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Insolvency Law: possible future work

Addendum

Proposal by the delegation of Switzerland for preparation of a study on the feasibility of an instrument regarding the cross-border resolution of large and complex financial institutions*

1. The financial crisis, in particular the insolvency of Lehman Brothers on 15 September 2008, has made it painfully clear that certain financial institutions are “too big” or “too interconnected to fail”. They cannot be wound down in an orderly fashion without exposing the financial system to unacceptably high risks. This state of play implies a great deal of moral hazard and imposes potentially huge costs on taxpayers. Establishing a legal framework which permits the winding down of a large and complex financial institution without putting the stability of the financial system at large at risk therefore is a priority for Switzerland.
2. In the case of large and complex financial institutions with major cross-border activities, an orderly resolution cannot be achieved without coordination among relevant jurisdictions. In the absence of a coordinated approach, reorganization and/or liquidation measures will be of limited effect, resulting almost inevitably in a disorderly dismantling of the institution or the group. Coordination across borders, therefore, is a necessary, albeit not sufficient, condition for an orderly winding down of large and complex financial institutions with major cross-border activities.
3. The need for improved cross-border coordination of resolution proceedings has been acknowledged by leading international organizations and specialized bodies. In particular, recommendation 4 of the Cross-border Bank Resolution Group (CBRG), a subcommittee of the Basel Committee on Bank Supervision, advocates

* This document was submitted as soon as possible following receipt of the proposal.



that “further work toward more effective recognition of foreign crisis management and resolution proceedings should be undertaken at the bilateral, regional or international level”.¹ The CBRG specifically refers to the work undertaken by UNCITRAL regarding the treatment of domestic enterprise groups, suggesting that the relevant concepts developed in the Legislative Guide may provide guidance in view of the establishment of such a framework.

4. We therefore recommend that Working Group V prepare a study on the feasibility of an international instrument regarding cross-border resolution of large and complex financial institutions. Such a study should outline the options available to improve cross-border coordination, including (i) the recognition of measures taken by the home-state authority in host states; (ii) the coordination through parallel proceedings in home and host states; (iii) coordination by means of cross-border insolvency agreements; (iv) other methods to improve coordination. The study would also have to take into consideration cross-border effects of resolution tools generally used in the resolution of financial institutions, like e.g., the transfer of assets to a bridge bank, a temporary stay of default clauses in financial contracts, and the conversion of debt into equity. A particular focus should finally be put on problems of groups of enterprises including financial and non-financial firms.

5. Insolvency of banks and other financial institutions has been excluded so far from the scope of insolvency-related work undertaken by UNCITRAL.² The reason for these exclusions are typically that banks and other financial institutions are subject to special resolution regimes in many jurisdictions and that the winding down of financial institutions raises important public policy issues, especially if the institution is of systemic relevance. The resolution of large financial institutions differs also in other respects from the winding down of other commercial undertakings, e.g. with respect to the time available and the size and the composition of the estate.

6. This proposal is suggested for consideration by this Working Group, since it is obvious that UNCITRAL is better suited than any other international organization to tackle this kind of issue. First, a resolution is primarily a highly technical process requiring special skills and knowledge, whether or not the firm is a financial institution. Second, many tools used in national resolution regimes can also be found in corporate bankruptcy, like e.g., the transfer of assets to a new corporation or the conversion of debt into equity. Switzerland therefore is convinced that UNCITRAL is better suited than any other organization to undertake the proposed study.

7. Switzerland attaches great importance to the coordination of the substantive works undertaken in the various international fora in which certain or all UNCITRAL member and observer states participate. We are grateful to the Secretariat for the overview given over the work in progress within the EU, the International Monetary Fund, the World Bank and the Basel Committee on Bank Supervision (A/CN.9/WG.V/WP.93, paras. 9-15). We would like to emphasize that this proposal in all respects intends to be complementary to the activity of the

¹ See Report and recommendations of the Cross-border Bank Resolution Group — final paper (March 2010), <http://www.bis.org/publ/bcbs169.htm> (accessed April 15, 2010).

² See Legislative Guide on Insolvency Law, p. 40 (2005); UNCITRAL Model Law on Cross-Border Insolvency, Art. 1(2) (1997).

aforementioned bodies and that continuous attention must be given to the avoidance of substantive overlaps as the work progresses. Also, closely liaising with financial market regulators and supervisors and with central banks will be crucial for the success of this work.
