THE INSOLVENCY LIQUIDATION OF A MULTINATIONAL BANK (December 1992)

Introduction

This paper discusses the insolvency liquidation of a multinational bank using the Bank of Credit and Commerce International S.A. (BCCI S.A.) as a case study. It is based on a review of the events that occurred after the decision to close the bank was taken and an analysis of insolvency liquidation laws in Luxembourg, the United Kingdom and the United States.[1] The purpose of the analysis is to help supervisors shape their goals, assess their responsibilities and refine supervisory practices in the light of the issues that could surround the failure of a multinational bank.

This topic has proved to be complex. A survey of the laws of just three countries has identified a number of basic issues the study group believes could arise in the insolvency of any multinational bank. The resolution of these issues in any particular case, however, will depend upon the interaction of the laws of the various jurisdictions involved. The study group's objective in this paper is to make general observations which may be useful to supervisors.

Part I and the Annex of the paper provide background. Part I discusses the key legal concepts underlying Part II - the implications for bank supervisors arising out of the bankruptcy of a multinational bank. Part III provides some observations on netting and payment systems based on the BCCI closure. The Annex reviews the structure of the BCCI group of companies and the story of its liquidation up to 31st December 1992.

Reflecting the fact that there is no internationally-agreed regime for the liquidation of an insolvent multinational bank, the study group's work revealed a number of areas in which uncertainty and a potential for conflict can arise in the closure and liquidation of a multinational bank. In particular, the study group made the following observations with implications for bank supervisors, which are discussed in Part II: A) when closing a multinational bank, supervisors should pay attention to the nature and timing of communications among themselves and of their communications with creditors, shareholders and management; B) the nature of liquidation rules may be relevant to the manner in which

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1 Any reference to the law of the United Kingdom is a reference to the law of England and Wales; the law of Scotland is not considered. The analysis of US law focuses on state law in New York and California and federal law.

multinational banks are supervised; C) differences in liquidation rules across jurisdictions in a winding-up can affect returns to depositors and other creditors and the operations of deposit protection schemes; and D) coordination and cooperation between liquidators can affect the returns to creditors in a liquidation and can be affected by the role of supervisors in a liquidation.

I. Summary of key legal concepts

This section of the paper outlines five basic legal concepts which are necessary to understanding the implications for bank supervisors arising from the bankruptcy of a multinational bank discussed in Part II. These are: the separate-entity doctrine, the single-entity doctrine, the applicable law of bank liquidation, set-off and the impact of criminal and civil penalty proceedings on bank liquidation.

The separate-entity doctrine is followed in the United States. Under this doctrine each branch or agency (branch) of a foreign bank operating in the United States is treated as a separately incorporated legal entity for some purposes. In the event of a liquidation of a foreign bank with a US branch, the branch would be liquidated separately from the entity as a whole. Creditors of a US branch would be paid from the assets of that branch and other assets of the bank in the jurisdiction. The US liquidator would marshal not only the assets of the branch worldwide but all assets of the bank in the United States. If the assets of the branch were insufficient, the creditors of that branch might be able to prove their claims in other jurisdictions. Creditors of other branches could not participate in the US liquidation.

By contrast, Luxembourg and the United Kingdom follow the single-entity doctrine. In these jurisdictions, banks are wound up as one legal entity and branches of foreign banks are treated only as offices of the larger corporate entity. All the worldwide creditors of the bank are entitled to prove in the liquidation. As a general rule, claims of creditors of a particular branch would not obtain priority over the claims of creditors of other branches in the liquidation. In theory, liquidators in single-entity jurisdictions are concerned with the collection and realisation of the worldwide assets of the company in liquidation. However, in practice, they are likely to obtain control only of assets located within their jurisdictions and foreign assets that are located in jurisdictions where they can obtain recognition. It is interesting to observe that, while the US liquidator is required to apply a separate-entity doctrine to the liquidation of US branches of foreign banks, the US liquidator of a US-chartered bank is required to liquidate that bank and all its foreign branches as a single entity.

In the United States, in conformity with the separate-entity doctrine, a branch of a foreign bank would be liquidated by the bank supervisor, state or federal, responsible for that branch in accordance with state or federal banking liquidation law, respectively. However, if the foreign bank had more than one US branch and one of the branches was a federally-chartered branch, the Comptroller of the Currency would liquidate all the branches, whether state or federally chartered. The general bankruptcy law does not apply to banks, including branches of foreign banks. The general US bankruptcy law would apply only to the assets in the United States of a foreign bank with no US branches. If the grounds for liquidation of a branch exist, the supervisor has no alternatives to liquidation, such as conservatorship or suspension of payments, as it might in respect of a domestically-chartered bank. Under state and federal banking law, creditors of the branch in liquidation have priority over all other creditors of the foreign bank in respect of assets of the branch and assets of the foreign bank in the United States. In fact, other creditors cannot prove in the liquidation, and claims by other branches and, in some cases, affiliates are not allowed. After priority creditors are paid, the excess, if any, is turned over to the domiciliary liquidator.

The laws of Luxembourg and the United Kingdom are different. These jurisdictions follow the single-entity doctrine and liquidate the branch in the same manner as the entity as a whole. Significantly, unlike the United States, the supervisor is not the liquidator. In general, the liquidation law applicable to commercial entities in the United Kingdom also applies to banks. In Luxembourg, the court will decide on a case-by-case basis whether the liquidation law applicable to commercial entities also applies to banks. In contrast to supervisors in the United Kingdom and the United States, the Luxembourg supervisor has more flexibility to take other actions, such as conservatorship or suspension of payments, in respect of a branch of a foreign bank. Unlike the creditors of a US branch, creditors of a Luxembourg or UK branch in liquidation have no priority with respect to assets of the branch. In the United Kingdom, for example, any creditor of any office of the bank can prove in the UK liquidation of the bank. There is a rule in effect, the "hotchpot" rule, which prevents any creditor from obtaining more than he would otherwise obtain in the UK liquidation, merely by claiming in more than one liquidation proceeding.

As discussed in Part II, these different regimes create issues for supervisors because a multinational bank is likely to have branches in some jurisdictions which follow the separate-entity approach and branches in other jurisdictions which follow the single-entity approach.

Set-off refers to a non-judicial process whereby mutual claims between parties, such as a loan and a deposit, are extinguished. There are substantial differences in the laws of set-off in an insolvency among the three jurisdictions studied. In general, each jurisdiction's approach to insolvency set-off is consistent with its application of the single-entity and separate-entity doctrines. In the United States, set-off is permitted between claims in the same currency that appear on the books of the same branch. Claims in different currencies and claims on different branches, such as a loan on the books of a US branch and a deposit that appears on the books of a foreign branch, cannot be set-off. In the United Kingdom, a broad right of set-off exists. There is no requirement that claims be in the same currency or that the claims be on the books of the same branch or in the same country. In Luxembourg, set-off may not be exercised after the date of a liquidation order (except where the credits and debts derive from a specific agreement relating to the relevant transaction), but claims that are fixed in amount, liquid and mature may be set-off before a liquidation order.

The criminal and civil law, especially US criminal law, imposes limitations on all the legal and supervisory principles outlined in this paper. A detailed discussion of these limitations is beyond the scope of the paper. Among the three jurisdictions studied, it is unique to US law that criminal proceedings can be commenced against a bank that has entered insolvency proceedings. In the United States, the Racketeer Influenced and Corrupt Organizations Act (RICO) is a powerful tool that can be brought to bear by law enforcement officials against a bank that has engaged in criminal activity. RICO permits prosecutorial authorities to seize and forfeit assets in pursuit of the fruits and proceeds of a crime. Assets can be traced into the hands of innocent parties, in effect upsetting expectations about the finality of transactions. Criminal forfeiture actions can take assets that would otherwise be distributed in accordance with the rules of law discussed in this paper. Significantly, supervisors have no part in the conduct of such criminal proceedings. Another issue, which the study group has identified but not analysed in detail, is the fact that, in certain jurisdictions, civil enforcement against a bank by a bank supervisor could result in a diminution of the amount of assets available for creditors and shareholders of the closed bank.

II. Observations with implications for bank supervisors

A. The nature and timing of communications should be considered when closing a bank

When closing a multinational bank, supervisors should pay attention to the nature and timing of their communications with other supervisors and of their communications with creditors, shareholders and management. The decision to close a multinational bank is principally the domain of the bank's home-country supervisor. However, the home supervisor may wish to consider the extent to which it consults and coordinates with other supervisors ahead of the closure. The home supervisor may require coordinated actions by other supervisors to achieve certain objectives, such as ensuring that some creditors do not benefit at the expense of others prior to the commencement of the liquidation, e.g. if certain branches remained open after the intended time for closure. A supervisor could find that it does not have the procedural ability to take coordinated actions to effect closure as a matter of urgency. Therefore, supervisors may wish to consider whether they have adequate measures available to close the operations of a multinational bank in their jurisdictions as a matter of urgency, e.g. if requested to do so by a home supervisor.

The home supervisor could find that its actions trigger automatic effects under the laws of host countries, which could have unintended consequences. For example, it might be undesirable if local law required a host supervisor to liquidate the bank's branch in its jurisdiction even in the case of a conservatorship in the home country. In the process of deciding what measures should be adopted when closing a multinational bank, bank supervisors may wish to consider whether adopting measures could give rise to automatic effects under the laws of certain overseas jurisdictions in which the bank has branches. They also may wish to consider whether their domestic laws are sufficiently flexible so as to permit the temporary closure of a foreign bank's operations in their jurisdictions if that is what is being done in the home country.

The home supervisor's decisions regarding consultation and the communication of information could be affected by several additional factors. The home supervisor might have existing cooperation arrangements with some supervisors, which could facilitate communications, but not with others. In general, the supervisor might have concerns about confidentiality because of the possibility that some parties connected with the failing bank could gain an unfair advantage if they receive information which others do not. The size of the bank's operations could pose practical problems which complicate the assessment further.

Parties who have entered financial contracts with a multinational bank could be subject to uncertainty by the timing of the bank's closure. This can give rise to the temporal Herstatt risk, which was observed in the BCCI S.A. case. The potential for temporal settlement risk suggests there might be some times which are better than others for supervisors to act jointly to close a multinational bank. Although it might be desirable to close a bank at a time that minimises Herstatt risk, it should be recognised that the imperative of the situation or constraints of local laws could make achieving the goal less desirable or impossible.

Supervisors may wish to consider whether they have adequate procedures available to effect the closure of a bank outside of normal business hours so as to minimise Herstatt risk.

The uncertainty and confusion associated with the insolvency liquidation of a multinational bank, particularly one that has a significant number of retail depositors, emphasise a need for the supervisors involved to have open and reliable channels of communication. In the initial period after the closure, a home supervisor might expect to receive inquiries from creditors and users of the bank's services worldwide. Similarly, host supervisors might need to have information available for local creditors and bank customers. Given the possibility that there could be many liquidation proceedings related to the multinational bank, as the bankruptcy progresses, it would be desirable for host supervisors to report to the home supervisor about developments in their jurisdictions, and for the home supervisor to keep other interested supervisors informed on overall developments to the extent possible.

B. Liquidation rules may be relevant to the supervision of multinational banks

1. General

The study group has observed that the differences between liquidation regimes may have implications for the supervision of multinational banks. Although supervisors should be aware of the implications of different liquidation regimes, the study group does not mean to suggest that in practice supervisory policies should necessarily follow liquidation regimes. In some circumstances, gearing supervisory policies rigidly to liquidation regimes could lead supervisors to adopt policies that are incompatible with generally appropriate banking practices, particularly for healthy banks. This could result in an inefficient allocation of capital on a branch-by-branch basis, which would be uneconomic for the industry as a whole, or complicate the task of supervising multinational banks on a consolidated basis.

Moreover, the study group has found in the case of BCCI S.A.'s liquidation that the interaction of different liquidation regimes and other relevant laws can introduce many complexities and uncertainties with respect to the disposition of a failed multinational bank's assets and the payment of claims against it. In essence, it is extraordinarily difficult for supervisors - and for banks - to identify and manage all the potential risks posed by the intricacies of laws which might be relevant in the failure of a multinational bank. Thus, pursuing policies based on the expectation of certain outcomes in a liquidation may not be appropriate.

The complexities and uncertainties that can result from the liquidation of a multinational bank's operations confirm that effective consolidated supervision performed by home-country supervisors remains paramount in protecting depositors and other creditors. Further, these complexities and uncertainties reinforce the need for host-country supervisors to be satisfied that banks seeking to enter their markets are supervised by home-country authorities that perform consolidated supervision, consistent with the *Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments*.

2. Location of capital

Capital adequacy is one of the principal factors supervisors take into account in assessing the financial soundness of a bank. In the case of a multinational bank, the location of its capital (or the assets representing capital) may be relevant to the issue of whether the capital is available to perform the function of absorbing losses of the bank as a whole.

In order to determine the location of a bank's capital, capital may be thought of either as being represented by the assets of the bank or as the surplus of the bank's assets over its general or current liabilities. It is difficult to determine where the capital of a multinational bank is located. If capital refers to the surplus of a bank's assets over its general liabilities, in the case of a bank which, if it failed, would have all its branches and assets liquidated under the single-entity doctrine, the starting point, in theory, would be that its capital is not located in any particular branch. Rather, the capital is located either at the centre, i.e. in its country of incorporation, or is spread over every location in which the bank does business; in either case, it is available for all the bank's worldwide creditors. However, if a multinational bank has a branch in a separate-entity jurisdiction and there is a surplus of assets over the general liabilities of that branch, it is possible to think of the bank as having capital located at that branch. (The amount of the capital located at that branch would depend upon the realisable value of the branch assets.)

But the issue is more complicated than this. It may be more accurate to think of the capital of a multinational bank as being "located" where the assets of the bank are located (rather than the jurisdiction in which the assets are booked). For example, if a bank incorporated in country A (a single-entity jurisdiction) has a branch in country B (a separate-entity jurisdiction) and that branch has assets on its books located in country C, it is the law of country C that may determine whether the relevant assets would go to the liquidator appointed under the law of country A or country B, if these liquidators make competing claims for the assets, or to an attaching creditor from country D. The location of an asset itself is a complex legal question beyond the scope of this paper.

A consequence of the separate-entity doctrine may be that assets of the bank located at a branch in such a jurisdiction would not be available for the worldwide creditors of the bank if the bank were liquidated. This may mean that, in certain circumstances, home-country supervisors may wish to make an adjustment when assessing capital adequacy in respect of capital or assets located at such a branch.

3. The function of a branch

Insolvency laws tend not to recognise inter-branch claims for purposes of liquidation, whereas claims between a branch (or the bank) and a failed bank's affiliates are so recognised. A branch that is net "due from" other offices, i.e. it is funding other parts of the bank, may not be able to realise the "asset". Thus, for example, creditors of a branch that is covered by the separate-entity liquidation approach and that has a significant "due from" balance may find the branch's remaining assets allow for a relatively small fractional return in the local liquidation compared to their claims; they may then have to prove in an another liquidation proceeding to realise a higher return.

The treatment of inter-branch claims in an insolvency liquidation can raise issues for supervisors regarding the appropriate function of a branch. Consistent with the theme that supervisory policies should not necessarily follow liquidation regimes, it would seem inappropriate - and uneconomical - to prevent branches in all circumstances from funding other branches. However, a host supervisor might not want a branch of a foreign bank whose creditworthiness is seriously in question to act as a funding vehicle for other branches of the bank. Host supervisors may wish to limit the amount of funding a branch may provide in these circumstances.

4. Supervisory ring-fencing

For various reasons, supervisors sometimes attempt to protect the assets of a bank (or a branch) or to limit the exposure of a bank (or a branch) to certain risks. This process can be referred to as "ring-fencing", and it can take a number of forms.

A supervisor could require a bank to limit its exposures to other members of its corporate group. Similarly, a supervisor may attempt to place limits on the degree to which the bank has exposures to certain categories of country risk. These forms of ring-fencing can be effective whether a branch or a bank would be wound-up under the single-entity or the separate-entity doctrines. Supervisors also may seek to protect the assets of a branch or to limit the exposure of a branch to the rest of the bank.

In single-entity jurisdictions, all the worldwide creditors of a bank can prove in the liquidation. Therefore, attempts by supervisors to ring-fence a branch in such a jurisdiction would not enhance the return to creditors of the local branch as it might in a separate-entity jurisdiction. However, such ring-fencing might result in a greater pool of assets being available for distribution to the worldwide creditors of the bank.

Where the creditworthiness of a multinational bank is in doubt, difficult issues may arise between the home supervisor and a host supervisor in a separate-entity jurisdiction. The host supervisor may require the transfer of assets to the branch (from the home country or elsewhere) to protect the interests of creditors of that branch. The home supervisor may be reluctant to permit this to take place because it could mean that fewer assets are available to support the liabilities of the bank as a whole and that there might be a lower return to the worldwide creditors of the bank if the bank were liquidated. Overly protective measures by the host supervisor could bring about the insolvency of the bank. Such problems are best resolved through supervisory cooperation and coordination, as stated in the Concordat.

C. Liquidation rules can affect returns to creditors and the operations of deposit protection schemes

1. General

In addition to affecting the supervision of multinational banks, differences in liquidation regimes across jurisdictions can affect the recovery by creditors in the liquidation and the operations of deposit protection schemes. As discussed above, the insolvency laws of countries with the separate-entity approach to liquidation circumscribe the assets of a branch (and in the case of the United States all the foreign bank’s assets in the jurisdiction). The assets would be collected and realised first for the benefit of the branch creditors, and any excess may be remitted to other liquidators for distribution to remaining creditors. This approach has a distributional consequence. Creditors in the jurisdiction with the separate-entity approach, including depositors, may receive a higher proportion of their claims in the liquidation at the expense of other creditors, possibly including deposit protection schemes in countries with the single-entity approach.

2. Insolvency set-off

There are significant differences between insolvency set-off regimes in Luxembourg, the United Kingdom and the United States. Luxembourg law does not permit the setting-off of mutual obligations once a liquidation order has been made (except where the credits and debts derive from a specific agreement relating to the relevant transaction). UK insolvency law has a mandatory set-off regime that requires the setting-off of a wide range of mutual obligations owed between a bank and its customer worldwide on the basis that the bank is one legal entity. US law provides for a broad right of set-off in a liquidation. However, where a branch of a bank is being liquidated, it applies on the basis that the branch is a distinct legal entity.

Thus, there are differences between systems of law which provide for insolvency set-off and those which do not. There also are differences between insolvency set-off regimes which treat a multinational bank as a single legal entity and those which regard a branch of a multinational bank as having a separate legal identity. The detailed provisions of the insolvency set-off regimes also may differ, e.g. the treatment of foreign exchange contracts.

The complexities arising from the differences between insolvency set-off regimes are exacerbated by the fact that there do not appear to be clear, generally accepted principles of private international law. Moreover, there is no international convention regarding cross-border insolvency which provides for set-offs in one jurisdiction to be recognised overseas or which specifies the system of law governing the parties' rights. This means, for example, that if a Luxembourg-incorporated bank in liquidation there has branches in England and New York:

(i) it is not clear whether a set-off effected in the New York branch liquidation would be recognised in Luxembourg;

(ii) if the English winding-up is ancillary to the Luxembourg liquidation, it is not clear whether the Luxembourg liquidator can sue a customer of an English branch for the full amount of a loan even though the loan could have been set-off against the customer's deposits under the English law of set-off; and

(iii) it is not clear whether the New York superintendent of banks, liquidating the New York branch as a separate entity, could sue a customer for the full amount of a loan appearing on the New York branch's books when the customer has a deposit with the English branch that would be available for set-off against the loan under English law.

The differences between insolvency set-off regimes, which reflect national policy choices, may affect the return to creditors in the different jurisdictions in which a multinational bank operates. Where set-off is permitted, creditors who also owe sums to the insolvent bank are placed in a similar economic position to secured creditors. If set-off is not permitted, such creditors are treated on the same basis as unsecured creditors for the gross amount of their claims. Where set-off is permitted on the basis that a branch is a separate legal entity, priorities under local law given to creditors of the branch in a liquidation can be preserved (by preventing assets of the branch from being set-off by creditors of other branches of the bank).

One factor potentially affecting the return to creditors is how set-off relates to the assets involved in the liquidation. The liquidators of foreign branches in the United States marshal all the assets of the foreign bank in their jurisdictions, even if those assets are not assets of the US branch. Thus, there seems to be some imbalance in that set-off may only be asserted against a branch when the asset and liability are on that branch's books, but set-off may not be asserted against a correspondent balance that is an asset of another branch. For example, if bank A in the United States has a deposit with the New York branch of failed bank B and holds a correspondent balance for a non-US branch of failed bank B, it would have to turn over the correspondent balance to the New York liquidator and prove in the New York liquidation for the amount of its deposit with the New York branch. Bank A would not be able to set-off the correspondent balance against its claim on the New York branch of bank B. Similar issues may arise in the case of cross-border collateralisation arrangements.

The lack of an international convention providing for mutual recognition of insolvency set-off or of generally applicable choice of law rules can mean that the expectations of parties at the time contracts are entered into may not be fulfilled if the contract is entered into in a jurisdiction which has one type of insolvency set-off regime but the customer has to prove his claim in a liquidation taking place in a country with a different insolvency set-off regime.

The different approaches to set-off in the jurisdictions studied reinforce the conclusions of the Lamfalussy Committee on Interbank Netting Schemes that netting schemes should have a well-founded legal basis under the laws of all relevant jurisdictions. The greater the number of branches and the degree of complexity of such arrangements, the greater is the risk that they will not take legal effect in accordance with their terms. In the light of this, a supervisor may wish to examine how its banks measure and control counterparty risk.

3. Deposit protection schemes

As noted above, differences between the single-entity and the separate-entity approaches in the liquidation of a multinational bank can have distributional consequences. Creditors of a branch in a jurisdiction with the separate-entity approach may receive a higher proportion of their claims in the local liquidation. This is likely to result in fewer assets of the bank being distributable to other creditors of the bank, particularly those who have to prove in liquidations in which the single-entity doctrine applies. Deposit protection schemes in countries which apply the single-entity approach could be among those affected if the bank had operations in separate-entity jurisdictions.

In structuring a deposit protection scheme or in calculating the amount of compensation which should be payable to depositors at a failed bank, it may be relevant to consider whether set-off in an insolvency is permitted or required in the relevant jurisdiction. It may be appropriate for deposit protection schemes to pay deposit protection on a gross basis in jurisdictions which do not permit insolvency set-off and on a net basis in jurisdictions which do. Another issue is whether the deposit protection scheme, in making protection payments, should take into account any right of set-off a depositor might have in another jurisdiction.

In all three countries studied, deposit protection schemes are subrogated to the rights of depositors against a failed bank when protection payments have been made. The differences between insolvency set-off regimes may affect the amounts recovered by deposit protection schemes. A deposit protection scheme in country A (which does not permit insolvency set-off and pays deposit protection on the gross amount of the deposit) may have difficulty in enforcing its subrogation rights if it has to prove its claim in the principal liquidation of the failed bank in country B (which requires insolvency set-off). These problems might be overcome by an international convention regarding the treatment of deposit protection schemes' subrogation rights in liquidation proceedings in different countries.

In both Luxembourg and the United Kingdom, the deposit protection schemes (when subrogated to a depositor's rights) obtain a priority over the depositor in respect of protection payments made in relation to his deposit until such time as the scheme has been fully reimbursed. This priority is granted by statute in the United Kingdom, whereas in Luxembourg the depositor executes an agreement subordinating his rights against the insolvent bank to those of the scheme. It is not clear whether the priority rights granted to a host-country deposit protection scheme under its local law will be given effect if it has to prove in the liquidation of the insolvent bank in its country of incorporation. It may be that specific subordination agreements have a greater chance of being given effect overseas than statutory rights of priority. In such circumstances, it may be necessary for arrangements to be entered into or for steps to be taken by the courts of the host country if it is desired to preserve the priority the host country scheme would have under its local law.

When a bank fails, it may be subject to certain insolvency procedures which do not involve the formal commencement of a liquidation, e.g. the appointment of provisional liquidators in the United Kingdom or the respite from payment procedure in Luxembourg. In such circumstances, depositors may be adversely affected if, for example, their ability to enforce their contractual right to repayment is frozen and they are not entitled to receive payments from deposit protection schemes. This raises the question of whether a deposit protection scheme is intended to insure *timely* repayment of a deposit or *ultimate* repayment of a deposit.

D. Coordination and cooperation between liquidators can affect creditors and can be affected by the role of supervisors in a liquidation

As already mentioned, there is no internationally-agreed regime that applies to the liquidation of an insolvent multinational bank. Therefore, the closure of an insolvent multinational bank is likely to involve separate insolvency proceedings in each of the countries in which the bank had branches and may also involve different liquidators being appointed in respect of each branch. In addition, the study has shown that countries may have very different insolvency regimes for banks and branches - the distinction between the single-entity and the separate-entity approaches being one significant difference.

Differences in the insolvency regimes which may apply and the fact that there may be multiple liquidators give rise to the potential for conflicts between the interests of the different liquidators. This can adversely affect the interests of creditors. The liquidators could make competing claims to assets or they may fail to exchange information and documents, which could inhibit the prosecution of third-party claims and reduce the amount distributable to creditors.

The affairs of a multinational bank involve a level of complexity that requires a significant amount of sharing of information and documents by liquidators for the effective winding-up of the company, e.g. to assess the value of creditors claims, to realise assets and, where criminal activity has occurred, to cooperate in enforcement and supervisory proceedings. The inability or unwillingness to share information and documents can delay the winding-up process. The failure to share information or documents may be due to (a) certain liquidators being required by law to pursue interests of creditors of a branch, for example, to the exclusion of other creditors, (b) bank secrecy laws, e.g. where the law of a country recognises only the local liquidator as the bank and would not permit customer information to be provided to a liquidator of the bank in another country because he is regarded as a third party or (c) other constraints of local law. In addition, liquidators may not be able to share information with liquidators appointed in other countries because they are engaged in confidential negotiations with a third party, e.g. to settle litigation claims.

There are a number of means by which insolvency proceedings in different jurisdictions may be harmonised in order to achieve a coordinated liquidation of a multinational bank in the interest of achieving fair treatment of, and maximum return to, all creditors. These include recognition of the home liquidator in overseas jurisdictions and ancillary insolvency proceedings. Certain jurisdictions also have rules to prevent creditors obtaining an unfair advantage by proving in more than one liquidation such as the hotchpot rule in the United Kingdom. However, where a multinational bank has branches in a large number of countries, it is unlikely that a coordinated liquidation of the bank can be achieved merely by relying on mutual recognition rules. Moreover, certain jurisdictions may have laws which preclude participation in coordination arrangements or make such participation unnecessary because they require the local branch to be dealt with on a discrete basis.

Given the difficulties discussed above, other measures may be necessary if it is desired to promote a coordinated liquidation of a multinational bank. Supervisors may attempt to secure the appointment of the same liquidator in each of the countries where the bank has branches. This may streamline communications, simplify the process of the realisation of assets and facilitate negotiations with third parties. However, the local laws of certain countries or conflicts of duties may prevent a common liquidator from being appointed. Contractual cooperation arrangements could be entered into among the different liquidators, e.g. contractual pooling of assets and claims. An international convention or regime covering cross-border insolvencies of multinational banks could provide for such banks to be liquidated on a coordinated basis.

The role of the supervisor in the liquidation of a bank can vary across jurisdictions. In some jurisdictions, the supervisor is the liquidator of the bank. Other supervisors may have the role of advising the court regarding the possible modes of liquidation. Others may not have a formal role in the liquidation but retain certain information-seeking or supervisory powers over a failed bank. The role of the supervisor in the liquidation can affect its ability to influence the conduct of the liquidation, the disposition of the failed bank's assets and the payment of creditors' claims.

III. The implications of the BCCI closing on payment and netting issues

During the course of the study group's discussions, the implications of the BCCI closing on payment and netting issues were reviewed. This has relevance to the work of a number of the committees of the G-10 Central Bank Governors relating to cross-border, multibranch netting issues. However, based on the experiences of the three liquidation proceedings reviewed, there is not a great deal to report at this stage of those proceedings. Nonetheless, some observations can be made.

As is true with any business, mistakes will be made; a number of mistaken payments were made involving BCCI. In the United States, some parties transferred funds to BCCI accounts by mistakenly using BCCI's account number at the receiving bank, as opposed to the intended beneficiary's account number. To the relief of the parties involved, it is likely that the funds will be returned by the liquidator but only after great effort and expense to prove the mistake. In the criminal RICO proceeding, there is a question whether transferors may obtain the return of their funds mistakenly paid. They may be left to a general claim on the estate. Similarly, payments made to BCCI as intended beneficiary after closure may not be returned. Some banks incurred Herstatt loss on foreign exchange transactions by paying BCCI but not receiving payment from BCCI. While there are only a few instances of this occurring, the amounts involved were not minor.

BCCI was not a major participant in payment and settlement systems; there was little, if any, systemic impact on such systems. To date, no issues seem to have arisen in connection with BCCI's off-balance-sheet activities, other than foreign exchange contracts and letters of credit. It appears that most foreign exchange contracts were closed out. Moreover, it appears that no issues have risen in connection with netting agreements or master agreements, such as the International Swap Dealers Association's master swap agreement.

The fact that there is so little anecdotal information available is not a great source of comfort. It may well be that BCCI had little involvement in these systems or with these instruments. On the other hand, it is possible that, over time, as the liquidators take steps to enforce claims held by BCCI, more issues may surface.

Annex

Background and history of liquidation

A. The BCCI companies

As of 5th July 1991, the BCCI companies consisted of:

1. BCCI Holdings (Luxembourg) S.A. (BCCI Holdings) incorporated in Luxembourg, the holding company for the group;
2. BCCI S.A., one of the principal operating subsidiaries of BCCI Holdings with 47 branches and two subsidiaries located in 15 countries;
3. BCCI (Overseas) Ltd. (BCCI Overseas), the other principal operating subsidiary of BCCI Holdings with 63 branches located in 28 countries; and
4. the other subsidiaries and affiliates of BCCI Holdings which operated 255 banking offices in about 30 countries, including Credit and Finance Corporation (CFC).[2]

At the time BCCI was closed, it had approximately 380 offices in nearly 70 countries, and its senior management was based in Abu Dhabi. The majority shareholders of BCCI Holdings were the ruler and government of Abu Dhabi and certain other related entities and persons.

ICIC Overseas and ICIC Holdings were companies incorporated in the Cayman Islands. They were not subsidiaries of BCCI Holdings but had a close working relationship with the BCCI group of companies.

B. The closure of BCCI

On 24th June 1991, the Bank of England (Bank) received a draft report on certain affairs of BCCI S.A. which had been prepared by Price Waterhouse under Section 41 of the Banking Act 1987. The report contained allegations of serious and widespread fraud and indicated that the accounting records and financial position of BCCI had been falsified. In the light of the matters contained in the report, the Bank consulted with certain other BCCI supervisors. It

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[2] The term BCCI refers generally to BCCI Holdings, its subsidiaries and affiliates including BCCI S.A. and BCCI Overseas. However, in certain contexts it may also include International Credit and Investment Company (Overseas) Ltd. (ICIC Overseas) and International Credit and Investment Company Holdings (ICIC Holdings).

was concluded that joint action should be taken to secure control of the assets of BCCI S.A. and BCCI Overseas.

On 5th July 1991, the Institut Monétaire Luxembourgeois (IML) lodged a request at the Luxembourg court under Section 38 of the Luxembourg Banking Law for a respite from payment to be granted in respect of BCCI S.A. and for the company to be placed into controlled management. These procedures took automatic effect once BCCI S.A. and its board were notified. On 8th July 1991, Mr. Brian Smouha of Touche Ross was appointed as a commissaire de surveillance of BCCI S.A. Within a period of six months, Mr. Smouha was required to deliver a report to the court recommending either the restructuring of BCCI S.A. or its liquidation.

On 5th July 1991, the Bank presented a petition to the UK court for a winding-up order to be made in respect of BCCI S.A. and for the immediate appointment of provisional liquidators. The court appointed three partners of Touche Ross as provisional liquidators of BCCI S.A. On 30th July 1991, the court adjourned the winding-up proceedings until December 1991 for the affairs of BCCI to be investigated further and to consider whether it would be possible to restructure BCCI.

On 5th July 1991, the Governor of the Cayman Islands appointed a receiver to assume control of BCCI Overseas, CFC and ICIC Overseas. The attorney general obtained injunctions restraining several closely connected companies from transferring or disposing of assets. On 22nd July 1991, the Governor of the Cayman Islands revoked the banking and trust licences of BCCI Overseas, CFC and ICIC Overseas. Petitions were presented to wind-up BCCI Overseas, CFC and ICIC Overseas, and the Cayman court appointed two partners of Deloitte Ross Tohmatsu as the joint provisional liquidators. The petitions were adjourned until 16th December 1991.

On 5th July 1991, the superintendent of banks of the State of New York took possession of the business and property of BCCI S.A. located in New York and closed its New York agency. The superintendent of banks of the State of California took possession of the business and assets of BCCI S.A. in California and closed its agency in California.

The IML informed all host-country supervisors of BCCI S.A. branches of the actions taken in Luxembourg and the United Kingdom and requested them to take consistent action within their jurisdictions.

On 9th July 1991, on the application of BCCI Holdings, Judge Maryse Welter was appointed by the Luxembourg court to ascertain whether a controlled management of BCCI Holdings would be practical. Mr. Smouha was appointed to report on the financial position of BCCI

Holdings. In the light of his report, BCCI Holdings was put into controlled management, and Mr. Smouha was appointed as one of its commissaires de surveillance. The commissaires were required to deliver a report to the court by 9th January 1992 recommending either the restructuring of BCCI Holdings or its liquidation.

C. Developments during the respite from payment

In October 1991, the majority shareholders issued a press release stating that, although they had been exploring every alternative to liquidation, there was little real prospect of restructuring BCCI S.A. On 22nd November 1991, Touche Ross issued a press statement explaining that it had been working with the majority shareholders to determine whether an overall plan for the liquidation could be agreed. The plan involved a pooling of the property and assets of BCCI S.A. and BCCI Overseas with a view to their distribution to all the creditors of those companies. In addition, the plan involved BCCI S.A. and BCCI Overseas (and other participating companies) waiving any claims that they might have against the majority shareholders and the majority shareholders waiving any claims they might have (other than as ordinary creditors) against those companies, as well as a cash contribution of the majority shareholders to be paid in several instalments. Touche Ross stated that, without an outside contribution, the likely return to creditors would be less than ten cents in the dollar. The arrangements with the majority shareholders could result in a return to creditors within the range of thirty to forty cents in the dollar. The discussions developed into the pooling arrangements and the majority shareholders' agreements.

D. Developments in the United States

On 29th July 1991, a New York grand jury returned an indictment against Agha Hassan Abedi, Swaleh Naqvi, BCCI Holdings, BCCI S.A., BCCI Overseas, ICIC Overseas and ICIC Holdings. It charged a scheme to defraud, grand larceny of $30 million from American Express Bank and falsification of bank records. On the same day, the Board of Governors of the Federal Reserve System (Board of Governors) imposed a civil penalty of $200 million on BCCI Holdings, BCCI S.A., BCCI Overseas and ICIC Overseas in connection with the secret acquisition of the shares of First American Bankshares Inc. On 15th November 1991, a federal grand jury returned an indictment against BCCI Holdings, BCCI S.A., BCCI Overseas, ICIC Overseas and certain individuals.

On 19th December 1991, federal prosecutors filed an information (which superseded the indictment of 15th November) and proposed a plea agreement to resolve the New York indictment, the federal criminal charges and the enforcement action by the Board of Governors. Under the plea agreement, BCCI Holdings, BCCI S.A., BCCI Overseas and ICIC Overseas (BCCI Defendants) agreed to plead guilty to the federal information and to six counts of the New York indictment. The BCCI Defendants also agreed to forfeit virtually all of their US assets. The forfeited assets were to be applied to two funds - one to pay a $10 million fine in New York and mainly to minimise the risk of potential losses to the Federal Deposit Insurance Corporation, and the other to be distributed to worldwide creditors who did not use BCCI's banking facilities for criminal purposes. On 9th January 1992, the BCCI Defendants pleaded guilty to the federal information and to the New York indictment and agreed to forfeit all their assets located in the United States. The federal court accepted the plea agreement on 24th January 1992. On 31st January 1992, the federal court entered an additional RICO forfeiture order against BCCI.

E. The liquidation of BCCI

On 3rd January 1992, the Luxembourg court ordered the winding-up and liquidation of BCCI S.A. The ruling fixed the powers of the liquidators and the mode of liquidation. On 14th January 1992, the UK court issued a winding-up order in respect of BCCI S.A. On the same date, the Cayman court issued winding-up orders in respect of BCCI Overseas and CFC. On 11th June 1992, the Luxembourg court ordered the winding-up and liquidation of BCCI Holdings. On 21st November 1991, a New York State court ordered the commencement of a claims process in the liquidation of BCCI S.A.'s New York agency, commencing on 9th December 1991 and ending 27th March 1992. The claims procedure in the liquidation of BCCI S.A.'s Los Angeles agency began on 30th August 1991 and ended on 30th December 1991.

On 20th February 1992, draft agreements implementing the pooling arrangements and the arrangements with the majority shareholders were initialed by the liquidators of BCCI and representatives of the majority shareholders. The parties agreed to use reasonable efforts to obtain court approval for the principal liquidators of BCCI to enter into the agreements.

At a hearing on 12th June 1992, the UK court authorised the joint liquidators of BCCI S.A. to proceed with the pooling arrangements and the majority shareholders' agreements. An appeal against this order was not successful. The pooling arrangements and the agreements with the majority shareholders were also approved by the Cayman court in June 1992.

On 29th July 1992, the Luxembourg court ruled that the liquidators should consult all the known creditors of BCCI S.A. and arrange a vote by creditors on whether the pooling arrangements and the majority shareholders agreements should be entered into. Each creditor would have one vote regardless of the amount of his claim. On 22nd October 1992, considering the vote in the ballot, the Luxembourg court approved the arrangements. On 24th December 1992, several creditors lodged an appeal against this judgement.