 (T&C Burgerlijk Wetboek), Section 6:130 BW, para. 2b, who refers to HR 27 January 2012, *NJ* 2012, 244 (*Gangadin/Sheoratan*), para. 3.5.2-3.6.2; Rank 2015, p. 27.

The BGB also does not seem to offer full protection of set-off and netting rights in case of a partial transfer in a resolution procedure. Section 406 BGB, which largely corresponds with the Dutch section 6:130 BW, provides that

> '[d]er Schuldner kann eine ihm gegen den bisherigen Gläubiger zustehende Forderung auch dem neuen Gläubiger gegenüber aufrechnen, es sei denn, dass er bei dem Erwerb der Forderung von der Abtretung Kenntnis hatte oder dass die Forderung erst nach der Erlangung der Kenntnis und später als die abgetretene Forderung fällig geworden ist.'[446]

To apply section 406 BGB in case of a partial transfer under section 107 SAG, several issues need to be addressed. Firstly, section 406 BGB provides that a set-off right is not preserved in cases that involve a specific chronology of due dates of the claims, namely if the counterclaim becomes due and payable after the debtor discovered the assignment and later than the assigned claim.[447] Secondly, section 406 BGB applies to a contractual assignment of a claim under section 398 BGB (Übertragung einer Forderung) while under section 107 SAG the claim passes by operation of law. However, this does not form an obstacle in this case because section 412 BGB provides that section 406 BGB applies to an assignment by operation of law (*cessio legis*) mutatis mutandis.[448] Thirdly, while it is undisputed that section 412 BGB applies to several types of assignments of a particular claim, legal scholars argue that the provision does not apply to all types of universal succession.[449] It has been submitted, for instance, that section 412 BGB does not apply to a merger under the UmwG because after a merger a 'former creditor' does not exist.[450] Nevertheless, the provision seems to leave room for application in case of universal succession through division of a company under the UmwG.[451] It has also been argued that, in view of the protection of the debtor, section 406 BGB itself has to be applied by analogy in case of a universal succession.[452] These views support the view that section 406 BGB should apply to a partial transfer of assets, rights, and liabilities on the basis of section 107 SAG.

446 Translation of section 406 BGB by the present author: [t]he debtor may set-off against the new creditor as well a counterclaim which he has against the former creditor, unless when acquiring the counterclaim, he was aware of the assignment or unless his counterclaim became due only after he became aware of the assignment and later than the assigned claim became due.

447 MünchKomm-BGB/Roth/Kieninger 2016, Section 406, para. 10-11.

448 MünchKomm-BGB/Roth/Kieninger 2016, Section 406, para. 15.

449 MünchKomm-BGB/Roth/Kieninger 2016, Section 412, para. 15-18.

450 MünchKomm-BGB/Roth/Kieninger 2016, Section 412, para. 15; Rieble 1997, p. 309.

451 *See* MünchKomm-BGB/Roth/Kieninger 2016, Section 412, para. 15-18; Schmitt/Hörtnagl/StratzKomm-UmwG/Hörtnagl 2016, Section 131 UmwG, para. 30; Kresse & Eckard 2012, Section 412, para. 1. *See also* Von StaundingersKomm-BGB/Busche 2012, Section 412, para. 9-10.

452 Lieder 2015, p. 768.

However, according to several authors, section 406 BGB is not applicable to a contractual set-off arrangement which is concluded already before the assignment, because the claim and the counterclaim have already been disposed of by the set-off contract and cannot be assigned. Hence, in this view, the contractual disposal before the assignment takes precedence over the later disposal by assignment.[453] It is unclear if a German court would accept this view and decide that this rule of general private law can overrule the transfer order under section 107 SAG.

Moreover, similar to section 6:130 BW, section 406 BGB may not fully safeguard the enforceability of netting rather than set-off rights, and the provision is not applicable if a third party acquires a liability rather than a claim of the bank. Section 417 BGB seems to offer an important safeguard in the latter case by providing that after a debt assumption by a third party under section 414 BGB, the new debtor may, in principle, raise against the creditor any defenses arising from the legal relationship between the creditor and the former debtor. The section, however, also provides that he may not set-off a claim to which the former debtor is entitled. A provision equivalent to section 406 BGB does not exist in this case.[454] Furthermore, although it has been argued that section 417 BGB should be applicable to universal succession,[455] literature also indicates that this is not the case at the moment.[456] The latter provision, therefore, does not provide parties any safeguards in case of universal succession.

Comparable conclusions can be drawn under English law. English law also protects set-off that was available between the original creditor and his debtor after a transfer of the claim to an assignee. The assignment does not disrupt contractual set-off if the set-off agreement was concluded between the assignor and the debtor and the reciprocal claims were incurred before the date on which the debtor received a notice of the assignment.[457] It is a matter of debate if a debtor can also assert a contractual set-off if the set-off agreement existed before the notice of assignment but the cross-claim of the debtor arose out of new transactions with the original creditor. Most authors seem to agree that this is possible because the assignee takes subject to the set-off agreement, including to any cross-claims falling within the set-off agreement that arose after the assignment.[458] As regards statutory and equitable set-off, two rules apply.[459] First, a debtor cannot successfully

453 Von StaundingersKomm-BGB/Busche 2012, Section 406, para. 10; PalandtKomm-BGB/Grüneberg 2015, Section 406, para. 3.
454 Von StaundingersKomm-BGB/Rieble 2012, Section 417, para. 31.
455 Lieder 2015, p. 768.
456 Von StaundingersKomm-BGB/Rieble 2012, Section 414, para. 21; Rieble 1997, p. 309.
457 Wood 2007b, para. 5.012; Derham 2003, para. 17.40, who both refer to the case *Mangles v Dixon* [1852] 3 HLC 702.
458 Gullifer 2013, para. 7.27; Derham 2003, para. 17.42.
459 Tettenborn 2002, p. 489-490.

set-off against an assignee a cross-claim against the assignor if the claims do not qualify for set-off.[460] Set-off is, for example, not possible if claims do not meet the mutuality requirements, i.e., they are not between the same parties in the same right.[461] Second, temporal restrictions exist.[462] Set-off is available for the debtor if he incurred or acquired his cross-claim before the day on which he received the notice of assignment.[463] This requirement is not met if the cross-claim arises under an agreement that was reached before this notice was given.[464] Moreover, although his cross-claim does not have to be due at the date of the notice, this claim has to be due and payable before assigned claim becomes due and payable.[465] The claim of the assignor, by contrast, does not have to arise and to be payable at that date. It is sufficient that the contract existed.[466]

Nonetheless, also under English law, it is unclear if the rules on set-off after assignment offer parties any safeguards in the event of a partial transfer under the BA 2009. It is uncertain if a court allows the application of the rules by analogy in case of a transfer by operation of law of claims of a bank under resolution. Moreover, the rules may not sufficiently protect netting positions of parties, and do not protect set-off rights if a liability of the bank rather than a claim of the bank is transferred to a third party by a resolution authority.

5.3 Liquidation of the transferor or transferee

5.3.1 Introduction

The BRRD and SRM Regulation emphasize the strong ties between the bank resolution rules and more general national insolvency law by using the terms 'liquidation', 'wound up' and 'normal insolvency proceedings'. The BRRD defines the latter term as

> 'collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person.'[467]

460 Gullifer 2013, para. 7.68-7.69; Tettenborn 2002, p. 490-493.
461 Gullifer 2013, para. 7.43 and 7.53.
462 Tettenborn 2002, p. 493-496.
463 *See Roxburghe v Cox* [1881] 17 Ch.D. 510 and *see* Gullifer 2013, para. 7.70; Smith & Leslie 2013, para. 26.69-26.70.
464 Gullifer 2013, para. 7.70.
465 Wood 2007b, para. 5.020-5.021.
466 *See Rother Iron Works Ltd v Canterbury Precision Engineers Ltd* [1974] Q.B. 1 and *see* Gullifer 2013, para 7.70.
467 Article 2(1)(47) BRRD.

The definition is broad and acknowledges the distinction made in the Winding up Directive between bank insolvency procedures administered by a liquidator on the one hand, who is 'any person or body appointed by the administrative or judicial authorities whose task is to administer winding-up proceedings', and by an administrator on the other hand, who is 'any person or body appointed by the administrative or judicial authorities whose task is to administer reorganization measures'.[468]

Hence, 'normal insolvency proceedings' seem to potentially include several types of national insolvency procedures for banks which are considered 'normal' under national law compared to a resolution procedure, whether it is under general insolvency law or a bank-specific insolvency regime.[469] The BRRD and SRM Regulation, however, use the term only in the context of liquidation or winding up and thus seem to consider this (and not reorganization measures) the only alternative to a resolution procedure.[470] As mentioned in chapter 2, they require that a bank is only put under resolution if it 'cannot be wound up under normal insolvency proceedings without destabilizing the financial system and the measures are necessary in order to ensure the rapid transfer and continuation of systemically important functions'.[471] Thus, '[t]he winding up of a failing institution through normal insolvency proceedings should always be considered before resolution tools are applied.'[472] Besides, the no creditor worse off-principle requires the resolution authorities to compare the actual treatment of shareholders and creditors in the resolution of the bank with the position of these stakeholders in a hypothetical 'winding-up under normal insolvency proceedings'.[473] After application of the sale of business tool or bridge institution tool under the BRRD and SRM Regulation, the residual part of the bank is to be 'wound up under normal insolvency proceedings'.[474] Moreover, following the termination of a bridge institution's operations this entity also is to be 'wound up under normal insolvency proceedings'.[475]

468 Article 2 Winding up Directive. The BRRD itself does not define the terms 'liquidator' and 'administrator'. For a discussion of the meaning of the term 'normal insolvency proceedings', *see also* Haentjens, Janssen & Wessels 2017, p. 59-61.

469 *See* Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 48.

470 *See* Binder 2015a, p. 94-95.

471 Recital 49 BRRD. *Cf.* Article 32 BRRD; Article 18 SRM Regulation.

472 Recital 46 BRRD.

473 Article 75 BRRD. *See also* Article 34(1)(g) BRRD; Article 15(1)(g) SRM Regulation.

474 Article 37(6) and Recital 50 BRRD; Article 22(5) and Recital 62 SRM Regulation.

475 Article 41(8) BRRD.

The central questions in this paragraph are what is considered a 'normal insolvency proceeding' for a bank under national insolvency law, and what role does the national resolution authority play in the opening of such a procedure. The sections below do not aim to make a comprehensive study of the insolvency procedures available for a bank but analyzes some important aspects. They show that the Dutch, German, and English rules on bank insolvency procedures deviate from general insolvency law. It is also shown that the legislatures of the three investigated jurisdictions have considerable discretion in determining how an insolvency procedure for a bank looks like. For instance, differences exist as to what is regarded a 'normal insolvency proceeding', what are the grounds for the opening of the procedure, and what is the role of the resolution authority in the context of such a procedure.

5.3.2 Liquidation under Dutch bank insolvency law

The Fw has a Chapter 11AA with the heading 'Of the bankruptcy of a bank' (*Van het faillissement van een bank*), which currently consists of over 50 bank-specific insolvency provisions.[476] Following the transposition of the BRRD into Dutch law, it has long been unclear if only the bankruptcy procedure under Chapter 11AA Fw or also the emergency procedure (*noodregeling*) under sections 3:160 et seq. Wft should be considered a 'normal insolvency proceeding' for a bank under Dutch law. As discussed in chapter 3 of the present study,[477] in the latter procedure, the Amsterdam district court appoints an administrator (*bewindvoerder*) who is authorized to restructure or liquidate the failing bank. The Explanatory Notes to the Draft Part 3a Wft suggest that both procedures are a 'normal insolvency proceeding' within the meaning of the BRRD.[478] Section 3a:20 Wft confirmed this view at that time (November 2015) by requiring that for the application of the no creditor worse off-principle the position of shareholders and creditors in resolution is compared with the outcome of liquidation in a hypothetical emergency procedure under the Wft or bankruptcy procedure under the Fw. At another part of the Explanatory Notes it is suggested, however, that a

476 Under sections 214(4) and 284(5) Fw, the suspension of payments procedure (*surseance van betaling*) and the statutory debt management scheme for natural persons (*schuldsaneringsregeling natuurlijke personen*) under the Fw are not applicable to banks.

477 Paragraphs 2.1.2 and 2.1.3 of chapter 3.

478 Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 48, stating that '[d]aarnaast bestaan voor banken en verzekeraars in de huidige wet- en regelgeving twee insolventieprocedures: de noodregeling en het faillissement. […] Voor de goede orde wordt opgemerkt dat in de richtlijn regelmatig sprake is van 'normale insolventieprocedures'. Met 'normaal' wordt bedoeld: normaal ten opzichte van het afwikkelingsinstrumentarium. Men houde evenwel in het oog dat de noodregeling ten opzichte van het faillissement, dat kan worden uitgesproken ten aanzien van iedere schuldenaar, juist een bijzondere procedure is.'

resolution procedure under the Wft and a bankruptcy procedure under the Fw are the only available procedures for a failing bank under Dutch law.[479]

The literature argues that the emergency procedure for a bank did no longer exist following the implementation of the BRRD. According to that view, the provisions in Chapter 11AA Fw that contained references to the emergency procedure were mistakenly not deleted when the legislature implemented the BRRD in 2015.[480] It is the present author's view, however, that the procedure still exists under Dutch law at the moment since section 3:160 Wft explicitly provides that the procedure can be opened for a bank. The currently pending proposal for the Act recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) is intended to repeal the emergency procedure for both banks and insurance companies.[481] According to the parliamentary notes, the bank resolution procedure and bankruptcy procedure almost entirely overlap this procedure and, therefore, the emergency procedure does not have any added value.[482] Thus, once adopted, this Act would leave the bankruptcy procedure under Chapter 11AA Fw as the only available 'normal insolvency proceeding' for a bank under Dutch law. Similar to a bankruptcy procedure under general Dutch insolvency law,[483] in a bankruptcy procedure for a bank, the task of the bankruptcy trustee is considered to be directed towards the maximization of the proceeds for the joint creditors.[484]

Following a transfer of assets, rights, and liabilities of a bank under resolution to a private sector purchaser or a bridge institution in a resolution procedure, under section 3a:30 Wft the national resolution authority, which is DNB, must request the Amsterdam district court to order the bankruptcy of the residual entity. It must do so unless the continuation of the entity is

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479 Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 127, which state that '[n]u in beginsel slechts een keuze bestaat tussen de route van afwikkeling ingevolge Deel 3A en faillissement is het ook niet langer noodzakelijk de bewindvoerder in de noodregeling een bevoegdheid te geven faillissement aan te vragen.' *See also* Wessels 2016, para. 1530.

480 Berends 2017 (SDU Insolventierecht), sections 212l and 212m Fw. *See also* Wessels 2018, para. 1515b.

481 Proposal for the Dutch Act on recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) (*Kamerstukken II* 2017/18, 34842, no. 2).

482 Proposal for the Dutch Act on recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) (*Kamerstukken II* 2017/18, 34842, no. 3), p. 7-8.

483 *See* paragraph 4.2.1 of this chapter.

484 *See* e.g., A.A.M. Deterink, H. Oosterhout & E.M. Jansen Schoonhoven, 'Deskundigenbericht inzake Bepaling werkelijke waarde onteigende effecten en vermogensbestanddelen SNS Bank en SNS Reaal per 1 februari 2013', Enterprise Chamber of the Amsterdam Court of Appeal (*Hof Amsterdam, Ondernemingskamer*), 27 April 2018, case number 200.122.906/01 OK, p. 197.

required for the achievement of the resolution objectives or compliance with the resolution principles set out in the SRM Regulation.[485] In all other cases, DNB must apply for a bankruptcy order for a bank on the basis of section 212ha Fw. The section explicitly provides that for a bankruptcy order, two of the three conditions for resolution listed in article 18(1) SRM Regulation have to be met: the bank is failing or likely to fail, and no private sector measure is available to prevent the failure. The resolution condition that the opening of a resolution procedure is in the public interest must not be fulfilled.[486] A bankruptcy request by another party than DNB is inadmissible.[487] Thus, these provisions explicitly depart from the general rule in section 1 Fw. According to the latter provision, a debtor who has ceased to pay can be declared bankrupt (*in staat van faillissement*) by a court order on his own request, at the request of one or more creditors, or at the request of the Public Prosecution Service (*Openbaar Ministerie*).[488] The court can order the opening of a bankruptcy procedure for a bank if it is summarily satisfied that the bank meets the two conditions referred to in section 212ha Fw.[489] According to the parliamentary notes to Part 3a Wft, it can be assumed that a bank which has been placed under resolution, meets the conditions for the opening of a bankruptcy procedure in most cases, as the resolution conditions are more stringent.[490]

The Fw does not answer the question of whether DNB initiates the bankruptcy procedure under section 212ha Fw in its capacity as a national resolution authority or as a bank supervisory authority.[491] According to the present author, this question is relevant to determine which authority within DNB is responsible for filing the request. The task used to be regarded a

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485 *See* Memorandum of Amendment to the Dutch Draft Financial Markets Amendment Act 2017 (*Herstelwet financiële markten 2017*, *Kamerstukken II* 2016/17, 34634, no. 7), p. 4; Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 97-98.

486 *See* Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 127.

487 Section 212ha(2) Fw. *See* Wessels 2016, para. 1543d. Under section 212ha(3) Fw the bank can also file a request for its own bankruptcy, but in that case, the Amsterdam district court will allow the ECB or DNB, depending on the allocation of competences under Articles 4 and 6 SSM Regulation, to be heard before deciding on the request.

488 *See* Explanatory Notes to the Dutch Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 78.

489 Section 212hg(1) Fw. *See* Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 98 and 127.

490 Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 97.

491 *Cf*. Explanatory Notes to the Dutch Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 97, which state that under section 3a:30 Wft the resolution authority initiates the bankruptcy procedure.

task of DNB in its capacity as a supervisory authority.[492] Since the entry into force of the SRM Regulation, however, section 212ha Fw requires an assessment of whether the bank meets the resolution conditions listed in article 18(1) SRM Regulation. The national supervisory authority and the ECB in principle only assess whether a bank is failing or likely the fail. It is then the task of the national resolution authority or the SRB, in close cooperation with the national resolution authority,[493] to assess whether the other two resolution conditions in article 18(1) SRM Regulation are also fulfilled.[494] It is the present author's view that DNB is then likely to initiate the bankruptcy procedure in its capacity as resolution authority if the public interest condition is not met. Accordingly, the Fw limits the role of the Dutch resolution authority in the context of a bankruptcy procedure for a bank mainly to the filing of the request for the opening of the procedure and making of recommendations for the appointment of the bankruptcy trustee.[495]

5.3.3 *Liquidation under German bank insolvency law*

In contrast to the approach followed by Dutch insolvency law, the German bank-specific insolvency provisions can be found in the KWG rather than in the German general insolvency legislation, which is the InsO. Except for these few provisions in the KWG, some of which this section further discusses below, the general insolvency provisions of the InsO govern the insolvency procedure over a bank's assets.[496] This means, for example, that under section 1 InsO the primary objective of such a procedure is the collective satisfaction of the creditors by the liquidation of the debtor's assets and distribution of the proceeds or by rescuing the company as a going concern. Section 46b KWG, which the literature considers a *lex specialis* to the InsO,[497]

492 Explanatory Notes to the Draft Intervention Act (*Kamerstukken II* 2011/12, 33059, no. 3), p. 2.
493 Article 30(2) SRM Regulation.
494 Article 18(1) SRM Regulation.
495 Sections 212ha and 212hga Fw.
496 *Cf.* Bauer & Hidler 2015, p. 252, who note that 'im KWG [verbleibt, LJ] […] ein besonderes Bankeninsolvenzrecht, welches durch die allgemeine Insolvenzordnung (InsO), die auch im Bankensektor Geltung beansprucht, abgerundet wird und einen abschließenden Rahmen um die speziellen sanierungs- und abwicklungsrechtlichen Gesetzeswerke bildet.' and Weber 2009, p. 632, who notes that '[m]it dem insolvenzantrag enden die Besonderheiten einer Bankeninsolvenz. Die Eröffnung des Verfahrens und deren weiterer Verlauf richtet sich nach dem algemeinen Bestimmungen der InsO.' *See also* Explanatory Notes to the German Draft SAG (Gesetzentwurf der Bundesregierung, BRRD-Umsetzungsgesetz, Deutscher Bundestag, Drucksache 18/2575, 22 September 2014), p. 181, noting that '[n] ach der Anwendung eines Abwicklungsinstruments ist der Weg für den Beginn eines Insolvenzverfahrens in Bezug auf das in Abwicklung befindliche Institut frei, das ohne die „too-big-to-fail"-Problematik zur Anwendung gekommen wäre.'
497 Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 2.

provides that the BaFin has the exclusive power to request the court to order the opening of an insolvency procedure for a bank under the InsO. The rule derogates from section 13 InsO under which the debtor or creditors may file the request for a procedure. Section 46b KWG also sets out some duties the insolvency court and the insolvency trustee have in relation to the BaFin, including the duty of the trustee to inform the BaFin on an ongoing basis about the progress of the procedure. The grounds for the opening of an insolvency procedure under section 46b KWG are insolvency (*Zahlungsunfähigkeit*), over-indebtedness (Überschuldung) and imminent insolvency (*drohenden Zahlungsunfähigkeit*), which terms are further defined in the InsO.[498] In the event of imminent insolvency, the BaFin may file the request only with the consent of the bank. It is an accepted view in German literature that the request by a creditor or the bank itself on the basis of section 13 InsO is inadmissible.[499] Contrary to Dutch bank insolvency law, under German insolvency law, there is not one exclusive court to decide on the opening of an insolvency procedure for a bank.[500]

The InsO provides for all insolvency measures that can be taken, also for a bank, such as the opening of a self-administration (*Eigenverwaltung*) or insolvency plan procedure (*Insolvenzplanverfahren*).[501] Moreover, some scholars hold the view that section 46b KWG does not exclude the possibility for a bank to request the court to order the opening of such a self-administration procedure or to submit an insolvency plan to the court for a reorganization in an insolvency plan procedure.[502] Literature also indicates, however, that in practice in most cases a liquidation procedure is opened for a bank.[503]

498 *See* Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 2 and 17-24. *See also* Pannen 2010, p. 114-120.

499 Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 36; Boos/Fischer/Schulte-Mattler/Komm-KWG/CRR-VO/ Lindemann 2016, Section 46b, para. 26 and 30; MünchKomm-InsO/Schmahl & Vuia 2013, Section 13, para. 55. According to Schmahl & Vuia at para. 55, the BaFin can confirm a request made by a creditor or the debtor. *Contra* Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 36.

500 *Cf.* Sections 2-3 InsO. For an overview of recent bank insolvency procedure in Germany and the competent courts, *see* Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 13.

501 Sections 218 and 270 InsO. *See* Schillig 2016, p. 448-449; Pannen 2010, p. 123.

502 Beck/Samm/Kokemoor/Skauradszun 2016, Section 46b KWG, para. 38a.

503 Schillig 2016, p. 448-449; Pannen 2010, p. 124. *See also* Binder 2005, p. 542-553, arguing at p. 544-547 that the self-administration procedure and the insolvency plan procedure are not suitable procedures for the restructuring of a bank. He claims, amongst other things, that the insolvency plan procedure is not flexible enough to facilitate rapid solutions and that the news that a self-administration procedure is opened for a bank is likely to cause panic amongst creditors.

Notwithstanding the bank-specific insolvency rule of section 46b KWG, the SAG provides that the national resolution authority files the request for an order to open an insolvency procedure over the residual entity's assets after application of the sale of business or bridge institution tool. The conditions mentioned above for the opening of such a procedure have to be met. Under the SAG, the resolution authority also files the request for an order opening a procedure over a bridge institution's assets after termination of the operations.[504] Section 46b KWG applies mutatis mutandis in such a case. Since 1 January 2018 the BaFin is the German resolution authority. The legislative history of the SAG does not clarify how the above-mentioned power of the resolution authority under sections 116(1) SAG and 128(5) SAG relates to the supervisory power of the BaFin under section 46b KWG and whether the BaFin can, for instance, also file the request for the residual entity or bridge institution on the basis of section 46b KWG. The literature assumes that the resolution authority has the exclusive power to apply to the court for an order opening an insolvency procedure if this application follows the prior use of resolution tools. Sections 116(1) and 128(5) SAG are then to be considered *leges speciales* to section 46b KWG.[505]

5.3.4 Liquidation under English bank insolvency law

In England, the UK BA 2009 provides for a bank-specific administration procedure and bank-specific insolvency procedure. It stipulates that the term 'normal insolvency proceedings' used in the Act has the meaning given by the BRRD 'and, in particular, includes the bank insolvency procedure and the bank administration procedure.'[506] Both procedures are based on and exist in parallel with the general administration and winding-up procedures out-of-court and by court order under the IA 1986 and the IR 2016.[507] The bank itself, the directors, one or more creditors, and the competent supervisory authority may apply for a general administration or winding-up order.[508]

Unlike the insolvency procedures for banks under Dutch and German law, a bank insolvency procedure governed by the BA 2009 is a modified procedure in which the bank liquidator has a special primary, statutory objective. This objective is to work with the UK deposit guarantee scheme, i.e., the Financial Services Compensation Scheme, to ensure that the depositors have access to their accounts, either through a transfer of the accounts to

504 Sections 116(1) SAG and 128(5) SAG.
505 Bauer & Hidler 2015, p. 261.
506 Sections 8ZA(5), 12AA(2) and 81ZBA(9) BA 2009.
507 *See* Singh et al 2016, para. 7.10
508 Section 124 IA 1986 and Schedule B1 to the IA 1986, para. 12; Section 359 and 367 FSMA 2000. *See* Schillig 2016, p. 391-392, 440-441.

another institution or payments from the deposit guarantee scheme. This objective is given priority over the objective to wind up the affairs of the bank to achieve the best result for the bank's creditors as a whole,[509] which the literature considers the primary objective of general English insolvency law.[510] For example, although it may be in the interests of the creditors as a whole to reduce costs by closing down the operations of the failing bank, it seems that a liquidator in a bank insolvency procedure may be required to keep a part of the banking business open and retain the employees to assist the deposit guarantee scheme.[511] The bank insolvency procedure under the BA 2009 takes precedence over other insolvency procedures.[512] The BoE as resolution authority, the competent supervisory authority, and the Secretary of State may apply for a bank insolvency order by the court on different grounds.[513] For example, the former may do so if (1) it has been informed by the supervisory authority that the bank is failing or likely to fail, and that (2) it is satisfied that the failure cannot be averted, (3) the bank has depositors and (4) either the bank is unable, or likely to become unable, to pay its debt or the winding up is considered to be 'fair'.[514] These grounds contrast with the primary ground for a winding-up order for most corporate debtors other than banks under the IA 1986, which is that 'the company is unable to pay its debt'.[515] Besides a possible role in the initiation of the bank insolvency procedure under the BA 2009, the BoE is involved in the procedure as it nominates members for the liquidation committee, which is informed by and can make recommendations to the bank liquidator.[516]

Contrary to the approach followed by Dutch and German bank insolvency law, after a partial transfer of assets, rights, and liabilities to a private sector purchaser or a bridge institution, a bank administration rather than a winding-up procedure is opened for the residual entity under the BA 2009.[517] According to the literature, it would appear that the bank administration procedure may result in a reorganization of this entity, even though the BRRD requires that such a company is wound-up.[518] A bank administration procedure can also be opened following the application of the asset

509 Section 99 BA 2009. *See* Singh et al 2016, para. 7.62
510 *See* paragraph 4.2.3 of this chapter.
511 *See* The City of London Law Society, Response to consultation document dated July 2008 entitled 'Financial Stability and Depositor Protection: Special Resolution Regime', September 2008, schedule 1, para. 4.2.
512 Section 120(1)-(8) BA 2009. *See* Schillig 2016, p. 440.
513 Sections 95-96 BA 2009.
514 Sections 7 and 96(1)-(2) BA 2009. Section 93(8) BA 2009 provides that the term 'fair' has the same meaning as the term 'just and equitable' under general insolvency law. *See* Schillig 2016, p. 441-442, 445-446. *Cf.* Section 122(1)(g) IA 1986.
515 Section 122(1)(f) IA 1986.
516 Sections 100 and 102 BA 2009.
517 Section 136(2)(a) BA 2009.
518 Schillig 2016, p. 405.

separation tool so that the residual entity is placed in administration.[519] For example, following the application of the bridge institution tool, the resolution authority may prefer to place the assets that are used to provide services to the bridge institution in an asset management vehicle. It may do so because the assets may later be required by the bridge institution and have to be separated for that purpose.[520] The resolution authority plays a central role in the bank administration procedure, not only during but also after the initiation phase.[521] Only the BoE can apply to the court for a bank administration order appointing an administrator if the residual entity is unable or is likely to become unable to pay its debts as a result of the transfer.[522] Moreover, the BA 2009 explicitly provides that the bank administrator is 'able and required', as the primary, statutory objective, to ensure the supply to the transferee of services and facilities to enable it operating successfully.[523] Only if the BoE considers that this objective has been achieved, the objectives that are pursued in a 'normal administration'[524] procedure come into play,[525] i.e., to rescue the entity as a going concern or to achieve a better result for the creditors than under a liquidation without administration.[526] Other modifications to the normal administration procedure under the IA 1986 include that when is pursued, the bank administrator may only make distributions to creditors with the BoE's consent.[527]

6 Conclusions

This chapter investigated the objectives, principles, and rules of the national legal frameworks on the transfer tools established by the BRRD and SRM Regulation. Resolution authorities have the transfer tools at their disposal to transfer shares or assets, rights, and liabilities in a resolution procedure to a private sector purchaser, a bridge institution or an asset management vehicle. The paragraphs paid particular attention to the question of how the legal frameworks on the transfer tools currently interact with and how they have been embedded into private law at the national levels. The sections below summarize the main conclusions of the chapter.

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519 Section 136(2)(a) BA 2009.
520 *See* The City of London Law Society, Joint response of the Financial Law Committee and the Insolvency Law Committee of the CLLS and the Banking Reform Working Group of the Law Society of England & Wales to the HMT consultation paper on the transposition of the Bank Recovery and Resolution Directive, October 2014, para. 8.2.
521 *See* Singh et al 2016, para. 7.21.
522 Sections 136(2) and 141-143 BA 2009.
523 Sections 136(2)(c) and 138 BA 2009.
524 *Cf.* the heading of Section 140 BA 2009.
525 *See* Singh et al 2016, para. 7.27.
526 Section 140 BA 2009.
527 Section 145(3) and Table 1 of applied provisions in the BA 2009; Schedule B1 to the IA 1986, para. 57.

6.1 Do the rules on the transfer tools and national general insolvency law share objectives?

The rules on the transfer tools and Dutch, German, and English insolvency law share objectives but only to a limited extent. The resolution rules and national general insolvency law recognize that besides a restructuring of a debtor's business with the existing legal entity, a going concern sale of a part of the debtor's business *en bloc* to an external party can be an alternative to a piecemeal sale of the debtor's assets in liquidation. Differences exist between the Dutch, German, and English general insolvency laws as to the extent societal interests can affect the course of an insolvency procedure. Nevertheless, the primary objective of Dutch, German, and English general insolvency law is considered the collective satisfaction of the creditors. Maximizing the returns to creditors and shareholders may also play a role in the application of the transfer tools. The resolution rules require the authorities, inter alia, to market the shares or assets, rights, and liabilities that they intend to transfer to obtain the best possible sale price and to realize sales to a private sector purchaser on commercial terms. Any proceeds have to benefit the creditors and shareholders directly or indirectly. However, the primary objectives in a resolution procedure are the resolution objectives. These objectives include the objectives to avoid significant adverse effects on the financial system and to ensure the continuity of critical functions of the bank under resolution. The fact that the resolution objectives are the primary objectives does not entail that a resolution authority does not consider the objectives of insolvency law in its assessment of how shareholders and creditors should be treated. The no creditor worse off-principle ensures that the claims of shareholders and creditors are satisfied up to at least the level that they would have been satisfied in a liquidation procedure under insolvency law.

6.2 How did the national legislatures ensure that the transfers ordered by a resolution authority have an immediate effect? How do the effect and scope of the application of the transfer tools relate to other types of acquisition of assets, rights, and liabilities or shares under national private law?

Under Dutch, German, and English law, the application of a transfer tool is a legal instrument whereby shares or assets, rights, and liabilities are acquired as a whole and *uno actu* by one or more legal entities. The resolution authority specifies in its decision which shares or assets, rights, and liabilities pass to the other party. To offer resolution authorities flexibility in the implementation of the measures, several procedural requirements that would otherwise apply to the measures do not apply if transfer tools are used, such as approval and notification requirements. The Dutch legislature provided that the application of the transfer tools results in acquisition under universal title under section 3:80 BW. To this end, the effect and scope of the application of the transfer tools can be comparable to the effect and

scope of a merger or division of a company under book 2 of the BW. The English legal framework on the transfer tools, by contrast, forms a framework separated from the legal framework normally applicable to a merger or division of a company. According to the German legislature, the resolution authority's decision on the application of the transfer tools under the SAG results in a transfer *sui generis*.

6.3 In case of a partial transfer of assets, rights, and liabilities, how do the resolution rules protect security rights under a security arrangement and set-off or netting rights under a set-off or netting arrangement respectively? Would creditors also benefit from these rights if an insolvency procedure is opened under national insolvency law? Do other areas of national private law also offer protection against a loss of these rights in case of a partial transfer in a resolution procedure?

The bank resolution rules require the resolution authorities to protect six types of arrangements, including security arrangements and set-off and netting arrangements, and the counterparties to these arrangements against a loss of the rights arising from the arrangements. The safeguards apply if the authorities transfer a part of the assets, rights, and liabilities of a bank under resolution and if they cancel or modify the terms of the contracts of a bank under resolution. The safeguards have a strong link with national general insolvency law because the resolution rules allow the resolution authorities to protect all arrangements under which creditors would benefit from their rights if an insolvency procedure is opened. In principle, under both Dutch and German insolvency law set-off positions gained before insolvency are not affected and netting rights are enforceable to the extent they remain within the boundaries created by the Fw or InsO, respectively. Under English insolvency law, insolvency set-off is mandatory and operates automatically. Contractual netting on insolvency is enforceable as long as it does not violate the anti-deprivation rules and does not give better rights than the provisions on insolvency set-off. Creditors with propriety security rights enjoy insolvency-specific privileges under Dutch, German, and English insolvency law. It has also been shown that Dutch, German, and English contract and property law cannot offer counterparties the same protection of their set-off, netting and security rights as the bank resolution rules do in a resolution procedure. The protection provided by the bank resolution rules in a partial transfer is broader.

6.4 What is considered a 'normal insolvency proceeding' for a bank under national insolvency law? Which role does the national resolution authority play in the opening of such a procedure?

The liquidation of a transferor or transferee as required by the bank resolution rules is largely left to existing national insolvency law. 'Normal insolvency proceedings' are the procedures for a bank that are considered

'normal' under national insolvency law as compared to a resolution procedure. Dutch, German, and English law have different approaches as to what is regarded a 'normal insolvency proceeding' for a bank, what the grounds are for the opening of such a procedure, and what the role is of the national resolution authority. For example, under Dutch insolvency law, the bankruptcy procedure under the bank-specific chapter 11AA Fw should be considered the 'normal insolvency proceeding'. In Germany, at least in theory, all general insolvency procedures under general insolvency law can be used for banks. English bank insolvency law, by contrast, provides for four types of insolvency procedures for a bank: the bank insolvency procedure and the bank administration procedure under the BA 2009, and the general administration and winding-up procedures under the IA 1986. When implementing the bank resolution rules, the Dutch and German legislatures both introduced the provision that the national resolution authority petitions the court to order the opening of an insolvency procedure for a bank under national law. The BaFin in its capacity as resolution authority does so following the application of resolution tools, such as a procedure over the assets of a residual entity or bridge institution, and DNB for all bank insolvency procedures under the Fw. The BoE as resolution authority now plays a central role in the bank insolvency procedure and bank administration procedure under the BA 2009, not only in the initiation phase but also during the procedure.

Part III

European bank resolution law

7 Bank resolution frameworks and national and supranational coherence

1 Introduction

The first chapter of the present study asked the question of how the bank resolution frameworks established by the BRRD and SRM Regulation currently relate to national private law.

Against that background, chapter 2 examined why a special legal framework to deal with failing banks is considered crucial. It concluded that it is the widely accepted view in the EU that the importance of both protecting financial stability and strengthening market discipline require special bank insolvency rules that deviate from rules of general insolvency law and other areas of private law. The European Commission, for example, pointed out in 2012 that:

> 'Special bank resolution tools (e.g. sale of business, asset separation, bridge banks), applied outside of judicial insolvency proceedings, would enable timely intervention, the maintenance of key banking services and the protection of depositors. Debt write-down and conversion would protect taxpayers' money even in the case of large and complex institutions. Changes in company law would ensure legal certainty for stakeholders. This part aims to put the burden on bank shareholders and debt holders instead of taxpayers and at the same time maintain financial stability and discourage moral hazard.'[1]

Chapter 3 then provided a historical overview of the development of bank insolvency rules in the Netherlands, Germany, and England and showed that over the years, banks acquired a more special position within national law. National, formal prudential supervisory frameworks were created first, although in different periods. Later also some special rules for bank failures were adopted. In response to national bank failures during the latest global financial crisis, the three countries introduced their own bank resolution frameworks.

1 Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 60.

Nevertheless, it is generally acknowledged that having a national bank resolution framework in place in each national legal system is 'not enough'. The national frameworks 'must be compatible at a minimum and mutually supportive at their best.'[2] It has been shown that the BRRD introduced a harmonized set of bank resolution tools and powers to enable resolution authorities in the EU to intervene in banks that are deemed to be failing or likely to fail. Also, it requires cooperation and coordination across borders. Under the SRM Regulation, a resolution authority at the EU level, i.e., the SRB, decides on the resolution of significant and cross-border operating banks in the SRM participating Member States.[3]

Chapters 2 and 4 also discussed that the BRRD and SRM Regulation aim to remove the implicit guarantees of government support to failing banks in the EU.[4] The price of bank debt should, as a result, be more sensitive to the actual risks banks face rather than reflect the expected government subsidy.[5] However, it is argued that market participants can only price the bank capital and debt instruments based on the actual default probability if they know what to expect.[6] It is important, therefore, that the national legislatures seek to adequately incorporate the EU bank resolution framework into their national legal orders to ensure that the interpretation and application of the bank insolvency rules are clear and predictable. Clarity and predictability in cross-border bank resolution procedures benefit in many cases from the greater convergence of national bank resolution regimes. Accordingly, at the EU level, potential differences in the interpretation and application of the resolution rules across jurisdictions have to be considered in the further development of the EU bank insolvency framework.[7]

To explore how the EU legislation in the field of bank resolution has been aligned with national private law and which differences may arise in bank resolution procedures across countries, chapters 5 and 6 analyzed several examples of relations between the existing bank resolution frameworks and Dutch, German, and English private law.

This chapter concludes the present study.[8] Paragraph 2 applies the national coherence theory that was developed in chapter 4 to the results of the

2 Hüpkes 2010, p. 219. *Cf.* Recitals 9-10 BRRD; Recital 10 SRM Regulation.
3 *See* paragraph 3.2.2 of chapter 2.
4 Tröger 2018, p. 36 and 41; Paterson 2017, p. 619 and *see* paragraph 3.2.1 of chapter 2 and paragraph 2 of chapter 4.
5 Tröger 2018, p. 36 and 41; Paterson 2017, p. 619.
6 Tröger 2018, p. 37, 41 and 45-46; Paterson 2017, p. 619.
7 *See* paragraphs 1 and 2 of chapter 4.
8 Since the outcomes of the Brexit are highly uncertain at the moment of finalizing this dissertation, which is August 2018, the options for the EU to agree with the UK, and vice versa, on legislation or soft law in the field of bank insolvency law are not considered here.

analysis in chapters 5 and 6 to investigate how the bank resolution rules, principles, and objectives relate to national private law. It discusses that the developments in the field of EU bank insolvency law entail that national bank insolvency law has been and will be increasingly governed by EU legislation. The EU legislation on bank insolvency deals with specific topics and objectives and contains rules and terminology that are entirely different from that in the existing national legislation, such as general insolvency law. Indeed, section 2.1 shows that the bank resolution frameworks provide for objectives and rules that explicitly depart from these in private law. Thus, moderate coherent connections with national private law exist. While the bank resolution frameworks may appear to be a fundamental shift from national private law, section 2.2 highlights that the bank resolution frameworks also seek to mirror some key private law rules and consider corporate restructuring and insolvency law practices.[9] Thus, the BRRD and SRM Regulation have created specialist legal frameworks for bank failures that diverge from but also incorporate certain parts of national private law, especially insolvency law.[10] The legislatures of the Member States are faced at the moment and will also be charged in the future with the difficult task of aligning their national legal orders with the quickly expanding EU legal framework on bank insolvency to ensure that their bank insolvency laws can continue to procedure clear and predictable outcomes. Section 2.3 argues that to contribute to the desirable clarity and predictability, the national legislatures should at least seek to solve the incoherent relations resulting from inconsistencies in the relations of their bank insolvency regime with existing rules of private law.

Paragraph 3 subsequently examines which potential differences can be put on the table in the debate about the closer harmonization of the EU bank insolvency framework (section 3.1). It also analyzes existing proposals for the harmonization of specific parts of national bank insolvency law (section 3.2). The sections maintain that the results of the analysis in chapters 5 and 6 suggest that differences currently may arise in the EU in the interpretation and application of the bank resolution rules. The EU Member States are left discretion in the field of substantive insolvency law, as has been observed by other scholars and policymakers. However, the investigated parts of the bank resolution frameworks suggest that divergences in bank resolution procedures may also be created by different national approaches and procedures to apply the harmonized bank resolution rules, which approaches and procedures are not directly related to insolvency law. Therefore, in the discussions about the further development of the EU bank insolvency framework, we may also need to consider the current implementations of

9 *Cf.* Massman 2015, p. 631 and 644; Baird & Morrison 2011, p. 287 and 300, who make the similar claim that the resolution regime in the US Dodd-Frank Act implements several traditional bankruptcy practices, rules, and principles.

10 *Cf.* Massman 2015, p. 631 and 644; Baird & Morrison 2011, p. 287 and 300.

the bank resolution framework and their effect on supranational coherence in the bank resolution procedures.

2. National coherence

2.1 Explicit departure from national private law

The bank resolution frameworks contain major deviations from national private law, especially insolvency law. They are designed to deal with the peculiarities of a bank failure when compared to a more traditional business failure.[11] Insolvency law is traditionally mainly directed towards the interests of the creditors of the insolvent debtor. By contrast, the bank resolution rules provide for a procedure to protect financial stability, such as by securing the failing bank's role in payment systems and its deposit-taking functions. To this end, they grant all powers over the resolution process to an administrative resolution authority with the aim to facilitate immediate and firm action. The key differences with national private law are evident from the resolution objectives set out in the BRRD and SRM Regulation and the resolution rules that explicitly depart from national private law. We will examine these resolution objectives and rules in turn. Because these rules explicitly derogate from national private law, their relations with domestic private law are considered moderate coherent.

2.1.1 Objectives of the transfer tools and national insolvency law

Chapter 6 showed that the bank resolution rules on the transfer tools and Dutch, German, and English insolvency law demonstrate only a limited unity in objectives.[12] It discussed that in insolvency procedures under Dutch, German, and English insolvency law, the objective of maximizing the returns to the creditors is considered the primary objective. In the three investigated jurisdictions, going concern sales of the business of a corporate debtor or a part thereof form a well-established practice as an alternative to piecemeal liquidation. The sales are often negotiated and concluded before the opening of the formal insolvency procedure, which practice is known as pre-packs. It is undisputed in the literature that these going concern sales allow viable parts of the business to be continued and that societal interests may be served. Moreover, Dutch case law leaves some room for a bankruptcy trustee to consider other interests than the financial interests of the joint creditors in a bankruptcy procedure. Nonetheless, according to the Dutch, German, and English doctrine, the sales in insolvency procedures should be primarily aimed at serving the financial interests of the joint creditors.

11 *Cf*. Massman 2015, p. 644.
12 Paragraph 4 of chapater 6.

When a resolution authority applies the transfer tools in a bank resolution procedure under the BRRD and SRM Regulation, it may need to consider how to obtain the best possible proceeds. For example, the BRRD requires the resolution authorities to market the shares or assets, rights, and liabilities of the bank under resolution and to try to sell them for a high price if the sale of business tool is applied. The sale of a bridge institution or sale of its assets, rights, and liabilities has to take place on commercial terms. Furthermore, the resolution authorities can establish an asset management vehicle to maximize the value of the transferred assets through a sale or orderly wind down. Hence, the rules on the transfer tools share with the national insolvency laws a value maximization objective. After a transfer of assets, rights, and liabilities with one of the three transfer tools, any consideration paid is to benefit the entity under resolution, and hence indirectly the creditors and shareholders that were left behind with this entity. If the sale of business tool or bridge institution tool is applied by transferring shares, the resolution authorities have to distribute any proceeds amongst the former owners of the shares.

Nevertheless, obtaining the best possible proceeds is not the primary objective in a bank resolution procedure. The bank resolution rules have five more important objectives. The five primary objectives in a resolution procedure are: to ensure the continuity of critical functions of the bank; to avoid significant adverse effects on the financial system; to protect public funds; to protect covered depositors and investors; and to protect client funds and client assets. These resolution objectives are of equal importance. The resolution authorities may, for instance, agree on a sale without openly marketing the shares or business of the bank and arrange a sale for a low price if the resolution objectives so require.

At the same time, the resolution rules do not put fully aside the objectives of Dutch, German, and English insolvency law. The no creditor worse off-principle requires a resolution authority to compare the position of creditors and shareholders in resolution with the position of these stakeholders in a hypothetical insolvency procedure for the bank and to ensure that the creditors and shareholders are not made worse off. Accordingly, the authority – or at least the valuer whom it appoints – has to consider the objectives of insolvency law in its assessment of how shareholders and creditors should be treated in a resolution procedure. Under Dutch and German insolvency law, the collective satisfaction of the creditors' claims is the primary objective in an insolvency procedure for a bank. In the bank-specific insolvency procedure under the UK BA 2009, a liquidator is also required to pursue the objective of achieving the best result for the bank's creditors. He must do so if its primary statutory objective is achieved, which is ensuring that either the deposit portfolio of the bank is transferred to another bank or depositors receive payments from the deposit guarantee scheme.

2.1.2 *Explicit departure from rules of national private law*

The bank resolution rules provide for many explicit derogations from the rules of national private law. These deviations aim to ensure, amongst other things, that a resolution procedure can operate quickly to promote financial stability and that certain groups of creditors are offered protection in the resolution process. We will consider a few examples.

To secure that the resolution measures can be implemented in a very short period, the BRRD and SRM Regulation explicitly require the Member States to remove procedural impediments to the exercise of the resolution tools and powers stemming from articles of association, contract, and law, including company law.[13] Under the laws of the investigated jurisdictions, the bank resolution tools and powers are exercised on the basis of a decision by the national resolution authority.[14] As a result, any reduction, conversion or cancellation in the application of the bail-in mechanism is immediately binding on the bank and affected creditors and shareholders,[15] unless the decision of the resolution authority provides otherwise.[16] The resolution authorities are, in principle, not subject to requirements to obtain consent or approval from any person, to publish a notice or prospectus, or to file or register a document with an authority.[17] This requirement entails, for instance, that approval of the general meeting of shareholders under company law is not necessary for amendments to the articles of association of the bank under resolution, and that the resolution authorities can modify the terms of a contract to which a bank under resolution is a party without the consent of the counterparty as would normally be required under private law.[18] An exception is that the consent of the purchaser is required if the sale of business tool is applied.[19]

Accordingly, the national bank resolution frameworks give far-reaching powers to the resolution authorities. The UK BA 2009 established a new legal framework that gives the BoE flexibility to transfer property, rights, and liabilities or securities to another legal entity and decide what the effects

13 Articles 38(1), 40(1), 42(1), 54 and 63(2) BRRD and *see* paragraph 5.2.1 of chapter 5 and paragraph 3 of chapter 6.

14 *Cf.* Section 3a:6 Wft; sections 99(4) and 136-137 SAG; sections 12A and 48B BA 2009.

15 Article 53(1) BRRD.

16 *Cf.* Section 3a:6(4) Wft.

17 Article 63(2) BRRD.

18 De Nederlandsche Bank, 'Operation of the bail-in tool', December 2017, p. 16; Explanatory Notes to the Draft BRRD Implementation Act (*Kamerstukken II* 2014/15, 34208, no. 3), p. 80.

19 Article 38(1) BRRD. *See also* articles 81-84 BRRD, which provide for some procedural obligations, including the requirement that a resolution authority notifies certain authorities when a resolution procedure is opened for a bank.

of such a transfer are.[20] A resolution instrument of the BoE may provide, for example, that in certain contracts the transferee is to be treated as the same person as the transferor, that the responsibility for the compliance with a license is divided between the transferee and transferor, and that a banking license is discontinued. In contrast to Dutch and German law, under English law, the concept of universal succession does not exist. While a transfer of assets, rights, and liabilities or shares of a company under English private law is typically effected on the basis of an agreement or on the basis of a scheme of arrangement to be sanctioned by a court, a transfer by virtue of a resolution instrument takes effect by operation of law. Hence, in the interest of speed in the resolution process, the transfers under the BA 2009 derogate from transfers under English private law, which traditionally attaches great value to private autonomy.

The national laws also grant the resolution authorities special powers in the context of the insolvency procedures which are applicable, for example, to the business of a residual entity following the application of the sale of business tool and a bridge institution following the application of the bridge institution tool.[21] For instance, under national general insolvency law, insolvency procedures are typically opened at the request of one or more creditors or the debtor. Chapter 6 concluded that, by contrast, the Fw provides that only the Dutch resolution authority, which is DNB, can request the court to order the opening of a bankruptcy procedure for a bank under the bank-specific Chapter 11AA Fw.[22] In Germany, the SAG empowers the national resolution authority, which is the BaFin, to file a request for the opening of an insolvency procedure following the application of resolution tools. In all other cases, the BaFin can initiate an insolvency procedure for a bank in its capacity as the supervisory authority under the KWG. The UK BA 2009 provides for a bank insolvency procedure, which is opened at the request of the BoE, competent supervisory authority or Secretary of State, and for a bank administration procedure. Only the BoE may apply to the court for a bank administration order. These national authorities are considered to be better suited to initiate an insolvency procedure than the creditors or the bank itself.

The resolution rules do not only aim to secure that authorities can move quickly and decisively through the resolution procedure but also to protect several types of creditors in the process. By way of illustration, it has been shown that the safeguards of the BRRD in partial transfers of assets, rights,

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20 *See* paragraph 5.1.4 of chapter 6.

21 *See* paragraph 5.3 of chapter 6.

22 Under section 212ha(3) Fw the bank can also file a request for its own bankruptcy, but in that case, the Amsterdam district court will allow the ECB or DNB, depending on the allocation of competences under Articles 4 and 6 SSM Regulation, to be heard before deciding on the request.

and liabilities for several types of arrangements, including security, set-off and netting arrangements, depart in all investigated jurisdictions from national private law.[23] In principle, a resolution authority cannot selectively choose which assets, rights, and liabilities falling within one of these types of arrangements are transferred and which stay with the residual entity. For example, it has to transfer all linked rights and liabilities within a set-off or netting arrangement or leave them all behind. Moreover, the authority may not transfer a liability of a transferor, such as a bank under resolution, without the assets against which this liability is secured, and vice versa. The safeguards aim to minimize uncertainty as to whether counterparties can still exercise their rights under such arrangements after a transfer ordered by a resolution authority. It has been shown that outside an insolvency procedure, Dutch, German, and English contract and property law do not offer set-off and netting arrangements and *in rem* security arrangements the same degree of protection against a loss of the rights under the arrangements as is offered by the bank resolution rules. Thus, these areas of private law would not prevent in all cases that the claim of a party against the bank ceases to be secured or that a party loses its set-off or netting rights under an arrangement in the event of a partial transfer of assets, rights, and liabilities.

Another example is that the German legislature included in the SAG an exception to the statutory subordination of shareholder loans under section 39 InsO.[24] A claim is not subordinated by operation of law on the basis of section 39 InsO if the creditor has also become a shareholder of the company only because of the application of the bail-in mechanism to his claim under the SAG. Hence, the provision in the SAG aims to protect the creditor by preventing the situation that he is 'hit twice' since bail-in also affects his remaining claim because it is statutorily subordinated.[25]

Furthermore, in all investigated jurisdictions the hierarchy of claims in bail-in explicitly derogates from the distributional order of priority in an insolvency procedure. Chapter 5 showed that Dutch and English law provides for a complex statutory ranking in insolvency.[26] German insolvency law recognizes four creditor groups and indirectly protects some other types of creditors, although it does not provide for a class with creditors who are formally granted preferential rights. The bail-in rules provide for a different system than national insolvency law to protect various types of claims. They follow in bail-in the national insolvency distributional order of priority and, thus, recognize that some types of claims may have a more

23 *See* paragraph 5.2 of chapter 6.
24 Section 99(5) SAG.
25 *See* paragraph 5.2.2 of chapter 5.
26 Paragraph 5.3 of chapter 5.

senior or more junior position than other types of claims. At the same time, they derogate from the system followed in an insolvency procedure by also excluding classes of liabilities from the scope of the bail-in mechanism. For instance, the bail-in rules exclude several types of debts that are granted a priority treatment under the national insolvency laws, including covered deposits. Furthermore, the resolution authorities have discretion to exclude or partially exclude other categories of liabilities in exceptional circumstances. Thus, the bank resolution rules combine the system in which some liabilities have higher priority ranking than other liabilities with a policy under which specific types of claims are carved out from bail-in.

2.2 Elements of national private law in the bank resolution frameworks

While the resolution objectives and many resolution rules depart from objectives and rules of national private law, we also concluded that other resolution rules copy or refer to private law provisions and consider corporate restructuring and insolvency law practices. Hence, the resolution frameworks do not fully set aside insolvency law and some other areas of national private law.[27] A resolution procedure may involve reorganization and liquidation. Accordingly, the economic effect of the restructuring measures in a bank resolution procedure may not be very different from the effect of a restructuring of another type of business, whether it is a restructuring within the same legal entity or through the establishment of a new one.[28] The BRRD and SRM Regulation require that in the procedure, the shareholders and creditors bear the losses, as they would do in an insolvency procedure, and that the resolution authorities apply a no creditor worse off-principle, which principle is also adhered to in corporate procedures under national law. Allocating to costs of failure to the shareholders and creditors should help to address market distortions known as moral hazard.[29]

The sections below highlight some principles in bail-in that seem to correspond to principles we already know from restructuring and insolvency law (section 2.2.1) and then give a few examples of rules of the resolution frameworks with which we are familiar because they were copied from general insolvency law (section 2.2.2). These examples of the close alignment of the bank resolution rules with national private law point to coherent connections between the bank resolution framework and private law.

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27 *Cf*. Massman 2015, p. 631 and 644; Baird & Morrison 2011, p. 287.

28 Schillig 2018, para. 3.2.

29 *See* paragraph 3.2.1 of chapter 2.

2.2.1 *Principles that look similar to those in national restructuring and insolvency law*

When we take a look at the level of the principles of the legal frameworks on bail-in, we can conclude that the bail-in rules share some important underlying principles with the investigated national corporate restructuring and insolvency laws.

In particular, it has been shown that the bail-in mechanism and a corporate restructuring or insolvency procedure can both be used to reduce the outstanding debt burden of a company through a debt write-down and conversion of claims into equity. Both seek to enable a company to continue operating and to avoid a liquidation procedure under insolvency law.[30] As discussed in chapters 2 and 5,[31] when seeking an informal financial restructuring through a contractual arrangement, whether it concerns the debt and equity of a bank or a non-financial corporate debtor, coordination issues may present itself.[32] These issues are called 'anticommons problems'. The literature on corporate restructuring procedures argues that if all involved creditors and shareholders need to agree with the financial restructuring plan, some of them may refuse to take part in the restructuring and to give their consent. They may be confident that if they hold out they have a chance to receive a larger individual stake in the pie. Accordingly, the shareholders and creditors holding out frustrate the adoption of the restructuring plan.[33] Similarly, in case of a bank failure, creditors and shareholders may hold out and prevent the implementation of a restructuring plan, confident that if the plan does not go ahead, the bank will, for instance, be bailed-out by the government. If the government does so, their equity stake or claim may be saved.[34]

Chapter 5 ascertained that the Dutch, German, and English laws that facilitate a corporate financial restructuring and the rules on the bail-in mechanism all seek to address potential hold out issues.[35] They share the underlying principle that a financial restructuring can be imposed or 'crammed down' on shareholders and creditors.[36] However, the corporate procedures differ from the bail-in mechanism as to the conditions under which such a cramdown can take place. The proposed Dutch extrajudicial plan procedure, the German insolvency plan procedure, and the English

30 Gracie 2012, p. 4-5.
31 Paragraphs 2.2.1 and 3.2.1 of chapter 2 and paragraph 2.2 of chapter 5.
32 *See* Schillig 2016, p. 61-66; De Weijs 2013; De Weijs 2012, who refers to the literature on insolvency law and property law that introduced and applied the theory of anticommons, including to Baird & Rasmussen 2010; Heller 1998.
33 De Weijs 2013, p. 210-215; De Weijs 2012, p. 74-78.
34 De Weijs 2013, p. 215-221.
35 Paragraph 4 of chapter 5.
36 *Cf.* De Weijs 2013.

scheme of arrangement, for instance, require the approval of the financial restructuring plan by a certain percentage of affected shareholders and creditors in a class or classes rather than unanimous vote, and they require a subsequent confirmation of the plan by the court. In the three procedures, the court performs an important oversight role and may refuse its confirmation if it finds that the plan does not comply with the applicable safeguards for involved shareholders and creditors.[37] The bank resolution rules have replaced both the vote of the stakeholders and the court confirmation with a 'fast-tracked'[38] administrative decision taken by resolution authorities in the public interest.[39] According to the EU legislature, an administrative authority is better suited than a court to make the necessary proactive decisions on a bank financial restructuring within a short period.[40]

The bail-in mechanism also shares another principle with the English scheme of arrangement and the draft bill for the Dutch extrajudicial plan procedure, namely that a financial restructuring can take place outside a traditional, court-centered insolvency procedure.[41] A company does have to be insolvent, and a formal insolvency procedure does not have to be opened for the use of a scheme of arrangement or extrajudicial plan procedure, or for the use of the bail-in mechanism. For a financial restructuring through an insolvency plan under German law, by contrast, the court has to open a formal insolvency procedure under the InsO. The literature argues that this may change, however, after the implementation of the proposed EU Directive on preventive restructuring frameworks.[42] According to the proposal, EU Member States have to ensure that corporate debtors in financial difficulty have access to a restructuring framework that enables them to restructure their debts or business, where there is a 'likelihood of insolvency'.[43] Accordingly, in the future German corporate financial restructuring law and the bail-in mechanism may demonstrate a stronger unity of underlying principles.

2.2.2 *Rules that incorporate national private law*

The fact that the bank resolution frameworks seek to mirror parts of insolvency law and some other areas of national private law also appears from the resolution rules. The previous chapters highlighted that some bank resolution rules look quite similar to those under national insolvency law.

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37 *Cf.* Payne 2018.
38 Ugena Torrejon 2017, p. 237.
39 *See* De Weijs 2013, p. 219-220.
40 *Cf.* Recitals 4 and 5 BRRD.
41 *See* paragraph 4 of chapter 5.
42 Madaus 2017, p. 333.
43 Article 4 Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM (2016) 723 final, 22.11.2016).

An example is the definition of the term 'liabilities' in the provisions on the PRA Rulebook on bank resolution, which is based on the definition of 'provable debts' in English insolvency law.[44]

Moreover, the German legislature copied several provisions of the InsO to clarify what are the effects of resolution action under the SAG. A provision in the SAG that closely resembles section 254a(2) InsO on the effect of an insolvency plan in an insolvency plan procedure provides what the effect of a resolution decision is.[45] The resolution decision replaces all decisions and approvals which company law requires for the ordered measures. Also, resolutions, announcements and other measures required in the preparation of the measures under company law as well as declarations of involved parties needed for the implementation of the measures under company law are deemed to have been effected in the prescribed form. Section 99(8) SAG mirrors another provision of the InsO to clarify that a reduction of a liability of a bank does not affect the rights the involved creditors may have against the debtor's co-debtor, a surety or any other party who is liable for the debtor's obligations. Equivalent to the effect of an insolvency plan, an indemnity claim of these parties against the bank is then treated as discharged to the same extent as the bank's original liability is reduced.[46] The SAG also largely copies section 254(4) InsO by providing that after conversion of claims into shares, the new shareholders are not liable for any shortfall in value (*Differenzhaftung*) because their claims were initially overvalued, which risk would otherwise exist for them under German company law.[47] Thus, in addition to being a radical departure from national private law, the resolution procedures share some basic characteristics with insolvency procedures.[48]

2.3 Further alignment with national private law

The sections above showed that the bank resolution rules have created specialist legal frameworks for bank failures that diverge from but also incorporate certain parts of national private law. As we concluded in chapter 3, special rules for bank failures are not new in the three investigated jurisdictions, but since the latest financial crisis, the adoption of such rules has gathered pace. While the three countries first established national bank resolution frameworks, the resolution regimes are now strengthened and harmonized by a constantly expanding EU legal framework. Chapter 4 discussed that EU law typically pursues political, economic, and social objectives, such as the development of the internal market, without considering

44 *See* paragraph 5.1.2 of chapter 5.
45 Section 99(4) SAG and *see* paragraph 5.2.2 of chapter 5.
46 *See* paragraph 5.1.3 of chapter 5.
47 *See* paragraph 5.2.2 of chapter 5.
48 *Cf.* Massman 2015, p. 631 and 644; Baird & Morrison 2011, p. 287 and 300.

the coherence with the law in which it has to be integrated.[49] It also showed that Dutch, German, and English scholars have expressed concerns about the challenges presented by the incorporation of EU law into national law because the specific legal concepts of EU law do not always fit very well with existing domestic law.

The question arises whether the national legislatures need to and can something to more closely align the derogating bank resolution frameworks with other areas of national law, for instance, to ensure more consistency between the effects and outcomes of bank resolution and corporate insolvency procedures.

The literature suggests two solutions. The solutions are legislative spill-over and judicial spill-over.[50] In the first case, the national legislature expands the scope of the new rules deriving from EU law to areas of national law that are not directly covered by the EU legislation. A hypothetical example to illustrate this point seems to be the introduction of transfer tools to reorganize non-financial companies under national law while pursuing public objectives that are based on the resolution objectives.[51] Broadening the scope of the transfer tools and their societal-related, primary objectives to other types of companies would ensure, at least in theory, that the reorganization of these companies can be dealt with in the same way as the resolution of banks.[52]

In the second case, a court applies rules and principles of EU law by analogy to a non-harmonized area of national law, which it can only do if the national laws leave room for such an application.[53] A hypothetical example to illustrate this option is that a court would apply the resolution rules that exclude certain types of financial obligations from bail-in to a corporate financial restructuring.[54] It may rule in a specific case, for example, that liabilities such as short-term liabilities to other companies should not be included in the financial restructuring. Such a decision would derogate from general rules on corporate debt restructuring procedures, which, in principle, do not distinguish between liabilities that need to be excluded from restructuring to protect certain interests and all other liabilities of a company. The application would broaden the influence of the bail-in rules in national law.

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49 *See* paragraph 4 of chapter 4.

50 Manko 2015, p. 16-17; Van Gerven 2006, p. 65-67. *See also* Loos 2007, p. 523-529, who calls it 'spontaneous harmonization by the legislator' and 'spontaneous harmonization by the courts'.

51 *Cf.* paragraph 4 of chapter 6.

52 *Cf.* paragraph 4 of chapter 6.

53 *Cf.* Loos 2007, p. 527-529.

54 *Cf.* paragraph 5.3 of chapter 5.

It is questionable that these two solutions are realistic solutions to better cohere the derogating bank resolution rules and their objectives with other areas of national law. Moderate coherence in national legal orders caused by EU legislation may not persuade national legislatures and courts to broaden the scope of rules contained in EU legislation. Even if they introduce rules and concepts of the bank resolution framework in another area of national law, the explicit derogations from some other fields of national law will remain in effect.[55] For example, in the Netherlands a legislative proposal for a resolution framework for insurance companies was recently submitted to the Senate. The proposed regime is based on the BRRD and also deviates from existing rules of national private law.[56] It is submitted, therefore, that the resolution frameworks will remain specialist regimes that enable authorities to deal with the particular circumstances that may surround the failure of a bank and other types of financial institutions.

Nevertheless, this dissertation did not only give examples of provisions that explicitly deviate from and provisions that incorporate national private law. The parts of the national bank resolution frameworks that were analyzed in the present study also gave a few examples of resolution rules which have an incoherent relation with national private law. Their private-law effect is unclear because they do not have a logically valid relation with private law. As we saw above, the bank resolution frameworks should enable market participants to get an accurate picture of their possible position and losses in a bank failure. Therefore, it is the present author's view that the national legislatures should at least consider how such inconsistencies in their national bank insolvency laws can be prevented or removed to contribute to the desirable clarity and predictability of bank resolution and insolvency procedures. They will remain entrusted with this challenging task since, as we will see in the next paragraph, the EU bank insolvency framework will significantly expand in the future.

For example, it has been shown that some unclarity exists in German law. The parliamentary notes to the SAG state that the decision of the resolution authority on the application of the transfer tools under the SAG results in a transfer *sui generis*. The notes do not provide how such a transfer is to be classified in private law terms. Chapter 6 assumed that the resolution decision effectuates a (partial) universal succession and that the principles as to what is the effect and scope of universal succession under the UmwG also apply to the transfers under the SAG.[57] If that is the case, such a universal succession would not create uncertainty in terms of its effect. The German legislature or case law may need to provide some clarification as to what

55 *Cf*. Hesselink 2006, p. 303-304.

56 Proposal for the Dutch Act on recovery and resolution of insurance companies (*Wet herstel en afwikkeling van verzekeraars*) (*Kamerstukken II* 2017/18, 34842, no. 2).

57 Paragraph 5.1.3 of chapter 6.

the transfer *sui generis* constitutes and how it relates to and differs from universal succession under other statutes. As explained in chapter 4,[58] such a clarification would improve the relation between the resolution rules and private law.

Moreover, some aspects of the course and effects of the procedures for the conversion of claims into equity as proposed by DNB and the BoE remain unclear.[59] To take an example, it is unclear in both papers whether the tradeable certificates/claim rights would be transferred together with the part of a liability to the creditor that is not reduced by the resolution authority and with the rights to a potential write-up at a later stage. If a certificate/right holder can sell his certificate/claim right separately from the non-reduced part of his claim against the bank, it may become unclear who is entitled to a write-up of the bailed-in claim of the creditor at a later stage. The Dutch paper does not discuss if different types of claim rights would be issued to reflect the different types of creditors in bail-in, as determined based on the distributional order of priority amongst creditors under national insolvency law. Moreover, part 3a Wft and the paper by DNB do not provide if the general, Dutch private law rule on priority substitution applies in bail-in. If the rule would apply if a pledged claim against or pledged share in the capital of the bank is bailed-in, the right of pledge may become a right of pledge on a share or compensation claim following the bail-in. An obvious answer to this problem would be that the resolution authorities devote more attention in their papers to the course and effects of the procedures. According to the Financial Stability Board in its principles on bail-in execution, the disclosure of the relevant information about the anticipated exchange mechanic by resolution authorities enhances the predictability of the procedure for market participants.[60]

3. Supranational coherence

3.1 Differences between the national bank resolution frameworks

It is generally acknowledged that EU directives do not necessarily create a uniform application and interpretation of rules. They harmonize national law on the basis of common standards but leave room for different domestic legislation, legal traditions, and terminology.[61] The selected parts of the national bank resolution frameworks that were analyzed in chapters 5 and 6 of this study show that the BRRD is not an exception. The directive leaves some room for divergent national approaches to bank resolution.

58 Paragraph 4 of chapter 4.
59 *See* paragraph 5.2.3 of chapter 5.
60 Financial Stability Board, 'Principles on bail-in execution', 21 June 2018, principle 10.
61 Saintier 2011, p. 544. *See also* Hartkamp 2012, p. 125-157. *Cf.* article 288 TFEU.

The SRM Regulation aims to enhance the uniform application of the bank resolution frameworks in the SRM participating Member States.[62] It is, as opposed to the BRRD, directly applicable in the legal orders of the Member States.[63] However, the Regulation also provides that the national resolution authorities implement the decisions taken under the Regulation based on the national legislation transposing the BRRD.[64] Hence, it does not create a unified bank resolution framework.

The results of the present study show that jurisdictions are left discretion in the design of the hierarchy of claims in resolution and insolvency and in the design of the insolvency procedures for banks. They suggest that divergences in bank resolution procedures may be created by national insolvency law as well as by different national approaches and procedures to apply the harmonized bank resolution rules that are not directly related to insolvency law. We will consider both types of differences in the sections below.

3.1.1 Divergent approaches in national insolvency law

As indicated in chapter 2, the bank resolution and bank insolvency procedures in the EU are both governed by the procedural principles established by the Winding-up Directive under which the starting point is that the law of the home Member State of the bank is the applicable law in the procedures.[65] Hence, if a banking group consists of separate legal entities (subsidiaries) in several Member States and resolution action is expected to be taken at the level of these group entities in case of failure, the resolution authorities rely on the laws of the home Member States of the legal entities, for instance, to determine the ranking of claims.[66]

Chapter 5 discussed that the hierarchy of claims in bail-in follows to a large extent the distributional order of priority in insolvency procedures under national law.[67] It showed that differences in the application of the bail-in mechanism may exist between the investigated jurisdictions because Dutch, German, and English law have their own approaches to the hierarchy of claims in insolvency and resolution. Chapter 6 subsequently ascertained that the EU Member States also have leeway to determine how an insolvency procedure for a bank under national insolvency law looks like.[68] The national bank insolvency procedures and harmonized resolution procedure

62 *Cf.* Recital 10 SRM Regulation.
63 *Cf.* Article 288 TFEU.
64 Articles 23 and 29 SRM Regulation.
65 *See* paragraphs 3.1 and 3.2.1 of chapter 2.
66 *Cf.* Article 10(2)(h) Winding-up Directive.
67 *See* paragraph 5.3 of chapter 5.
68 Paragraph 5.3 of chapter 6.

are closely related. For instance, an insolvency procedure – rather than a resolution procedure – is still the preferred choice in case of a bank failure. After application of the sale of business tool or bridge institution tool in a resolution procedure, the residual part of the bank is to be made subject to an insolvency procedure. Moreover, the no creditor worse off-principle requires the resolution authorities to compare the actual treatment of shareholders and creditors in the resolution of the bank with the position of these stakeholders in a hypothetical insolvency procedure.

The literature has argued that the existing national differences and national discretion in the field of insolvency law create uncertainty for shareholders and creditors about the possible outcomes of resolution and insolvency procedures for banks.[69] For example, the Member States are not prevented from changing their insolvency framework if a particular bank insolvency case so requires.[70] Furthermore, the heterogenous national approaches to the ranking of claims complicate for investors in bank debt the assessment of where they would stand in the hierarchy in resolution and insolvency.[71] The diverging national approaches to the ranking of claims and differences in bank insolvency procedures are also expected to make the application of the no creditor worse off-principle by a resolution authority more difficult. The assessment required by the principle is to be performed at the level of each group entity subject to resolution to take into account the national insolvency laws that would be applicable had the group entities entered insolvency procedures.[72] In particular, the principle requires the SRB at the supranational level – or at least the valuer whom it appoints – to be able to take into account the diverse national legal frameworks to determine the possible outcomes of a hypothetical insolvency procedure.[73]

The discretion that the BRRD left at the national level as regards the hierarchy of claims in bail-in and insolvency is illustrated by the fact that, in contrast to the Dutch and the English legislature, in 2017 the German legislature introduced a new class of bank debt in German law that was statutorily subordinated in resolution and insolvency to the other senior unsecured

69 International Monetary Fund, 'Euro Area Policies. Financial sector assessment program. Technical note – bank resolution and crisis management', IMF Country Report No. 18/232, p. 14; Merler 2018, p. 2 and 8-11.
70 Merler 2018, p. 2 and 8-11, who discusses that in an Italian bank insolvency case the opened liquidation procedure was an amended version of the ordinary bank liquidation procedure under national law.
71 *See* Wojcik 2016, p 125-126.
72 European Banking Authority, Single Rulebook Q&A, article 74 BRRD, Question 2015_2458, as referred to by Deslandes & Magnus 2018, p. 5. The conclusion may be different if the national insolvency regime provides for specific treatment of groups of companies.
73 Wojcik 2016, p. 125-126.

claims against banks.[74] Furthermore, chapter 5 set out that since liabilities to tax authorities are only excluded from the scope of bail-in under the BRRD if they are awarded a preferential treatment under national law, these liabilities do not fall within the scope of the bail-in mechanism under Dutch law but are bail-inable under German and English law. Article 108 BRRD does not stipulate how the priority position required by that provision for claims of depositors and deposit guarantee schemes should relate to the priority positions of claims of other preferential creditors and secured claims. In contrast to Dutch and German law, under English law covered deposits and the related claims of deposit guarantee schemes rank equally with other preferential claims in resolution and insolvency, such as the preferential claims of employees. The UK legislature also had the discretion to decide how the position of floating charges in the insolvency ranking of claims relates to the position of deposits and claims of deposit guarantee schemes in that ranking. It ultimately decided to give floating charges a more junior ranking than the deposits and claims of deposit guarantee schemes that are awarded preferential treatment under article 108 BRRD.

Chapter 6 showed that Dutch, German, and English law differ in their approaches as to what is regarded as a 'normal insolvency proceeding' for a bank, what the grounds are for the opening of such a procedure, what the role is of the resolution authority, and which objectives are pursued. For example, under Dutch insolvency law the bankruptcy procedure under the bank-specific chapter 11AA Fw is the only available insolvency procedure for a bank, whereas in Germany, at least in theory, all general insolvency procedures under the InsO can be used for banks. English law, by contrast, provides for four types of insolvency procedures for a bank: the bank insolvency procedure and the bank administration procedure under the BA 2009, and the general administration and winding-up procedures under the IA 1986.

The different procedures and the divergent objectives the insolvency trustees or administrators have to pursue in such procedures may lead to differences in terms of the preferred strategy and outcomes.[75] In the insolvency procedures under Dutch and German law, for instance, the collective satisfaction of the claims of the creditors is the primary objective, as is the case in insolvency procedures for other types of corporate debtors. In contrast to German insolvency law, Dutch case law on insolvency law leaves some room for the bankruptcy trustee to consider other interests than the financial interests of the joint creditors.[76] In the bank-specific insolvency

74 As we saw in Paragraph 5.3 of chapter 5 and is also discussed below, the relevant provisions in German law have now been amended to implement a directive that introduces a harmonized class of senior non-preferred debt.

75 *Cf.* De Groen 2018, p. 11.

76 *See* paragraphs 4.2.1 and 4.2.2 of chapter 6.

procedure under the BA 2009, a liquidator is also required to pursue the objective of achieving the best result for the bank's creditors as a whole but only if the primary statutory objective is achieved. The primary statutory objective in the procedure is ensuring that either the deposit portfolio of the bank is transferred to another bank or depositors receive payments from the deposit guarantee scheme. For example, as we saw in chapter 6, although it may be in the interests of the creditors as a whole to reduce costs by closing down the operations of the failing bank, it seems that the primary statutory objective may require a liquidator in a bank insolvency procedure to keep a part of the banking business open and retain the employees to assist the deposit guarantee scheme.[77]

Contrary to the approach followed by Dutch and German bank insolvency law, after a partial transfer of assets, rights, and liabilities to a private sector purchaser or a bridge institution, a bank administration rather than a winding-up procedure is opened for the residual entity under the BA 2009. The BA 2009 explicitly provides that the bank administrator is required, as the primary, statutory objective, to ensure the supply to the transferee of services and facilities to enable this transferee operating successfully.[78] Only if the BoE considers that this objective has been achieved, the objectives that are pursued in a 'normal administration' procedure come into play. i.e., to rescue the entity as a going concern or to achieve a better result for the creditors than under a liquidation without administration. Thus, it would appear that the bank administration procedure under the BA 2009 may result in a reorganization of this entity, even though the BRRD requires that such a company is wound-up.[79]

Another example of a possible difference relates to the fact that the conditions for the opening of a bankruptcy procedure for a bank under Chapter 11AA Fw have been aligned with the resolution conditions in the SRM Regulation. Under the Fw, the conditions are that the bank is failing or likely to fail and that no private sector measure is available to prevent the failure, which conditions are defined in the SRM Regulation. Hence, the third resolution condition in the SRM Regulation, i.e., the condition that the opening of a resolution procedure is in the public interest, must not be satisfied. Assume that the resolution authority determines in its assessment of

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77 *See* The City of London Law Society, Response to consultation document dated July 2008 entitled 'Financial Stability and Depositor Protection: Special Resolution Regime', September 2008, schedule 1, para. 4.2.

78 Such supply of services and facilities is required by articles 37(6) and 65 BRRD. *See* paragraph 3 of chapter 6. *Cf.* Sections 3a:36 and 3a:30 Wft (which provides that DNB should not request the Amsterdam district court to order the bankruptcy of the residual entity if the continuation of the entity is required for the achievement of the resolution objectives or compliance with the resolution principles) and section 80 SAG.

79 Schillig 2016, p. 405.

the resolution conditions that a resolution procedure should not be opened for a bank that is deemed to be failing or likely to fail because this public interest condition is not met. In the Netherlands, the bank is then likely to meet the conditions to be put in a bankruptcy procedure instead, although a court order is required for the opening of the procedure. In Germany, by contrast, in such a case more uncertainty may exist as to whether a court decides to open an insolvency procedure for the bank that is considered to be failing or likely to fail by the supervisory authority. The grounds for the opening of a bank insolvency procedure under German law are defined by general insolvency law. The grounds are insolvency, over-indebtedness and imminent insolvency. Accordingly, if a resolution authority determines that a bank has to be put into an insolvency procedure, this decision does not necessarily entail that an insolvency procedure is indeed opened for the bank – including a legal entity within a banking group – at the national level.[80]

3.1.2 Other types of possible divergent approaches in bank resolution

The parts of the national bank resolution frameworks which this dissertation investigated suggest that differences in the application and interpretation of the bank resolution rules may not only be caused by the different national insolvency laws. Divergences may also be created by different national approaches and procedures to apply the harmonized bank resolution rules that are not directly related to insolvency law. We need to take into account these differences as well in our debate about the closer harmonization of the EU bank insolvency framework.

One example of such divergent national approaches to apply the provisions in the BRRD which this book discussed relates to guarantees.[81] It has been shown that between the investigated jurisdictions, differences may exist as to what is the effect on guarantees under national law, including a guarantee of a group company, if the resolution authority reduces a liability of a bank. The potential inconsistencies are caused by a different effect of the national provisions that transpose article 53(3)-(4) BRRD. It is the present author's view that this article aims to ensure that if an authority reduces a bank's liability, the bailed-in (part of the) debt can no longer be collected from this bank. The article does not aim to interfere in the relationship of a creditor and another party and does not require that a claim of this creditor against the other party is also treated as discharged by operation of law.

Indeed, German law explicitly provides that the debt reduction by the resolution authority does not affect the rights the involved creditors may have against the bank's co-debtor, a surety or any other party who is liable

80 *Cf.* Deslandes & Magnus 2018, p. 17-18.
81 Paragraph 5.1.3 of chapter 5.

for the debtor's obligations. An indemnity claim of these parties against the bank is treated as discharged to the same extent as the bank's original liability is reduced. By contrast, if the bank's liabilities are bailed-in under Dutch law, national private law determines whether the discharge of the principal debt claim by operation of law results in a release of the guarantee liability. It has been shown that under Dutch law, the likely effect of the debt reduction is that a surety is then no longer liable to the creditor and a co-debtor no longer for the joint and several obligation (*hoofdelijke verbintenis*) to the extent the liability of the bank is reduced. The position of a guarantor may be different if the guarantee agreement is structured as an independent guarantee (*onafhankelijke garantie*) and the creditor beneficiary is entitled to payments on first demand and without evidence of the size of his loss. In such a case, the obligation of the guarantor is typically independent of that of the obligor and the beneficiary is entitled to receive payments in accordance with the terms of the guarantee. The UK BA 2009 seems to leave it to the discretion of the BoE to provide in its resolution instruments that a liability of the bank is, for example, canceled and what is the effect of such a cancelation on a liability of a guarantor under a related guarantee. However, similar to Dutch law, the general rule under English private law is that the surety is discharged if the principal liability is extinguished by operation of law.

Chapter 5 also highlighted that the bail-in rules may be applied differently in different Member States because divergent procedures are followed to apply the harmonized bail-in rules.[82] In particular, it showed that jurisdictions intend to use different processes for the conversion of bank debt to equity in a resolution procedure. The conversion procedure under the SAG seems to follow to a large extent the provisions of general German company and insolvency law that are normally applicable to a debt-to-equity swap. The Dutch legislature and resolution authority and the BoE have proposed their own conversion procedures in which creditors are first provided tradeable claim rights or certificates of entitlement, and they are delivered a share in the resolved bank only at a later date. It has been shown that the papers of DNB and the BoE do not address all relevant aspects of the conversion procedures. To take an example, the papers do not discuss if the market value of the claim rights/certificates of entitlement plays a role in the determination of the rate of conversion of debt to equity. Different outcomes of the proposed national conversion procedures may be achieved, for instance, if in some jurisdictions the market value of the claim rights of certificates is taken into account to set this conversion rate.

82 Paragraph 5.2 of chapter 5.

3.2 Further alignment of the national bank resolution frameworks

When the European Commission presented its proposal for the BRRD, it explicitly stated that insolvency procedures fell outside the scope of the harmonization efforts. A coordination framework for bank resolution was regarded the first necessary step at that moment. '[T]he need for further harmonisation of bank insolvency regimes, with the possible aim of resolving and liquidating banks under the same procedural and substantive rules', including the introduction of 'administrative liquidation proceedings for banks to facilitate a faster and more orderly liquidation than the standard court-based procedure' was seen as a project for the longer term.[83] Even though the BRRD eventually did harmonize a small part of national insolvency law, namely the position of depositors and deposit guarantee schemes in the distributional order of priority amongst creditors,[84] the Commission noted in 2012 that

> '[b]ank resolution has many ties with insolvency procedures (e.g. bridge banks, debt write down). Liquidation under judicial insolvency procedure is not discussed in this impact assessment, as the current proposal does not aim to change insolvency procedures and legislation in the EU.'[85]

The harmonization of substantive insolvency law in the EU has always been considered a politically highly sensitive matter.[86] Insolvency laws are strongly intertwined with other areas of national legislation and are deeply rooted in domestic legal traditions.[87] Fletcher and Wessels note in that context that 'the combination of "harmonisation" and "insolvency law" in

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83 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the European Court of Justice and the European Central Bank, 'An EU Framework for Cross-Border Crisis Management in the Banking Sector' (COM(2010) 579 final), p. 16.

84 Article 108 BRRD.

85 Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM(2012) 280 final, 6.6.2012), p. 62.

86 Mucciarelli 2013, p. 178 and 196-199.

87 *See* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the European Court of Justice and the European Central Bank, 'An EU Framework for Cross-Border Crisis Management in the Banking Sector' (COM(2009) 561/4), p. 16, noting that '[t]he difficulty and sensitivity of such work [harmonization of insolvency laws for banks, LJ] should not be underestimated. Insolvency law is closely related to other areas of national law such as the law of property, contract and commercial law, and rules on priority may reflect social policy. Accommodating particular national concepts such as "trusts" or "floating charges" in a unified code would be complex.'

Europe was [long, LJ] regarded just as impossible as a combination of fire and water.'[88]

This approach to the scope of the harmonization efforts at the EU level now seems to have changed to a certain extent. The changed approached is illustrated by the fact that, as indicated in chapter 1 and further discussed below,[89] since the entry into force of the BRRD and SRM Regulation, academic and policy discussions have devoted much attention to need to adopt new EU legislative instruments for bank resolution. Several proposals deal with the harmonization of substantive insolvency law. According to some scholars, the current developments and legislative proposals in the field of bank insolvency law should be seen as a step towards an eventual single bank insolvency regime in the EU.[90]

Even though bank insolvency law has been and is likely to be more and more harmonized at the EU level, it is the present author's view that the EU legislature is unlikely to achieve full supranational coherence in the application and interpretation of bank insolvency law in the EU soon. Obviously, the adoption of new EU legislative instruments to unify or harmonize specific areas of bank insolvency law would not render fully compatible national provisions in other fields of law. In unified or harmonized areas of bank insolvency law, there would be a need to apply the provisions in conjunction with provisions of national law which EU law does not cover. Moreover, while the Member States may now generally be more favorably disposed towards harmonization of insolvency law, the process to closer harmonize insolvency law is still expected to be 'be complex and time-consuming'.[91] Accordingly, we may need to focus on a selection of specific parts of national insolvency law to make these areas more consistent at the EU level in the near future.

Removing all differences in bank resolution and insolvency procedures across jurisdictions may also not be necessary, for example, if the different national laws do not lead to substantial differences in the procedures that undermine the predictability of the timing and outcomes of the procedures for market participants, which concern chapter 4 examined.[92] An example can be found in chapter 6.[93] The chapter discussed that several types of arrangements, including *in rem* security arrangements, are subject to

88 Fletcher & Wessels 2012, p. 35.
89 Paragraph 1 of chapter 1.
90 Véron 2018, p. 9; Bénassy-Quéré at al. 2018, p. 6.
91 International Monetary Fund, 'Euro Area Policies. Financial sector assessment program. Technical note – bank resolution and crisis management', IMF Country Report No. 18/232, p. 22.
92 Paragraphs 1 and 2 of chapter 4.
93 Paragraph 5.2 of chapter 6.

safeguards in partial transfers of assets, rights, and liabilities in resolution procedures. It was shown that the safeguards aim to prevent that a liability of the transferor, such as the bank under resolution, is transferred without the assets against which that liability is secured, and vice versa. Significant differences exist between the *in rem* security interests under Dutch, German, and English law. Nevertheless, the effect of the safeguards for *in rem* security arrangements should be the same. The assets and secured liability or liabilities should either be transferred together or both left behind. Accordingly, the safeguards may not require more harmonization of national security rights to achieve the intended effects in a resolution procedure.

As indicated in chapter 1, the debate about the further development of the EU bank insolvency framework has already selected several parts of national law that may need to be closer harmonized. Recent academic and political discussions have called for the harmonization of the hierarchy of claims in resolution and insolvency, national collateral enforcement procedures that allow banks to recover value from secured non-performing loans, and bank insolvency procedures. We will briefly consider the developments in the mentioned three fields.

First, as discussed above,[94] a directive that amends article 108 BRRD to harmonize a small part of the hierarchy of claims under national insolvency law was adopted in December 2017 and has to be transposed into national law by 29 December 2018.[95] The directive introduces a new class of bank debt, namely so-called 'senior non-preferred debt'. The new debt class ranks in resolution and insolvency senior to regulatory capital instruments and other subordinated liabilities, and junior to other senior debt. However, since the new directive only harmonizes a small part of the hierarchy of claims in resolution and insolvency, it has now been argued that more aspects of the hierarchy have to be aligned, including the treatment of deposits.[96]

Second, in March 2018 the European Commission published a proposal for a directive that creates a common 'accelerated extrajudicial collateral enforcement procedure'.[97] The proposal was part of a package of measures

94 Paragraph 5.3.4 of chapter 5.

95 Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy (OJ L 345, 27.12.2017, p. 96–101).

96 International Monetary Fund, 'Euro Area Policies. Financial sector assessment program. Technical note – bank resolution and crisis management', IMF Country Report No. 18/232, p. 22 & 25-27.

97 Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral (14.3.2018, COM(2018) 135 final).

to reduce the level of non-preforming loans of banks in the EU.[98] Under the proposal, banks as lenders and their borrowers can contractually agree in advance on a mechanism to recover the value from a loan secured by collateral. According to the Commission, the procedures to enforce collateral under national insolvency law are often slow and differ from Member State to Member State. In the meantime, the secured loan remains on the balance sheet of the bank, which reduces the capacity of the bank to grant new loans. A harmonized collateral enforcement procedure would enable a bank as a lender to recover its money from the secured loan out of court if the borrower defaults and may stimulate cross-border lending transactions.[99] Because the proposed procedure would facilitate the removal of a secured non-performing loan[100] from a bank balance sheet, according to the present author, it is to be considered an alternative to the separation of assets into an asset management vehicle in a bank resolution procedure under the BRRD.

Finally, scholars have advocated further alignment of the insolvency procedures for banks.[101] The literature recommends that the common bank insolvency chapter within the national insolvency laws of the EU Member States contains at least provisions on the right to file an insolvency procedure for a bank, the conditions for the opening of such a procedure, the types of companies to which the chapter is applicable, the procedure itself, and the continuation of the business of the company.[102] According to another proposal, the SRB has to be equipped with an administrative liquidation tool so that it can initiate an insolvency procedure and appoint a trustee for failing banks in the SRM, and it is less dependent on the national insolvency laws and authorities to take such action.[103]

The results of the present study that were analyzed in the previous paragraphs confirm these conclusions that jurisdictions are left much discretion in the design of the hierarchy of claims in resolution and insolvency, and in the design of the insolvency procedures available for banks. It is submitted

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98 The Commission also proposed to amend the CRR to require banks to set aside funds to cover the risks associated with non-performing loans and published a blueprint that provides national authorities guidance on how to set up asset management companies to deal with non-performing loans. The proposed directive that creates a common 'accelerated extrajudicial collateral enforcement procedure' also includes measures to encourage the development of secondary markets for non-performing loans. *See* https://ec.europa.eu/info/publications/180314-proposal-non-performing-loans_en.

99 Explanatory Memorandum to the Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral (14.3.2018, COM(2018) 135 final), p. 3 and 8-10.

100 For a definition of the term 'non-performing loan', *see* paragraph 2.1 of chapter 6.

101 E.g., Merler 2018; Philippon & Salord 2017, p. 46.

102 Philippon & Salord 2017, p. 46.

103 International Monetary Fund, 'Euro Area Policies. Financial sector assessment program. Technical note – bank resolution and crisis management', IMF Country Report No. 18/232, p. 22-23.

that the EU legislature may indeed need to consider the differences in these fields in the further development of the EU bank insolvency framework. As we saw above, clear specification in legislation of the potential treatment of creditors in the bank resolution and insolvency, including transparent and predictable hierarchies of claims and bank insolvency procedures, will help market participants to better price the credit risks.[104]

New EU legislative instruments may need to be adopted to achieve the closer harmonization in these fields of bank insolvency law. Article 114 TFEU may be the appropriate legal basis for the instruments. The European Commission has used article 114 TFEU as the legal basis in its proposals for the adoption of legislative instruments to expand the EU bank insolvency framework further. For instance, it considers this provision the appropriate legal basis for the introduction of the accelerated extrajudicial collateral enforcement procedure.[105] Article 114 TFEU also provided the legal basis for the adoption of the SRM Regulation, BRRD, and directive on national bank creditor hierarchies. The provision allows the adoption of measures for the 'approximation' of national provisions 'which have as their object the establishment and functioning of the internal market'.[106] Thus, it limits its scope to the measures that contribute to the elimination of competitive distortions or obstacles to trade.[107] For example, the rationale for using article 114 TFEU as the legal basis for the BRRD was that ensuring that Member States use the same tools and procedures to resolve failing banks would eliminate distortions to competition between banks and improve the functioning of the internal market in financial services.[108]

The question arises which other types of measures can be used at the EU level to create more supranational coherence in interpretation and application of the bank insolvency laws, including in the abovementioned national approaches and procedures to apply the harmonized bank resolution rules.

In addition to the EU legislative instruments proposed by the Commission, the 'regulatory products'[109] of the EBA are likely to play an important role in achieving greater consistency in the existing EU bank insolvency framework in the future. The BRRD currently already confers specific tasks on this agency, including to develop draft regulatory and implementing

104 *Cf.* Tröger 2018, p. 45, 47 and 71.
105 Explanatory Memorandum to the Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral (14.3.2018, COM(2018) 135 final), p. 7-9.
106 *Cf.* Article 26 TFEU. *See* paragraph 5 of chapter 4.
107 Tuominen 2017, p. 1366. *See also* Moloney 2014, p. 1653-1659.
108 Tuominen 2017, p. 1369. *Cf.* Recitals 9 and 108 BRRD. *See also* paragraph 3.2.2 of chapter 2.
109 Ferran 2016, p. 294.

technical standards and to issue guidelines.[110] The technical standards further specify the content of certain provisions in the BRRD and become binding EU rules after endorsement by the European Commission under articles 290-291 TFEU.[111] They are intended to be technical, but, in practice, they often contain political and strategic decisions.[112] The standards on MREL, for example, take important decisions on the scope of regulatory criteria for the MREL framework.[113] Furthermore, several provisions in the BRRD mandate the EBA to develop guidelines with the formal objective of creating 'consistent, efficient and effective supervisory practices' and ensuring 'the common, uniform and consistent application of Union law.'[114] These guidelines include the guidelines on the treatment of shareholders in bail-in.[115] The EBA may, however, also issues guidelines and recommendations addressed to authorities and financial institutions on its own initiative.[116] Although they are not formally binding, financial institutions and authorities are expected to 'make every effort to comply'.[117] Other regulatory products the EBA produces include opinions,[118] such as its opinion addressed to the European Commission on the classes of arrangements to

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110 Recitals 114-118 BRRD. *Cf.* Article 1(2) Regulation 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12) (EBA Regulation), as amended by Regulation 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013 (OJ L 287, 29.10.2013, p. 5).

111 Articles 10-15 EBA Regulation.

112 Ferran 2016, p. 295-296; Cappiello 2015, p. 428-429.

113 Ferran 2016, p. 295-296. Article 45(2) BRRD provides that the 'EBA shall draft technical regulatory standards which specify further the assessment criteria […] on the basis of which, for each institution, a minimum requirement for own funds and eligible liabilities […] is to be determined.' It resulted in the 'Final Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU' of 3 July 2015 (EBA/RTS/2015/05), which were endorsed by the Commission as the Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities (OJ L 237, 3.9.2016, p. 1).

114 Article 16(1) EBA Regulation.

115 Article 47(6) BRRD; European Banking Authority, 'Final Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments', 5 April 2017, EBA/GL/2017/04.

116 Recital 115 BRRD; Ferran 2016, p. 298.

117 Article 16(3) EBA Regulation, which provides that if authorities decide not to comply they must give reasons for non-compliance and institutions may also be required to do so. *See* Ferran 2016, p. 298-299.

118 Articles 8(1)(a) and 34(1) EBA Regulation.

be protected in partial transfers under article 76 BRRD,[119] and the Q&A tool on its website.[120]

Accordingly, different applications of the EBA toolkit are conceivable to foster consistent transpositions of bank insolvency rules and national procedures to apply the harmonized rules. By way of example, the EBA could issue guidelines on the execution of the conversion of claims in bail-in at the national level, which execution chapter 5 analyzed. Likewise, one could consider mandating the EBA to draft technical standards on the effects of bail-in on guarantees in resolution procedures since we have seen that differences may also exist in this field. Legal practice has already called for EBA guidelines to address divergences in national implementations of another provision of the BRRD, namely article 69 BRRD on the powers of resolution authorities to temporarily suspend certain payment and delivery obligations of a bank.[121]

4 Conclusions

This chapter has applied the coherence theory that was developed in chapter 4 to the results of the analysis in chapters 5 and 6. The results of the research indicate that essential differences in the field of substantive insolvency law to which the literature and policymakers have paid attention indeed exist across jurisdictions. In particular, they confirm the conclusions of academic and policy discussions that jurisdictions are left much discretion in the design of the hierarchy of claims in resolution and insolvency and in the design of the insolvency procedures available for banks. At the same time, the parts of the bank resolution framework that were selected for the present study illustrate that other types of potential differences in bank resolution procedures may also need to be considered in the debate about the closer harmonization of the EU bank insolvency framework. Different national approaches and procedures to apply the harmonized bank resolution rules may also lead to different application and interpretation of bank resolution rules.

Moreover, the examination of how selected bank resolution rules, principles, and objectives currently interact with and how they have been embedded into existing areas of national private law signals that inconsistencies in legislation may not only exist at the supranational level. The developments in

119 European Banking Authority, Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer, EBA/Op/2015/15, 14 August 2015.

120 *See* Ferran 2016, p. 296-299 and 304; Cappiello 2015, p. 430.

121 International Swaps and Derivatives Association (ISDA), 'ISDA position paper: Challenges with expanding BRRD moratoria powers', August 2017, p. 18.

the EU bank insolvency framework entail that the national bank insolvency laws have been and will be increasingly governed by EU legislation. The EU legislation on bank insolvency deals with specific topics and objectives and contains rules and terminology that are entirely different from that in the existing national legislation. The legislatures of the Member States are faced at the moment and will also be charged in the future with the difficult task of aligning their national legal orders with a quickly expanding EU legal framework on bank insolvency. The national legislatures should seek to solve incoherent relations resulting from inconsistencies in the relations of their bank insolvency regime with existing rules of private law to contribute to the desirable clarity about and predictability of bank resolution procedures.

Samenvatting (Dutch summary)

Hoofdstuk 1: Inleiding

Tijdens de meest recente financiële crisis bleek dat autoriteiten in de Europese Unie (EU) geen adequate instrumenten hadden in te kunnen grijpen bij falende banken. De richtlijn herstel en afwikkeling van banken en beleggingsondernemingen (Bank Recovery and Resolution Directive, BRRD) en de verordening inzake een gemeenschappelijk afwikkelingsmechanisme (Single Resolution Mechanism Regulation, SRM-verordening) pogen dit tij te keren.

De BRRD biedt nationale afwikkelingsautoriteiten afwikkelingsinstrumenten en -bevoegdheden om tijdig te kunnen interveniëren in een bank om zo de continuïteit van de kritieke functies te waarborgen en het effect van het falen de bank op het financiële systeem en de economie te beperken. Andere belangrijke doelstellingen van de BRRD zijn het beperken van de kosten voor de belastingbetalers en het voorkomen van moreel risico (moral hazard). Dat laatste begrip verwijst in deze context naar risicovol gedrag van banken dat wordt gevoed door de impliciete garanties van overheden dat banken die in financiële problemen komen, de helpende hand wordt geboden. Naast het versterken van de bestaande nationale afwikkelingsmechanismen, streeft de BRRD ook naar meer coherente afwikkelingsvoorwaarden, -bevoegdheden en -procedures en het bevorderen van de samenwerking tussen nationale autoriteiten in de EU. De SRM-verordening regelt de centrale Europese besluitvorming met betrekking tot de afwikkeling van falende significante banken en grensoverschrijdend opererende banken, namelijk door de instelling van een Europese afwikkelingsraad.

De bepalingen van de BRRD en SRM-verordening staan niet op zichzelf maar worden deels ingekleurd door het nationaal privaatrecht. Zowel academici als beleidsmakers pleiten nu voor verdere harmonisatie van het nationaal privaatrecht, voornamelijk het insolventierecht, voor de afwikkeling van banken. Verdere harmonisatie van de juridische kaders voor de afwikkeling van banken zou zorgen voor minder onzekerheid voor banken en beleggers en zou toepassing van de afwikkelingsregels op grensoverschrijdend opererende banken en de samenwerking tussen autoriteiten vergemakkelijken.

In dit onderzoek staat de vraag centraal hoe de nationaal juridische kaders voor de afwikkeling van banken zich verhouden tot het nationaal privaatrecht. Daartoe worden verschillende relaties van de afwikkelingsregimes

met het Nederlands, Duits en Engels privaatrecht onderzocht. De nadruk ligt op de relatie met het insolventierecht. Enerzijds wordt bekeken of verschillen in het nationaal privaatrecht en de nationale implementaties van de afwikkelingsregels mogelijk zorgen voor verschillen in de toepassing en interpretaties van de afwikkelingsregels tussen de drie onderzochte jurisdicties (supranationale coherentie). Anderzijds gaat het proefschrift in op de coherentie van de afwikkelingsregels met nationaal privaatrecht (nationale coherentie).

Hoofdstuk 2: Europees bancair insolventierecht

Hoofdstuk 2 bespreekt allereerst enkele belangrijke doelstellingen van het insolventierecht en waarom een insolventieprocedure voor andere type ondernemingen niet altijd werkt voor een falende bank. Het toont onder andere aan dat de focus van het algemeen insolventierecht ligt op de debiteur en de belangen van de betrokken crediteuren. Door deze focus op private belangen is in insolventieprocedures niet altijd voldoende oog voor de ernstige gevolgen die een bankinsolventie kan hebben voor het financiële stelsel en de economie. Niettemin blijkt in het hoofdstuk dat het insolventierecht een belangrijke rol speelt in het juridisch kader voor de afwikkeling van banken. Zo volgt bail-in in beginsel de rangregeling in insolventie naar nationaal insolventierecht en mogen vermogensverschaffers in een afwikkelingsprocedure geen grotere verliezen lijden dan zij zouden hebben geleden in het kader van een normale insolventieprocedure ten aanzien van de bank. Het laatste beginsel is bekend als het 'no creditor worse off' beginsel en is gebaseerd op de 'best interest of creditors test' en gerelateerde beginselen uit het insolventierecht. De afwikkelingsregels beogen voor de aandeelhouders en crediteuren van de bank de economische uitkomst van een insolventieprocedure na te bootsen om zo de kosten voor de belastingbetaler zoveel mogelijk te beperken en marktdiscipline te bevorderen.

Het hoofdstuk onderzoekt ook de belangrijkste ontwikkelingen op het gebied van het bancair insolventierecht op EU-niveau vóór de inwerkingtreding van de BRRD. Het stelt vast dat vóór de meest recente financiële crisis slechts enkele regels op het gebied van het bancair insolventierecht waren geharmoniseerd. De richtlijn sanering en liquidatie van kredietinstellingen (Winding-Up Directive) voorziet sinds 2001 slechts in procedurele regels voor grensoverschrijdende reorganisatie- en liquidatieprocedures.

Het Europees kader voor de afwikkeling van banken heeft gezorgd voor verdere harmonisatie van het bancair insolventierecht. Als een bank faalt of waarschijnlijk zal falen, moet de bevoegde afwikkelingsautoriteit bepalen of een insolventieprocedure of een afwikkelingsprocedure wordt geopend. Indien wordt gekozen voor de afwikkelingsprocedure, kan de autoriteit vier afwikkelingsinstrumenten toepassen: het instrument van overgang van de onderneming, instrument van de overbruggingsinstelling, instrument

van afsplitsing van activa en passiva en het bail-in mechanisme. De SRM-verordening bepaalt dat in de Eurozone de Europese afwikkelingsraad primair verantwoordelijk is voor het vaststellen van afwikkelingsbesluiten voor significante banken en grensoverschrijdend opererende banken. Deze besluiten worden vervolgens op nationaal niveau uitgevoerd op basis van de nationale wetgeving die de BRRD implementeert.

Hoofdstuk 3: Ontwikkeling van een nationaal, bank-specifiek insolventieregime

Hoofdstuk 3 beschrijft de historische ontwikkeling van het bancair insolventierecht in Nederland, Duitsland en Engeland. Het laat zien dat banken in de loop der jaren een meer bijzondere positie hebben verworven in nationaal recht. De introductie van de afwikkelingsregels voor banken in de afgelopen jaren moet worden gezien in de context van de historische trend naar verdere uitbreiding van bank-specifieke toezicht- en insolventieregimes. Insolventies van banken in de drie jurisdicties hebben als katalysator gewerkt voor uitbreidingen van en wijzigingen in het prudentieel toezicht en bancair insolventierecht. Dit zijn niet alleen de insolventies van enkele banken gedurende de meest recente financiële crisis maar ook de faillissementen van de Nederlandse bank Teixeira de Mattos in 1966 en Duitse Herstatt Bank in 1974 en de Britse bankencrisis in de jaren 1973-1975.

Nationaal, formeel prudentiële toezichtregimes werden het eerst gecreëerd in Nederland, Duitsland en Engeland, hoewel in verschillende perioden. Een Nederlands en Duits juridisch kader voor prudentieel toezicht op banken bestaat al sinds de eerste helft van de twintigste eeuw. In Engeland gaven de ontwikkelingen gedurende de bankencrisis in 1973-1975 pas aanleiding tot de introductie van een meer formeel regime voor prudentieel toezicht. Vervolgens werden in de drie onderzochte jurisdicties ook enkele speciale regels voor bankinsolventies aangenomen, zoals de regel dat de nationale toezichthouder de rechtbank kan verzoeken een insolventieprocedure voor een bank te openen. De Nederlandse wetgever introduceerde de noodregeling als een bank-specifieke surseance van betaling in 1978 en de Duitse toezichthouder heeft sinds 1976 een moratorium tool tot zijn beschikking. In Engeland werden insolvente banken tot 2008 afgewikkeld door toepassing van het algemeen insolventierecht.

Hoofdstuk 4: Nationale en supranationale coherentie

Hoofdstuk 4 ontwikkelt twee coherentiebegrippen om in de volgende hoofdstukken enkele relaties te kunnen beoordelen tussen enerzijds de afwikkelingsregimes en anderzijds onderdelen van het Nederlands, Duits en Engels privaatrecht die rechtstreeks worden beïnvloed door of nauw verband houden met de afwikkelingsregels.

Het gehanteerde begrip van horizontale, nationale coherentie gaat uit van consistentie tussen de afwikkelingsregels en regels van nationaal privaatrecht. Consistentie betekent dat de regels logisch in elkaar passen en elkaar niet tegenspreken. Wanneer de regels inconsistent zijn, bestaat in beginsel een incoherente relatie. Wanneer echter duidelijk is aangegeven hoe de inconsistente regels zich tot elkaar verhouden, kan een matig coherente in plaats van een incoherente relatie bestaan. Op een dieper niveau van het nationale rechtssysteem vereist het coherentiebegrip dat de rechtsgebieden beginselen en doelstellingen delen.

Supranationale coherentie gaat uit van een zekere mate van uniformiteit in de interpretatie en toepassing van de afwikkelingsregels in meerdere lidstaten. Verschillen in de interpretatie of toepassing kunnen bijvoorbeeld worden veroorzaakt door uiteenlopende interpretaties of onjuiste implementaties van de Europese afwikkelingsregels. Dergelijke verschillen kunnen ook worden veroorzaakt door verschillende regels in andere rechtsgebieden en diverse juridische culturen.

Het Europees kader voor de afwikkeling van banken beoogt marktdiscipline te versterken. Volgens de literatuur betekent marktdiscipline in een efficiënte markt dat investeerders veranderingen in de financiële positie van een onderneming correct en onmiddellijk verwerken in de kosten van financiering voor de onderneming, bijvoorbeeld als de onderneming meer risicovolle investeringen doet. Het wordt voor de onderneming vervolgens duur overmatige risico's te nemen.[1] Als deze onderneming echter een bank is en de marktpartijen geloven dat de overheid de bank de helpende hand zal bieden als de bank in financiële moeilijkheden raakt, zullen de investeerders minder belang hechten aan het werkelijke risicoprofiel van de bank. De bank kan goedkoop aan financiering komen en heeft geen (of minder een) prikkel de riskante activiteiten niet te ontplooien. De afwikkelingsregels beogen bij te dragen aan marktdiscipline door de aandeelhouders en crediteuren van de bank (en zo min mogelijk de belastingbetaler) verliezen te laten dragen in een afwikkelingsprocedure. Om de risico's vervolgens te kunnen verwerken in de financieringskosten voor banken, moeten marktpartijen tijdig en met voldoende zekerheid hun mogelijke positie en verliezen in een afwikkelingsprocedure kunnen bepalen. Dit vergt dat de afwikkelingsprocedures zo transparant en voorspelbaar mogelijk worden gemaakt.[2]

Tegen deze achtergrond, betoogt dit proefschrift dat de nationale wetgevers coherentie tussen de nationale afwikkelingsregimes en het nationaal privaatrecht moeten meenemen als een van de beginselen in de verdere ont-

1 Flannery 2010, p. 378-379; Bliss & Flannery 2002.
2 Tröger 2018, p. 46.

wikkeling van de afwikkelingsregimes op nationaal niveau. De Europese wetgever dient de mogelijke verschillen in de interpretatie en toepassing van de afwikkelingsregimes tussen lidstaten mee te nemen bij de verdere ontwikkeling van het afwikkelingsregime op EU-niveau. Nationale en supranationale coherentie dragen bij aan transparantie in rechten van partijen en duidelijkheid en voorspelbaarheid van de interpretatie en toepassing van de afwikkelingsregels.

Hoofdstuk 5: Europees regime voor de afwikkeling van banken: bail-in mechanisme

Hoofstuk 5 onderzoekt vier onderwerpen die betrekking hebben op het bail-in mechanisme. Met dit mechanisme kan de afwikkelingsautoriteit kapitaalinstrumenten en passiva afschrijven en passiva omzetten in aandelen of andere kapitaalinstrumenten. In de eerste plaats wordt gekeken naar beginselen op een dieper niveau van de nationale rechtsstelsels. Vervolgens wordt aandacht besteed aan de relatie van de regels die zien op het bail-in mechanisme met regels van nationaal privaatrecht.

Een tendens in het herstructurerings- en insolventierecht in veel lidstaten in de EU de afgelopen jaren is het faciliteren van een herstructurering op basis van een akkoord dat is aangenomen door de stemmende aandeelhouders en crediteuren als een alternatief voor een liquidatieprocedure. Een voorstel voor een EU-richtlijn beoogt bovendien in alle lidstaten een juridisch raamwerk in te voeren dat een snelle en efficiënte herstructurering van ondernemingen mogelijk maakt. Nederlands, Duits en Engels recht voorzien op dit moment al in procedures waarin een akkoord dat is aangenomen door de vereiste meerderheden in een groep vermogensverschaffers kan worden opgelegd aan tegenstemmende partijen. Voor een dergelijk bindende werking is in bijna alle procedures een beslissing van de rechter nodig. Engels recht voorziet bovendien in procedures die buiten de context van een formele insolventieprocedure kunnen worden gestart, waaronder de scheme of arrangement procedure. In Nederland publiceerde de De Minister van Veiligheid en Justitie in 2017 een voorstel voor een met de scheme of arrangement vergelijkbare, zogenaamde onderhands akkoord-procedure. Het bail-in mechanisme deelt deze beginselen met de recente ontwikkelingen in het herstructurerings- en insolventierecht. Het wordt toegepast buiten het kader van een formele insolventieprocedure en bij voorkeur ook voordat de onderneming formeel insolvent is. Bovendien is het een mechanisme dat aandeelhouders en crediteuren dwingt bepaalde herstructureringsmaatregelen te aanvaarden. In die zin kan net zoals in de voorgestelde Nederlandse onderhands akkoord-procedure, de Engelse scheme of arrangement en de Duitse insolventieplan-procedure sprake zijn van een *cramdown*. In bail-in worden de vermogensverschaffers echter niet gebonden door een democratische beslissing en beslissing van een rechter maar door een bestuursrechtelijk besluit van de afwikkelingsautoriteit.

Hoofdstuk 5 bespreekt vervolgens het effect van een vermindering van de schulden van een bank in afwikkeling door een afwikkelingsautoriteit op de passiva zelf en op daarmee verband houdende garanties naar nationaal privaatrecht. Artikel 53 BRRD bepaalt dat indien een afwikkelingsautoriteit de hoofdsom of het uitstaande verschuldigde bedrag van een verplichting tot nul verlaagt, die verplichting en eventuele verplichtingen of vorderingen die daaruit voortvloeien en die niet vorderbaar waren op het moment waarop de bevoegdheid werd uitgeoefend, als voldaan worden beschouwd voor alle doeleinden. Bovendien kunnen zij niet worden ingebracht in het kader van eventueel latere procedures met betrekking tot de bank of een eventueel opvolgende entiteit bij een latere liquidatie. De bepaling suggereert dat zowel de hoofdvordering op de bank als een eventuele regresvordering van een derde als voldaan moeten worden beschouwd. Het artikel is niet duidelijk over wat het effect op een vordering van een crediteur op bijvoorbeeld een borg of hoofdelijk schuldenaar moet zijn. Uit de memorie van toelichting bij de Nederlandse bepalingen die de BRRD implementeren, kan worden opgemaakt dat naar Nederlands recht geen beroep kan worden gedaan op hoofdelijke aansprakelijkheid of borgtocht omdat de hoofdvordering niet meer bestaat. Naar Duits recht heeft bail-in van een vordering op een bank geen effect op de vordering op een hoofdelijk schuldenaar of een borg. Een eventuele regresvordering wordt in dezelfde mate verminderd als de hoofdvordering is verminderd door de afwikkelingsautoriteit. De Bank of England lijkt de bevoegdheid te hebben expliciet te bepalen wat het effect van de vermindering van passiva van een bank is. Een dergelijke bevoegdheid lijkt relevant in geval niet duidelijk is wat de gevolgen zijn voor de vordering op een garantiegever na bail-in van de hoofdvordering bij *statute*.

De BRRD bevat geen detailleerde regels voor de omzetting van vreemd vermogen in eigen vermogen. De richtlijn vereist slechts dat procedurele belemmeringen voor de omzetting in statuten, contract of de wet worden weggenomen, zoals voorkeursrechten van aandeelhouders en het vereiste dat aandeelhouders toestemming moeten geven voor een kapitaalverhoging. Het Duitse afwikkelingsregime en de bijbehorende wetsgeschiedenis suggereren dat bail-in naar Duits recht in grote mate de regels volgt van het Duits ondernemings- en insolventierecht die van toepassing zijn op een debt-to-equity-swap. De Nederlandse en Engelse afwikkelingsautoriteiten hebben papers gepubliceerd die op een hoog niveau beschrijven hoe het conversieproces eruit kan zien. De voorgestelde procedures wijken aanzienlijk af van het gebruikelijke proces voor omzetting van vreemd in eigen vermogen naar nationaal ondernemingsrecht en kunnen ook verschillen van de procedures die worden gebruikt in bail-in in andere jurisdicties. In de procedures worden de crediteuren claimrechten gegeven die kunnen worden verhandeld totdat de waarderingen van de bank zijn voltooid en de aandelen in het kapitaal van de bank aan de crediteuren kunnen worden geleverd.

De volgorde van afschrijvingen en omzettingen bij de toepassing van het bail-in mechanisme is in beginsel hetzelfde als de rangregeling in insolventie van een bank naar nationaal insolventierecht. Bovendien is het uitgangspunt dat de aandelen en vorderingen van alle vermogensverschaffers beschikbaar zijn voor bail-in. De regels die zien op het bail-in mechanisme geven echter enkele uitzonderingen, waaronder voor deposito's die worden gedekt door het depositogarantiestelsel en door zekerheid gedekte passiva. Bovendien kan de afwikkelingsautoriteit passiva geheel of gedeeltelijk uitsluiten van bail-in in een aantal situaties. De afwikkelingsregels combineren dus het systeem van het nationaal insolventierecht waarin verschillende crediteuren een andere rang in de rangregeling kan toekomen met een systeem waarin sommige crediteuren worden beschermd doordat ze zijn uitgezonderd van bail-in. Doordat de volgorde van afschrijvingen en omzettingen bij de toepassing van het bail-in mechanisme in beginsel de rangregeling in insolventie van een bank naar nationaal insolventierecht volgt, wordt de nationale wetgevers en afwikkelingsautoriteiten enige discretie gegeven in hoe bail-in precies zal worden geïmplementeerd.

Hoofdstuk 6: Europees regime voor de afwikkeling van banken: overdrachtsinstrumenten

Hoofstuk 6 onderzoekt vervolgens vier onderwerpen die betrekking hebben op de overdrachtsinstrumenten (het instrument van overgang van de onderneming, instrument van de overbruggingsinstelling en instrument van afsplitsing van activa en passiva). Met deze instrumenten kunnen de afwikkelingsautoriteiten een overdracht van aandelen of activa en passiva aan een private partij of overbruggingsinstelling bewerkstelligen. Bovendien kunnen activa en passiva worden overdragen aan een entiteit voor activa- en passiva beheer. In de eerste plaats wordt gekeken naar doelstellingen op een dieper niveau van de nationale rechtsstelsels. Vervolgens wordt aandacht besteed aan de relatie van de regels die zien op de overdrachtsinstrumenten met regels van nationaal privaatrecht.

De regels die zien op de overdrachtsinstrumenten en het Nederlands, Duits en Engels insolventierecht delen slechts in beperkte mate doelstellingen. De afwikkelingsregels en het nationale insolventierecht erkennen dat naast een herstructurering van een onderneming in de bestaande juridische entiteit, een going concern verkoop van de onderneming een alternatief kan zijn voor een *piecemeal* liquidatie. Er bestaan verschillen tussen het Nederlands, Duits en Engels insolventierecht over de mate waarin maatschappelijke belangen een rol kunnen spelen in een insolventieprocedure. Niettemin wordt het verbeteren van de totale opbrengst voor de crediteuren als groep beschouwd als het primaire doel van het Nederlands, Duits en Engels insolventierecht. Het behalen van een zo hoog mogelijke opbrengst kan ook een rol spelen bij de toepassing van de overdrachtsinstrumenten in een afwikkelingsprocedure. De BRRD bepaalt bijvoorbeeld dat een overdracht

van aandelen of activa en passiva aan een private partij plaats dient te vinden onder commerciële voorwaarden. De belangrijkste doelstellingen in een afwikkelingsprocedure zijn echter de afwikkelingsdoelstellingen, waaronder het vermijden van significant nadelige gevolgen voor het financiële stelsel. De afwikkelingsautoriteit neemt de doelstellingen van het nationale insolventierecht echter wel mee in een afwikkelingsprocedure om te bepalen hoe aandeelhouders en crediteuren moeten worden behandeld. Een belangrijk beginsel in de afwikkelingsprocedure is immers dat een vermogensverschaffer van een bank niet slechter af mag zijn dan in geval de bank zou zijn geliquideerd onder nationaal insolventierecht.

Naar Nederlands, Duits en Engels recht zorgt toepassing van een overdrachtsinstrument ervoor dat de activa, rechten en passiva of aandelen en andere eigendomsinstrumenten als een geheel en van rechtswege worden overgedragen. De afwikkelingsautoriteiten specificeren in hun besluit wat precies overgaat en zijn niet onderworpen aan procedurele vereisten zoals vereisten dat toestemming of medewerking van bepaalde partijen nodig is. Naar Nederlands recht resulteert toepassing van een overdrachtsinstrument in een verkrijging onder algemene titel in de zin van artikel 3:80 BW. Het effect kan daardoor gelijkenis vertonen met het effect van een fusie of splitsing van een onderneming in de zin van Boek 2 van het BW. Het Engelse wettelijke kader voor de overdrachtsinstrumenten vormt daarentegen een kader dat losstaat van het juridische kader dat normaal gesproken van toepassing is op een fusie of splitsing van een onderneming. Volgens de wetsgeschiedenis van het Duitse afwikkelingsregime resulteert de toepassing van een overdrachtsinstrument in een overdracht *sui generis*. Het is niet geheel duidelijk wat een dergelijke overdracht precies inhoudt.

De afwikkelingsautoriteiten dienen zes soorten overeenkomsten te beschermen in een afwikkelingsprocedure tegen een verlies van rechten die voortvloeien uit die overeenkomsten. Deze waarborg geldt indien sommige maar niet alle activa en passiva worden overgedragen en indien de voorwaarden van een overeenkomst worden gewijzigd of een ontvanger als partij wordt vervangen. De beschermde overeenkomsten zijn onder andere zekerheidsregelingen en verrekenings- en nettingovereenkomsten.

De genoemde waarborgen hebben een nauwe band met het nationaal insolventierecht. Een Gedelegeerde Verordening van de Europese Commissie specificeert welke overeenkomsten precies in aanmerking komen voor de bescherming in een afwikkelingsprocedure. De Verordening bepaalt echter ook dat de afwikkelingsautoriteiten alle overeenkomsten mogen beschermen op grond waarvan schuldeisers nog steeds de uit de overeenkomst voortvloeiende rechten zouden genieten als een insolventieprocedure wordt geopend. Dit geldt met name voor zekerheidsovereenkomsten en verrekenings- en nettingovereenkomsten die op grond van het nationaal insolventierecht zijn beschermd. In principe worden zowel in het Nederlands als in

het Duits insolventierecht verrekeningsposities verkregen vóór insolventie niet aangetast en zijn bevoegdheden tot netting afdwingbaar voor zover ze binnen de grenzen blijven die zijn gecreëerd door respectievelijk het Nederlands en het Duits insolventierecht. Volgens het Engels insolventierecht is verrekening in insolventie verplicht en werkt het automatisch. Contractuele netting in insolventie is afdwingbaar zolang het *anti deprivation* beginsel niet wordt geschonden en het geen betere rechten geeft dan het insolventierecht. Schuldeisers met zekerheidsrechten genieten bescherming onder Nederlands, Duits en Engels insolventierecht.

Vervolgens bespreekt de paragraaf of nationaal contracten- en goederenrecht de zekerheidsovereenkomsten en verrekenings- en nettingovereenkomsten dezelfde mate van bescherming zou kunnen bieden als de afwikkelingsregels in geval van een gedeeltelijke overdracht van activa en passiva. Geconcludeerd wordt dat de bescherming die de afwikkelingsregels bieden aan gesecureerde crediteuren en crediteuren met verrekenings- en nettingposities breder is dan de bescherming die contracten- en goederenrecht in een dergelijk geval biedt tegen verlies van rechten die voortvloeien uit zekerheidsovereenkomsten en verrekenings- en nettingovereenkomsten. Enige onduidelijkheid over de waarborgen in de afwikkelingsregels kan bestaan omdat volgens de BRRD en de nationale implementaties van de BRRD slechts zakelijke zekerheidsovereenkomsten (rechten *in rem*) moeten worden beschermd. Op grond van de genoemde Gedelegeerde Verordening van de Europese Commissie dienen ook persoonlijke zekerheden te worden beschermd in een afwikkelingsprocedure.

De laatste paragraaf van hoofdstuk 6 gaat in op wat een 'normale insolventieprocedure' is voor een bank naar nationaal insolventierecht en welke rol de nationale afwikkelingsautoriteit speelt in een dergelijke procedure. Er bestaan aanzienlijke verschillen tussen de insolventieprocedures voor banken in de drie onderzochte jurisdicties. Zo is volgens het Nederlandse insolventierecht de faillissementsprocedure onder het bank-specifieke hoofdstuk 11AA Fw de 'normale insolventieprocedure', terwijl in Duitsland het uitgangspunt is dat alle insolventieprocedures naar nationaal insolventierecht kunnen geopend voor een bank, waaronder de insolventieplan procedure. Naar Engels bancair insolventierecht zijn vier verschillende soorten insolventieprocedures mogelijk voor een bank: een liquidatieprocedure of *administration* naar Engels algemeen insolventierecht of een bank liquidatieprocedure of bank *administration* in de zin van het Britse afwikkelingsregime. De Duitse afwikkelingsautoriteit is bevoegd de rechtbank te verzoeken een insolventieprocedure voor de bank te openen na toepassing van de afwikkelingsregels, terwijl DNB in de rol als afwikkelingsautoriteit dit ook zonder voorgaande toepassing van de afwikkelingsregels kan. De BoE speelt als afwikkelingsautoriteit een centrale rol in een bank liquidatieprocedure en bank *administration*, niet alleen in de initiatiefase maar ook tijdens de procedure. Deze afwikkelingsregels wijken dus af van de traditio-

nele regel dat onder andere de debiteur en crediteuren de rechtbank kunnen verzoeken een insolventieprocedure te openen.

Hoofdstuk 7: Regimes voor de afwikkeling van banken en nationale en supranationale coherentie

Hoofdstuk 7 sluit het onderzoek af door de twee coherentiebegrippen die zijn ontwikkeld in hoofdstuk 4 toe te passen op de analyse in hoofdstukken 5 en 6. De ontwikkelingen op het gebied van het bancair insolventierecht in de EU hebben tot gevolg gehad dat het nationaal bancair insolventierecht steeds meer is onderworpen aan EU-wetgeving. De huidige afwikkelingsregimes vormen specialistische juridische raamwerken voor bank insolventies. Enerzijds bevatten deze regimes specifieke regels en hebben ze specifieke doelstellingen. Deze regels en doelstellingen wijken expliciet af van regels en doelstellingen in het bestaande nationaal privaatrecht, waaronder het algemene insolventierecht. Er bestaan matig coherente relaties tussen deze regels en het privaatrecht. Anderzijds wordt geconstateerd dat de afwikkelingsregimes echter ook enkele beginselen en regels van het nationaal privaatrecht incorporeren. De nationale wetgevers in de EU zullen ook de komende jaren de moeilijke taak blijven houden nieuwe EU-wetgeving op het gebied van het bancair insolventierecht in te passen in hun nationale rechtsordes. De afwikkelingsregimes kunnen nooit volledig coherent worden met het nationaal privaatrecht. Om te zorgen dat de afwikkelingsprocedures zo duidelijk en voorspelbaar mogelijk zijn, dienen de nationale wetgevers echter wel zoveel mogelijk te zorgen dat incoherente relaties in de nationale regelgeving worden voorkomen of verholpen in de verdere ontwikkeling van het bancair insolventierecht op nationaal niveau. Op dit moment bestaat bijvoorbeeld nog enige onduidelijkheid over het effect en verloop van de in Nederland en England voorgestelde procedures voor de omzetting van vreemd vermogen in eigen vermogen in bail-in.

Het proefschrift heeft ook aangetoond dat diverse verschillen kunnen bestaan tussen de afwikkelingsprocedures in de drie jurisdicties. Veel onderdelen van het insolventierecht zijn niet of slechts in beperkte mate geharmoniseerd. Zo kunnen verschillen bestaan wat betreft de rangregeling in bail-in en insolventie van een bank en wat betreft insolventieprocedures voor banken. Aan deze verschillen is aandacht besteed in recente academische en beleidsdiscussies. Verschillen in afwikkelingsprocedures kunnen echter ook worden veroorzaakt door een verschillende toepassing van de geharmoniseerde afwikkelingsregels. Voorbeelden vormen de voorgestelde procedures voor de omzetting van vreemd vermogen in eigen vermogen in bail-in en het effect van bail-in op garanties naar nationaal recht. De Europese wetgever dient niet alleen nationaal insolventierecht maar ook de verschillen in implementaties van de afwikkelingsregels en het mogelijke effect daarvan op supranationale coherentie mee te nemen bij de verdere ontwikkeling van het bancair insolventierecht op EU-niveau.

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Curriculum Vitae

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