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# Institutional and Legal Impediments to Efficient Insolvent Bank Resolution And Ways to Overcome Them

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# Institutional and Legal Impediments to Efficient Insolvent Bank Resolution And Ways to Overcome Them

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## PREFACE

After a thorough examination and careful consideration of existing legislation, the paper submits for consideration a new scheme for the reorganization and liquidation of insolvent banks, of the kind that would greatly improve the process. As a statement of appropriate principles, the new scheme is meant to serve as a point of reference for the assessment of similarities and differences in current bank insolvency law in the United States, and the EU and EEA. The purpose of this study is not to draft the legislation that would go with the scheme, but to indicate a range of possible solutions to the problem of treatment of insolvent banks.

# I. INTRODUCTION AND SUMMARY

This paper explores the legal constraints for establishing a more efficient procedure for removing unsuccessful banks from the system. It calls for special legal techniques that treat banks differently than other companies. A number of important propositions about banks underlie the proposals in this paper:

- Banks are unique because they create money balances repayable at par and on demand, take deposits from the public and invest them in their own name, play a central role in countries' supply of credit, and operate payment systems.
- A bank's financial condition is difficult to determine and monitor. Without adequate information, the failure of one bank can lead depositors to withdraw their funds from other banks as well (contagion).
- For the effective functioning of a monetary system, all banks operating within it must be sound and efficient. Though markets generally ensure such conditions in other industries by driving bad firms out, the unique nature of banks justifies supervision and regulation.
- Bank regulators supervise banks in the public interests, and, therefore, have a duty to revoke licenses of insolvent to protect public confidence in the banking system.
- In order to ensure a return on their investment, it is in the interest of bank owners to keep their banks sound and efficient. It is the responsibility of the market participants, on the one hand, and of bank supervisors, on the other, to monitor their success.
- Preventing a bank's failure and depositor losses by allowing it to continue operating when insolvent, encourages excessive risk taking by such banks (moral hazard) that historically have resulted in still larger losses down the line which were ultimately paid for by depositors or (almost always) the public treasury (tax payers).
- Discouraging bank runs by guaranteeing all depositors eliminates important market incentives to monitor bank soundness, thus placing an unrealistic responsibility on supervisors and on the public treasury.
- The best way to preserve market discipline, while protecting the confidence of depositors on the soundness of banks, is for the regulators and supervisors to intervene early, while the problem bank still has sufficient assets to cover deposits, and to do so with such speed that depositors' access to withdrawal of their funds is not seriously interrupted.
- Experience shows that general insolvency proceedings are not adequate for the task of an expeditious, effective, and economic administration of insolvent banks or deployment of their assets. There are powerful reasons to believe that there is a superior way to deploy bank assets and to settle liabilities. Generally, this goal cannot be met by resorting to traditional company reorganization or bankruptcy proceedings

and hence, requires government intervention under special administrative procedures for dealing with bank insolvency.

## A. The Need for Efficient Bank Exit

An effective exit policy for removing unprofitable banks from the industry is an important component of the framework for developing and/or maintaining a healthy banking sector. The joint regulation of banks by the market, by owners, and by the state, to be effective, requires clear and efficient procedures for removing unprofitable or dishonest banks from the industry. There is a distinction between bank failure and the problem of preventing further losses that an exit policy is meant to resolve.

In every industry some firms are more successful (better quality produces desired by the public at lower prices) than others. Those that fall below the market's standards of performance are forced out as the result of being unprofitable and eventually unable to meet their financial obligations. Banks are no different in this regard. In addition to the problems of poor management, inefficient or bloated staffs, and poor service levels, banks can lose their ability to honor their obligations to depositors and other creditors as a result of investments of depositor resources that decline in value or loans that can not be repaid. Those firms that systematically act impulsively or underestimate the risks of investment are replaced by those that calculate risks better.

Allowing an insolvent bank to keep its license and continue operating is dangerous. The owners and managers of insolvent banks have a financial incentive to take large risks in the hopes of restoring solvency (if they lose, their depositors, deposit insurance and/or the public treasury bear the cost). Typically, the outcome is a further accumulation of losses. Their continued operation diverts deposits from other banks, which both reduces the productivity of these resources and weakens good banks. Interest rates can be distorted by the distress borrowing of such banks, and the public's confidence in the banking sector reduced, shrinking the size and contribution of the banking sector in the overall economy.

Generally, if insolvent banks are not removed from the industry, spreads between deposit and lending rates will be greater than necessary, and savings will be allocated less efficiently to investment thus slowing the pace of economic growth. Banking system problems can also reduce the effectiveness of monetary policy and reduce monetary policy options, create large fiscal costs relating to rescuing troubled financial institutions, trigger capital flight, and sometimes derail stabilization programs. Further, as global financial markets integrate, the risk increases that financial weaknesses in one country will spillover to another. The lesson is that bad banks poison the system for everyone and should be removed.

## B. The Features of Efficient Bank Exit

### License revocation under general insolvency laws

Typically, the authority that licenses banks is authorized to revoke their licenses. In some countries, the revocation of a banking license means immediate liquidation, by the

operation of law, for insolvent (and solvent) banks. In others, the liquidation decision is made by a court upon its own findings on insolvency.

A bank that loses its license would have to stop taking new deposits and to repay existing ones if it could. If it could not do so, uninsured depositors or other creditors could petition the court to place the bank in bankruptcy. A bankruptcy decree, which might not be issued by the courts for many months, results in the freezing of deposits pending the liquidation of its assets under liquidation procedures. Only then would the proceeds of selling off its assets be distributed to its remaining creditors in accordance with their priorities of payment, with a surplus (if any) going to its owners. The liquidation process could take up to five to ten years, though limited interim deposit payouts could be allowed by the court before the completion of the process.

Due to the unique nature of banks, such an exit policy provides minimal protection of the resources due to depositors and other creditors of banks. This is because depositors can continue to withdraw their funds on a first-come-first-served basis until their bank's liquidity runs out or until their deposits are frozen under bankruptcy, which axiomatically results in less recovery of value by others. Under these circumstances, the authorities have generally chosen not to revoke a banks license until they were able to obtain a court declaration of bankruptcy.

When faced with the choice between (i) significant depositor losses and the long delays that they would have before gaining access to the amounts that can ultimately be returned to them, or (ii) regulatory forbearance (allowing insolvent banks to continue to operate) and/or a full guarantee (bail out) for all depositors, virtually every government has chosen the latter option, and done so despite the well-known moral hazards and the public treasury's costs of such policies.

Another approach is needed based on special legislation. Before the authorities will actually use more appropriate procedures for bank exit, however, the procedures must be legally unchangeable, politically acceptable, and economically efficient.

**Temporary protection of assets**

The potentially long delays in resolving an insolvent bank by revoking its license encourages runs on the bank. While a run that forces the closing of an insolvent bank, when the regulator was too slow in initiating the closure, is a good thing—the delay allows depositor withdrawals on a-first-come-first-serve basis. This permits those withdrawing their money first to opt out of the sharing of the assets among creditors on a pro rata basis, a fundamental principle of all insolvency law, and thus, undermines public confidence in the banking sector.

In order to gain time and contain the dissipation of a bank's assets pending a declaration of bankruptcy by a competent court, some countries provide the bank regulator with a number of powers to restrict the undertaking by the bank of new commitments and any transfers of funds in settlement of existing commitments. It may be necessary to place

immediate limits on individual deposit withdrawals or even to close the bank for a few days until an assessment can be made of the value of its assets and liabilities. These are temporary powers of compulsory administration which may be used to limit any activities of the bank, but do not permit the regulator to step into the shoes of its shareholders and proceed with its reorganization, liquidation, or other deployment of assets outside courts.

In the EU and EEA countries, the administrator may not recapitalize a bank without express consent of its shareholders' meetings.[2] Instead, the administrator may only suspend shareholders' meetings.

Nevertheless, the protection of assets during the temporary period of compulsory administration will be helpful in making bank exit more efficient in some cases. However, unless the value of the bank, including the presumably negative liquidation value of its balance sheet, is considered positive by at least one potential new owner, liquidation under the provisions of the bankruptcy law remains the means of resolution at the end of the temporary period of administration.

**Rapid financial restructuring or liquidation outside general insolvency laws**

For closed banks (and other companies), most countries' laws provide for the courts to distribute losses and allocate entitlements. Under company bankruptcy procedures, owners lose all rights of property except for a claim on any residual value of the liquidated bank. Court-appointed and supervised liquidators act on behalf of the creditors in obtaining and distributing the realizable value of the bank's assets. They may be limited to selling the assets by auction unless creditors agree to some other approach. Closing and liquidating a problem bank piecemeal is generally not feasible (increasing the risks of runs on good banks).

Economic efficiency and depositor confidence generally require that a failing bank be resolved without serious disruption of its depositors' access to their funds. These factors also require that intervention takes place immediately upon the event of insolvency, maximizing the value of the assets of the bank (i.e., minimizing losses to all creditors). The fulfillment of these criteria generally calls for distribution of losses up-front—at the beginning of the intervention—and continuing the bank, in legal personality and entity, under new owners and new management. Closing and liquidating a bank piecemeal is a last resort that is rarely a practical option for all but the smallest banks.

The ability of the regulator to seize an insolvent bank, succeeding to its shareholders' interests or to its assets, would represent a very important improvement over simply revoking the insolvent bank's license. Having an option to transfer the ownership of the bank from its shareholders to an expert agency, allows the authorities to freely dispose of the shares and assets attached to the bank to the greatest advantage (i.e., to maximize their value). The passing of ownership through seizure means that the government incurs an obligation to compensate those divested of their rights and interests. This obligation to depositors and

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[2] See the judgment of the European Court of Justice (ECJ) of March 12, 1996 in Panagis Pafitis v. Trapetza Kentrikis Ellados, et. al. (C-441/93).

other creditors can be based on a hypothetical liquidation valuation of the subject bank's assets and liabilities as of the date of intervention. Such conversions of ownership, inconsistent with bankruptcy law, require special legal provisions to enable the authorities to seize the bank and its assets, and to sell it or its assets to new owners. ***Thus, bank insolvency must be explicitly exempted from the provisions of the general Bankruptcy Law, which do not authorize such conversions of ownership.***

Since seized banks would generally be deeply insolvent, it will not be possible to sell them at a positive price. If financial assistance is needed (whether from the government budget, deposit insurance fund, or reductions in the claims of creditors) to make the sale possible, it would be inappropriate (both in terms of fairness and economic incentives) for the owners of the insolvent bank to benefit from such assistance. In addition, excessive reliance on the budget as a source of such assistance would also be inappropriate (both in terms of tax payer acceptance and market regulation by depositors). For both reasons, ***the insolvent bank, if continued in legal personality and entity, requires both equity and debt restructuring (i.e., the elimination of pre-existing owners, and the reduction of claims by creditors—or haircuts)***.

In order to pass the bank to new owners, the authorities must be able to take control of the bank's outstanding shares, management, assets and operations as soon as the insolvency is determined. Since banking supervisors have no particular expertise in running or administering banks, the intervened bank will also need to be sold (in whole or in part) very quickly, for which purpose the risks and obligations undertaken by potential new owners will need to be well understood and limited. Ideally, the bank would remain in operation during this short period. These requirements pose significant legal and practical challenges and preclude the use of traditional bankruptcy procedures that freeze the pre-petition claims of depositors and other creditors (automatic stay), and subordinate them to post-petition claims.

An insolvent bank that is taken over by the authorities is vulnerable to runs if its solvency is not reestablished forthwith, and guaranteed by the state subsequently.

The agency responsible for the bank's resolution (e.g., the FDIC in the United States) may be able financially to meet the losses of the bank, or announce that it guarantees the bank's ability to discharge its deposit liabilities and other obligations as they fall due and become payable. Such a risk of deposit withdrawals exceeding the bank's assets can be taken on by the agency (i.e., the government)). A court cannot impose such liability on the government.

For any prompt resolution of the bank (e.g. a sale of the whole bank (as a legal or economic entity), or a purchase and assumption of substantially the whole bank and liquidation of the rest), it is necessary for the agency to be able to establish the bank's hypothetical liquidation value, and to allocate on that basis, in accordance with liquidation rights and interests, any short-fall up front as of the date of intervention. The process of establishing the value of assets and liabilities, and, derivatively, the value of each claim

supported by the assets can be completed almost immediately after takeover. The latter process is pure arithmetic if the authorities follow the absolute priority principle.

The reestablishment of solvency is, of course, a prerequisite for continuing a bank in legal personality and entity for the time being. The valuation provides a key to the selection of claims and interests for cancellation. In addition to the rateable reduction of liabilities (haircuts), the privilege of cancellation would extend to the cancellation of contingent liabilities and to the selective repudiation of the bank's future liability on a range of possible claims (including repudiation of outstanding labor and rental contracts) as well. Once restructured, the newly solvent bank would be sold to an acquirer that is able and willing to recapitalize the newly solvent bank up to the applicable legal and regulatory capital requirements.

The legal provisions for the seizure of an insolvent bank, its financial restructuring up-front, and its sale to new owners must be carefully designed and drafted to ensure that they are not confiscatory of private property of its owners or creditors. The law must ensure due process, say, if the apparently insolvent bank was not, in truth, insolvent as of the date of intervention. In the event of any undervaluation of assets or overvaluation of liabilities, the law could provide that the net profit—remaining in the agency's books after administrative expenses—could be returned to those divested of their rights or interests.

The requisite legal issues differ from country to country because there is no uniform bank insolvency law. The fact that some countries follow civil law and others follow common law, complicates the analysis. This paper examines these problems and proposes an approach that would appear to be legally unchallengeable and economically efficient.

## C. Public and Private Law Approaches

There are two polar regimes for the enforcement of insolvency law in respect of banks. These are the systems of enforcement of bank insolvency laws of the kind that prevail in the EU and EEA countries, on the one hand, and the systems of enforcement of the kind that prevail in the United States, on the other. The former is a private law approach, while the latter is a public or administrative law approach. The paper lays down a new scheme for bank reorganization and liquidation, based on public enforcement, as opposed to private enforcement of the law.

Bank insolvency laws in EU and EEA countries are a part of general insolvency laws that are predicated on the principle of private autonomy. This presupposes the existence of impartial and independent courts or tribunals that decide upon the merits of each case on the basis of the record as established by the individual parties involved. States are not, therefore, parties to bank insolvency proceedings. They do not, therefore, intervene as successors to an insolvent bank, or to its assets or liabilities, in insolvency proceedings before courts, although they may appear, having an exclusive right to file reorganization or liquidation petitions, as interested non-parties (Germany). As claimants, they intervene, like the creditors, under private law. Private law distributes the losses and, conversely, allocates the entitlements, according to the material general law (general property, contract and corporation laws), and

the insolvency law (classified as civil procedure in some countries). The decision-making by which the process functions is carried out by courts (or tribunals), without review by governments.

In the U.S., the Government charters and terminates banks. Designated administrative agencies take over (seize) problem banks, and then, as successors in interest, liquidate their assets and liabilities for their own account (and not for the account of depositors and other creditors). Their successor liability is limited to the value of the "receivership estate," a misnomer. Under the prescribed rules of succession, they also succeed to the shareholders' interests, and to the creditors' claims with respect to the bank and its assets. Except to the extent the liabilities are supported by the hypothetical liquidation valuation of the seized bank's assets (including any amount available to the bank under the obligation that the FDIC owes to the insured institution), the law discharges as "moot" any further liability that the government might have incurred as successor. These powers to carry out seizures of banks and their assets, to terminate the seized banks in legal personality and entity, and to limit successor liability vis-à-vis those divested of their property and assets, have not been successfully challenged, for example, on constitutional grounds.

## II. Proposed Approach

### A. Outline of the New Scheme

The objective of a "new" scheme of the kind outlined in this paper, is to provide the legal means for taking an insolvent bank from its owners, financially restructuring it (up front and without significant interruption in the access of depositors to their funds) if needed in order to sell it or its valuable assets to new owners. Such a process would have greater prospect of being used by the supervisory authorities promptly, thereby removing the moral hazard and ultimate cost to the public treasury of forbearance and bailouts.

Under the new scheme the administrative authorities would remain in control of the legal consequences that license revocation or other similar intervention bears on the depositors and other creditors of an insolvent bank. Thus, in lieu of simply revoking the license of an insolvent bank (and, indeed, remaining indifferent to litigational outcomes), the authorities would carry out a seizure: their succession to the ownership of the subject bank would ensure a speedy conversion of the ownership of the bank in reorganization from pre-existing shareholders to new owners. Alternatively, their succession to the ownership of the assets of the bank, would ensure their speedy conversion from the ownership of the subject bank to its depositors or other creditors. The latter liquidation option would be always available if the authorities wish to skip finding a new owner, and, hence, proceed to an outright liquidation of assets.

In other words, the seizure of ownership of the bank (as opposed to a seizure of its assets) under the new scheme, implies that the bank continues in legal personality and entity, and does not change its status from a bank to a nonbank. Compare this with the seizure of assets from the insolvent bank, which removes, by the operation of law, its competence to

dispose of them. In the latter case, the bank may well survive as a corporation under EU and EEA-type general corporation laws, which may continue its existence, for the time being, in legal personality and entity as an empty legal shell. Under the U.S. banking laws, having been placed in receivership, the insolvent bank cannot continue, although the government succeeds—by the operation of law—by its shareholders' interests the mandatory pulling of its charter terminates it in legal personality and entity forthwith. As a result, the U.S. law—unlike the new scheme—precludes bank reorganizations.

Moreover, the purpose of a new system is not to underwrite the losses incurred by an insolvent bank. At one level, a concurrent asset, debt and equity restructuring of an insolvent bank upon its seizure would limit its indebtedness to what is supported by its assets, on a hypothetical liquidation valuation carried out as of the date of intervention: that is, as if the bank had been liquidated on that date. Such a restructuring, which would be carried out by the operation of law, as of the date of intervention, would re-establish the solvency of the bank. Thus, upon its seizure by the specialized agency, the bank's net assets would be zero, limiting the bank's and the agency's successor liability (if any) to meeting the post-seizure losses arising during the agency's ownership of the bank. Any successor liability of the State would be limited accordingly.

Compared with the U.S. system of bank "resolution," the new system would permit the authorities either (i) to reorganize an insolvent bank; or (ii) to liquidate it's assets outright, or upon the conversion of the reorganization into liquidation, if the bank proves nonviable, or cannot be sold. In the U.S., however, the authorities pull the charter of each and every bank upon seizure, which terminates the seized bank in legal personality and entity. There then follows a rapid conversion of the assets (i) from the ownership of the terminated bank to the ownership of the Government (seizure), (ii) from the Government to acquirers of assets and liabilities (purchases and assumptions); and, then, (iii) from the Government to the depositors and other creditors. In other words, the proceeds of asset sales are credited to a receivership account established to discharge the Governments' successor liability for its own account. It is not as a true trust account for the benefit of creditors.

Parallel to passing the ownership in the assets of the bank—as has been explained in the preceding paragraph—the U.S. system also passes the ownership in the seized bank to the Government, conferring—for legal purposes only—a moot claim on the former owners against the Government for divestment of their interests (so that they cannot trace the assets held by the Government or subsequent purchasers, or attach them for successor liability). Indeed, experience shows that former owners always lose their case against the Government in U.S. courts: their claims for wrongful conversion are typically disposed of by a summary judgement for lack of any recognizable interests. Owners' interests are treated at zero value in insolvency, according to the absolute priority principle.

Thus, like the U.S. system, the new system would carry out a prescribed series of changes of ownership on a hypothetical liquidation valuation of the property (shares) and assets in question: for example, from the pre-existing shareholders to the Government (seizure), and, then, from the Government to the depositors and other creditors through a novation or cash discharge of their claims. Unlike the U.S. scheme, however, the new

scheme offers the option of keeping a bank alive (if it is worth more alive than dead), which means continuing it in legal personality and entity. This cures the defect of the FDI Act which is a categorical requirement that each and every bank must be resolved upon seizure. This would not be a realistic move where the costs and risks of converting an insolvent bank's assets into cash through judicial insolvency proceedings would be exorbitant, especially if the deposit insurance covers only small claims or a fraction of all claims.

### B. Organization of the Paper

The following sections examine by reference to a proposed new system of bank reorganization and liquidation the rules that govern the distribution of losses and, conversely, the allocation of entitlements in bank reorganizations and liquidations. They also review the rules that govern the collective decision-making by which the process functions:

- By reference to private systems of enforcement of bank insolvency law and to the systems of public enforcement (section III); and
- By reference to collective reorganization and liquidation proceedings (insolvency proceedings) that apply to banks under general insolvency laws in the EU and EEA countries, and under the U.S. Bankruptcy Code that does not apply to banks, but only to bank holding companies (section IV).

Indeed, the synthesis below of the observed divergent national trends shows that the four existing systems of bank reorganization and liquidation mentioned in the above, are so far incompatible as to make it difficult even to contemplate any international rules and standards in the field of bank insolvencies.

## III. Comparison of Private Systems of Enforcement of Bank Insolvency Law with Systems of Public Enforcement

### A. Introduction

This Section compares and contrasts the two polar systems of private and public enforcement of bank insolvency laws. It will be submitted below that the distinction between the two systems is one of a difference in decision-making authority. Such authority forms the legal basis on which the process of bank reorganization and liquidation functions. It may not be a distributional difference: because the rules that govern the distribution of losses and, conversely, the allocation of entitlements in bank reorganizations and liquidations, may be identical, the answer to the questions of who gets what, how much, and in which order, can be the same under both systems. Systems of private and public enforcement vary relative to the degree of centralization of decision-making in the administrative authorities. The characteristic feature of decision-making under systems of public enforcement, is the omission of collective proceedings.

Under either system, the legal safeguards of the uninsured creditors and shareholders vary—from country to country—according to collateral constitutional law or other legal

requirements. In the U.S., for example, the legal safeguards are equivalent under systems of private and public enforcement of insolvency laws, since any disputes arising under judicial insolvency proceedings under the U.S. Bankruptcy Code, or under administrative debt settlement procedures prescribed in Section 11 of the FDI Act, must be settled by courts if a party so desires.

The legal safeguards of the creditors and owners of an insolvent bank in any particular country, depend on the applicable substantive and procedural law and the definition of private property as opposed to other pecuniary rights. Thus, the collateral legal characteristics of each legal system determine the level of legal protection, rather than whether the enforcement of civil rights or obligations, vested in the administrative or judicial authorities.

Thus, in the final analysis, the difference between systems of private and public enforcement is one of decision-making. The former typically vest the decisions by which the process functions in individual creditors and shareholders, in meetings of individual creditors and shareholders (collectively), in court-appointed reorganizers and liquidators, and in the competent courts themselves. Systems of public enforcement rely on the Government, or a designated specialized agency, to perform those decision-making functions single-handedly.

The following subsections examine eight features of systems of private enforcement that are inherently unsuitable in the field of compulsory reorganization and liquidation of insolvent banks, and, therefore, cannot be corrected without a changeover to a system of public enforcement.

### B. Objects and Purposes of Bank Insolvency Law

Disregarding purposes that are in the public interest, the existing systems of private enforcement of bank insolvency law differ from systems of public enforcement by their very object and purpose.

General insolvency laws protect the rights of creditors and, therefore, cannot derogate from their rights by pursuing multiple objectives. Focusing on debtor-creditor relations, general insolvency laws do not concern the corporate status of an insolvent bank, the protection of which belongs to general corporation laws, or even the public treasury, of which the protection belongs to public law. Their object or purpose is no more than to satisfy the depositors and other creditors, vesting both the rights of initiative, and of other legal actions exclusively in them, indeed, a veritable function of debt-collection. In contrast, the purpose of the Federal banking laws that make up the bank insolvency law in the U.S., is to maintain confidence in its banking system: securing the rights of insured depositors is within the public interest, as is the fair and equitable treatment of uninsured creditors.

**Under a new scheme for public enforcement, a specialized agency would function solely in the public interest, including the prompt settlement of claims held by uninsured depositors and other creditors, and the wiping of the pre-seizure shareholders.**

### C. Expedition, Efficiency and Economy

By subordinating expedition, efficiency and economy to the absolutes of the judicial process (indifference to the passage of time), the systems of private enforcement of bank insolvency law cannot replicate the respective benefits available under systems of public enforcement.

Regarding systems of private enforcement of bank insolvency laws, the opening of court-supervised insolvency proceedings may be triggered by way of private petition. Since private parties do not have access to relevant data, court proceedings involve delays. Especially in contentious cases, this collective decision-making by which the process functions may involve considerable delays in the opening of insolvency proceedings. For example, individual creditors may, for strategic reasons of their own, delay the opening of insolvency proceedings.

The determination by the court (on the basis of the record) of the condition of the subject bank may involve long delays in contentious cases. During judicial reorganization proceedings, it may take a long time to carry out of the collective creditor voting procedures find it hard to make a bargain. Alternatively, if the bank is put into liquidation, the finding of buyers to buy assets and assume equivalent liabilities on terms that are acceptable to the court, the carrying out of the liquidation of its assets, and the distribution of proceeds thereof, will take time. Experience shows that the completion of such proceedings may take years.

In contrast, systems of public enforcement are predicated on decision-making by the government, or a specialized agency. The *lex specialis* typically provide for an up-front seizure by the authorities of an insolvent bank. That is to say, the seizure may be limited to the shareholders' interests attaching to an insolvent bank in reorganization, or, alternatively, to the assets of a bank in liquidation. In either case, the authorities, having appropriated the shares or assets, may keep the bank open and operating, pending a decision on whether or not to reorganize or liquidate the bank.

**Under a new scheme for public enforcement, a specialized agency would step into the shoes of an insolvent bank, omitting collective proceedings in the presence of a multitude of parties.**

### D. Revaluation

Judicial reorganization proceedings omit an authoritative valuation by a court of the assets and liabilities of a subject bank. Courts rely exclusively on liquidity tests on determining insolvency. As they lack financial powers to make any valuation stick (e.g., by guaranteeing asset values), any determination of the value of the assets and liabilities up-front would be pointless. The existing systems of private enforcement do not, therefore, provide for the settlement of an insolvent bank's liabilities up-front.

Under systems of private enforcement, therefore, any distribution of proceeds of reorganization or liquidation must await the completion of the settlement process. A bank in reorganization or liquidation cannot resume the making of payments and transfers with respect to pre-petition commitments. Thus, the continuation of the bank in legal personality and entity is a rather theoretical possibility. Under systems of public enforcement, however, the law fixes the liability of the bank in reorganization with respect to its pre-petition commitments, or, alternatively, the liability of the specialized agency as successor to its assets. The up-front valuation of the assets and liabilities of an insolvent bank would enable the bank to honor a good portion of its pre-petition commitments.

In addition, the proving of claims may be expedited in the administrative process. The hypothetical liquidation valuation of the claims takes place as of the date of intervention, with the liability of the State getting fixed at that point. True, the State would take the losses due to dissipation of assets under its administration, but it would also take the profits (permitting the authorities to change the distribution of losses and the allocation of entitlement retroactively. Lacking any financial resources whatsoever, it is not for the court-supervised liquidators take such risks in settlements carried out in judicial process.

As a consequence, the rates at which depositors and other creditors recover their claims are likely to be higher in an administrative claims settlement process than the rates that can be realized in judicial process, since the latter may involve material interest losses over longer periods required for the completion of settlements with uninsured depositors and other creditors, or with deposit insurance funds that subrogate for the rights of insured creditors. Primarily these greater losses are the result of the inevitable loss in value of a bank that is not able to continue to operate.

**Under a new scheme for public enforcement, a specialized agency would perform the revaluation of the assets and liabilities of a subject bank up-front. The valuation of assets at market is justified if the bank is apparently insolvent, e.g., it has generated arrears in the settlement of its commitments.**

### E. Assumption by the State of that Portion of the Insolvent Banks' Indebtedness Above the Cut-off Point and Cancellation of the Balance

Under systems of public enforcement, the uninsured depositors and other senior creditors of an insolvent bank normally benefit from the assumption by the State of the portion of its indebtedness that is above the cutoff point ("solvency point"), which is determined by the authorities, in a binding and final manner, as of the date of intervention.

Unless the State participates in a bailout, it incurs no liabilities relating to insolvent banks vis-à- vis the banks themselves, or third parties, under systems of private enforcement. Courts or their officers cannot pre-finance any allocations of entitlements (i.e., of non-cash proceeds of reorganization and of cash proceeds of asset sales), but individual depositors and other creditors will await the confirmation by a court of a reorganization plan, or a liquidation plan, whichever comes first. Under systems of public enforcement of bank insolvency laws, the pre-intervention shareholders benefit from the assumption by the State

of liability for the divestment by the authorities of their shares. The value of the outstanding shares of an insolvent is, by definition, zero, and, therefore, the liability would attach to the State if, after all, it was not, in truth, insolvent on the date of intervention (e.g., the succession by the authorities to the shareholders' interests, or to the assets of the bank—which belonged to the creditors on that date).

Under systems of public enforcement, the State typically incurs a liability to pre-intervention shareholders if it succeeds to their interests (i.e., for purposes of reorganization), or to the pre-intervention creditors' rights to the assets of the bank (for purposes of liquidation). This liability of the State, is fixed by the authorities up-front: that is, as of the date of succession by the State to the assets of an insolvent bank, and the assumption by the State of an equivalent liability vis-à-vis the pre-existing depositors and other creditors. Such a binding and final determination removes any contingencies, and, thereby, transforms the claims in the hands of beneficiaries into marketable assets. Moreover, the final and binding hypothetical liquidation valuation carried out as of that date, insulates, by logical necessity, the claims from changes in value due to post-intervention costs and risks, pending the eventual redemption by the State of the claims.

In contrast, the legal claims of depositors and others remain indeterminate under systems of private enforcement until the eventual completion of collective proceedings. The determination of the value of their claims, in relative and absolute terms, must await the confirmation by a court of a reorganization or liquidation plan, which is contingent on the prior approval by the depositors and other creditors of the plan, or by the prior approval of a shareholders meeting. In other words, the creditors also bear the post-petition losses. This is true under the private enforcement of general insolvency laws in the EU and EEA countries, and of the private enforcement of the provisions of chapter 11 of the U.S. Bankruptcy Code.

Indeed, there is no way for an individual depositor or other creditor to know beforehand his distributive share of the proceeds of an eventual reorganization, until the confirmation by a court of the plan. It is hard to know even then, as the eventual distribution of proceeds of a judicial reorganization takes the form of allotment of novated claims that are not necessarily redeemable at par and on demand. The value of any new shares of an insolvent bank may issue in exchange for unpaid debt under chapter 11 of the US Bankruptcy Code (if it applied to banks in the first place ) is also indeterminate.

**Under a new scheme for public enforcement, a specialized agency would succeed to the liabilities of an insolvent bank to the extent supported by the up-front valuation of its assets and liabilities.**

### F. Absolute Priority Principle to Replace Relative Priority Rules in Bank Reorganization

In EU and EEA countries, judicial bank reorganizations involve collective proceedings among creditors and shareholders to determine the allocation of proceeds of reorganization. This is besides, the adoption by a legislature of symmetric rules to govern the distribution of losses, and the allocation of entitlements both in the reorganization and

liquidation of an insolvent bank might give the parties an incentive to "bargain in the shadow of law," and to implement a workout without any intervention by the authorities. To be sure, unless the rules are symmetric regarding the distribution of proceeds or reorganization or liquidation, the shareholders would engage in strategic behavior to opt for reorganization.

**Under a new scheme, the distribution of losses, and, conversely, the allocation of entitlement would take place according to the absolute priority principle. This solution avoids any collective proceedings.**

### G. Super Priority for Pre-intervention Depositors and Other Creditors

An unwritten purpose of systems of private enforcement is to impose the costs and risks of post-petition developments on uninsured depositors and other creditors, on the one hand, and on the deposit insurance fund upon subrogation to the rights of insured creditors, on the other. The reason for the above problem is, as has been noted above, the fact that courts cannot act for the account of the State: for instance, by guaranteeing any valuation for the purposes of trades in an insolvent bank's assets and liabilities. Systems of public enforcement, presuppose the carrying out of an valuation of assets and liabilities upon intervention, with the State assuming the balance of liabilities on its own valuation of the seized assets.

**Under a new scheme for public enforcement, a specialized agency would discharge the obligations or meet the losses when an insolvent bank is intervened (i.e., guarantee the pre-intervention of assets and liabilities after restructuring). Therefore, those claiming on the basis of affirmed pre-intervention liabilities would be insulated from the costs and risks of subsequent operation of the bank, or the administration of its assets by the authorities.**

### H. Exposure of Administrative Authorities to Legal Process

Under systems of private enforcement, the State incurs no liability to pay compensation to those divested of their rights and interests attaching to an insolvent bank in reorganization or liquidation. Acting only through the courts that traditionally enjoy immunity from judicial process, the State does not become liable for losses.

However, under systems of public enforcement, the State incurs a liability to compensate those divested of their rights and interests in the course of public enforcement of bank insolvency law due to the seizure by the authorities of the bank or its assets. In assuming any successor liability, the authorities may disclaim the excess portion of such liabilities.

**Under a new scheme for public enforcement, a specialized agency would not have sovereign immunity from the judicial process with respect to the assumed and unassumed liabilities of the insolvent bank.**

### I. Liability for Discretionary and Non-Discretionary Decisions

When acting through the judicial authorities under systems of private enforcement, the State limits its residual responsibility to the intentional misconduct of proceedings. When acting through the administrative authorities under a system of public enforcement, the State incurs liability for the administrative acts, thus safeguarding the legal position of those divested of their rights and interests.

**Under a new scheme for public enforcement, the specialized agency would incur liability for its nondiscretionary decisions. The statute would disclaim liability for certain discretionary decisions, such as the valuation of assets and liabilities of a subject bank. Without more, such decisions could not be appealed to courts. Other discretionary decisions could be reviewed by the government or courts, as the case may be.**

## IV. COMPARISON OF BANK INSOLVENCY LAWS OF THE EU AND EEA COUNTRIES WITH THE U.S. BANKRUPTCY CODE

### A. Introduction

This section compares the collective reorganization and liquidation proceedings (insolvency proceedings) under general insolvency laws in the EU and EEA countries, which apply to banks, with the U.S. Bankruptcy Code (which does not apply to banks, but only to bank holding companies). It examines differences in the rules governing the distribution of losses and, conversely, the allocation of entitlements; and in the collective decision-making by which the process functions.

As private systems of enforcement, general insolvency laws in EU and EEA countries give legal effect exclusively to the creditors' substantive and procedural rights. The courts observe other interests to the extent they are reflected in the formulation of the creditors' rights. An examination of the civil law and common law systems of private enforcement reveals three main differences between general insolvency laws in the EU and EEA countries, on the one hand, and the U.S., on the other.

Those three features of general insolvency laws which are listed under (B), (C), or (D) below, are inconsistent with an appropriate legal regime for insolvent banks.

### B. General Insolvency Laws Do Not Affect, Modify, or Annul Shareholders' Interests

By their very purpose, the provisions of general insolvency laws in EU and EEA countries may affect, modify, or annul rights and obligations in the debtor-creditor relationships, and, conversely, do not affect, modify, or annul the interests of shareholders, which are regulated separately under general corporation law.

In the U.S., however, chapter 11 of the U.S. Bankruptcy Code refers both to creditors' claims, and shareholders' interests, as objects of distribution of losses, and, conversely, of the allocation of entitlements. As has been noted, this applies only to bank holding companies but not to banks, which are resolved pursuant to section 11 of the FDI Act. Section 11 does not authorize any compulsory debt or equity restructuring of banks in conservatorship or receivership, and, consequently, does not even raise the issue of debt or equity restructuring.

General insolvency laws of the kind that prevail in Europe today, do not affect, modify or annul the shareholder's interests, or the corporate charter or the bylaws of an insolvent bank, for the reason that this would conflict with the provisions of general corporation law. Each national system of civil law is based on a division of its rules into categories. This division determines whether a set of circumstances falls within a recognized type of legal relations. Typically, general insolvency laws take the subjects' property rights and interests as they come. This means that they do not override shareholders' interests, for example, by way of authorizing compulsory amendments of charters and bylaws of banks.

As regards debtor-creditor relationships, the general insolvency law vests the rights and obligations in the exclusive jurisdiction in the competent general court. Concurrently, general corporation laws apply to the corporation-shareholder relations in a parallel process. This rigorous adherence to categories, has precluded any combining the two processes into one. The field of bank insolvency law is no exception.

**Under a new scheme for public enforcement, decisions of the authorities would affect, modify, or annul rights and obligations in the debtor-creditor relationship as well as shareholders' interests in corporation-shareholder relationships; for example, by amending bylaws.**

### C. General Insolvency Laws Permit Holders of Worthless Shares to Refuse Equity Restructuring

Having exempted the shareholders of insolvent banks from general insolvency law, thus, granting them a virtual "immunity" from any insolvency proceedings, the general insolvency laws of EU and EEA countries presuppose that holders of worthless shares have an incentive to cooperate in the equity restructuring of a bank in reorganization. They do not. This is inconsistent: the holders of worthless equity instruments can participate in collective equity restructuring of proceedings, whereas the holders of worthless debt instruments cannot participate in collective debt restructuring proceedings. In the U.S., however, shareholders cannot block equity restructuring (debt or equity exchanges) in judicial reorganizations under chapter 11 of the U.S. Bankruptcy Code.

Under a new system for public enforcement, the agency would determine the cutoff point (or solvency point) by administrative decision, based on a hypothetical liquidation valuation of the assets and liabilities of an insolvent bank. The holders of worthless equity instruments under water would be wiped out by the operation of law.

The above difference between the jurisdiction of competent European general courts under general insolvency laws, and that of American bankruptcy courts is not very transparent. It has escaped analysis in legal literature.

### D. General Insolvency Laws Preclude Other Than Debt Restructuring

As a result, the general insolvency laws in EU and EEA countries preclude the carrying out by the authorities of a comprehensive asset, debt and equity restructuring, say, as a prerequisite for a bailout. The concurrent application of property, contract, corporation and insolvency laws, has so far precluded comprehensive bank restructurings under private systems of enforcement, whereas systems of public enforcement of bank insolvency law override other laws (*lex superior*), and are not hampered by highly compartmentalized law in the EU and EEA countries.

**A new scheme of public enforcement would provide—in addition to some features of the FDI Act—for the asset, debt and equity restructuring of insolvent banks. A new scheme of the kind that is described above, would not run afoul of *Pafitis*. Indeed, the EC 2nd Capital Directive prohibits measures of compulsory equity restructuring by way of a judicial or administrative decision addressed to shareholders. Therefore, if the authorities seize the shareholders' interests as a pre-requisite for restructuring, no legal issue arises. The European Court of Justice (ECJ) took a strong stand in the *Pafitis* case against the use of Government orders to issue new shares without prior approval from a shareholders' meetings, diluting, thereby, the outstanding shares.**

## V. EVALUATION OF THE TWO POLAR REGIMES

**Claims settlement**

The European Convention of Human Rights (ECHR Convention)[3] does not require a judicial review of administrative decisions and actions affecting civil or common law rights and obligations. For example, the French system of administrative law precludes the judicial review of administrative decisions.

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[3]Article 6 of the European Convention on Human Rights provides that, in the determination of his civil rights and obligations, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial court or tribunal established by law. Accordingly, Article 13 of the First European Banking Directive provides that member states shall ensure that decisions taken in respect of a credit institution in pursuance to laws, regulations and administrative provisions adopted in accordance with the Directive may be subject to the right to apply to the courts, and that the same shall apply where no decision is taken within six months of its submission in respect of an application for authorization which contains all the information required under the provisions in force.

The above Convention forms a common core of constitutional law regarding protection of private autonomy for the some [50] countries that as of now are members of the Council of Europe. Indeed, it is legally significant that a review of administrative decisions and actions by an administrative tribunal, satisfies the applicable standard of procedural due process contained in Article 6 (1) of the ECHR Convention which ensures access to independent and impartial courts or tribunals regarding administrative decisions that affect, modify, or annul civil rights or obligations. Article 6 (1) can be satisfied by limiting access to such administrative tribunals as long as the government cannot overturn their decisions. This, of course, stands in stark contrast to the U.S. standard of constitutional law, which subjects the settlement of disputes by the government and administrative authorities, to a judicial review, and, thereby, precludes the establishment of a complete regime of administration for banks in distress.

Accordingly, the new scheme contemplates that the administrative functions of intervention and claims settlement be separated from the performance of judicial functions by courts. It is, therefore, neutral on the question whether or not the dispute settlement functions proper belong to a court or to a tribunal. In any event, it precludes any review by Government of administrative decisions and actions affecting, modifying, or annulling civil or common law rights and obligations, provided that such decisions and actions have been confirmed in an impartial and independent process.

**Problems of existing systems for enforcement of bank insolvency law**

This synthesis and assessment of observed divergences in the field of bank insolvency laws suggests necessary changes in current bank insolvency laws in the EU and EEA countries, as well as in the U.S. To give an example, legislation in EU and EEA countries does not authorize seizures of banks in distress other than for their provisional administration by the authorities, as opposed to the seizure by the administrative authorities of an insolvent bank under the Federal banking laws in the U.S. Although the U.S. banking laws authorize the administrative authorities to carry out seizures of insolvent banks on the account of the State, they omit the provisions for the comprehensive restructuring of a seized insolvent bank. In conclusion, therefore, neither the EU and EEA countries, nor the U.S., authorize the debt and equity restructuring of insolvent banks.

For example, instead of restructuring banks upon bailouts or seizures, the current Federal banking laws in the U.S. provide for bailouts of banks in systemic cases, and for their seizure by the authorities in non-systemic cases, and do so without any requirement of their restructuring. These laws expect voluntary concessions from shareholders and creditors to serve as a pre-requisite for bailouts by the authorities. This does not minimize the potential costs and risks to taxpayers in bailouts. Under current law—in Europe as well as in the U.S.—there is no alternative to a bailout of a bank that the authorities want to continue in legal personality and entity. Indeed, being unable to restructure an insolvent bank and to continue it, the FDIC sets up successor banks (e.g., so called "bridge banks") to purchase their assets and to assume their liabilities.

**Proposed solution**

Why not provide for the reorganization of insolvent banks in all cases in which the bank is better continued in legal personality and entity than terminated? The new scheme provides for the seizure by the administrative authorities of an insolvent bank, combining the seizure with a comprehensive asset, debt and equity restructuring of the seized bank to be carried out by the operation of law up-front upon seizure. The re-establishment by the operation of law of the solvency of the seized bank and its ability to sell new shares following equity restructuring, would serve as a pre-requisite for any bailouts of the bank, whether the bailout would be carried out at the expense of the public treasury, or at the expense of any third party (unpaid creditors or new investors). In all cases, therefore, the new scheme always eliminates the over indebtedness of the bank, and reestablishes its solvency at the expense of its shareholders and creditors upon its seizure (i.e., according to the so-called absolute priority principle). Among other things, this distribution of losses eliminates the moral hazard that would otherwise face the shareholders and uninsured creditors as beneficiaries of state aid—the literature refers to them as free riders and hold-outs.

The above solution would also resolve the legal problems that relate to the compulsory equity restructuring of insolvent banks. The ECJ declared in *Pafitis* that certain bank insolvency laws of Greece[4] which authorized the administrative authorities to order capital increases and the issuance of new shares, were inconsistent with the EU 2nd Capital Directive (EU Capital Directive). The Directive pertains to so-called public limited liability companies registered in member States. As ownership passes from shareholders to a specialized agency thereunder, the new scheme would eliminate the need.

## VI. CONCLUSIONS

The preceding sections provide a comparative examination of current national legislation in the U.S., and in the EU and EEA countries pertaining to (i) the distribution of losses and, conversely, the allocation of remaining entitlements in the reorganization and liquidation of insolvent banks, and (ii) the administrative and judicial decision-making by which the process functions. The question is whether or not there are overriding or hard legal constraints that prevent the adoption of more expeditious, effective and economic bank insolvency laws than the existing laws. The answer is no.

It appears that no hard legal constraints prevent the delegation of legislative authority for bank reorganization and liquidation to a specialized agency, although there lingers a perception that the supervision of insolvent banks belongs to courts. No such constraint can be identified in EU and EEA countries. In the U.S., however, their seizure belongs to an administrative agency that settles, in its capacity as successor to their assets, any claims for its own account under a *lex specialis*. The U.S. Constitution does permit the agency to settle

[4] Other countries, at least Norway continue to have legislation on its books that permits the Government to order that an insolvent bank to recapitalize itself by issuing new shares. This, of course, may dilute to near zero the voting power of pre-existing shareholders.

debt disputes by entering conclusive factual and legal findings. The agency is "no more an adjudicator than an insurance company authorized to disallow any claim not proven to its satisfaction...."[5] By assigning the settlement of claims to an administrative agency and the settlement of disputes there of to courts, the U.S. banking laws greatly gain in speed and efficiency.

Where taxpayers have bailed out banks, the laws have failed the tests of expedition, efficiency and economy. Yet, it would appear that the current laws do not wipe out at least the shareholders of an insolvent bank as a pre-requisite of a bailout by the public treasury, as would happen if the bank had been liquidated as of the date of intervention. Indeed, the liquidation of an insolvent bank is unlikely in systemic cases. The authorities are likely to continue insolvent banks in legal personality and entity, at the expense of the public treasury. With a bailout being a probability, there is little prospect of voluntary contributions from an insolvent bank's directors, managers and employees, or shareholders or other owners (that have not committed to stand behind the bank as controllers of banks often undertake to do); or from its uninsured creditors, or from holders of its contingent liabilities; from its landlords and so forth. Indeed, their chances that the Government will rescue the bank are augmented for three intertwined reasons in EU and EEA countries:

- The inability of the Government, or the administrative authorities, to proceed, without delegation of legislative authority, to seize the insolvent bank (i.e., by "taking" its outstanding shares), or its assets, in order to keep it open and operating for the time being (irrespective of whether it would be liquidated or reorganized later);
- The inability of the authorities to compulsorily recapitalize an insolvent bank (i.e., without approval by a general meeting of shareholders;
- In some EU and EEA countries,[6] banking laws place restrictions on the filing by the bank itself of voluntary petitions for reorganization or liquidation, as well as on the filing by their depositors and other creditors of involuntary petitions for the opening of judicial insolvency proceedings contrary to the fundamental principles of their access to judicial process to vindicate private rights; and
- The availability of State aid for a bank's recapitalization (at least) in systemic cases, both to reestablish the solvency of the beneficiary, and then to recapitalize it to the point at which it would meet applicable legal and regulatory capital requirements.

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[5] Morrison-Knudsen Co. v. CHG Int'l Inc., 811 F.2d 1209 (9th Cir. 1987). The holding in Knudsen was reviewed in Coit, which confirmed that administrative agencies cannot be empowered to resolve disputes with the force of law. They can only notify the claimants of their claims and wait for a reasonable time before filing suit while the agency decided whether to pay, settle or disallow the claim. Coit Indep. Joint Venture v. Federal Savings and Loan ins. Corp., 489 U.S. 561, 109 S.Ct. 1361 (1989).

[6] Federal banking laws place a prohibition on the filing by banks themselves, or by their depositors and other creditors of administrative or judicial petitions for the seizure banks. Acting in the public interest, the FDIC preempts their concerns having a power to investigate banks, and initiate action, in order to maintain confidence in the U.S. banking system.

Of course, the exposure of the public treasury would be reduced, were the applicable law to reduce the (apparently) insolvent bank's debt, or debt service, to the point at which the banks assets would meet its liabilities, and to wipe out pre-existing shareholders to enable the bank to recapitalize. As a corollary, the law would, based on a hypothetical liquidation valuation of an insolvent bank's assets and liabilities, preserve any liquidation rights and interests as of the day of intervention by the authorities. Ideally, such a downward adjustment (or, what is referred to in business as a compulsory debt and equity restructuring), would serve as a prior or concurrent condition of any seizure, bailout or other form of compulsory replenishment that may be carried out by the authorities in respect of the insolvent bank's net assets.

The first topic was concerned with the principles of hypothetical liquidation valuation of an insolvent bank's assets and liabilities and the relative and absolute priority principles which come into play in the allocation of entitlements during bank reorganizations (e.g., debt and equity instruments). The latter determine the multilateral burden-sharing (if any) between the public treasury (as it may be claiming reimbursement of costs and indemnity for risks), and the shareholders, depositors, and other creditors. The paper shows that current law does not extract mandatory concessions from the latter, or require the assignment of an insolvent bank's future earnings to the public treasury as a pre-requisite of a bailout. Asymmetric rules apply to the "who gets what, how much, and in which order" in the distribution of the proceeds of reorganization, as opposed to the priority that creditors should have over shareholders in the liquidation of the assets of an insolvent bank.

The second topic was concerned with the scope and content of the administrative and judicial decision-making by which the process of bank reorganization and liquidation functions. What is it that the owners and uninsured creditors of an insolvent bank have in the back of their minds as they turn into potential free riders and holdouts? The answer is that they know that bailouts by the Government do not generate legal consequences for them except by their own assent (e.g., in collective proceedings). The Government cannot (unless it can show intentional wrongdoing) make pre-existing shareholders discharge any of the obligations of the subject bank, or make them meet the losses incurred by it. For example, the EC Commission's approval policy regarding State aid for problem banks does not condition its approvals of infusions of public money on the making of prior concessions by pre-existing shareholders or creditors. The FDIC's open bank policy, which was predicated on voluntary concessions by shareholders and creditors, lapsed since last year.

The State aid provisions of the EC Treaty do not preclude permanent legislation that wipes out pre-existing shareholders of insolvent banks, reestablishes the solvency of the bank by debt or debt service reduction, or authorizes the State to recapitalize the newly solvent bank. According to the private investor principle, the State may subscribe to share issues on the same basis as any investor.

In conclusion, efficiency, expedition and economy speak for taking insolvent banks out of the supervision of courts and vesting the decision-making by which the process functions in the administrative authorities under a public law l*ex specialis*. Appropriate

procedures for the seizure, reorganization or liquidation of insolvent banks could be put in place.

The European Human Rights Convention (EHRC) requires no judicial review of administrative acts that affect, modify or annul civil (or common law) rights and obligations. Indeed, case law under the Convention shows that the requirement can be met by setting up a dispute settlement body inside an administrative agency, or a separate administrative tribunal. The Convention imposes no maximum speed for the conduct of insolvency or like proceedings before a dispute settlement body, on the condition that the body is impartial and independent, and that its decisions are final and binding (i.e., they cannot be reviewed by the Government).