HANDLING NON-SYSTEMIC BANK FAILURES: THE UNIDROIT LEGISLATIVE GUIDE ON BANK LIQUIDATION

Myrte Meijer Timmerman Thijssen[1]
Senior Legal Officer
International Institute for the Unification of Private Law (UNIDROIT)

Revistas@iustel.com

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ABSTRACT: This paper presents the *UNIDROIT Legislative Guide on Bank Liquidation*, a new soft law instrument addressing the legal vacuum surrounding non-systemic bank failures. After outlining the motivations behind the *Guide* and its development process, the paper explains some of the main building blocks and recommendations for designing effective bank liquidation frameworks. These include effective liquidation tools, an appropriate institutional architecture, mechanisms for timely intervention, adequate funding options and a tailored creditor ranking.

KEYWORDS: UNIDROIT, bank liquidation, non-systemic banks, creditor hierarchy, financial stability, depositor protection, legal framework.

MANEJO DE QUIEBRAS BANCARIAS NO SISTÉMICAS: GUÍA LEGISLATIVA DEL UNIDROIT SOBRE LIQUIDACIÓN BANCARIA

RESUMEN: Este artículo presenta la Guía Legislativa de UNIDROIT sobre Liquidación Bancaria, un nuevo instrumento de derecho indicativo que aborda el vacío legal que rodea a las quiebras bancarias no sistémicas. Después de esbozar las motivaciones detrás de la Guía y su proceso de desarrollo, el documento explica algunos de los principales componentes básicos y recomendaciones para diseñar marcos efectivos de liquidación bancaria. Entre ellas figuran instrumentos de liquidación eficaces, una arquitectura institucional adecuada, mecanismos para una intervención oportuna, opciones de financiación adecuadas y una clasificación de acreedores adaptada.

PALABRAS CLAVE: UNIDROIT, liquidación bancaria, bancos no sistémicos, jerarquía de acreedores, estabilidad financiera, protección de los depositantes, marco jurídico.

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I. INTRODUCTION

1. Need for international guidance on bank liquidation

Banks are essential institutions in our societies. By accepting deposits, providing credit, and facilitating payments, they support the operations of the real economy and are vital in the transmission of monetary policy. Due to their relevance, they are subject to authorisation and sector-specific regulation and supervision, with the objective of ensuring financial stability and maintaining public trust. However, even the strongest supervisory frameworks cannot eliminate bank failures. When a bank fails, the repercussions can be severe, not just for the bank's clients (depositors and borrowers), but also for local economies, the interbank market, and occasionally, the broader financial system. General business insolvency laws are not designed to address the specific features of banks and the public policy concerns their failure can raise.

The need to create the *Legislative Guide* becomes clearer when viewed in the broader context of post-crisis regulatory reform. After the many bank failures during the global financial crisis that started in 2007, international reform efforts have focused on systemic institutions, those whose failure could trigger widespread financial disruption and could be considered "too big to fail". The international community prioritised the development of dedicated regimes for such institutions. This led to the Financial Stability Board's (FSB) *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("*FSB Key Attributes*"),[2] which introduced a comprehensive framework to resolve financial institutions that are systemic in failure, while preserving financial stability and without exposing taxpayers to loss, including through the famous bail-in tool. These developments spurred widespread reforms and the establishment of bank resolution regimes across jurisdictions.

Yet, no international guidance existed on how to manage failing "non-systemic banks"[3]. Guidance was also lacking on how to liquidate parts of banks during, or after, a bank resolution action—for instance, after having transferred only some of the bank's business to another bank or bridge bank.[4] Jurisdictions' frameworks differ, with some countries relying on general business insolvency law (with little or no modifications) while others have dedicated frameworks for the forced liquidation of banks. The frameworks differ not only in design and content but also in effectiveness. For instance, value may be

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[2] FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (revised 2014), available at Key Attributes of Effective Resolution Regimes for Financial Institutions (fsb.org).

[3] The concept of "non-systemic banks" refers in this context to banks that are not considered to be systemic at the point of failure for the purposes of the FSB Key Attributes, see the UNIDROIT Legislative Guide on Bank Liquidation, paras 3-6.

[4] The FSB Key Attributes (KA 3.2(xii) only indicate that frameworks should include the power to *"[e]ffect the closure and orderly wind-down (liquidation) of the whole or part of a failing firm with timely payout or transfer of insured deposits and prompt (for example, within seven days) access to transaction accounts and to segregated client funds)."*

destroyed if frameworks do not include appropriate tools to address bank failures (e.g., the power to transfer a bank's assets and liabilities in bulk, as explained below). Even in the European Union, which introduced a uniform bank resolution regime by means of the Bank Recovery and Resolution Directive (BRRD)[5] and the Single Resolution Mechanism Regulation (SRMR)[6], jurisdictions' frameworks for "normal insolvency proceedings" are not harmonised.[7] This has the potential to cause issues, for instance when applying the "no creditor worse off" (NCWO) safeguard in resolution, which uses a hypothetical piecemeal liquidation as counterfactual.

The absence of international guidance on the treatment of banks that are not considered systemic at the point of failure has left a critical gap. The *UNIDROIT Legislative Guide on Bank Liquidation* addresses this need; it provides comprehensive guidance to legislators and policymakers on how to design and implement effective legal frameworks for liquidating such banks. The *Guide* recognises that failures of non-systemic banks, while often localised in scope, can still pose risks and need to be governed by rules that consider the unique characteristics of banks. The *Guide* thus complements the *FSB Key Attributes.* It also complements international instruments from the World Bank and UNCITRAL on general business insolvency law, which were not designed to be applied to banks specifically.

2. Development of the Legislative Guide on Bank Liquidation

UNIDROIT started a project on Bank Insolvency in 2021, based on proposals by the European Banking Institute and the Bank of Italy. The project was conducted in partnership with the Financial Stability Institute (FSI) of the Bank for International Settlements (BIS), given the mix between private law and regulatory law. The *UNIDROIT Legislative Guide on Bank Liquidation* was developed over a period of three years by a Working Group that brought together leading international legal experts in insolvency and bank failure management. Apart from individual experts, representatives of 40 institutional observers participated in the project, including relevant international and re-

[5] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

[6] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund.

[7] Pursuant to the EU resolution framework, "normal insolvency proceedings" should commence if resolution action is not in the public interest. The resolution framework is subject to change; in June 2025, political agreement was reached on a proposal of the European Commission to review the bank crisis management and deposit insurance framework (CMDI). One of the main objectives of that reform was to enhance the ability of resolution authorities to manage the failure of small and medium-sized banks.

gional organisations, as well as deposit insurers, resolution authorities, and bank supervisory authorities from across the globe.[8]

Throughout the project, the Working Group on Bank Insolvency engaged in extensive deliberations and benefited from comparative insights across jurisdictions. A global technical survey on bank liquidation frameworks was conducted to collect baseline information on legislative frameworks and practices in 22 jurisdictions.[9] Additionally, in 2024, a public consultation on the draft *Legislative Guide* was held, enabling authorities and experts worldwide to provide feedback and ensure that the *Guide* is well-suited to be applied in a broad range of legal traditions. This feedback was considered at the Working Group's final session in November 2024. The final draft *Legislative Guide* was adopted by UNIDROIT's Governing Council at its 105th session, held from 20 to 23 May 2025.[10]

II. KEY ASPECTS OF EFFECTIVE BANK LIQUIDATION FRAMEWORKS

The *Legislative Guide* contains 105 recommendations, organised across ten chapters, offering both conceptual foundations and practical guidance for jurisdictions that are seeking to introduce or reform bank liquidation regimes. The recommendations as such are not meant to be directly translated into national law. They can rather be seen as a checklist of issues that should be addressed in a bank liquidation framework. The guidance applies to any type of bank[11], regardless of legal form (e.g., joint stock companies, mutuals, cooperatives) or business model. The Working Group did not identify specific characteristics of certain forms or business models for which tailored legislative guidance is required, although the Guide does recognise that cooperative banks might be governed by a different legislative act in some jurisdictions and that their deposits may not be insured.

The *Legislative Guide* is especially useful for jurisdictions that distinguish between "resolution", on the one hand, and "liquidation/insolvency" on the other (dual-track regimes), such as in the European Union. In jurisdictions that have a single framework to deal with any bank failure (single-track re-

[8] For the composition of the UNIDROIT Working Group on Bank Insolvency and its meeting documents, see https://www.unidroit.org/work-in-progress/bank-insolvency/.

[9] Argentina, Belgium, Brazil, Canada, China, Colombia, France, Germany, Ghana, Greece, India, Italy, Japan, Malaysia, Moldova, the Netherlands, Nigeria, Paraguay, South Africa, Spain, Switzerland, Ukraine.

[10] To access the Legislative Guide on Bank Liquidation as approved by the UNIDROIT Governing Council, see https://www.unidroit.org/work-in-progress/bank-insolvency/. The Secretariat is now preparing the official English publication, which will be available on the UNIDROIT website soon. The official French version, as well as unofficial translations into Chinese and Japanese commissioned by the relevant deposit insurance corporations, are expected to be published later in 2025.

[11] For the definition of "bank" in the Guide, see paragraph 13, point (2).

gime), such framework will be informed by the *FSB Key Attributes*. Nevertheless, several aspects of the Guide are equally relevant to both regimes.[12]

The *Guide* does not prescribe the level at which rules should be introduced in the domestic framework, although many issues would be expected to be included in primary legislation. For dual track-regimes, it advises to introduce bank liquidation provisions in a dedicated bank liquidation law. This makes it easy to identify the applicable rules and ensure internal consistency. As an alternative option, bank-specific liquidation rules could be integrated into the general business insolvency law or the banking law. The *Guide* offers guidance that can be tailored to local specificities, recognising the diversity of banking sectors and legal frameworks.[13]

The remainder of this paper offers a structured overview of several key aspects of an effective bank liquidation framework as advocated in the *Guide*, concerning the tools, institutional arrangements, procedural mechanisms, and advisable arrangements on funding and creditor ranking. The overview provided here is not exhaustive. For instance, the *Guide* includes two full chapters dedicated to the liquidation of banks within a group and to cross-border liquidations—topics that are not covered in this paper. Nevertheless, it is hoped that this summary offers a useful introduction to the Guide's core content and serves as a helpful starting point for readers interested in exploring its content further.

1. Effective liquidation tools[14]

According to the *Legislative Guide*, a legal framework for the orderly liquidation of banks that are not placed into resolution, or whose resolution leaves behind a residual entity to be liquidated, should provide the necessary tools and powers to enable an efficient, value-preserving, and well-governed process. These tools must be tailored to the characteristics of banks and the objectives of bank liquidation, including depositor protection and financial stability,[15] while ensuring transparency and legal certainty.

Traditionally, insolvency regimes often relied on "piecemeal liquidation", resulting in the immediate cessation of activity of the failing entity, and the gradual sale of assets, piece by piece, to meet creditors' claims according to

[12] For instance, the detailed guidance on tools and advice on modifications to general business insolvency law for piecemeal liquidation (Chapter 6) as well as the guidance on creditor hierarchy (Chapter 8) are equally relevant for jurisdictions with a single-track regime.

[13] The neutral approach in the Guide is explained in Chapter 1, Section E of the Legislative Guide.

[14] Chapter 6 of the Guide.

[15] Chapter 1 of the Legislative Guide sets out the key objectives of an effective bank liquidation framework: value preservation and maximisation, depositor protection, financial stability, avoiding loss to public funds, and certainty and predictability. The liquidation objectives of depositor protection and, where applicable, financial stability, are together referred to as "public policy objectives", see paragraph 13, point (26) of the Guide.

the applicable creditor hierarchy by a court-appointed liquidator.[16] The process often takes years, with uncertainty for creditors as to the recovery they might obtain.

A major difference between banks and other businesses is that banks are characterised by their liability side, which includes the deposits of clients. Depositor could be significantly affected if they lose access to their deposits, and a sudden disruption of a bank's operations could even have broader effects. A means of allowing depositors continued access to their deposits is to transfer the deposit base of a failing bank to another bank. Such a transfer of deposits together with a bundle of assets (e.g., performing loans) is not only in the interest of the bank liquidation objectives, including depositor protection, but also tends to be preferable from the point of view of value maximisation. This is because the sale of entire client relationships (deposits and loans) is generally attractive for an acquiring bank, leading to a higher price. In many cases, transferring certain assets and liabilities, rather liquidating the entire bank on a piecemeal basis, may thus result in more efficient and less disruptive outcomes.

Consequently, the *Guide* recommends that a bank liquidation framework should provide an explicit power to transfer a non-viable bank's assets and liabilities to a sound acquirer—which is referred to as a "sale as a going concern"[17] in the *Legislative Guide*. In the EU, the "sale of business tool" provides such possibility if resolution action is taken. However, not all jurisdictions have such option also under "normal insolvency proceedings". The sale as a going concern, as outlined in the *Guide*, closely resembles the power to transfer assets and liabilities under the *FSB Key Attributes*. Both approaches prioritise value maximisation and depositor protection, making it reasonable for them to share key features. However, differences naturally emerge in their specific objectives—particularly the emphasis on financial stability and maintaining critical functions within resolution frameworks—as well as in the safeguards, constraints, and access to external funding that apply.[18]

The *Guide* emphasises that the legal framework should provide the liquidation authority and/or the liquidator with discretion to choose the most appropriate tools and powers, whether a sale as a going concern or piecemeal liquidation, based on the specific circumstances of the case.[19] No hierarchy or default option should be imposed, as this may discourage optimal strate-

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[16] Business insolvency laws may also facilitate other insolvency strategies, such as a collective sale of assets, "pre-pack" sales, or a reorganisation process aimed at restoring the entity's business.

[17] See paragraph 13, point (29) of the Guide for the definition of "sale as a going concern". Jurisdictions use different terms for such transfer of assets and liabilities. For instance, in the United States, it is referred to as a Purchase and Assumption ("P&A") transaction.

[18] The key distinction lies in the flexibility that resolution allows—for example, departing from the *pari passu* rule to preserve financial stability, providing compensation if the NCWO principle is violated, or exceptionally using public funds in specific circumstances.

[19] See paragraph 242 and Recommendation 45 of the Legislative Guide.

gies; rather, flexibility should be combined with appropriate safeguards to ensure a fair and effective process.

The *Legislative Guide* offers detailed guidance on preparatory steps for a sale as a going concern, such as conducting a valuation, and a confidential due diligence and bidding process among interested parties. It also sets out elements that need to be covered in the bank liquidation framework in order to allow a sale as a going concern to be executed quickly[20] and effectively. Importantly, like for transfer tools in resolution, no individual notice or approval requirements of third parties (creditors and shareholders) should apply[21] because that could delay execution and risk the erosion of value. Furthermore, the liquidation authority or liquidator should be free to determine which assets and liabilities to include in the transfer perimeter, also through negotiation with interested bidders[22]—after all, transfers fundamentally depend on a willing acquirer. At the same time, the *Guide* warns that there should be some exceptions to the liquidator's discretion; liabilities secured by collateral should in principle be transferred or left behind together, and a "no cherry-picking" rule should apply to the transfer of financial contracts. The *Guide* also considers issues of coordination with supervisory procedures (e.g., evaluating the acquisition from a prudential and governance perspective). It explains that it should be possible, in exceptional cases, to grant permission to continue specific regulated activities—such as maintaining deposits—together with waivers of regulatory requirements, if this is necessary to effectively complete a transfer.[23] Moreover, the *Guide* discusses particularities of transfers and related parties. Noting that such parties might have contributed to the bank's failure, it recommends prohibiting the transfer of related party claims or at least allowing the liquidator to exclude those from the perimeter. For the same reason, it recommends introducing restrictions on the transfer *to* a related party of assets and liabilities of the failing bank.[24]

In addition to transfers of assets and liabilities to a healthy bank, the *Legislative Guide* also touches upon other possible transfer strategies (e.g., transfers to bridge banks and asset management companies). However, it generally advises against such strategies for the liquidation of non-systemic banks due to their complexity and costs.

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[20] Pursuant to the IADI Core Principles for Effective Deposit Insurance Systems (IADI Core Principles), in a liquidation scenario insured depositors should be reimbursed within seven working days. This means that a sale as a going concern should in any case be concluded before that deadline.

[21] See Recommendation 46.

[22] See paragraph 254 and Recommendation 50(e) of the Guide. For example, in jurisdictions with a deposit insurance scheme, the liquidator should be able to decide whether to transfer only insured deposits along with specific assets or also include uninsured deposits. The Legislative Guide mentions different possible approaches to the treatment of contingent liabilities: *"The legal framework may indicate that the acquirer will only acquire the assets and liabilities stipulated in the act of transfer, and/or may include a presumption against the transfer of contingent liabilities, or at least should not include a presumption in favour of their transfer, since this may deter potential acquirers"* (paragraph 254 of the Legislative Guide).

[23] See paragraph 255 and Recommendation 50(a) of the Guide.

[24] *Ibid*, paragraph 273 and Recommendation 52.

Although the *Legislative Guide* priorities a sale as a going concern as the approach most likely to meet the liquidation objectives of depositor protection and value maximisation, piecemeal liquidation cannot be excluded. If only part of the assets and liabilities of the non-viable are sold, the residual part will need to be liquidated on a piecemeal basis. And if a sale is not feasible, the entire business will be subject to piecemeal liquidation. According to the *Legislative Guide*, the legal provisions on piecemeal liquidation can mostly draw on the rules in the general business insolvency law. However, it recommends some adjustments. An example concerns the proof of claims. In general business insolvency proceedings, creditors are required to submit their claims, which are then reviewed through a verification process. In bank liquidation, the *Guide* recommends that insured depositors should not be required to file claims for amounts protected by deposit insurance, and given that strict record-keeping requirements apply to banks, liquidation authorities should be able to rely on the bank's records, unless those records are deemed unreliable.[25] Furthermore, it recommends allowing liquidators to make advance payments to uninsured depositors (allowing them to withdraw funds up to a certain threshold) to minimise disruption.[26] This is especially important for jurisdictions that do not have a deposit insurance system, but it may also be useful in countries that do have deposit insurance, to avoid disruption for uninsured depositors whose claims are left behind in the rump entity.

Moreover, to preserve the integrity and value of the liquidation estate, the legal framework should allow a stay on enforcement actions (moratorium), while providing rules that would enable the continuity of essential contracts, and the ability to set aside fraudulent or preferential transactions, drawing on general insolvency law with necessary adjustments for banks (e.g., shielding resolution actions from the scope of avoidance rules, while introducing stricter rules for related party transactions). Protections should also extend to funds in transit (temporary settlement accounts). The *Guide* recognises that counterparties under specified financial contracts are often excluded from the scope of general moratoria in insolvency and may exercise contractual rights of early termination and close-out netting. While generally recognising enforceability of close-out netting, the *Guide* recommends including a power in the legal framework that would allow the liquidator to impose a temporary stay on the exercise of early termination rights where that is needed to facilitate a sale as a going concern. The stay should be limited in duration and subject to the same safeguards as set out in the *FSB Key Attributes*.[27]

[25] *Ibid*, paragraph 291 and Recommendation 55 of the Guide.

[26] *Ibid*, paragraph 292 and Recommendation 56 of the Guide.

[27] For a more detailed discussion, see Chapter 6, Sections G (*Protection of the liquidation estate: stay on enforcement, contract termination and transaction avoidance*), H (*Temporary settlement accounts*), and I (*Limited stay on enforcement of certain financial contracts*) of the Legislative Guide.

2. Appropriate institutional set-up[28]

Institutional arrangements in a bank liquidation framework should be designed in a way that supports an orderly exit of non-systemic banks from the market. The institutional framework is arguably the most critical and complex issue a legislator must address when designing a bank liquidation framework. Even the most advanced framework is likely to be inefficient if the actors responsible for its implementation are not fit for purpose. This area also shows great variation across jurisdictions, because the choice of institutional model and the distribution of responsibilities must reflect each jurisdiction's specific characteristics, strengths, and weaknesses. The effectiveness and appropriateness of any institutional model will depend on jurisdiction-specific factors such as legal traditions, constitutional protections, the competence and capacity of courts and administrative bodies, and the availability of skilled insolvency professionals.

The *Legislative Guide* describes the two main institutional models, namely administrative and court-based models. In practice, the institutional arrangements for bank liquidation are usually a mix of these two extremes. While some jurisdictions assign most or all of the insolvency proceeding to administrative authorities, fundamental principles—such as access to justice, due process, and accountability—require that courts ultimately have the ability to review certain decisions, even if only *ex post*. Conversely, a system that treats bank liquidation purely as a matter for courts, with no involvement of banking authorities, is not a viable option.

The *Guide* sets out several key factors that can help legislators in designing the most appropriate institutional set-up for their jurisdiction.[29] The institutional arrangements must align with the objectives of bank liquidation, allowing the interests of private creditors to be effectively balanced with public policy concerns. It should enable adequate preparation, including contingency planning and early coordination among relevant authorities. Timely action is important, actors involved must have the necessary technical expertise, sufficient human and financial resources, and access to relevant information about the bank and affiliated entities. Effective cooperation between banking, resolution, and deposit insurance authorities, both domestically and internationally, is crucial for ensuring the coordinated management of liquidation. Additionally, the independence and accountability of liquidation authorities or courts must be protected through strong governance structures and judicial oversight mechanisms, precisely balanced to avoid delays and maintain legal certainty. Finally, institutional arrangements should encourage transparency by clearly defining roles and procedures while also safeguarding confidentiality to prevent premature disclosure of sensitive information that might undermine market stability.

[28] Chapter 2 of the *Guide*.

[29] See Chapter 2, Section C (*Considerations in the design of institutional arrangements*) of the Guide.

Most of the factors for institutional design generally point to an administrative model for bank liquidation as the preferred choice. Administrative authorities (e.g., the banking supervisor, resolution authority or deposit insurer) are typically well-equipped to prepare for a bank's liquidation. They benefit from existing cooperation arrangements under bank supervision and resolution frameworks, have access to bank-specific information and possess in-depth knowledge of the banking sector, including potential buyers for a failing bank's assets and liabilities. In addition, their technical expertise and mandate allow them to make complex decisions more swiftly than courts, while also factoring in the broader public policy implications of a banks' critical role in the economy.

While generally favouring an administrative model, the *Guide* acknowledges that the importance of the design factors may vary throughout the liquidation process.[30] Legislators might determine that banking authorities should play a more prominent role in the early stages—such as deciding to liquidate a bank—due to their responsibility for maintaining financial stability. Their involvement may also be crucial when selling a bank as a going concern. In contrast, during a piecemeal liquidation, public policy concerns are typically less pressing, allowing for a standard court-led process, though banking authorities should still monitor proceedings and intervene if necessary to protect the liquidation objectives. A hybrid model, combining administrative and court-based elements, can thus be effective if it ensures a strong and clearly defined role for banking authorities. Irrespective of the chosen arrangements, in the interest of clarity and transparency the legal framework must explicitly set out the roles and responsibilities of each actor involved in the liquidation process.

For jurisdictions that adopt an administrative model, the *Legislative Guide* provides a number of recommendations. For instance, the administrative liquidation authority should be able to appoint an external liquidator, who would operate under its direction and oversight.[31] This helps to ensure that sufficient persons with the necessary experience are consistently available throughout the liquidation process and allows tasks to be assigned to persons with specialised expertise, particularly in areas where banking authorities may have limited knowledge—such as assessing claims or handling employee matters. The administrative liquidation authority should have exclusive competence to select any external liquidator(s) and determine the remuneration.[32] The standard of legal protection may differ; for an administrative liquidation authority, it is advisable that existing provisions on legal protection apply to its role (and that of its staff) in bank liquidation,[33] while private liquidators may not be covered by such protection.

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[30] See paragraphs 112-113 of the Legislative Guide.

[31] *Ibid*, Recommendation 10.

[32] *Ibid*, Recommendations 19 and 21.

[33] International standards set a high bar for the liability of banking supervisors (Basel Core Principles, CP 2 and EC 9), resolution authorities (FSB Key Attributes, KA 2.6), and deposit insurers (IADI Core Principles, CP 11, EC 2).

For jurisdictions with predominantly court-based proceedings, the *Guide* strongly recommends that banking authorities nevertheless play a substantial role. This should be the case from the outset; it should be a banking authority that has the right to petition the court to open the liquidation process.[34] Ideally, this is an exclusive right. A banking authority is generally better placed than individual creditors to assess a bank's non-viability and consider the feasibility of alternatives to liquidation. If the legal framework does not reserve this right solely to the banking authority, safeguards should be in place to prevent panic and preserve value (e.g., keeping the petition confidential and ensuring that the banking authority is involved before the liquidation process is initiated). Also important for the start of the liquidation process is that the *Guide* emphasises that the banking authority's assessment of the bank's viability should be leading. The court should defer to that authority's expertise and discretion in making such a technical determination.

Apart from its role in starting the liquidation, the role of banking authorities in court-based systems may include participation in the appointment of the liquidator (or being the liquidator itself), providing specialist advice to the court, being part of a liquidation committee,[35] monitoring liquidation activities through regular reporting mechanisms, and having the ability to challenge actions of the liquidator.[36] The *Guide* adds that, in any case, issues that concern financial stability should be decided by the banking authority (if necessary, through instructions to the liquidator).[37]

An important drawback of court-based systems is that the court only gets involved once a petition for insolvency has been made, while certain liquidation strategies—particularly a sale as a going concern—can only be successfully executed if they are prepared in advance. Means of addressing this shortcoming include relying on the advance work of banking authorities (e.g., for identifying suitable acquirers and defining the perimeter to be transferred) and appointing a prospective liquidator, who may participate in preparatory actions and is later nominated to the court for appointment as liquidator.[38]

While the role of creditors in bank liquidation should generally be reduced compared to general business insolvency laws, there is one creditor that, to the contrary, plays a special role: the deposit insurer. The involvement of the

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[34] Chapter 3, Section C (*Initiation of bank liquidation proceedings*) and Recommendation 17 of the Legislative Guide.

[35] E.g., in the predominantly court-based system in the United Kingdom, the liquidation committee is entirely composed of banking authorities until protected deposits have been paid out or transferred. The Guide also offers guidance on creditor committees. Where such committee is established, the Guide advocates that the relevant banking authorities should be permitted to participate and have a leading role in the initial phase of the liquidation process—such as deciding to liquidate the bank, determining the strategy, and implementing depositor protection measures (e.g., payouts or transfers). Importantly, creditors should not be permitted to influence decisions that serve public policy objectives. This reflects a key distinction between bank liquidation and ordinary business insolvency proceedings, where creditor involvement is typically more extensive and influential throughout the process.

[36] Recommendation 11 of the Legislative Guide.

[37] *Ibid*, Recommendation 12.

[38] *Ibid*, paragraphs 85, 172, 175, and Recommendation 11a.

deposit insurer ranges from simply paying out insured deposits in a piecemeal liquidation ("pay box")—and becoming a creditor in the liquidation proceeding by subrogating to the rights of insured depositors—to acting as liquidation authority or liquidator. Whether it would be appropriate for the deposit insurer to fulfil the latter role depends on a number of factors, including its mandate, institutional nature and governance arrangements. The *Guide* also explains that if the deposit insurer is the liquidation authority or liquidator, its role as a major creditor may create potential conflicts of interest, which can be mitigated by requiring it to act in the interests of all creditors, supported by governance measures that promote fairness, neutrality, and independence. Regardless of their specific role and mandate, deposit insurers should be granted the right to timely and comprehensive information from liquidators, and there should be clearly defined coordination and information-sharing mechanisms among deposit insurers, administrative authorities, and other financial safety-net participants.

3. Provisions enabling a timely and swift opening of bank liquidation proceedings[39]

Another key aspect of effective bank liquidation frameworks is to enable timely action and a swift opening of bank liquidation proceedings to prevent unnecessary destruction of value and protect depositors. The ability to act swiftly and effectively depends partly on the capacity to prepare for liquidation and partly on the legal grounds for initiating bank liquidation.

Resolution planning is a core element of bank resolution frameworks. At the same time, planning for liquidation purposes is generally limited (although resolution plans may focus on liquidation as the preferred strategy). While the *Legislative Guide* does not cover planning in "normal times", it does emphasise the need for "contingency planning" —that is, planning in the run up to a bank's failure.[40] This is especially relevant when a sale as a going concern is envisaged, since a transfer of assets and liabilities should ideally take place almost simultaneously with the opening of the bank liquidation process. Contingency planning could then involve a separability analysis to assess how components of the bank's operations can be operationally, legally, and financially disentangled from the rest of the entity, enabling the liquidator to quickly sell viable business units and maximise value. Some planning is also required for an effective piecemeal liquidation, focused on enabling a quick payout of insured depositors (e.g., having up-to-date information on the depositor base and cooperating with the deposit insurer).

In order to facilitate preparation, authorities should be aware of the bank's difficulties sufficiently in advance. Legal frameworks should already contain an early notification requirement for banks *vis-à-vis* their supervisory author-

[39] Chapter 3 to 5 of the Legislative Guide.
[40] Paragraphs 163-173 of the Legislative Guide.

ity.[41] In addition, the *Guide* recommends introducing a requirement for banks to notify all the relevant authorities (supervisor, resolution authority, liquidation authority) of approaching non-viability to enable a timely and coordinated intervention. It emphasises that the legal framework should allow close cooperation to take place between all relevant administrative authorities before a bank's liquidation. Apart from provisions in the legal framework about cooperation and information-sharing (subject to confidentiality requirements), this can be arranged by means of cooperation agreements or memoranda of understanding.

For banks with listed or traded securities, cooperation with the relevant market authority is key. The *Guide* recommends that such authority should be notified in a timely and confidential manner of the bank's situation so that it may determine whether to suspend the trading of the bank's securities. Cooperation with the market authority and the bank is also relevant since disclosure requirements may apply. This implies difficult trade-offs; on the one hand, the disclosure of information that a bank is approaching non-viability might accelerate its failure. On the other hand, withholding such information could prevent creditors from making informed decisions about continuing to transact with the bank, while uncertainty among investors might also lead to destabilising effects. The *Guide* advises that the legal framework may permit delaying public disclosure of a bank's approaching non-viability, but only for the time strictly needed to finalise liquidation preparations.

Coordination challenges can emerge when the institutional framework for bank liquidation includes courts and court-appointed liquidators. Typically, the court becomes involved only once the formal filing for liquidation is made, limiting or excluding its role in the preparatory phase. One way to enhance preparation and foster cooperation between the court and banking authorities is to involve a prospective liquidator early in the process (see above, sub-section 2). Appointing a banking authority as the liquidator can further support a seamless transition from the pre-liquidation phase to formal proceedings and promote effective collaboration between the court and relevant authorities.

As to the grounds for opening bank liquidation proceedings, the *Legislative Guide* explains that these should go beyond traditional insolvency standards, such as balance-sheet insolvency and cessation of payments or illiquidity, given the specificities of banks, particularly their reliance on depositor confidence and the maturity mismatch between their assets and liabilities.[42] A bank's book value may not promptly reflect asset impairments or expected losses, and accurately valuing a bank's assets quickly is difficult. Waiting for the bank to become balance-sheet insolvent before acting can result in significant value loss before liquidation. Delaying action for too long also heightens the risk that sophisticated clients will withdraw first, potentially harming retail depositors and triggering panic or contagion. It is also important to

[41] See Basel Core Principles (2024), CP 9, EC 20, requiring banks to notify the banking supervisor as soon as they become aware of any "material adverse developments", including breach of legal and prudential requirements.

[42] See Chapter 5 of the Guide.

recognise that, unlike ordinary companies, a bank's liquidity issues can escalate far more rapidly—especially in the digital age, with tools like mobile banking, instant payments, and the viral nature of social media.[43] Thus, forward-looking liquidation grounds are important to prevent asset reduction and safeguard depositors. In line with the *FSB Key Attributes*, the *Guide* advocates that the concept of non-viability or likely non-viability[44] should guide the formulation of such grounds.[45] In this line, the indicators in the *FSB Key Attributes Assessment Methodology for the Banking Sector* are useful.

In jurisdictions with dual-track regimes, where non-viability may lead either to resolution or liquidation, the *Guide* recommends aligning he triggers for both procedures.[46] This is important to avoid "limbo" situations where a bank is found to be failing based on the criteria in the resolution framework, but the grounds for opening liquidation proceedings are not yet met. If the resolution authority finds a bank non-viable but decides not to take resolution action, the legal framework should require the bank's swift entry into liquidation. Conversely, if resolution is pursued, it should be possible liquidate any residual entity, without the need for a fresh assessment.

To avoid conflicting assessments between administrative authorities and courts about a bank's viability, especially in court-based regimes, safeguards should be introduced. The *Guide* indicates that one option to reduce uncertainty would be to treat licence revocation as a self-standing ground for liquidation; in such case, the court has no further assessment to make. Where licence revocation is not a liquidation ground, the prinicple of deference is important (see above, sub-section 2).

The *Guide* also emphasises the importance of coordination between licence revocation and the opening of liquidation proceedings more generally. The revocation of a bank's licence, often triggered by the same financial or regulatory grounds, can itself serve as a valid and sufficient ground for liquidation. It can also be a consequence of the opening of liquidation proceedings. Where revocation and liquidation are handled separately, it recommends aligning the provisions and procedures.

4. Funding and creditor hierarchy that facilitate an orderly liquidation[47]

In bank liquidation proceedings, external funding (i.e., beyond the failing bank's own resources) may be needed to protect depositors and enable an

[43] The rapid pace of modern bank runs was highlighted by the collapse of Silicon Valley Bank in the United States (March 2023), when nearly 30% of its deposits were withdrawn in a single day. See FSB, 2023 Bank Failures — Preliminary lessons learns for resolution (2023), available at https://www.fsb.org/2023/10/2023-bank-failures-preliminary-lessons-learnt-for-resolution/.

[44] See FSB Key Attributes, KA 3.1.

[45] Recommendation 42.

[46] Paragraphs 223-224 and Recommendation 44 of the Legislative Guide.

[47] Chapter 7 and 8 of the Legislative Guide.

orderly liquidation. The financing framework should be structured in such way that the use of public funds is avoided. Following the experience in the global financial crisis—during which a significant amount of public funds were used to address several major bank failures—reducing loss exposure of taxpayers is a primary aim of bank resolution regimes. Public funds may only be used exceptionally in a resolution and mechanisms should be in place to recover those funds from the failed bank or the sector.[48] Using public funds to support non-systemic banks is even harder to justify than in the case of systemic banks.

In a piecemeal liquidation, funding may be necessary to quickly reimburse insured depositors. In such cases, industry-financed deposit insurance funds (DIFs) can be used to make pay outs to insured depositors up to a pre-established amount, after which the deposit insurer assumes the rights of the depositors through subrogation and becomes a creditor in the insolvency estate. This is the default use of DIFs.

However, funding may also be needed to support deposit transfers. Often, there is a gap between the assets and the liabilities that are transferred to a sound acquirer. Funding may also be needed to offer guarantees or cover risks not fully assessed during due diligence. The *FSB Key Attributes* and the *IADI Core Principles* recognise the use of DIF resources to fund measures that preserve depositors' access to their funds as an alternative to payout. Whether such use of DIF resources is possible depends on the mandate of a deposit insurer. According to the *IADI Core Principles*, when the legal framework allows the use of DIF resources for non-payout measures, it must include additional features and safeguards—particularly when the deposit insurer is not the authority handling the bank failure. Those safeguards are intended to ensure accountability and protect the DIF from depletion.[49]

The *Legislative Guide* explains that the ability to use DIF resources to support a sale as a going concern in liquidation offers key benefits. As explained above, a sale as a going concern will often be in the interest of depositor protection (it allows continued access to deposits) and value maximisation. Using DIF resources enables a successful transfer of deposits, because without such funding, there may be no banks willing to acquire the failing bank's assets and liabilities. Permitting the use of industry-funded DIF resources to facilitate a sale as a going concern also reduces the risk that resort is had to public funding. The *Guide* therefore recommends that the legal framework allows the deposit insurer to authorise the use of DIF funds for a sale as a going concern, subject to the safeguards in the *IADI Core Principles*.[50]

The contribution of DIFs to non-payout solutions is limited by a "payout counterfactual", which is a rule that restricts the insurer's support to the costs

[48] FSB Key Attributes, KA 6.1, 6.2 and 6.4.
[49] See *IADI Core Principles*, CP 9, EC 8.
[50] See paragraph 326 and Recommendation 67 of the Legislative Guide.

in a direct payout scenario.[51] This limit can be calculated on a net basis (by already deducting expected recoveries in liquidation) or gross basis (without subtracting liquidation recoveries upfront, provided that they are recovered by the deposit insurer at a later stage in the piecemeal liquidation of the residual entity).

The methodology for calculating the limit (e.g., the range of costs that should be taken into account or assumptions about recovery levels) significantly affects how much support a deposit insurer can offer in practice. The *Guide* advises to clarify the applicable methodology in policy statements or guidance.[52] Furthermore, it explains that, when designing the bank liquidation framework, legislators should consider that the amount recoverable by the DIF is also influenced by the deposit insurance coverage level and the ranking of depositors within the creditor hierarchy. The higher the ranking of insured depositors, the greater the deposit insurer's potential recovery—and consequently, the smaller its contribution to a sale as a going concern.

DIF support may range from straightforward cash contributions to more complex forms such as guarantees, loss-sharing arrangements, or other types of contingent commitments. While cash payments are simpler and commonly used, more intricate structures require legal and operational sophistication, as well as close coordination with supervisory authorities. Legal frameworks typically outline these options only in general terms, leaving specific transaction design to be determined case by case, based on the circumstances of the failure and available transfer options.[53]

The *Legislative Guide* also addresses post-liquidation financing from private lenders, although this is typically less relevant for bank liquidations compared to ordinary business insolvencies because a sale as a going concern must be executed quickly, minimising the transitional period during which ongoing operations may require funding. Nevertheless, drawing on business insolvency principles, the *Guide* indicates that the legal framework could allow private lenders to provide post-liquidation funding with a high-priority claim—such as classifying it as an administrative expense or ranking it above other administrative costs.[54]

As already follows from the above, an element that is directly linked to external funding arrangements in liquidation is the creditor hierarchy, which determines how internal resources, namely the failed bank's remaining assets, are distributed among creditors. In most insolvency cases, the proceeds are insufficient to cover all existing claims, making it necessary to have rules that govern the distribution of these proceeds—or, conversely, the allocation of losses—among creditors.

[51] The "payout counterfactual" restricts the amount the DIF may contribute no more than the costs it would otherwise incurred in a payout of insured depositors net of expected recoveries. See IADI Core Principles, CP 9, EC 8, point (d), and related commentary in Chapters 6 and 8 of the Guide.

[52] See paragraph 329 of the Legislative Guide.

[53] *Ibid*, paragraphs 331-332.

[54] *Ibid*, paragraph 392 and Recommendation 81.

Clear rules on creditor ranking in bank liquidation are important for predictability and to enable cross-border recognition. The creditor ranking is also relevant for bank resolution actions. It informs the exercise of resolution strategies since these must in principle respect the hierarchy of claims. Furthermore, the recoveries of creditors in a hypothetical piecemeal liquidation are the counterfactual for the purposes of the NCWO safeguard in bank resolution.[55]

The *Legislative Guide* recommends including rules on ranking in a dedicated bank liquidation framework (or, in the absence thereof, incorporating tailored rules in the general business insolvency law or banking law).[56] Consistent with existing international guidance, it adds that the number of creditor classes should be limited to the minimum necessary, although differentiated treatment, such as giving depositors a priority ranking or subordinating specific liabilities, may be advisable.[57]

The *Guide* offers guidance on the relative ranking of certain types of claims—those that are unique to banks or necessitate special rules in bank liquidation proceedings. First and foremost, this concerns claims of depositors. Depositors constitute a large portion of a bank's creditors and the protection of depositors is one of the core objectives of bank liquidation, which makes their ranking a crucial element to consider. While some provide no priority for depositors, most jurisdictions introduced some form of depositor preference, which gives depositors' claims a higher ranking than ordinary unsecured creditors. The specific form of depositor preference—insured, tiered, or general—varies. "Insured depositor preference" limits priority to claims covered by deposit insurance and within the insurance limit; "tiered preference" prioritises insured deposits, followed by some or all uninsured deposits, which still rank higher than ordinary unsecured claims; and "general depositor preference" grants equal priority to all deposits regardless of coverage.[58]

These design choices have important policy and practical implications. Each of these options affect how deposit claims are treated in liquidation and the recoveries of the deposit insurer when it subrogates to depositors' claims. The *Legislative Guide* advises jurisdictions to make their own choice weighing the potential advantages of depositor preference against the potential disadvantages, but it highlights that some form of depositor preference is generally recommended.[59] Supporting reasons include the unique legal characteristics of deposits and policy considerations such as minimising runs and contagion, safeguarding the payment system, lowering deposit insurance scheme costs, and ensuring consistency between deposit treatment and the protections offered under resolution frameworks. The *Guide* provides a detailed discussion on how different forms of depositor preference impact transfer strate-

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[55] The creditor hierarchy underpins both the use of liquidation tools and the NCWO safeguard in resolution or transfer scenarios. See FSB Key Attributes, KA 5.1 and 6.3.

[56] Recommendation 68 of the Legislative Guide.

[57] *Ibid*, Recommendation 69.

[58] See Illustration 2 (paragraph 349) in the Legislative Guide; IADI Briefs (2020), pp. 4-5.

[59] See paragraphs 350-351 and Recommendation 72 of the Legislative Guide.

gies,[60] explaining that general depositor preference facilitates the transfer of deposit books compared to tiered depositor preference from a funding standpoint[61] and makes it easier to transfer both insured and uninsured deposits (since they have the same ranking, both ahead of ordinary unsecured claims). Regardless of the approach, the *Guide* emphasises that depositor preference should complement and not substitute deposit insurance, which remains essential for swift reimbursement and overall depositor confidence.

The *Legislative Guide* also addresses the ranking of interbank deposits, explaining that there are both arguments for and against giving them a preferred ranking.[62] Moreover, it explains how specific attention should be given to the ranking of related party claims in liquidation. Related-party transactions have the potential of being unfair, abusive and potentially fraudulent, and can even contribute to a bank's failure. Therefore, generally, there are advantages to subordinating related-party claims and excluding related-party deposits from preferential depositor rankings.[63]

In addition to depositor ranking and the treatment of related party claims, guidance is provided in Chapter 8 on claims for post-liquidation interest, recommending to specify in the legal framework that subordinated creditors rank below ordinary unsecured creditors, *including* any claims for interest accrued by those unsecured creditors during the liquidation process. In economic terms, deferring interest payments to senior creditors until after liquidation ends can effectively result in them financing subordinated creditors, who may be paid in full during the proceedings. This is not only contrary to the general principle that senior creditors have priority over junior creditors, but may also have undesirable consequences in resolution.[64] Furthermore, guidance is provided on the ranking of shareholders (which should be last in line, after all creditors)[65], resolution financing arrangements, and secured creditors—including covered bondholders and central banks.

III. CONCLUDING REMARKS

At the global level, there is well-established guidance for general business insolvency laws and bank resolution frameworks. Until recently, however, specifically tailored guidance to manage the failure of non-systemic banks was lacking. The recently adopted *UNIDROIT Legislative Guide on Bank*

[60] *Ibid*, paragraphs 354-357.

[61] In a hypothetical piecemeal liquidation, recoveries of the deposit insurer are lower under general depositor preference than tiered depositor preference, so conversely, the contribution of the deposit insurer to a sale as a going concern can be higher.

[62] See paragraph 364 of the Legislative Guide.

[63] For a comprehensive discussion on the risks of opaque bank ownership structures and excessive related party exposures and transactions, including their possible treatment in resolution and liquidation, see Karlsdóttir et al., Resolving Opaque Bank Ownership and Related-Party Exposures (IMF Technical Notes and Manuals No. 2024/002), especially Box 10.

[64] See paragraphs 383-386 and Recommendation 78 of the Legislative Guide.

[65] *Ibid*, paragraphs 387-389 and Recommendation 79.

Liquidation fills this gap by offering practical guidance to support legislators and policymakers worldwide in developing bank liquidation regimes that are clear, effective, and suited to the unique characteristics of banks.

This paper has presented an overview of several key elements of the *Legislative Guide*, including the application of liquidation tools, institutional arrangements, mechanisms for timely and effective action, funding considerations, and creditor ranking rules tailored to the specific features of banks. Although not exhaustive, the overview is intended to underscore the *Guide*'s practical relevance and to promote further exploration of its content.

Now that the *Legislative Guide* has been finalised and adopted, after a robust and inclusive development process, it is expected to play a significant role in enhancing bank liquidation frameworks around the world. It is hoped that this paper will prompt reflection, foster informed dialogue, and support the adoption and implementation of the *Guide*'s key elements across jurisdictions.