BAIL-IN AND PRIVATE INTERNATIONAL LAW: HOW TO MAKE BANK RESOLUTION MEASURES EFFECTIVE ACROSS BORDERS

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Abstract Bank resolution is key to avoiding a repetition of the global financial crisis, where failing financial institutions had to be bailed out with taxpayers' money. It permits recapitalizing banks or alternatively winding them down in an orderly fashion without creating systemic risk. Resolution measures, however, suffer from structural weakness. They are taken by States with territorially limited powers, yet they concern entities or groups with global activities and assets in many countries. Under traditional rules of private international law, these activities and assets are governed by the law of other States, which is beyond the remit of the State undertaking the resolution. This paper illustrates the conflict between resolution and private international law by taking the example of the European Union, where the limitations of cross-border issues are most acute. It explains the techniques and mechanisms provided in the Bank Resolution and Recovery Directive (BRRD) and the Single Resolution Mechanism (SRM) Regulation to make resolution measures effective in intra-Eurozone cases, in intra-EU conflicts with non-Euro Member States and in relation to third States. However, it also shows divergences in the BRRD's transposition into national law and flaws that have been uncovered through first cases decided by national courts. A brief overview of third country regimes furthermore highlights the problems in obtaining recognition of EU resolution measures abroad. This article argues that regulatory cooperation alone is insufficient to overcome these shortcomings. It stresses that the effectiveness of resolution will ultimately depend on the courts. Therefore, mere soft law principles of regulatory cooperation are insufficient. A more stable and uniform text on resolution is required, which could take the form of a legislative guide

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or, ideally, of a model law. It is submitted that such a text could pave the way for greater effectiveness of cross-border resolution.

Keywords: asset transfer, bail-in, bank resolution, conflict of laws, cross-border restructuring, FSB, Key Attributes of Effective Resolution Regimes, model law, private international law.

I. A SHORT INTRODUCTION TO BANK RESOLUTION IN A GLOBAL CONTEXT

Governments around the world were forced to step in and save banks in order to stem the effects of the global financial crisis starting in 2008. They were faced with the choice of either 'bailing out' financial institutions or risk the deepening of the financial crisis. The dilemma of financial institutions being 'too big to fail' created perverse incentives for bankers to engage in excessive risk taking and to 'socialize' their losses. Avoiding the recurrence of this situation has become a priority of governments ever since. At the same time, States must ensure the continuity of systemic banking functions, such as the running of payment systems, or else risk economic havoc and social upheaval.

In order to meet these goals, various tools have been devised which are usually summarized as 'resolution measures'.[1] They are designed to ensure that critical banking functions will be fulfilled in times of crisis, to prevent contagion from affecting solvent institutions, and to avoid a general loss of trust in the banking system that might ultimately result in a bank run, without spending taxpayer money. The most important resolution measures are the bail-in tool and the transfer tool.[2] The bail-in tool aims at redressing the financial situation of the bank by reducing the equity of its shareholders and the liabilities held by its creditors. This is done by writing down equity and liabilities until as much as zero or by converting the liabilities into equity.[3] The transfer tool is designed to ensure the continuity of the bank's systemically important functions by transferring them, eg to a solvent institution or to a bridge bank. Both measures are comparable to an expropriation of an ailing bank's shareholders

[1] A comprehensive overview can be found in FSB, 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (2014) 7–10. See also RM Lastra and A Campbell in RM Lastra (ed), *Cross-Border Bank Insolvency* (Oxford University Press 2011) 44–6.

[2] For an overview of these tools, see SN Grünewald, *The Resolution of Cross-Border Banking Crises in the European Union: A Legal Study from the Perspective of Burden Sharing* (Kluwer Law International 2014) 32ff; J-H Binder, '"Resolution": Concepts, Requirements and Tools' in J-H Binder and D Singh (eds), *Bank Resolution: The European Regime* (Oxford University Press 2016) 25ff; M Haentjens, 'Party Autonomy, Public Policy and European Bank Insolvency Law', Hazelhoff Research Paper Series No 7, available at <http://papers.ssrn.com/abstract=2608903>; K-P Wojcik, 'Bail-in in the Banking Union' (2016) 53 CMLRev 91, 106 ff.

[3] The alternative way would be to increase the asset side of the bank through the issuance of new equity, see eg A Admati and M Hellwig, *The Bankers' New Clothes* (Princeton University Press 2013) 81ff. However, in the current financial environment it may prove difficult to find investors willing to inject more equity into the bank.

and creditors.[4] They are thought to stimulate them to exercise proper control over the bank's management and to punish them for their failure to do so, thus helping to maintain the stability of the financial system.

A crucial condition to make resolution tools work is their effectiveness across borders. In a world in which financial activities are no longer confined to States, banks frequently have assets abroad, for instance in a branch, a securities account or in parts of their payment system. If the resolution tools were restricted to the territory of the enacting State and spare foreign assets, an inefficient split-up of economic entities would follow, which might threaten the continuity of systemic banking functions. The measure taken by the enacting State must therefore encompass all of the ailing bank's assets, no matter where they are located. Similarly, debt instruments issued by banks are often governed not by the law of their home country, but by foreign law. A bail-in would be less effective if it did not cover this debt. It could even provide opportunities for arbitrage and trigger claims of creditor discrimination if certain bank debts were exempt from resolution.

But herein lies a problem: under traditional principles of conflict of laws or private international law, these assets and debt are governed by foreign private law.[5] They are therefore beyond the authority of the State that adopts the resolution measure (the 'resolution State'). Rather, it is the law of the State governing the asset or debt (the 'target State') that will determine their ownership and content. Legislation or measures by the resolution State can have effect only to the extent permitted by the law of the target State.

Private international law on the one hand, and banking resolution on the other, are thus on a collision course. The problem is serious enough for the Financial Stability Board (FSB) to have recently published principles for the cross-border effectiveness of bank resolution measures.[6] It suggests different strategies which may be adopted by national legislators and supervisors in order to give resolution measures transnational force, independent of the law applicable under traditional rules of conflict of laws. From the supervisory perspective, the problem is particularly acute because of the legal requirement that banks must at all times have sufficient equity or debt that can be written down or (in the case of debt only) be converted into equity.[7] This threshold—called MREL[8]—must be distinguished

[4] See Haentjens (n 2) 13 (arguing that expropriation and bail-in 'may boil down to the same thing, because expropriated investors have the right to appropriate damages').

[5] Things are different for shareholdings in a company. They are governed by the law of the entity under resolution, so there is no conflict-of-laws problem in so far as equity concerned. The bail-in of shareholders will work in a cross-border as in a domestic context.

[6] FSB, 'Principles for Cross-Border Effectiveness of Resolution Actions' (2015).

[7] BRRD, (Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, [2014] OJ L 173/190),art 45(1), first sentence.

[8] 'Minimum Requirement of Own Funds and Eligible Liabilities' (MREL) is the EU's version of the Total Loss-Absorbing Capacity (TLAC) that is set by the FSB. See FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution – 'Total Loss-absorbing Capacity (TLAC) Term Sheet' (2015).

from the 'normal' capital rules to which banks are subject under the Basel III standards and their transposition into EU law.[9] The requirement for the bank to have 'enough debt' may seem counterintuitive, yet this is necessary if the exercise of the bail-in tool by the resolution authority is to have some effect. Liabilities can only be counted towards MREL where the decision to bail them in is legally enforceable. With regard to bank liabilities governed by the law of a third country, the resolution authority may—and in certain circumstances must—require an institution to demonstrate that a bail-in decision would be effective with regard to liabilities governed by the law of a third country.[10] Should the resolution authority not be satisfied that this is the case, the liability will not be eligible for the calculation of MREL. The cross-border effectiveness of resolution therefore ought to be clarified in advance. The FSB recommends that States should identify those contracts and assets that cannot be transferred with legal certainty and assess the implications for the successful operation of the resolution tool.[11]

But how can the effectiveness of resolution actions by a State be assessed where the law of that State does not govern the asset in question? And assuming that the resolution action is not effective, how can it be made effective? These are the questions which this essay examines. Special emphasis will be placed on the law of the European Union (EU) because the problems of cross-border effectiveness are most severe due to the integration of various States into a single market.

The structure of this article is as follows: Part I explains the background to the conflict between private international law on the one hand and bank resolution on the other, as well as strategies to circumvent it. Part II shows how EU law attempts to resolve the problem. Part III provides a brief overview of third country regimes and their interaction with the EU mechanism. Part IV suggests how the effectiveness of resolution worldwide might be improved. Part V provides a conclusion.

II. THE CLASH OF TWO REGIMES

A. Private International Law vs Bank Resolution

Conflict of laws or private international law determines the law applicable to disputes and legal relations. Its modern form is a product of nineteenth-century legal thinking.[12] Although private international law derives from national law and differs from country to country, in most parts of the world

[9] Basel III is a capital standard for banks published by the Basel Committee on Banking Supervision (BCBS). It is transposed into EU law by the Capital Requirements Directive – CRD IV (Directive 2013/36/EU) and by the Capital Requirements Regulation – CRR (Regulation (EU) 575/13).

[10] BRRD, art 45(5).

[11] FSB (n 1) 34.

[12] On the genesis of private international law, see A Mills, 'The Private History of International Law' (2006) 55 ICLQ 1; M Gutzwiller, *Geschichte des Internationalen Privatrechts: Von den Anfängen bis zu den grossen Privatrechtskodifikationen* (Helbing & Lichtenhahn 1977).

similar or even identical rules are followed.[13] This means that the applicable law to a dispute is more or less determined in the same way no matter where a suit is brought. This so-called 'decisional harmony' essentially serves the interests of persons involved in private litigation. Ideally, they can foresee the applicable law regardless of the court in which a dispute is decided. Traditional private international law achieves this by classifying legal issues according to specific categories and using a specific connecting factor for each of them to identify the applicable law.[14] The aim is to find the country which has the closest or 'most significant' connection with the dispute or legal relationship.[15]

This splitting up of legal issues becomes more noticeable when determining the law applicable to an asset or debt. Private international law distinguishes between different asset classes and determines the connecting factor for each of them differently. For tangible assets, whether movable or immovable, the connecting factor is their geographic location, or 'situs'. They are therefore governed by the law of the State in which they are located. This is the so-called *lex rei sitae* rule,[16] which is known all over the world.[17] For securities embodied in physical documents such as share certificates, the so-called *lex cartae sitae* rule refers to the place where the shares are located.[18] Where shares are registered in electronic accounts, as is most often the case today, some countries use the place of the relevant intermediary which manages the securities account as the connecting factor (so-called 'Place of the Relevant Intermediary' or 'PRIMA' approach).[19] Different conflicts rules apply for unsecuritized bank debt, which is considered to be a contractual obligation. According to the principle of party autonomy, parties are free to choose the

[13] A notable exception is the United States, where some courts apply very different methodologies such as governmental interest analysis, see P Hay *et al., Conflict of Laws* (5th edn, West 2010) 27ff; S Symeonides, *The American Choice-of-Law Revolution: Past, Present and Future* (Martinus Nijhoff Publishers 2006) 14–18.

[14] T Hartley, *International Commercial Litigation: Text, Cases and Materials on Private International Law* (2nd edn, Cambridge University Press 2015) 560–1; J Fawcett, J Carruthers and P North, *Cheshire, North & Fawcett: Private International Law* (14th edn, OUP 2008) 41–5.

[15] See eg G Kegel and K Schurig, *Internationales Privatrecht: Ein Studienbuch* (9th edn, CH Beck 2004) 131ff; D Bureau and HM Watt, *Droit international privé*, vol 1 (2nd edn, Presses Universitaires de France 2010) paras 340 and 347ff.

[16] Hartley (n 14) 763; Kegel and Schurig (n 15) 138 and 765; D Bureau and HM Watt, *Droit international privé*, vol 2 (2nd edn, Presses Universitaires de France 2010) para 654ff; L Collins (ed), *Dicey, Morris & Collins on the Conflict of Laws*, vol 2 (Sweet & Maxwell 2012) para 22R–001 (rule 128).

[17] KA Sfeir, *Droit international privé comparé*, vol 1 (Sader 2005) 674 (para 544).

[18] See M Lehmann, *Finanzinstrumente* (Mohr Siebeck 2009) 490.

[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 [1998] OJ L166/45, art 9(2); and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims [2002] OJ L168/43, art 9(1). The PRIMA approach is also followed by the Hague Securities Convention, which has yet to enter into force, see Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary, Hague Convention, arts 4(1)2 and 5(1); and RM Goode, H Kanda and K Kreuzer, *Explanatory Report on the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary: Hague Securities Convention* (Brill 2005) para Int–41.

law governing their contract.[20] Where they fail to do so, a subsidiary rule is used: in many countries, the contract will be governed by the law in force at the habitual residence of the seller or service provider or, more generally, the party to the contract that must effect the characteristic performance.[21] For particular types of contracts, there are special connecting factors to be observed. For consumer contracts, for example, it is generally acknowledged that the law at the habitual residence or domicile of the consumer plays an important role.[22]

In sum, private international law divides the assets and liabilities of the bank into specific categories and identifies the applicable law for each of them separately. The goal is to find the law that has the closest or most significant connection to the legal relationship in question. This serves the private interest of having a law applied to a legal relationship that is both foreseeable and close to the situation, and, most importantly, that does not depend on the court that is seized of a particular dispute.

Resolution measures interfere with this regime. They require obedience independent of the law that is applicable under the rules of private international law. To illustrate, an asset transfer purports to affect all property rights of the bank no matter where the assets are located. From the viewpoint of the target State, the measure seeks to have extraterritorial effect beyond the borders of the resolution State. Similarly, a bail-in seeks to write-down, cancel or convert debt independently of the law that applies to the debt in question. It even purports to affect debt that is governed by the law of a foreign country.

It follows that there exists a very deep conflict between private international law on the one hand and resolution on the other. At the heart of this clash seems to be a conflict between private and public interests. From the viewpoint of the private individuals involved, it would be preferable if the assets and liabilities remained subject to the law that is normally applicable to them.[23] Yet public interest requires deviation from such an approach. The immediate purpose of bank resolution measures is to maintain global financial stability, which is a

[20] See eg Rome I Regulation (Council Regulation (EC) 593/2008 of 17 June 2008 on the law applicable to contractual obligations [2012] OJ L 177/6), art 3(1); Inter-American Convention on the Law Applicable to International Contracts, done at Mexico, D.F., on 17 March 1994, art 7; Swiss Federal Private International Law Act, art 116; Law on the Application of Law for Foreign-Related Civil Relations of the People's Republic of China, art 41 phrase 1; Japanese Act on the General Rules of Application of Laws (Law No 10 of 1898, as newly titled and amended 21 June 2006), art 7; Russian Civil Code, art 1210.

[21] See Rome I Regulation, art 4(1)(a), (b), (2); Swiss Federal Private International Law Act, art 117(1); Law on the Application of Law for Foreign-Related Civil Relations of the People's Republic of China, art 41 phrase 2; Japanese Act on the General Rules of Application of Laws, art 8(2); Russian Civil Code, art 1211(2).

[22] See Rome I Regulation, art 6; Swiss Federal Private International Law Act, art 120; Law on the Application of Law for Foreign-Related Civil Relations of the People's Republic of China, art 42; Russian Civil Code, art 1212.

[23] See also Haentjens (n 2) 9, who speaks of a 'brutal restriction of party autonomy'. Although he uses the term to refer to freedom of contract (see ibid), the same applies to party autonomy in the sense that the term is used in conflict of laws.

common good. To achieve this end, it is necessary that the applicable law is that of the resolution State. The authorities of this State must have the power to bail in equity and debt and transfer assets which are governed by the law of another State. This may seem radical, but it is inevitable, given the need to address the critical situation of the ailing bank without creating additional risks for the stability of the global financial system. Ultimately, this stability also benefits private individuals because stability is the backdrop against which private transactions can flourish.

Presented in this way, it seems clear that resolution measures should be prioritized because they serve important public interests. Yet such a view would be too one-dimensional because behind the collision between private international law and bank resolution lurks a manifest conflict between sovereign States.[24] While the resolution State feels an obvious need to recapitalize its credit institution, the target State may have other goals. It may fear, in particular, that in the process of restructuring important business activities may be moved abroad. More palpable still is its desire to keep as many assets as possible for local creditors in the event of a looming bankruptcy.[25]

Beyond such self-interest, there may also be other reasons to resist the effectiveness of foreign cross-border measures. A foreign government might engage in 'abusive resolution', for instance by discriminating against a target State's creditors or by using the resolution procedure as a pretext to cleanse its banks of debt.[26] It is also possible that a foreign resolution measure negatively impacts on the financial stability of domestic institutions whose rights as creditors are curtailed by a bail-in. In situations such as these, the governing law deserves respect.

The tension between private international law and resolution measures is therefore much more complex than the somewhat simplistic juxtaposition of private and public interests suggests. It must be borne in mind that private international law also safeguards important public interests, such as the rule

[24] On the conflicting sovereign interests, see eg E Hüpkes, '"Form Follows Function" – A New Architecture for Regulating and Resolving Global Financial Institutions' (2009) 10 EBOR 369, 377; E Hüpkes, 'Rivalry in Resolution: How to Reconcile Local Responsibilities and Global Interests?' (2010) 7 ECFR 216, 235.

[25] See Bank for International Settlement (BIS), 'Report and Recommendations of the Cross-Border Bank Resolution Group' 15 (highlighting that 'National resolution authorities will seek, in most cases, to minimise the losses accruing to stakeholders (shareholders, depositors and other creditors, taxpayers, deposit insurer) in their specific jurisdiction to whom they are accountable.'); see also C Hendren, *Judicial and Administrative Approaches to Bank Resolution: Prospects for International Harmonization* (Financial Institutions Center, Wharton School, University of Pennsylvania 2011) 11 (stressing that ring-fencing by individual countries can limit and undermine the actions taken by other jurisdictions).

[26] The FSB has warned States against creditor discrimination, see FSB (n 1) 13. However, that does not mean that this type of behaviour does not occur. A particularly striking example of abusive and discriminating resolution is provided by the case *BayernLB v Hypo Alpe Adria (the HETA case)* discussed in section III.F.2.

of law, legal certainty and the protection of investments. Resolution measures should therefore not be enforced at any cost, but only where they serve overriding public interests and are in line with the principle of proportionality, ie do not go beyond what is necessary for the protection of public interests.

B. Contractual Bail-In Clauses as a Solution?

There are different strategies for avoiding the clash between private international law and bank resolution that has been described above. The most important of them is to include an explicit clause in bank debt that gives effect to resolution measures by the competent national authority. The FSB strongly recommends the inclusion of such contractual bail-in clauses in all debt instruments governed by the law of a third country.[27] The EU has turned this into a general obligation. According to the BRRD, Member States should require institutions to stipulate in debt instruments that the counterparty recognizes the write-down and conversion powers of the resolution authority and agrees to be bound by any of its decisions.[28] Through such a contractual provision, the counterparty autonomously accepts the resolution measures. Their basis is therefore no longer a command by the resolution authority, but the free will of the creditor, ie the counterparty. In other words, resolution is transformed from a statutory into a contractual mechanism.

Bail-in clauses will function as long as they are valid under the applicable foreign law governing the contract. Nevertheless, one must caution against an overly optimistic view of such clauses.[29] First of all, it will not always be easy to convince the bank's counterparty to accept them. Usually it will ask for an interest rate premium in return. It is true that such a premium will also be charged when the issuer is subject to a statutory bail-in regime, but a contractual bail-in regime is different because it will prove more costly than a statutory regime at the outset: the initial investors in the new instruments will require a hefty surcharge because their interests will be subordinated to *almost all* other creditors. Second, it is uncertain that bail-in clauses will be accepted by courts. Though they are supported by the principle of freedom of contract, there are important policy concerns that may be raised against private parties submitting to the decisions of foreign public authorities. At any rate, court judgments on this are lacking. Another drawback of contractual bail-in clauses is that it is difficult for the supervisor resolution authority to assess their effectiveness because their terms and their interpretation may vary from

[27] FSB (n 6) 7–8.
[28] BRRD, art 55(1).
[29] For a cautious view on the efficiency of contractual bail-in clauses, see JH Sommer, 'Why Bail-In? And How!', 20 Economic Policy Review (2014) 207, 228; TF Huertas, 'The Case for Bail-Ins', Financial Institutions Center Working Papers, Wharton School, University of Pennsylvania (5 December 2012) 5.

one instrument to another. A further disadvantage is that it takes time for the institution to build up a cushion of debt which can be contractually bailed in. Finally, contractual resolution clauses are of limited value for asset transfers. For instance, they do not work for transfers of immovable or intellectual property. The transfer of these assets often requires more than just an agreement by the parties, eg a record in a public register.[30]

For all of these reasons, contractual bail-in *alone* is not sufficient, but merely a complementary piece in the puzzle. The FSB is right in recommending that States should continue to pursue the development and adoption of *statutory* frameworks, which may supplement and even supersede contractual approaches.[31] There is therefore no contractual panacea for the clash of private international and banking law.

C. The Role of Bank Group Structure and Structural Bail-in

The tension between the governing law and bank resolution may be somewhat reduced in the case of bank groups. It must be remembered that most credit institutions are not single institutions, but part of a larger group of companies with a presence in a number of States. The measures for their restructuring will be decided in the EU by a so-called resolution college.[32] This college brings together resolution authorities of the different countries in which parents, subsidiaries and branches of the bank group are located. Once the college decides upon a so-called 'group resolution scheme' all the authorities that have not explicitly disagreed must implement its decision.[33] The group resolution scheme therefore has an automatic cross-border effect. Provided that all of the assets and liabilities of the bank group are located in States bound by the resolution college's decision, there can be no conflict of laws. Unfortunately, however, the group resolution scheme is not always effective because every Member State reserves the right to disagree and depart from it.[34] Moreover, it does not work where some assets of the group are governed by the law of third States that are not represented in the resolution college.

Such deficiencies do not plague structural bail-in measures, which is a more elegant way of dealing with bank groups. They are mostly practised in the United States, where such groups usually have a holding structure. A structural bail-in is achieved through a write-down, cancellation or debt/equity swap at the level of the holding company. The measure is taken by the resolution authority in the home country of the holding company. Provided that

[30] See in more detail section III.C.1.

[31] FSB (n 6) 9.

[32] BRRD, art 88. Outside the EU context, the same function is fulfilled by so-called Crisis Management Groups (CGMs) that have been created for global systemically important banks, see FSB (n 1) 14.

[33] BRRD, art 91(10) for the resolution of subsidiaries and BRRD, art 92(6) for the resolution of parent undertakings.

[34] BRRD, arts 91(8) and 92(4).

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the holding company has issued debt exclusively under the law of its home jurisdiction, no conflict with other countries can arise.[35] This is the so-called single point of entry (SPOE) strategy.[36]

The SPOE strategy has various advantages compared to resolution measures that affect individual group members.[37] First, it functions even where the law of a third State governs the bank's assets since it does not purport to transfer those assets but simply redresses the financial situation of the holding company. Second, the SPOE strategy is less costly than a group resolution because only the holding company must be endowed with additional capital that can be bailed-in, which can be used to recapitalize any of the group's subsidiaries. Third, a structural bail-in is easier to execute and enforce than a bail-in at the level of the multiple entities of the group. Finally, this strategy avoids the risk of obstruction by the regulators of the various jurisdictions in which group members are established.

Yet the SPOE strategy also suffers from distinct disadvantages. First of all, it only works properly where the group has a holding structure.[38] This is not the case for many European groups.[39] It would therefore be necessary to introduce a statutory requirement for reorganization in order to provide the conditions for SPOE, which may be costly. Second, once the creditors of the holding company have been bailed-in, it will be necessary to transfer the capital from the holding to the subsidiaries in need. This can be done by writing down, cancelling or swapping debt that has previously been issued by the subsidiary to the parent. But where this debt is not governed by the law of the resolution State, the conflicts problem re-emerges. Third, the countries in which the group's subsidiaries are based may worry that the resolution authority responsible for the holding company will not act as vigorously to recapitalize a troubled subsidiary abroad as it would with regard to its domestic institution.[40] Fourth, if the home country does not act, the resolution authority of the subsidiary's host State may be tempted to adopt its own resolution measures and cancel or write down the debt issued to the parent in order to protect its national interest. It is true that it could adopt a 'self-denying ordinance' promising to refrain from any such measure,[41] but it would be impossible to legally enforce such a pledge. The possibility for regulatory conflict is therefore not completely avoided.

[35] The FSB tries to ensure this by requiring that instruments eligible for TLAC are subject to the law of the jurisdiction in which the relevant resolution entity is incorporated, see FSB, 'Total Loss-Absorbing Capacity (TLAC) Term Sheet' (n 8) 17.

[36] On the single point of entry strategy, see eg JN Gordon and W-G Ringe, 'Bank Resolution in the European Banking Union: A Transatlantic Perspective on What It Would Take' (2015) 115 ColLRev 1297, 1323–30.

[37] See ibid.

[38] SPOE resolution strategies may also be applied at the level of the top operating company, but that does not have all the advantages of an SPOE bail-in applied at a holding company level.

[39] See K-P Wojcik, (n 2) 91, 136 (noting that many bank groups based in the EU have operating top-level banking entities).

[40] DA Skeel, 'Single Point of Entry and the Bankruptcy Alternative' (2014) SSRN Scholarly Paper ID 2408544, 11 <http://papers.ssrn.com/abstract=2408544>.

[41] See T Huertas, 'Safe to Fail' (2013) 1 Journal of Financial Perspectives 93.

In spite of some undeniable advantages, the SPOE strategy does not eliminate all problems of cross-border resolution. This is why the BRRD presents SPOE as one among a range of options.[42] Equally possible is a multiple point of entry-strategy (MPOE). At least in Europe, resolution will most often be done by mandatory statutory rules at the level of the individual institution. This comprises bail-in, but also asset transfers. In these cases, conflicts with other States are inevitable.

D. *Insolvency Law and the Principle of Universality*

A way to resolve the clash between private international law and banking resolution is to characterize resolution measures as belonging to insolvency law. This is due to a basic tenet of insolvency law: the principle of universality. According to this principle, bankruptcy proceedings opened in one State aspire to have a worldwide effect.[43] Applying this principle to resolution could reconcile the latter with private international law. It would endow resolution measures with the necessary worldwide effect without putting the applicable law into question.

It is true that the principle of universality is not accepted by all States under all conditions, and is often abandoned in favour of the alternative approach: the principle of territoriality of insolvency. Yet universality prevails at least in certain areas and situations. A case in point is bank insolvencies in the EU. The so-called Winding-up Directive empowers the authorities of the Member State in which a credit institution is established to decide on the bank's reorganization.[44] The competent authority may rely on the law of its State (the '*lex fori*') when making these decisions.[45] According to the Directive, the measures taken on the basis of the *lex fori* will be fully effective in other Member States.[46] The principle of universality thus governs bank insolvencies in the EU.

Crucially, the EU has decided to extend the Winding-up Directive's rules to resolution measures. It has introduced a new provision into the Directive according to which it also covers financial institutions or firms and their parents that are subject to measures under the BRRD.[47] More importantly, the term 'reorganisation measure' has been defined so as to include resolution tools and the exercise of resolution powers.[48] The BRRD and the Winding-up Directive are thus not separate regimes, but complement each other. The latter endows decisions taken under the former with universal effect throughout the EU.

[42] BRRD, Recital 80.

[43] M Virgós and F Garcimartín, *The European Insolvency Regulation: Law and Practice* (Kluwer Law International 2004) paras 11 and 14.

[44] Council Directive 2001/24/EC of 4 April 2001 on the reorganization and winding-up of credit institutions (Winding-up Directive) [2001] OJ L 125/15 art 3(1), 9(1) subpara 1.

[45] Winding-up Directive, art 3(2) subpara 1, art 10.

[46] Winding-up Directive, art 3(2) subpara 2, art 9(1) subpara 2.

[47] See Winding-up Directive, art 1(4), added by BRRD, art 117(1).

[48] See Winding-up Directive, art 2, as amended by BRRD, art 117(2).

Yet this technicality does not confer upon resolution measures transnational force in other Member States. The reason for this lies in the many exceptions that the Winding-up Directive contains. For instance, rights *in rem* in respect of tangible and intangible assets situated in other Member States are not affected by reorganization measures within the meaning of the Directive.[49] This exception is designed to protect the justified expectations of those creditors which have secured their rights by charges on the debtor's foreign assets and which rely on the exclusive applicability of the *lex situs*.[50] Reservations of title and set-off remain unaffected for similar reasons.[51] The same is true for proprietary rights registered abroad, which are subject only to the *lex rei sitae*.[52] The Winding-up Directive also spares transactions on regulated markets, such as the sale or acquisition of shares and bonds, in an attempt not to interfere with the functioning of exchanges.[53]

The situation with netting agreements and repos is more complex. Netting agreements are contractual clauses that aim to reduce counterparty risk by providing for the acceleration, termination and set-off of contractual obligations in case of financial distress of the co-contractor.[54] Repos (repurchase agreements) are contracts under which a seller agrees to sell a security—a share or a bond—and to buy it back at a later date for a price fixed in advance, with the purpose of extending a collateralized loan to the seller and/or allowing the buyer to use the share or bond, eg to cover the obligation resulting from a short sale.[55] In principle, netting agreements and repos are solely governed by the contract law chosen by the parties.[56] However, the Winding-up Directive provides certain exceptions that help to ensure the effectiveness of resolution measures. These exceptions will later be studied in more detail.[57] It suffices to say here that the law normally applicable to termination clauses (which are part of netting agreements) and repos is not completely discarded in favour of that of the resolution authority.

In sum, although the Winding-up Directive gives universal effect to reorganization measures and has the effect of centralizing the applicable law, it has many exceptions. The Directive alone therefore does not overcome the

[49] Winding-up Directive, art 21.

[50] On the similar provision of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (European Insolvency Regulation) [2000] OJ L160/1, art 5 (now European Insolvency Regulation (Recast) (Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, [2015] OJ L 141/19) Art 8): Virgós and Garcimartín (n 43) 142; S Smid in P Leonhardt, S Smid and M Zeuner (eds), *Insolvenzrecht: Kommentar* (2nd edn, Kohlhammer 2012) art 5 EuInsVO para 2.

[51] Winding-up Directive, art 22.

[52] Winding-up Directive, art 24.

[53] Winding-up Directive, art 27.

[54] There are different variants of netting, such as close-out netting; see PR Wood, *Set-Off and Netting, Derivatives, Clearing Systems* (2nd edn, Sweet & Maxwell 2007) 4, margin no. 1-005; P Paech, 'Close-out Netting, Insolvency Law and Conflict of Laws' (2014) 14 JCLS 419, 424.

[55] cf MC Faulkner, 'An Introduction to Securities Lending' in FJ Fabozzi and SV Mann (eds), *Securities Finance: Securities Lending and Repurchase Agreements* (Wiley & Sons 2005) 10–11.

[56] See Winding-up Directive, arts 25 and 26.

[57] See section III.E.

clash between private international law and bank resolution. The transnational effect which it gives to resolution measures is not comprehensive.

It is not surprising that the Winding-up Directive does not provide the solution to the cross-border enforcement of resolution measures. The Directive principally pursues an insolvency approach, which is evidenced by the parallel structure to the European Insolvency Regulation.[58] Banking resolution is different. Its purpose is macroeconomic, not microeconomic. Contrary to insolvency, it does not merely seek to maintain the debtor's business or share its assets among the creditors. Rather, it aims at preserving the stability of the financial system, by avoiding bank runs and contagion to other institutions as well as by maintaining critical functions such as payment systems.[59] To put it simply, without effective resolution mechanisms citizens might not be able to draw money from ATMs in the event of a banking crisis. Making resolution effective is thus crucial to public welfare, and much more so than the reorganization of an 'ordinary company' like a manufacturer of automobiles or other products. The goal of resolution measures goes well beyond that of insolvency law, and is also alien to it. That is why the determination of jurisdiction does not follow the COMI (centre of main interest) principle that is found in insolvency law.[60] Instead, the competent resolution authority is that of the State in which the bank is supervised, independently of the seat of the creditors. The particular goal of resolution is also the reason why typical resolution measures such as debt cancellation or the transfer of systemically important functions to a bridge entity are unheard of in insolvency law. The latter is built on the principle of equal treatment of creditors ('*par conditio creditorum*'). Though it provides for different ranks and privileges, it does not allow for the targeted reduction or even cancellation of particular debt. To be sure, the special resolution regime for credit institutions has nothing to do with extending special privileges to bankers. On the contrary, the goal is to make bank shareholders and creditors accountable without endangering the stability of the financial system.

III. EU LAW AND CROSS-BORDER EFFECTIVENESS OF RESOLUTION

A. A System of Differentiated Effectiveness

The key to the clash between the applicable law and bank resolution is to be found in the EU texts on resolution measures, the BRRD[61] and the SRM

[58] cf European Insolvency Regulation (Recast) (Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, [2015] OJ L 141/19), art 1(1), 2(a) and (c) and Appendices A and B.

[59] For a list of reasons why a special resolution regime for banks is necessary, see RM Lastra and A Campbell, in Lastra (n 1) 34 – 5 (para 2.27).

[60] See art 3(1) European Insolvency Regulation (Recast) (n 58).

[61] BRRD (n 7).

Regulation.[62] They organize a system of transnational cooperation designed to overcome differences in the applicable law. Yet they do so to a varying degree. With regard to the cross-border effects of resolution measures, EU law distinguishes between three different areas: the Eurozone, the Union at large and third countries.[63]

The strongest effects of resolution measures will be felt within the Eurozone. Inside the 19 Member States sharing the common currency, resolution decisions will be adopted at the EU level by the Single Resolution Board (SRB) in Brussels. This is a European agency charged with taking resolution measures with regard to banks in the Eurozone.[64] The SRB's decisions must be transposed by the Member States.[65] In this way, they have transnational effect throughout all Euro-countries. One could call this the 'centralized'[66] or 'federal' model.

Between the Eurozone and non-Eurozone countries and amongst the latter, a decentralized model is followed. The home country of the credit institution adopts the necessary measures, which the other Member States must recognize and support to become effective.[67] This is the country-of-origin principle which is found in other areas of EU law.[68]

In relation to third countries, the EU lacks any prescriptive and enforcement powers. The competent European or national resolution authority therefore must rely on persuasion to make sure that its decisions are respected; where this is not the case, they are without effect. This could be called the 'coordinative model'.

B. Solution of Intra-Eurozone Conflicts

The simple three-tier model that has been outlined above must be qualified. Though it is an essential element of the Banking Union, the SRB is not responsible for all banks in the Eurozone, but only for those that are supervised by the ECB. Broadly speaking, these are the systemically important institutions, or 'SIFIs'. The SRB has powers also with regard to

[62] Reg No 806/2014 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 [2014] OJ L 225/1.

[63] The BRRD also has relevance for the European Economic Association (EEA), which comprises in addition to the 28 EU Member States Iceland, Liechtenstein and Norway. However, the BRRD only applies within the EU until the EEA Joint Committee amends the EEA Agreement to allow its application in the EEA States.

[64] See in more detail section III.B.

[65] SRM Reg, art 29(1).

[66] See eg Grünewald (n 2) 115 (addressing 'centralized resolution in Banking Union').

[67] BRRD, art 66(1), (2).

[68] On the country-of-origin principle in EU law, see eg W-H Roth, 'From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law' (2003) 52 ICLQ 177; R Michaels, 'EU Law as Private International Law? Reconceptualising the Country-of-Origin Principle as Vested-Rights Theory' (2006) 2 JPrivIntL 195; A Mills, *The Confluence of Public and Private International Law* (Cambridge University Press) 200–1.

other banks where national authorities fail to respect its instructions.[69] Finally, it is competent whenever a resolution measure requires financing by the Single Resolution Fund (SRF).[70] In all other circumstances, Eurozone Member States remain in charge.

Even where the SRB is competent to decide, it usually does not have the power to take directly effective measures itself. Instead, it adopts a resolution scheme, which the national resolution authorities must implement.[71] For this purpose, the latter will use the powers conferred on them under the national law transposing the BRRD.[72] Only in the exceptional circumstance that a national authority fails to comply with a resolution scheme can the SRB exercise powers directly. In this case, it may itself order an asset transfer or a conversion of debt into equity.[73] As its measures are based on a regulation, they will have a direct effect in the Member States. They are supranational law, binding across the whole Eurozone.

One may wonder why the EU has not given the supranational powers to the SRB in all other cases as well, and provided its decisions with transnational effect in the Eurozone countries. The reason is the lack of a suitable competence in EU treaty law.[74] Under the so-called Meroni doctrine, the powers of the Commission cannot be delegated to new EU bodies that are not foreseen in primary law.[75] The European Parliament and the Council therefore chose to follow the model set by ESA Regulations which establish ‘supervisors of supervisors’ on the EU level;[76] a solution that has received the blessing of the CJEU.[77] Instead of a new agency with direct powers over market participants, it has created an EU resolution authority above national resolution authorities. The effectiveness of the latter’s decisions is further restricted by the veto right that the Commission and the Council may exercise within 24 hours after the decision has been transmitted to them by the SRB.[78] This introduces a political element into the process, which creates uncertainty.

In sum, though the Eurozone has the most advanced system of integration with regard to resolution measures, the need for implementation by Member

[69] SRM Reg, art 7(4).

[70] SRM Reg, art 7(3).

[71] SRM Reg, art 18(6). For the sake of clarity, one must not confound the ‘resolution scheme’ in the sense of the SRM Regulation with the ‘group resolution scheme’ under the BRRD. While the latter is binding only on those Member States that have not explicitly disagreed with it, the resolution scheme adopted by the SRB is mandatory for all Member States in the Eurozone without any possibility to deviate.

[72] See SRM Reg, art 29(1).

[73] SRM Reg, art 29(2) SRM.

[74] In the same sense: Wojcik (n 2) 102 (citing the Meroni doctrine as a reason for the SRM’s sophisticated decision-making sequence).

[75] See Cases C-9/56 and C-10/56 *Meroni v High Authority* [1957/1958] ECR 133.

[76] See eg Regulation (EU) 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) [2010] OJ L 331/12 (European Banking Authority Regulation).

[77] Case C-270/12 *United Kingdom v Parliament and Council* [2014] CJEU ECLI:EU:C:2014:18.

[78] On the latter restriction, see SRM Reg, art 18(7).

States' authorities and the possibility of objections by the Commission and the Council may lead to delay and political wrangling. This can become a crucial obstacle given the severe time constraints under which restructurings must be carried out. Therefore, the transnational effectiveness of resolution measures is not even fully guaranteed in the Eurozone.

C. Solution of Intra-EU Conflicts

The most detailed rule on how to overcome the clash between private international law and bank resolution can be found in the BRRD. Its Article 66 addresses the problem with regard to all conflicts inside the EU. This includes relations within the Eurozone because Member States must use the powers conferred on them under their national law which transpose the BRRD to implement resolution measures adopted by the SRB, save for the few cases in which the SRB is allowed to implement its resolution decisions itself.[79]

The relationship between Article 66 BRRD and the Winding-up Directive is not easy to fathom. It has already been shown that the Winding-up Directive gives automatic effect to resolution measures in other Member States, but contains a certain number of exceptions.[80] These exceptions are not repeated in Article 66 BRRD. The best way to interpret the relationship between the two texts is therefore to consider that the Winding-up Directive requires Member States to recognize foreign resolution measures, while Article 66 BRRD sets out the details of what this recognition entails, including those cases for which the Directive provides an exception.

1. Transfer measures

For the purpose of determining the cross-border effect of resolution measures, Article 66 BRRD distinguishes between two different groups of such measures. A first group concerns the 'transfer of shares, other instruments of ownership or assets, rights or liabilities'.[81] Such a transfer can be effected by three resolution measures: the sale of business tool, the bridge institution tool and the asset separation tool. Under the Winding-up Directive, the effectiveness of these measures is limited, eg where they concern rights *in rem* related to assets located abroad. Article 66(1) BRRD therefore provides for an alternative mechanism. It obliges Member States to ensure that the resolution measures have effect 'in or under the law' of the other Member State in which assets are located, ie the target State.[82] The Member State which takes the resolution measure must comply with the conditions set by this law in order to effect the transfer.

79 See section III.B. 80 See section II.D. 81 BRRD, art 66(1). 82 ibid.

This approach thus respects the rules of private international law. The major advantage of this is that it ensures legal certainty and protects the legitimate expectations of third parties. For instance, where the assets affected by a transfer measure are entered into a register, such as, for example, shares or real estate, the transfer must be made public in order to take effect. This guarantees certainty regarding legal ownership and the dissemination of information to the public. In addition, the EU might have had qualms about interfering directly with the Member States' property law regime.

The drawback of this approach, however, is that it may undermine the resolution measure's efficiency. The authorities of the bank's home country must respect the law of the target State, but they will not necessarily be familiar with the law of the other 27 Member States in which the assets may be situated. Where they fail to comply with the prerequisites for a transfer under any of these laws, the measures they take will be without effect in such Member State.

The EU has attempted to address this information problem by providing an original cooperation mechanism. According to Article 66(2) BRRD, Member States shall provide the resolution authority with 'all reasonable assistance' to ensure that the transfer complies with any applicable requirements of national law. The resolution State and the target State whose law is applicable will thus have to work together. The Directive does not say what this implies exactly. At a minimum, the target State will have to provide the resolution State with information about its law in general. But that alone is not sufficient. One may assume that the target State is also required to inform the resolution State about the concrete steps necessary to transfer the particular assets in question. This is a far-reaching obligation. It is even more so because it applies not only to actual, but also to prospective transfers, because the addressee of the information is described as the resolution authority that 'has made *or intends to make* the transfer'.[83] It follows that the information obligation already applies when a resolution is only at the planning stage. Member States must therefore cooperate early on to ensure that the measure will be effective under the applicable law.

2. Bail-In

With regard to write-down, cancellation or conversion of debt governed by foreign law or owed to foreign creditors, the BRRD follows another precept. Article 66(4) BRRD obliges the target State (called 'Member State B') to ensure that the transfer ordered by the resolution State (called 'Member State A') is effective. In other words, the burden is placed here on the target State. It must adopt measures in order for the debt of the ailing bank to be written down, cancelled or converted into equity under its law. One way to fulfil this

[83] See BRRD, art 66(2) *in fine* (emphasis mine).

obligation is to introduce a provision recognizing bail-in orders by other Member States. The result is a transnational effectiveness of the bail-in order without the need for any further steps on the part of the resolution authority.

At first sight, Article 66(4) BRRD seems difficult to square with the rules of private international law. The recovery measure directly affects debt governed by the law of another Member State. It is the target State's law which determines the content of the debt instrument and the person that is its creditor. On the other hand, the provision does not change the applicable law. It merely requires the Member State whose substantive law governs to change this law in view of the goal of the transfer. Applying the principle of equivalence,[84] the measure adopted by the recovery State must have the same force as measures taken by its own authorities. This is a truly transnational effect.

Member States will be able to comply with the obligation imposed on them where the debt in question is governed by their own law, ie the situation described in Article 66(4)(a) BRRD. Much more problematic is Article 66(4)(b), which obliges them to ensure the effectiveness of bail-in measures by other Member States where the creditor of a debt is located in their territory. In this case, the debt is not necessarily governed by their law under private international law rules. For instance, the parties may have chosen to apply the law of another State.[85] In such instances, it will be impossible for the State in which the creditor is located to write down, cancel or swap the claim because it is governed by another State's law.

The drafters of the BRRD seem to assume that a Member State could interfere with a claim under foreign law on the basis that the claim's creditor is domiciled on its soil. However, this is not the case. National law can introduce overriding mandatory or public policy rules, yet such provisions will only have limited effect before the courts of other States.[86] The legislator can also decide to expropriate the claim, but it appears that under general principles of public international law, an expropriation will only be valid where the *debtor* has its domicile or assets in the expropriating country.[87] The location of the *creditor* is

[84] The principle of equivalence requires that Member States apply the same rules to the enforcement of European Union law as to the enforcement of national law, see eg Case C-118/08 *Transportes Urbanos y Servicios Generales SAL v Administración del Estado* [2010] ECJ 2010 I-00635, paras 33–48.

[85] See Rome I Regulation, art 3(1).

[86] See eg art 19 of the Swiss Federal Private International Law Act 1987.

[87] G Kegel and I Seidl-Hohenfelder, 'On the Territoriality Principle in Public International Law' (1981) 5 HastingsIntl&CompLRev 245, 255. In the slightly different but similar context of assessing expropriations under the Act of State doctrine, US courts have determined the situs of debt as well by reference to the debtor's domicile, see *Menendez v Saks and Co.*, 485 F.2d 1355, 1364–1365 (2nd Cir. 1973); *United Bank Ltd. v Cosmic International Inc.*, 542 F.2d 868 (2d Cir. 1976). At the heart of this localization is the fact that the State of the debtor has exclusive power to enforce the claim; see JA Johnson, 'Act of State: The Fundamental Inquiry of Situs Determination for Expropriated Intangible Property: Braka v. Bancomer, S.N.C.' (1986) 11 NCJIntlL&ComReg 121, 129; KL Goldthwaite, 'Recent Approaches to Situs of Debt in Act of State Decisions' (1985–86)1 ConnJIntlL 151, 167. In later decisions, the domicile of the creditor was also taken into consideration, eg in *Allied Bank International v Banco Credito Agricola de Cartago*, 757 F.2d 516, 521 (2d Cir. 1985), but merely as a means to fend off expropriations of claims of US banks

currently not considered a sufficient connection justifying the taking away of a claim. Unless there is a change in the rules of public international law, which does not seem to be imminent, an expropriation by the country in which the creditor is domiciled is without effect. Therefore, the Member State in which the creditor is located cannot fulfil its task under Article 66(4)(b) BRRD. Its measures will, in all likelihood, not be enforced by the courts of other States.

3. *Remedies*

One possibly fatal obstacle for recovery and resolution measures could be legal actions seeking to enjoin them. If creditors, owners of shares or third parties could delay such measures by questioning their validity before the courts in different countries, then they are likely to fail given that resolution must be implemented in an extremely short time frame (often over a weekend) in order to avoid instilling a panic on the market. At the same time, the groups affected by resolution actions must have some access to justice. After all, measures such as a bail-in come close to expropriations.[88] The rule of law requires that courts control their legality.

The EU legislator has struck a balance. On the one hand, it has asked Member States to ensure that resolution measures cannot be challenged.[89] On the other hand, it obliges Member States that adopt such measures to grant the persons affected a right of appeal.[90] In this way, access to justice is preserved. It is simply monopolized in the resolution country. The BRRD adds that the appeal must be governed by the law of the Member State which adopts the measure.[91] But this is self-evident: since resolution measures are part of public law, they can only be controlled under the law of the State that enacts them and not under the law of another State.[92] The trickier issue which is not addressed by the legislator is the fact that resolution measures may also be the subject of civil proceedings. For instance, where the holder of a bond sues the issuer despite the fact that the bond has been written down by a bail-in measure, the civil court must incidentally rule on the validity of the bail-in measure in order to decide about the claim. Such disputes can be brought in many different courts for the same bond issue, and the law applied to them may vary. This creates substantial judicial uncertainty.[93]

and not as a basis of expropriating the claim by the State of the creditor's domicile. It is interesting to note that the EU itself considers that claims against third parties to be situated in the Member State of the debtor's main centre of interest, art 2(9) (viii) European Insolvency Regulation (Recast) (Regulation (EU) 2015/848 of 20 May 2015 on insolvency proceedings, [2015] OJ L 141/19).

[88] See section I.
[89] BRRD, see art 66(3), (5).
[90] BRRD, art 85(2), (3).
[91] BRRD, art 66(6).
[92] This is an insight from the perspective of international administrative law, see M Ruffert, 'Perspektiven des Internationalen Verwaltungsrechts' in C Möllers, A Voßkuhle and C Walter (eds), *Internationales Verwaltungsrecht* (Mohr Siebeck 2007) 409.
[93] On this point see section III.F.2.

D. Solution of Conflicts with Third States

The EU lacks any prescriptive powers over non-Member States. It therefore cannot require them to change their law or to recognize orders issued by the SRB or a Member State authority. This has dramatic consequences for the efficiency of recovery and resolution. One need not look further than the many debt instruments issued under New York law. If the creditors of such instruments are European banks, the EU cannot change the identity of the creditor by transferring the instrument to a bridge bank or another institution. The reason is that, from the perspective of the state of New York, these instruments are beyond the remit of the EU.[94] The identity of the creditor is a question exclusively determined by New York law. Other States will take a similar position based on traditional principles of private international law. Absent a special agreement with the EU on this point, this may include British courts after Brexit, which would be particularly harmful given the high number of financial instruments subject to English law. In the converse situation, in which European banks are debtors of instruments issued under a third country's law, the EU also lacks influence. It does not have the power to directly write down these instruments or convert them into equity. The governing law shields the instruments against interference by foreign legislators. In a sense, that is exactly the purpose of a choice-of-law clause.

Yet one must bear in mind that bail-ins and resolution measures are necessary to safeguard global financial stability, an interest shared by all sovereigns and private individuals alike. Such measures would be incomplete if they spared assets and instruments governed by foreign law. From a macroeconomic perspective, it is therefore preferable that the resolution encompasses them as well, provided that the measure itself is legitimate and justified. The way in which the EU makes them effective must necessarily be indirect.

1. Cooperation agreements

The smoothest way to make resolution measures transnationally effective is to conclude an agreement with third States. The BRRD seeks to promote such agreements by authorizing them at different levels. It empowers the Council, on a proposal by the Commission, to conclude cooperation agreements.[95] Where the Council has not done so, each Member State may conclude a bilateral agreement.[96]

The BRRD does not clearly state the subject of cooperation. Its Article 93(1) mentions that the agreements will concern information sharing, but also includes the important words 'inter alia'. That recognition of EU resolution

[94] This will be different where the parties have expressly consented to be bound by resolution measures affecting their co-contractor; see section II.B. The text assumes that no contractual bail-in clause has been inserted in the instrument.

[95] BRRD, art 93(1).

[96] BRRD, art 93(2).

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measures is the ultimate goal of cooperation can be gleaned from Article 94 BRRD. The provision allows Member States to unilaterally recognize and enforce third country resolution measures. It applies 'unless and until an international agreement as referred to in Article 93(1) enters into force with the relevant third country'. This clause implies that where the EU enters into a cooperation agreement, it must ensure that it provides for the execution of resolution orders by third country measures. In exchange, the third State will demand a similar commitment with regard to EU measures.

Alternatively, EBA may also enter into a framework agreement.[97] Such an agreement may complement or substitute an agreement by the Council. It may also coexist with Member State agreements. As one of its subjects, the BRRD mentions 'the application of resolution tools and the exercise of resolution powers'.[98] This may cover recognition of foreign measures. Yet such a framework agreement is by its very nature non-binding. It may thus not commit non-Member States to recognize EU resolution measures, and vice versa.

2. *Unilateral recognition by third State*

Another strategy to make EU resolution measures effective across borders is to consider whether the third country will recognize the EU measure of its own volition. This is by no means impossible. Many States around the world feel a similar need to restructure banks in financial distress.[99]

The EU Member States' power to unilaterally recognize resolution measures by third States is not contingent on reciprocity.[100] This is in line with the FSB recommendation that such a condition should be avoided.[101] It gives cooperation a head start and helps lift bureaucratic obstacles. Yet in recognizing foreign resolution actions, the EU certainly hopes that other States will return the favour. Article 94 BRRD therefore is a sort of advance compensation for future cooperation and the 'bait' that shall entice foreign countries to recognize the European measures.

3. *Extraterritorial leverage*

Where no international agreements exist and where third countries do not recognize European measures voluntarily, one must have resort to other methods. A well-known strategy of governments wanting to give extraterritorial effect to their actions is to exert pressure on those persons subject to their authority. Examples include embargo legislation or anti-suit

97 BRRD, art 97.
98 BRRD, art 97(3)(e).
99 See the overview of third country regimes in section IV.
100 See BRRD, art 94.
101 FSB (n 6) 12.

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injunctions.[102] Companies or persons present in the jurisdiction are forced to adopt a certain mode of behaviour with regard to foreign actions or relations.

Such extraterritorial leverage is also to be found in the BRRD. The Directive obliges the persons exercising control of the ailing bank as well as the transferee, ie an acquirer of the ailing institution or a bridge bank, to take all measures necessary to ensure that the transfer is effective.[103] These persons, the control person and the transferee, are subject to the EU Member States' jurisdiction and can therefore be expected to fulfil their duties under EU law. They are obliged to take the necessary steps to ensure that the transfer is effective as a matter of foreign law.

It is not entirely clear which steps the person must take. In case of a transfer order, one can surmise that it must try to contractually effect the transfer from the bank to the buyer or bridge entity. In case of a write-down or conversion, it will be obligated to try to convince the counterparty either to renounce the debt or agree with its conversion into equity. Yet there will be obstacles to what the controlling person can achieve. The counterparty will normally not agree to bail-in measures without receiving substantial compensation. The obligation therefore only carries so far. What is factually impossible cannot be legally demanded, in line with the adage *impossibilium nulla obligatio est*.

4. *Substitutes*

For cases in which the above strategies are unsuccessful, the BRRD provides a default rule. The person controlling the ailing bank will have to hold the assets 'on behalf' of the recipient until the resolution measure becomes effective.[104] In other words, the EU obliges those under its remit—i.e. the persons controlling the ailing bank—to provide an interim solution. The formula gives room for interpretation, as can be witnessed by the different ways in which it has been transposed into national law.[105]

5. *Abstention and invalidity of measures*

Despite the many provisions of EU law, there will be instances where a transfer or bail-in fails because of the applicability of foreign law and the absence of a contractual clause ensuring enforceability on the counterparty. The BRRD provides that where it is 'highly unlikely' that a recovery or resolution measure will become effective, the resolution authority shall not proceed with it.[106] The formula is conspicuously imprecise. It is also asking a lot to demand that the resolution authority, which must typically act under

[102] See KM Meessen (ed), *Extraterritorial Jurisdiction in Theory and Practice* (Kluwer 1996) 97; KM Meessen, *Economic Law in Globalizing Markets* (Kluwer 2004) 282.
[103] BRRD, art 67(1)(a). [104] BRRD, art 67(1)(b). [105] See section III.F.1.
[106] BRRD, art 67(2).

considerable time pressure, to analyse the chances of a transfer or bail-in of the many thousands of assets and obligations of a bank. Ideally, this question should therefore already be assessed at the resolution planning stage.

What happens if the resolution authority proceeds with the resolution despite it having little chance of success? The BRRD provides that in such cases the order should be 'void'.[107] This sanction is quite rigid. It is also detrimental to legal certainty given that the conditions triggering the measure being void are so imprecise. According to the text of the Directive, the resolution measure is void when it is 'highly unlikely' that it will be effective. This is extremely vague. It is not even clear whether its assessment has to be made on an ex-ante or an ex-post basis. Given the many questions surrounding invalidity, it would have been better to avoid providing for such draconian consequences. It seems that the European rule did not go down well with the Member States, which is reflected in domestic law diverging from the EU position.[108]

E. The Special Case of Termination and Netting Clauses

A very peculiar problem arises from termination clauses and their typical corollary provisions for close-out netting.[109] These clauses feature in complex debt instruments such as derivatives. They provide that in the event of an insolvency of one of the parties, the contract will end prematurely and all claims will be set off against each other.[110] If clauses like these were triggered by resolution measures, they could thwart any bail-in attempt because their operation reduces the number of claims and hence the opportunity for writing down, cancelling or converting debt into equity. The BRRD prevents this result by providing in Article 68(1) the fiction that resolution measures shall not be deemed to be an enforcement event for the purposes of the termination clauses and the European Directives that support their validity. In addition, its Article 71 requires Member States to grant their resolution authorities the power to suspend early termination rights that may arise for other reasons. This follows recommendations by the FSB that early termination rights and netting clauses under the relevant contracts should be temporarily stayed in order to prevent their interference with resolution measures.[111] A stay of a few days will generally suffice since the resolution is usually implemented very quickly.

[107] BRRD, art 67(2).
[108] See section III.F.1.
[109] See eg section 6 ISDA Master Agreement 2002. The purpose of such clauses is to reduce the risk of a fallout of one contractual party in the event of an insolvency of its counterparty.
[110] See section II.D.
[111] FSB (n 1) 10; FSB (n 6) 7. For a detailed treatment of the effects of resolution measures on derivatives, see F G Alférez, 'Treatment of Derivative Claims in Cross-border Insolvency Proceedings' in D Faber and N Vermunt (eds), *Bank Failure: Lessons from Lehman Brothers* (Oxford University Press forthcoming).

For the temporary stay to work, it must also apply if the contract—including the netting clause—is governed by a law other than that of the resolution State. One will recall in this context that under the Winding-up Directive, netting clauses in general are not affected by resolution measures.[112] Yet the Directive now contains a special twist that allows the distinctive rules of Article 68 and 71 BRRD to work independently of the law applicable to the netting clause.[113] In addition, Article 68 is explicitly designated as an 'overriding mandatory rule' in the sense of Article 9 of the Rome I Regulation.[114] This is well meant, but it is insufficient. It works only inside the EU where the Rome I Regulation applies and where Union law thus has the power to define the notion 'overriding mandatory rules'. It does not work before tribunals of third States which are not obliged to heed the temporary stay contained in the BRRD.

Again, having reached the limit of its prescriptive powers, the EU hopes for the cooperation of other States. The Directive extends the benefit of a temporary stay to resolution measures adopted by the authorities of third States.[115] They will not be considered as events triggering early termination rights. The only condition is that the foreign measure has been recognized by a Member State under Article 94 BRRD, but even this requirement can be avoided where an EU resolution authority so decides.[116] This is cross-border cooperation at its best. Crucially, reciprocity is not a requirement. But it is obvious that the EU hopes other States will return the favour of a temporary stay for European measures.

The most important initiative in the area of temporary stay, however, does not come from a national legislator, but from a private actor. The International Swaps and Derivatives Association (ISDA) published a 'Resolution Stay Protocol' in 2014, which was updated one year later by the 'Universal Resolution Stay Protocol', as well as a 'Jurisdictional Modular Protocol'.[117] ISDA suggests that the users of its Master Agreement adhere to these protocols by signing them. Where both parties to a derivative have done so, an annex is automatically added to their contract, by which a special resolution regime regarding one of them will be enforceable upon the other. The various special resolution regimes are defined for different countries. The main effect of this annex is a temporary stay of the default rights, in particular the right to early termination. Thus through contract, the national resolution regimes are made binding upon parties outside the borders of the enacting State.

[112] See section II.D.

[113] See the introductory clause of Winding-up Directive, art 25 as amended by BRRD, art 117(3). A similar clause has been inserted with regard to repos in the Directive's art 27 by BRRD, art 177(4).

[114] BRRD, art 68(6). [115] BRRD, art 68(2). [116] BRRD, art 68(2).

[117] For background, see <https://www2.isda.org/functional-areas/protocol-management/protocol/22>.

F. Inconsistencies in Member States' Transposition

1. Legislative divergence

The BRRD is a significant step forward in the resolution of the conflict between bank resolution and private international law, but it has also become clear that its rules are complex and sometimes vague. It is therefore little wonder that the way in which they have been transposed into Member State law differs considerably. There is not enough space in this article to trace those differences exhaustively. Some examples might, however, give an idea of their type and degree.

As has been seen, the relationship between the BRRD and the Winding-up Directive creates some confusion.[118] This has led to divergent approaches in the Member States. The UK, for instance, has followed Article 117 BRRD's approach and treats resolution measures adopted by other Member States as reorganization measures under its Credit Institutions (Reorganisation and Winding up) Regulations 2004.[119] This means that such measures are recognized, but also that the exceptions found in that text apply. Immovable property, registrable rights, or reservation of title agreements, among others, will therefore be exempted from recognition.[120] The same approach is followed in France.[121] In contrast, the German approach simply provides that resolution measures by other Member States 'have the same effect' as those taken by the German resolution authority itself.[122] In other words, the German legislator puts foreign measures on an equal footing with its own. This far-reaching approach certainly helps the efficiency of foreign resolution measures, but contrasts with the more reserved attitude of other legislators.

Another example of inconsistent transposition relates to the situation in which Member State measures are not recognized in a third State. The BRRD prescribes that in this event, the person controlling the ailing bank will have to hold the assets 'on behalf' of the recipient until the resolution measure becomes effective.[123] This requirement has been transposed quite differently. French law obliges the controlling person to conserve the assets.[124] The UK Act states that the bank, and not the person controlling it, must hold the property for the benefit

[118] See section II.D.

[119] See Reg 2, UK Credit Institutions (Reorganisation and Winding up) Regulations 2004, as amended by The Bank Recovery and Resolution (No 2) Order 2014 SI 2014/3348, sched 3. Accordingly the definition of 'directive reorganisation measure' in the 2004 Regulations include, besides 'reorganisation measures' in the original sense of the Winding-up Directive, 'any other measure to be given effect in or under the law of the United Kingdom pursuant to Article 66 of the BRRD'.

[120] See UK Credit Institutions (Reorganisation and Winding up) Regulations 2004, arts 23–35.

[121] See French Monetary and Financial Code (Code monétaire et financier), arts L613-31-2, L613-31-5 and L613-31-6.

[122] Art 153(1), (2) German Recovery and Resolution Act (Sanierungs – und Abwicklungsgesetz – SAG), Federal Gazette (Bundesgesetzblatt) 2014, Pt I, at 2091.

[123] See section III.D.4.

[124] Art L650-9(3) French Monetary and Financial Code (Code monétaire et financier).

of the transferee.[125] Germany takes a middle way by obliging the controlling person to ensure that the bank will hold the property until the transfer becomes effective.[126] While the compatibility of the UK and German implementation of the Directive with the Directive itself is debatable, the differences between the legal systems are striking. The only point that all three countries agree upon is that payments to the transferee must be made on behalf of the bank.[127]

A final example of inconsistency concerns the voidness of the resolution measure. The BRRD foresees that a resolution measure by a Member State is void in case it is 'highly unlikely' that it will become effective in a third country. This sanction has been criticized before as being overly rigid and impracticable.[128] It is interesting to note that the Member States have found ways to avoid it. The German legislator does not declare the transfer void, but instead obliges the resolution authority to revoke the resolution order.[129] The UK Banking Act provides for voidness, but conditions it upon a determination by the Bank of England that it is not possible to effectuate the transfer.[130] This determination necessarily comes ex post facto and is not based on the unlikeliness, but on the actual impossibility of the transfer taking effect. The French legislator has chosen to simply not address the issue and merely obliges the authority to abstain from the action.[131]

In sum, national laws still diverge considerably regarding the recognition of resolution actions by other Member States and their relation to third States. Despite efforts at harmonization in the BRRD and the Winding-up Directive, their effectiveness is not guaranteed. This is partly due to conscious choices by Member States' legislatures, but is also a result of misunderstandings caused by the complexity of the texts. With hindsight, it would have been preferable if the EU had proceeded by way of a regulation to avoid such differences. At least, it should have given the Member States a precise text on which to model their transpositions.

2. *Judicial uncertainty*

The legislative discrepancies are compounded by vagaries in the case law. The BRRD is still young, but it took off on the wrong foot. Two recent decisions illustrate the uncertainty surrounding it.

[125] UK Banking Act 2009, section 39(4)(a) Banking Act.
[126] Section 81(1) no 2 German Recovery and Resolution Act.
[127] UK Banking Act 2009, section 39(4)(b); art L650-9(3) French Monetary and Financial Code; section 81(1) no 2 German Recovery and Resolution Act.
[128] See section III.D.5.
[129] Section 81(2), last sentence German Recovery and Resolution Act.
[130] UK Banking Act 2009, section 39(4a), introduced by section 38 of The Bank Recovery and Resolution Order 2014, SI 2014 No 3329.
[131] Art L650-9(3) French Monetary and Financial Code. See also art L613-50(9).

In May 2015, the Regional Court 'Munich I' had to decide on an aspect of the Hypo Alpe Adria saga that had clouded the relationship between Bavaria and Austria for a long time.[132] Hypo Alpe Adria was an Austrian bank that had lost its authorization as a credit institution and went into resolution. Its assets were transferred to a wind-down entity called HETA. Hypo Alpe Adria and HETA had both issued debt, with the Republic of Austria and the state of Carinthia acting as guarantors. The German public bank BayernLB had acquired part of this debt. A few days after the BRRD came into force in July 2014, the Austrian legislator adopted an act that cancelled or suspended some of these debt instruments and associated guarantees which were specifically mentioned.[133] Undeterred, BayernLB brought an action against Hypo Alpe Adria in the Munich court for the payment of the debt and guarantees.

One of the contentious points was whether the German court was obliged to heed the Austrian Act because of the BRRD. The claimant BayernLB alleged that the Austrian Act was not a transposition of the Directive, but merely a 'fig leaf' because the moratorium was not intended to restructure an active bank. Moreover, it argued that the BRRD would not apply to the case at hand since Hypo Alpe Adria only had subsidiaries and not branches in other Member States. The Regional Court clarified that the Directive covers credit institutions with subsidiaries in other Member States. Nevertheless, it came to the conclusion that the cancellation and moratorium were not covered by the BRRD, for two reasons. First, it agreed with the claimant that the Austrian Act was not intended to recapitalize an active bank, but rather resolved an ailing institution. Second, the court highlighted that the measure was not taken by an authority but by the legislature itself. It was therefore not a resolution measure within the meaning of the Directive, and a German court thus had no obligation to recognize it. While one can easily accept the first ground, the second one is more difficult to follow. It is hard to understand why the obligation to recognize a resolution measure by another Member State's administrative authority should not apply *a fortiori* to measures adopted by its legislature. Before these questions could be decided on appeal, the Austrian Constitutional Court put an end to the affair by invalidating the Act of 2014 on the ground that it discriminated between bondholders and unjustly repealed the guarantees taken out by the Austrian Republic and Carinthia.[134]

Another case in which uncertainties over the BRRD emerged was decided by the High Court of Justice of England and Wales (Commercial Court) in 2015.[135] The claimant Goldman Sachs had acquired debt owed by the Portuguese Banco

[132] *BayernLB v Hypo Alpe Adria (HETA case)* Regional Court, Munich I, judgment of 8 May 2015, BeckRS 2015, 15096.

[133] The Federal Act on the restructuring of the Hypo Alpe Adria AG (HaanSanG), Austrian Federal Gazette (Österreichisches Bundesgesetzblatt), 31 July 2014.

[134] Austrian Constitutional Court, decision of 3 July 2015, ECLI:AT:VFGH:2015:G239.2014.

[135] *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm), per Justice Hamblen.

Espírito Santo. In August 2015, the Portuguese resolution authority decided to transfer all of the bank's debt to a bridge entity called Novo Banco. On the basis of this act, Goldman Sachs brought an action against Novo Banco in the English courts. The particularity of this action, when compared to that of BayernLB in the Hypo Alpe Adria case, was that Goldman Sachs wanted the resolution measure *to be effective*. In December of the same year, however, the Portuguese resolution authority had adopted another decision according to which the transfer to Novo Banco excluded the debt held by Goldman Sachs International on the ground that it had been a former shareholder of Banco Espírito Santo and therefore should be bailed in.

The question before Justice Hamblen of the Commercial Court was whether the court had jurisdiction over Novo Banco based on the forum selection clause in the debt instrument. Novo Banco opposed this on the basis of the December decision, which excluded its subrogation to the debt held by Goldman Sachs International. Novo Banco took the view that the Commercial Court was required by the BRRD to recognize this decision taken by the Portuguese resolution authority. It argued that Goldman Sachs International could not have the 'plums' without the 'duff', ie the August decision without the December decision. Justice Hamblen saw things differently, however. He ruled that the UK only needed to recognize the August decision which operated the transfer of all assets and debt, but not the December decision which excluded the debt held by the claimants from the transfer. He noted that at the time of the August decision there was no 'duff'. Although he accepted that the BRRD allows for the transfer as well as the retransfer of debt, he refused to qualify the December decision in this way. In his mind, it did not fit any of the categories of resolution measures provided by the BRRD and was therefore outside of its scope. This manner of arguing seems highly legalistic and inadequate.[136] Because the resolution authority has the power to transfer and retransfer debt of its own volition, it must also be able to delineate the breadth of its own measures. In this context, the precise moment such a decision is taken can hardly matter.

Both of these rulings show a certain disquiet on the part of Member State courts to accept foreign resolution measures. This uneasiness is most probably due to the political nature of such measures and their interference with legal certainty and private property rights. The State which adopts them may be motivated by egoistic interests, such as cleansing its national banks from debt. Understandably, courts of other countries therefore consider it to be their prime role to protect their citizens and companies from foreign resolution measures. In doing so, however, they may undermine the goals of

[136] See also A Gardella, 'Bail-in and the Two Dimensions of Burden-Sharing' in ECB (ed), *From Monetary Union to Banking Union, on the way to Capital Markets Union*, ECB Legal Conference 2015, 224, available at <http://www.ecb.europa.eu/pub/pdf/other/frommonetaryuniontobankingunion201512.en.pdf> (doubting the consistency of the High Court's judgment with the Winding-up Directive as modified by the BRRD).

the BRRD.[137] One of these goals is to centralize remedies against resolution measures in the courts of the country of origin. Contrary to this intention, the validity and scope of such measures is made subject to scrutiny in civil proceedings concerning the enforcement of debt in other Member States. If one takes into account that such proceedings may be brought in many different civil courts all over the EU and even outside of it, it is easy to see that this may seriously compromise the efficiency of resolution measures.

3. *Political risk*

Apart from the legislative and the judicial branch, there is also the threat that governments may not heed the new resolution regime. They may be tempted to disregard its rules for political reasons. A recent illustration is the situation in Italy, where banks have a staggering 360 billion Euro of non-performing loans in their books.[138] The way to overcome this situation and recapitalize the banks under the BRRD is to slash their equity and debt or convert the debt into equity. Yet the Italian government is hesitant to do so because this would effect a large number of private investors, who were lured to lend money to banks with promises of high yields and safety. For fear of creating social unrest and political instability, the government therefore has looked into alternative options, including a taxpayer funded bail-out.[139] This would, however, directly contravene the prescriptions of the BRRD. Such political risk is difficult to avoid unless there is a supranational institution which has the power and willingness to enforce the resolution regime.[140] It is also not a typical cross-border problem, but one that surfaces in the domestic context as well.

IV. AN OVERVIEW OF THIRD COUNTRY RECOGNITION REGIMES

The efficiency of resolution measures under the BRRD in large part depends upon third States, which must have a regime in place that allows for the recognition of EU measures.

Switzerland is one of them. It has introduced a special resolution regime for credit institutions as early as 2003.[141] This was probably due to the fact that the country has huge banks in comparison to the size of its GDP, and therefore cannot bail them out, which forcefully demonstrates the need for a special resolution regime. Under the current law, the Swiss financial markets

[137] In the same sense J-H Binder, 'The Position of Creditors Under the BRRD' in *Commemorative Volume in memory of Professor Dr. Leonidas Georgakopoulos* (2016) 26 <http://papers.ssrn.com/abstract=2698086>.

[138] 'Italian banks: Essential repairs', *Financial Times*, 10 July 2016.

[139] ibid.

[140] On the direct application of EU rules by the SRB see section III.B.

[141] See art 25ff Federal Act on Banks and Savings Banks (Bundesgesetz über die Banken und Sparkassen – BankG).

authority (FINMA) is empowered to recognize foreign insolvency decrees and other measures issued by the authorities at the real seat of a bank.[142] Although it does not directly follow from the text of the relevant provision of the Swiss Banking Act, the *travaux préparatoires* make it clear that this power also includes the recognition of third country recovery procedures.[143] The FSB estimates that the Swiss recognition procedure takes two months,[144] which is quite long considering the urgency with which resolution measures must be implemented. Alternatively, FINMA may allow access by the foreign resolution authority to assets located on the territory of Switzerland, the only condition being that Swiss creditors receive equal treatment in comparison to other creditors.[145] Following the FSB's recommendation, the Swiss rules do not contain any requirement of reciprocity. The Swiss authorities can therefore recognize foreign resolution actions even where the State from which they emanate would not or did not do the same with regard to Swiss resolution measures.

The United States is another country that establishes a comprehensive resolution regime.[146] The so-called 'Orderly Liquidation Authority' (OLA) was introduced shortly after the height of the financial crisis by the Dodd-Frank Act.[147] It comprises many tools that can also be found in the BRRD: asset and debt transfer, bail-in of unsecured creditors, suspension of termination clauses. However, it dedicates relatively few provisions to international cooperation.[148] The Federal Deposit Insurance Cooperation (FDIC) has drafted a joint paper with the Bank of England on a common SPOE approach, yet it does not contain any binding commitment.[149] In the absence of any specific text on recognition of foreign resolution actions, US courts will follow the same general principles as in bankruptcy cases. They may give effect to foreign resolution measures under the principle of comity, but will do so only on a case-by-case basis. In the past, pre-insolvency measures have been both accepted,[150] and rejected.[151] It is therefore

142 Section 37g(1), (3) Swiss Federal Act on Banks and Savings Banks.

143 See Botschaft zur Änderung des Bankengesetzes (Sicherung der Einlagen), 12 May 2010, Federal Gazette (BBl) (2010) 3993, 4021.

144 FSB (n 6) 18.

145 Section 37g(2) Swiss Banking Act (Bankengesetz – BankG).

146 For an analysis, see MA McDermott and DM Turetsky, 'Restructuring Large, Systematically-Important, Financial Companies' (2011) 19 American Bankruptcy Institute Law Review 401; Skeel (n 40).

147 Title II Dodd-Frank Wall Street Reform and Consumer Protection Act 2010.

148 Skeel (n 40) 9 (noting that the Act provides only 'a handful of exhortations of US regulators to coordinate with their foreign counterparts').

149 FDIC and BoE, 'Resolving Globally Active, Systemically Important, Financial Institutions', Joint Paper, (10 December 2012) <http://www.bankofengland.co.uk/publications/Documents/news/2012/nr156.pdf>.

150 *Finanz AG Zurich v Banco Economico S.A.*, 192 F.3d 240, 246 (2d Cir. 1999).

151 *In Re Treco*, 240 F3d 148 (2d Cir. 2001)

impossible to determine in advance whether foreign resolution measures will enjoy recognition in the US.[152]

Other major financial centres also have resolution mechanisms in place, such as Japan[153] and Singapore,[154] but it is also uncertain how they will deal with foreign measures. In other regions, the situation is even bleaker. To illustrate, special resolution regimes are still anathema in Latin America.[155] The IMF concluded in 2014 that

> Many countries still lack comprehensive resolution powers for banks and other financial institutions (including the power to 'bail in' creditors) and effective mechanisms for the recognition of foreign resolution measures.[156]

This fact makes international cooperation difficult and impedes the cross-border effectiveness of resolution actions.

V. IDEAS ON HOW TO IMPROVE THE CROSS-BORDER EFFECTIVENESS OF RESOLUTION

The foregoing has shown that international cooperation is crucial to making resolution transnationally effective, but that it is uncertain whether other States recognize or support EU measures in this regard. It is particularly frustrating that this uncertainty will last until the very moment of crisis, when recognition and support is most needed. Moreover, the relative rarity of such events does not help cooperation. Game theory provides that the likelihood of cooperation increases with the frequency of encounters between the two sides.[157] States that are called upon to recognize foreign resolution measures of another country might assume—rightly or wrongly—that they will not find themselves in the same position at any point in the near future and, for this reason, they withhold cooperation. It might be feared, therefore, that cooperation will not emerge automatically over time. Even where States have cooperated in the drafting of a prior resolution plan, there is a time-inconsistency problem, as the precise conditions surrounding the resolution cannot be known in advance.

The conditions for mutual recognition and support are thus far from being ideal. International cooperation is not to be assumed, but needs to be fostered. What can be done? The FSB has taken an important step with the publication of 'Key Attributes of Effective Resolution Regimes for Financial

[152] D Geen *et al.*, 'A Step Closer to Ending Too-Big-To-Fail' (2015) 35 Futures & Derivatives Law Report 1, 5 fn 35.

[153] See K Harada *et al.*, 'Japan's Financial Regulatory Responses to the Global Financial Crisis' (2015) 7 Journal of Financial Economic Policy 51, 61.

[154] FSB (n 6) 18–19.

[155] J García, V Santillana and S Fernández de Lis, 'Resolution Regimes in Latin America' (2016) <https://www.bbvaresearch.com/publicaciones/regimenes-de-resolucion-en-america-latina/?idioma=en>.

[156] IMF, 'Cross-Border Resolution: Recent Developments' (2014) at 2 <https://www.imf.org/external/np/pp/eng/2014/060214.pdf>.

[157] R Axelrod, *The Evolution of Co-Operation* (Penguin 1990) 10–11.

Institutions' and the 'Principles for the Cross-border Effectiveness of Resolution Actions'. Yet it seems unlikely that they will suffice. In addition to being non-binding, they are notoriously imprecise. For example, the texts are conspicuously vague about the situations that may allow resolution actions.[158] This may lead to abuse, which may in turn hurt recognition by other States. The conditions for such recognition are equally loosely formulated. The FSB in some instances simply relies on the 'good faith' of the resolution authorities.[159] This formula is too unclear for adjudication; States need more precise criteria. Another drawback of the 'Key Attributes' and the 'Principles' is that they are couched in regulatory terms. They mainly focus on cooperation between resolution authorities. Yet ultimately, the effectiveness of resolution actions will depend on courts in which they will be tested. If it will not be upheld in litigation, the extensive regulatory framework that has been developed over the past years may break down like a house of cards. It is therefore necessary to convince judges of the need to recognize foreign resolution measures as effective, even where they are at variance with the applicable law under classic conflicts principles. Many judges will be unfamiliar with international soft law texts such as the FSB recommendations, and might find it difficult to transpose them into a legal context. In order to spur worldwide convergence on resolution, one must resort to other methods of transnational law-making.

A. An International Treaty?

One idea would be to negotiate, sign and ratify an international treaty which might require States parties to respect and support each other's resolution measures.[160] It could stipulate conditions for such an obligation, for instance that the measure was adopted by the authorities at the seat of the bank. It could also place limitations upon resolution powers or restrict them to certain cases.

For all its possible benefits, it is unlikely that a treaty would work. First of all, States will be reluctant to assume any binding obligation under public international law in an area that is so crucial to their economic, political and social well-being as the protection of banks and bank creditors' assets. And even if they were, one may reasonably doubt whether it would be of any use in a crisis.[161] Confronted with pressing realities, national authorities would

[158] See FSB (n 1) no 3.1: 'Resolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so.'

[159] FSB (n 6) 13.

[160] An international convention on resolution has been suggested by the Institute of International Finance (IIF), *Making Resolution Robust – Completing the Legal and Institutional Frameworks for Effective Cross-Border Resolution of Financial Institutions* (June 2012). At the same time, the IIF has suggested that it would not be necessary to consider the convention as a 'hard, binding treaty'; see ibid, at 14. The exact legal status of the text is therefore unclear.

[161] See also Grünewald (n 2) 75 (noting that even legally binding obligations would not guarantee effective burden-sharing).

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probably prefer to protect short-term domestic interests, even at the cost of violating their treaty obligations. Public international law is inherently weak where economic and political stakes are high. Other governments know this and will anticipate non-compliance. States would therefore find themselves in the uncomfortable situation that they were unable to make a credible commitment before a crisis.

B. Uniform Resolution Law

A more promising suggestion would be to draft a uniform text on resolution, such as a legislative guide or—even better—a model law.[162] The idea would be to formulate a set of rules containing precise conditions for bail-ins and transfer orders, and for recognition and support of resolution measures by other States. The backbone of such a uniform text would be formed by the FSB 'Key Attributes of Effective Resolution Regimes for Financial Institutions' and the 'Principles for Efficient Cross-border Resolution Actions'. They would, however, need to be more precise.

Such precise rules could be inspired by national legislation. The resolution regimes eg of Switzerland or of EU Member States could serve as a starting point. They would have to be stripped of their idiosyncrasies and transformed into a baseplate that is universally acceptable. This work could be done by one of the different organizations that have uniform law as their mission, such as UNIDROIT, UNCITRAL, or the Hague Conference on Private International Law.

A legislative guide or model law could bring many benefits. First, it would ensure that resolution actions are recognized by the courts and not just by administrative agencies. One could imagine, for instance, that courts could be obliged to respect such measures provided that they have been agreed upon or accepted by their national resolution agency. In this way, cross-border regulatory planning and cooperation becomes effective in courthouses. Second, a uniform text would guarantee a level playing field for resolution. A State recognizing the measures of another would have a reasonable chance that its own measures would receive the same treatment in similar circumstances. It would therefore not withhold its cooperation for fear of being duped. In addition, a legislative guide or model law could assist those States who were unsure which text to adopt. Many States lack the expertise and the experience in financial law that is necessary to draft their own resolution law. Being far from the financial centres of the world, they also have no particular interest

[162] A uniform text in the form of a model law has also been suggested by I Mevorach, 'Beyond the Search for Certainty: Addressing the Cross-Border Resolution Gap' (2015) 10 Brooklyn Journal of Corporate, Financial & Commercial Law 1 24–30. To a large extent, this proposal is similar to the one made here. One difference, however, is that Mevorach is strongly influenced by ideas of general insolvency law. The plea made here draws a sharp distinction between insolvency and resolution because the latter has a different goal; see section II.D.

or stake in these matters. This may be a major hindrance for any adoption of an appropriate law. An internationally backed model could act as a catalyst inspiring all States to take action on this matter.

An obvious counterargument against harmonization is sovereignty—an ambiguous word, which has numerous dimensions. First, sovereignty may mean that there is a need to adapt a State's resolution regime to the particularities of its existing legal system bearing on such questions. Yet resolution is a highly technical area, stands on its own and is not tightly woven into the rest of a country's legislation. It is also a new area and so it is unlikely that there will be much existing law which could stand in the way of the adoption of a new act. There will thus be not much need to adapt a common approach to local circumstances.

Second, sovereignty may express the need for policy space and regulatory diversity.[163] Yet a model law on resolution is not at variance with this aspect either. Resolution is not an area where creativity is needed, but rather strong and robust rules must be applied in the same way around the globe. While policy space and regulatory competition are important, they would not be beneficial in an area where the temptation to protect domestic interests is so strong as in resolution. Any benefits of new and innovative rules would be clearly outweighed by the damage of legislative divergence.

In addition, sovereignty is not directly compromised because the suggestion of a model law leaves room for national deviation. Being a model law, its rules can still be departed from. Whilst this limits its harmonizing effect, a model law may nevertheless bring some benefits. First, it will provide guidance for those legislators who do not know which rule to adopt. Second, it will provide transparency. Against its backdrop, any domestic deviation stands out. It will thus become clearer where States diverge and how. As a result, national legislators might feel pressure to at least justify any departures from the global model regime. Moreover, the experience of other model laws, such as the Uniform Commercial Code (UCC), suggests that deviations will be limited. Finally, a uniform text may lead to the emergence of global case law on resolution that can be catalogued and compared, such as that which exists in relation to the Convention on the International Sale of Goods (CISG) and other texts.[164]

A model law, if well drafted, will therefore ultimately result in increased transparency and uniformity, while maintaining some policy space for States.

[163] See R Romano, 'For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture' (2014) 31 Yale Journal on Regulation 1; R Romano, 'The Need for Competition in International Securities Regulation' (2001) 2 Theoretical Inquiries in Law 387; C Tietje and M Lehmann, 'The Role and Prospects of International Law in Financial Regulation and Supervision' in T Cottier, JH Jackson, and RM Lastra (eds), *International Law in Financial Regulation and Monetary Affairs* (Oxford University Press 2012) 133, 149.

[164] See eg the CISG Database, available at <http://www.cisg.law.pace.edu>. For court decisions and arbitral awards relating to the UNCITRAL's Conventions and Model Laws see the CLOUT database, available under <http://www.uncitral.org/uncitral/en/case_law.html>.

It would greatly enhance the potential for cross-border effectiveness of resolution actions. It would also entice global cooperation and strengthen the foreseeability of such actions.

C. More Inclusive Resolution Colleges

A further and final proposal is to improve the cooperation through resolution colleges. So far, such colleges are set up when a bank has significant branches or subsidiaries in more than one country.[165] But other States will be affected by such a measure as well. This is true, in particular, for the target State whose law governs the bank's assets and debt. This State has an interest in protecting local creditors. It may therefore be tempted to resist any foreign resolution measure or to adopt its own one.

Including target States in the resolution decision could improve the effectiveness of the measure. The countervailing interests could be openly discussed and a mutually satisfying solution be found. It could also help to make clear from the beginning which actions have the chance of being recognized by the target State and which do not.

One should therefore seriously consider the possibility of including target States into resolution colleges. This, of course, need not apply to each and every State whose laws govern a miniscule amount of a bank's assets or debt. The proposal made here is restricted to those States in which a considerable part of the patrimony is located or whose law applies to an important number of debt instruments that are subject to resolution and recovery measures.

Arguably, the presence of target States complicates the decision-making process. Where they are in a minority, they may be wary of submitting to an institution in which they are outnumbered by EU Member States. Conversely, where assets are dispersed over many third countries, these target States could be in a majority, prompting concerns that Member States could be outvoted. Yet these concerns are largely unfounded because decision-making in the resolution college is not binding upon the participating States: The BRRD allows participating States to disagree with a group resolution scheme or depart from it provided it gives detailed reasons for its behaviour.[166] It is true that the discussions in the resolution college may be more partisan and fractioned where non-EU States are involved. Yet this only mirrors the practical problems that will be encountered anyway once steps are taken to put the bank into resolution. Dealing with third countries cannot be avoided at this stage, when they may be more inclined to reject decisions in which they have not been involved. It therefore makes sense to involve them from the beginning.

165 See, for instance, from the EU perspective, BRRD, arts 88–89.
166 Art 91(8), 92(4) BRRD.

VI. CONCLUSION: RESOLUTION AND LAW'S ELASTICITY

Katharina Pistor has observed that financial law tends to be relatively elastic at the apex of the financial system and more binding on the periphery.[167] The foregoing analysis of the effectiveness of resolution measures provides a striking confirmation of this insight. Resolution measures are prime examples of law's elasticity. They may transfer rights in assets to third parties, and they may reduce or even cancel straightforward contractual claims ('IOUs'). The more effective resolution measures are, the less binding property rights and obligations are. As has been shown, the effectiveness of resolution measures diminishes on a sliding scale from the Eurozone to third States. The measures are most effective in the Eurozone, which is the most deeply integrated part of the EU. That means that property rights and assets are most flexible there. A middle area is occupied by the Member States that are not part of the Eurozone, which recognize resolution measures taken by other Member States or by the SRB. The measures are least effective in relation to third countries, where property rights are seen as 'hard law'.

This diminishing effectiveness of resolution, and the consequent hardness of law, does not come as a surprise. Its basic reason is the limitation of sovereign powers. The EU strives to make its resolution measures effective across borders. Nevertheless, it encounters natural limits where the law of a non-Member State is applicable according to the traditional rules of private international law. The EU cannot simply impose its measures on third States whose law governs debt or where assets are located. Rather, it must rely on transnational coordination. It is this coordination which makes resolution measures effective and thus increases the law's flexibility. Two suggestions on how such coordination might be enhanced have been made in this article: the elaboration of a model law and the inclusion of target States—ie States whose law applies to the bank's assets—into resolution colleges.

[167] K Pistor, 'A Legal Theory of Finance' (2013) 41 Journal of Comparative Economics 315, 317.