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European Union Directive 2001/24 on the Reorganization and Winding-up of Credit Institutions

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1. EU Insolvency Regulation and Directive 2001/24

A cornerstone in Europe's international insolvency law is the Council regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, which came into effect May 31, 2002.² A Regulation is a Community law measure, which is binding and directly applicable in all Member States, including the ten new Member States, which enlarged the EU as of May 1, 2004.³ Art. 1(1) InsReg excludes from its scope insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings, holding funds or securities for third parties, and collective investment undertakings. 'Insurance undertakings' are defined according to the description, set out in the EU Directive 2001/17 of March 19, 2001, on the reorganization and winding-up of insurance undertaking⁴, and 'credit institutions' are covered by the definition of the Directive 2001/24 of April 4, 2001, on the reorganization and winding-up of credit institutions.⁵ These institutions are excluded from the Insolvency Regulation since they are subject to special arrangements. Unlike a Regulation, a Directive will go through a legislative implementation process in each individual EC Member State. The implementation dates are April 20, 2003 (insurance) and May 5, 2004 (credit institutions) respectively, but only a few countries made these dates. The Winding-Up Directive with regard to credit institutions is to be regarded as to plug a gap left by the Insolvency Regulation.⁶ Furthermore, it should be kept in mind that both Directives broaden the regulatory framework with regard to (prudential) supervision on insurance undertakings and credit institutions. The Directive 2001/24 on the reorganisation and winding up of credit institutions forms part of the European Community legislative framework on the

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² Official Journal (O.J.) L 160 of 29 May 2000 (also referred to as InsReg).

³ The Insolvency Regulation is not applicable to Denmark.

⁴ O.J. L 110 of 20 April 2001 (also referred to as WUD Insurance).

⁵ O.J. L 125 of 5 May 2001 (also referred to as WUD Banks).

⁶ See Moss, Fletcher and Isaacs (eds.), *The EC Regulation on Insolvency Proceedings: A Commentary and Annotated Guide*, Oxford University Press (2002), no. 8.11. See also: Hüpkes, *The Legal Aspects of Bank Insolvency. A Comparative Analysis of Western Europe, the United States and Canada*, Studies in Comparative Corporate and Financial Law, Volume 10, The Hague/London/Boston: Kluwer Law International (2000), 7ff.

coordination of laws, regulations and administrative provisions with regard to the taking up and pursuit of the business of credit institutions as set up by Directive 2000/12/EC (the 2000 Banking Directive).⁷ The preamble to the WUD Banks refers to the Directive's legal foundation within the EC Treaty and especially art. 47(2) EC Treaty and the directives for the coordination of the national laws with regard to the taking up and pursuit of activities as self-employed persons. Its foundation is the principle of free establishment or of free provision of services without any further authorisation by the host Member State. In general this legal basis is supported by a well-established broad interpretation of this norm, which was already employed as legal basis for the Banking Directives, which preceded the 2000 Banking Directive. During the preparatory work it has been recognized that the main topic of Directive 2001/24 would be rules on private international law, which would – like with the EU Insolvency Regulation – bring the subject matter within the area of judicial cooperation in civil matters in order to establish progressively an area of freedom, security and justice (art. 61(c) EC Treaty). This would, amongst other, mean that the European Court of Justice only would be able to provide guidance for interpretation when in a Member State the court of the highest instance would approach the ECJ. It was however considered that art. 47(2) EC Treaty could be a suitable legal basis as far as such norms on insolvency law and civil law could be regarded as just accessories to the more important rules with regard to (prudential) supervision.

2. Goals of the Winding-Up Directive

Recital 1 and 2 to the WUD Banks hold it in the interest of the proper functioning of the internal EC market that (i) coordinated rules are established at Community level for reorganisation measures or winding-up proceedings in respect of credit institution and that (ii) obstacles to the freedom of establishment and the freedom to provide services within the Community are eliminated, particularly where that institution has branches in other Member States. The recitals 4 and 5 provide two main reasons for the introduction of the WUD Banks:

- a. Where, while in operation, a credit institution and its branches form a single entity, which is subject to the supervision of the competent authorities of the State where authorization valid throughout the Community was granted, it would be ‘.... particularly undesirable to relinquish such unity’ between an institution and its branches where it is necessary to adopt reorganization measures or open winding-up proceedings (recital 4);
- b. The adoption of Directive 94/19 on deposit-guarantee schemes, which introduced the principle of compulsory membership by credit institutions of a guarantee scheme in their home Member State, ‘.... brings out even more clearly the need for mutual recognition of reorganisation measures and winding-up proceedings.’ (recital 5). The main purpose of the Directive on the reorganization and winding-up of credit institutions is to ensure the recognition throughout the European Union of reorganization measures and winding-up procedures applicable in the home country of a bank.

⁷ O.J. L 12 of 26 May 2000, p. 1, as amended by Directive 2000/28/EC (O.J. L 275 of 27 October 2000, p. 37). See in general: Dale, Regulatory Consequences of the BCCI Collapse: US, UK, EC, Basle Committee – Current Issues in International Bank Supervision, in: Norton, Cheng and Fletcher (eds.), International Banking Regulation and Supervision: Change and Transformation in the 1990s (1994), 377ff.

3. Reorganisation measures and Winding up proceedings

Several key definitions with regard to the Directive on credit institutions are formulated in art. 2 WUD Banks. Measures that qualify as ‘reorganisation measures’ shall mean measures ‘..... which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties’ pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims’ (art. 2, 7th dash WUD Banks). In the definition of ‘reorganisation measures’ the principle elements are: (i) the aim of the measure, as a measure, which is intended to preserve or restore the financial situation of a credit institution, and (ii) the effect of the measure, as a measure could affect third parties’ pre-existing rights. Measures of this type include ‘..... measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims’. The latter words I understand to mean: the possibility of a suspension of payment initiated by the competent authority (art. 2, 4th dash WUD Banks) of the home Member State or the credit institution itself, suspension of enforcement measures against the bank or the reduction of claims that creditors have at the moment of the initiation of the measure (‘pre-existing’) against the bank, not being guaranteed deposit-holders or counter-parties in contracts as meant under art. 25-27 WUD Banks. It is even more confusing, where in the recitals – not in the Directive itself – the meaning of the word ‘measure’ is narrowed down and the group of persons, which could be seen as ‘third parties’ (who’s pre-existing rights could be affected), is limited. Two examples may serve as illustration. Certain measures, in particular those, according to recital 8 ‘..... affecting the functioning of the internal structure of credit institutions or managers’ or shareholders’ rights, need not be covered by this Directive to be effective in Member States insofar as, pursuant to the rules of private international law, the applicable law is that of the home State’. Recital 10 limits said ‘third parties’: ‘Persons participating in the operation of the internal structures of credit institutions as well as managers and shareholders of such institutions, considered in those capacities, are not to be regarded as third parties for the purposes of this Directive.’ This part of the (recitals to the) Directive demonstrates the level of detail that is followed and which may easily lead to interpretation questions. The second set of activities to be initiated under the WUD Banks is: winding-up proceedings. The words ‘winding-up proceedings’ shall mean ‘collective proceedings opened and monitored by the administrative or judicial authorities of a Member State with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure’ (art. 2, 8th dash WUD Banks). In the definition of ‘winding-up proceedings’ the principle elements include: (i) that it is a collective proceeding, (ii) opened and monitored by the administrative or judicial authorities of a Member State, (iii) with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure. The recitals do not provide further guidance with regard to these three elements. The definition of ‘winding-up proceedings’ differs from the one in art. 2(d) WUD Insurance, in that the latter one adds to the words in art. 2 ending with ‘.....by a composition or other, similar measure’, the wording ‘.....by a composition or other analogous measure, whether or not they are founded on insolvency or are voluntary or compulsory’. It should be noted that, in contrast to the Insolvency Regulation, the winding-up directives are not supported by Annexes, specifically mentioning each Member State’s proceedings.

4. Basic Legal Principles for Applicable Law and Recognition

Art. 3(1) WUD Banks captures the question of the exclusive international regulatory authority ('jurisdiction') and the principle of unity. Exclusive jurisdiction is provided to the home Member State's administrative or judicial authorities to decide on the implementation of one or more reorganization measures. A single entity approach is followed from the addressees of the measures 'in' – meaning 'concerning', 'towards' and indeed for certain intervening measures 'in' – a credit institution '..... including branches established in other Member States'. Art. 9(1) with regard to winding-up proceedings contains too the provision of international jurisdiction and the single entity approach.

In the recitals to the WUD Insurance one finds a type of law school book explanation in recital 10: 'Only the competent authorities of the home Member State should be empowered to take decisions on winding-up proceedings concerning insurance undertakings (*principle of unity*). These proceedings should produce their effects throughout the Community and should be recognised by all Member States. All the assets and liabilities of the insurance undertaking should, as a general rule, be taken into consideration in the winding-up proceedings (*principle of universality*).'⁸ Although the value of adding these characterisations between brackets seems questionable (the 'unity principle' within the domain of international insolvency law mostly is used to cover the idea of one formal proceeding) I would regard the use of 'unity principle' as an additional identification mark for both art. 3(1) and art. 9(1) justified, in that only one administrative measure or one judicial proceeding in the Community (and no parallel administrative measures from another Member State or secondary or ancillary proceedings in other Member States) can come into play.

Art. 3(2) WUD Banks covers the items of applicable law and recognition. Reorganisation measures shall be applied in accordance with 'the laws, regulations and procedures applicable in the home Member State', unless otherwise provided in this Directive. It lies down the applicable law, being the 'laws' etc. of the home Member State. The places where the WUD Banks provides otherwise are articles 20 till and including 27 and 30 till and including 32. From art. 3(2) WUD Banks follows that 'they' (meaning these reorganisation measures) shall be fully effective in accordance with the legislation of that (home) Member State throughout the Community without any further formalities, including as against third parties in other Member States. Without using the word in the text or in the supporting recital, in this provision the general rule of automatic recognition is laid down. In its effect it mirrors art. 16(1) InsReg.⁹

The WUD Banks only authorizes host country authorities to take reorganization measures, not winding-up measures (art. 5). If reorganisation measures fail, winding-up measures, which entail a collective liquidation of the bank's assets, a judicial arrangement, a composition or any analogous proceeding, must be decided by the competent authorities of the home country according to the law in force in that home country (art. 9(1) WUD Banks). A decision taken by the competent authority of the

⁸ Italics are in the original quotation.

⁹ Art. 16 InsReg: 'Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognised in all the other Member States from the time that it becomes effective in the State of the opening of proceedings'. The latter words of art. 16(1) InsReg (moment of which effectiveness elsewhere is there) do reflect in the third and the last sentence of art. 3(2) WUD Banks.

home Member State to open winding-up proceedings must be recognised without further formality within the territory of all other Member States (art. 9(1)). The WUD Banks requires the competent home country authority to inform the competent host country authorities before deciding to open winding-up proceedings, unless it is necessary to take action as a matter of extreme urgency, in which case immediate information is sufficient (art. 9(2)). Here, the WUD Banks follows the universality principle rigorously by (implicitly) prohibiting any other secondary winding-up proceeding other than the proceeding opened by the competent authorities in the home country, art. 9(1) WUD Banks. On the other hand, the Directive reserves the application of the laws of the Member States, other than the home country's insolvency law, with regard to the effects of insolvency proceedings on certain contracts or rights, see art. 20 ff.

5. Conflict of Law Rules: Lex Domus and Its Exclusions

Art. 10(1) WUD Banks contains the important rule of the applicable law to the winding-up proceeding. A credit institution is wound up in accordance with '..... the laws, regulations and procedures' applicable in its home Member State insofar as the WUD Banks does not provide otherwise. The first part lays down the same rule as applies ex art. 4(1) InsReg to insolvency proceedings, which concerns natural persons or (non-financial) legal persons. This (so called) *lex concursus* (or: *lex forum concursus*) governs all the conditions for the opening, conduct and closure of the insolvency proceedings, the admissibility of claims and the rules on distribution and preferences, etc. There is one difference, though. Art. 10(1) WUD Banks does not determine that the 'law' of the home Member State is universally applicable, it provides that 'the laws' (plural) and '..... regulations and procedures' of the home Member State are applicable. To symbolize (at least in its wording) this broader regime I will refer to 'laws, regulations and practices' as the '*lex domus*', in contrast to the *lex concursus* as meant in art. 4(1) InsReg. With regard to credit institutions one can think of specific 'regulations' and 'procedures' not being 'law' in a strict sense, e.g. regulations following from capital adequacy standards, from information standards to use in reporting lines to the supervisory authorities, preventive procedures with regard to safety in use of technology and supervisory procedures based on a cross-border Memorandum of Understanding concerning coordination and cooperation between supervisory authorities in different (Member) States.

With regard to reorganisation measures art. 3(1) encompasses three norms, namely (i) 'single entity', the credit institution in the home Member State and the branch in another Member State form one legal entity, (ii) 'unity', resulting in only one competent authority, exclusively the home country authority [in applying art. 9, one should read: one exclusive '... proceedings (and no secondary or ancillary proceedings elsewhere)] and (iii) 'universality', the effects of the reorganization measures and its applicable law (*lex domus* being the *lex concursus*, see art. 10) shall in principle apply throughout the whole Community. Contrary to the ungrounded recital 6, that the administrative or judicial authorities of the home Member State 'must have sole power to decide upon and to implement the reorganisation measures', recital 16 provides a foundation for the rule of international jurisdiction art. 9(1) introduces with regard to the opening of winding-up proceedings: 'Equal treatment of creditors requires that the credit institution is wound up according to the principles of unity and universality, which require the administrative or judicial authorities of the home Member State to have sole jurisdiction and their decisions to be recognised and to be capable of producing in all the other Member States, without any

formality, the effects ascribed to them by the law of the home Member State, except where this Directive provides otherwise.’

The central starting point of the WUD Banks is that the ‘laws, regulations and administrative provisions’ applicable in the home country (lex domus) determine reorganisation measures or winding-up proceedings. During the final negotiations of the draft-Directive a group of exceptions to the applicability of the lex domus has been inserted, e.g. (i) employment contracts remain subject to the law of the Member State whose legislation was applicable to the employment contract, (ii) a contract conferring the right to make use of or acquire immovable property is governed by the law of the Member State in whose territory the immovable property is situated, and (iii) rights with respect to immovable property (including ships and aircrafts) subject to registration are governed by the law of the Member State under the authority of which the register is kept (art. 20(a) – 20(c) WUD Banks). Both in these situations as with regard to rights in rem, reservation of title and the right to set-off (art. 21 – 23 WUD Banks) Directive 2001/24 adopted in principle the same rules as arranged in the Insolvency Regulation.

6. Equal treatment of all creditors?

It has been stated¹⁰ that the Directive ensures equality of treatment between creditors by (i) providing for one collective proceeding, and (ii) with regard to courses of action open to creditors by requiring the authorities of the home Member State to adopt such measures as are necessary for the creditors of other Member States to be able to exercise such rights to take actions, particularly the right to lodge a claim or to submit observations concerning to claims (art. 16 WUD Banks and art. 7(2) WUD Banks). I would at first glance nevertheless be reluctant to qualify the WUD banks as ensuring equal treatment between creditors. The topics Hüpkes describes are quite formal in nature. Where substantial/material rights are concerned art. 24 – 27 WUD Banks carve out a group of creditors in certain financial contracts. It is a general understanding that legal certainty in the context of cross-border insolvency proceedings is enhanced by clear and uniform rules on the law applicable to such proceedings, such as the choice-of-law rules laid down in the Insolvency Regulation and both Winding-up Directives. Within the banking sector however, it is strongly felt that there are instances where exclusive reliance on the laws of the home Member State may be detrimental to the stability and functioning of the financial markets. This concern has been addressed in the WUD Banks, by creating a group of exclusions to the general principle of the application of the laws, regulations and procedures of the home Member State. To these exclusions to art. 10 (‘lex domus’), the Directive contains other rules, which determine the law that shall apply. The WUD Banks provides a general conflict-of-law rule in art. 24.¹¹ In addition ‘netting agreements’ (art. 25) and ‘repurchase agreements’ (art. 26) shall be governed solely by the law of the contract, which governs such agreements. Transactions carried out in the context of a regulated market (see art. 2, 10th dash WUD Banks) shall be governed solely by the

¹⁰ Hüpkes (note 6 above), 166ff.

¹¹ Art. 24: ‘The enforcement of proprietary rights in instruments or other rights in such instruments the existence or transfer of which presupposes their recording in a register, an account or a centralised deposit system held or located in a Member State shall be governed by the law of the Member State where the register, account, or centralised deposit system in which those rights are recorded is held or located’.

law of the contract, which governs such transactions. Although I think I understand the rationale behind these carve-outs (protection of the stability of the financial system and ensuring confidence in the banking and financial system as a whole)¹² it surprises that the recitals do not contain any considerations as to the principle of equal treatment of creditors, as it concerns too that ‘netting agreements’ and ‘repurchase agreements’ are not defined whatsoever, which may lead to forms of ‘agreement’ shopping to push ahead.

7. Conclusion

The Winding-Up Directives require an early exchange of information between supervising authorities and enable for coordination of reorganisation measures or winding-up proceedings for insurance undertakings and banks with branches in other Member States.¹³ Although a more efficient way of dealing with reorganization and winding-up matters is welcomed, both Directives will result in some drawbacks. Both are EU legal measures and therefore obviously the natural limitation applies: the Winding-Up Directives mainly focus on Europe, although they both contain several provisions, which are of importance for branches of non-EU insurance undertakings and credit institutions. For banks and insurance companies with their head office outside the Community the Directives shall apply only where a non-EU institution has branches in at least two Member States of the Community.¹⁴ When European insolvency legislation (including supervisory rules and insolvency law) would be seen as one painting, one would note that after several decades the canvass is still unfinished (lacking rules for (collective) investment undertakings), with some conflicting lines (doubtful justification for different treatment of financial institutions) and mismatching colors (principle of coordinated universality, which includes secondary proceedings, in the Insolvency Regulation versus the principle of unity and universality in both Directives). The portrait in the painting seems quite unrealistic too. Several banking organizations conduct their business in corporate groups, operating cross-border and cross-sector (‘bankassurance’). Moreover, there are some watercolours, as certain issues only can be understood and interpreted by two or more applicable EU measures. As the key rationale for insolvency proceedings in general is an equal protection to all creditors, the Winding-Up Directive on Credit Institutions reflects a one-sided look at a portrait that should have shown multi-interests, where it creates special positions for certain creditors (carve-outs with regard to certain financial transactions and agreements).¹⁵

¹² See Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, September 1997, available through <<www.bis.org>>.

¹³ In the line of the figures presented in the ECB-report ‘Structural Analysis of the EU Banking Sector, Year 2001’ (November 2002) one may deduce that in the beginning of 2004 in 15 EU Member States some 7500 credit institutions operate. The number of branches of credit institutions from EEA countries will be over 500.

¹⁴ The Directives create for these branches cross-border duties to inform authorities. See: Bob Wessels, Non-EU Insurancecompanies and Banks and the EU Directives 2001/17 and 2001/24 on reorganisation and Winding-Up of Insurance Undertakings and Credit Institutions, posted at <<www.iiiglobal.org>>.

¹⁵ For a more profound analysis see my article A Glance Through the Legal principles and the Key Issues of Multinational Bank Insolvency, in: Bob Wessels, Current Topics of International Insolvency Law, Kluwer, The Netherlands, 2004, 259ff.