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CROSS-BORDER BANK INSOLVENCY:

LEGAL IMPLICATIONS IN THE CASE OF BANKS OPERATING IN DIFFERENT JURISDICTIONS IN LATIN AMERICA*

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ABSTRACT

This article focuses on the issue of bank liquidation from an international perspective and discusses the legal implications of the liquidation of banks with branches and subsidiaries in different jurisdictions. The regional scope of the paper is Latin America, though references to EU and US law are also included. The paper is divided into five sections, beginning with an introduction to the subject. Section I broadly discusses the options available to the authorities to deal with failed banks (liquidation or rehabilitation). Section II deals with the international, regional, and bilateral rules regarding issues of cross-border insolvency. Special attention is given to the Montevideo Treaties and the Bustamante Conventions as relevant treaty developments in this field in Latin America. This section also covers a brief analysis of international law principles applicable to cross-border insolvency. Section III examines the work of the Basel Committee on Banking Supervision with regard to the international regulation of branches and subsidiaries. It also presents some observations with regard to the closure of a multinational bank. Section IV

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surveys the regulation of branches, subsidiaries, and joint ventures in some Latin American countries. This Section is complemented by three appendixes at the end of the paper which summarize the legislation applicable to foreign branches and subsidiaries and to local branches and subsidiaries overseas in six jurisdictions: Peru, Chile, Venezuela, Colombia, Brazil, and Argentina. A further appendix (Appendix 4) analyses the powers of supervisors, in particular with regard to the liquidation of banks, in these six jurisdictions. Section V presents the example of the Brazilian normative and practice to deal with the problems (including possible liquidation) of foreign branches and subsidiaries in the country as well as the problems (including possible liquidation) of branches and subsidiaries abroad. The latter is illustrated by a case which involved the liquidation of a Brazilian bank with branches in New York and Cayman Islands.

INTRODUCTION

Since the banking industry is inherently unstable, the authorities always need to be prepared to confront the possibility of crises or problems. Crisis management in banking involves an array of instruments that extend beyond the insolvency proceedings that are the only tool typically available to deal with corporate bankruptcy in other industries. Such an array of instruments includes the lender of last resort role of the central bank, deposit insurance schemes, and government policies of implicit protection of depositors (both insured or uninsured) or banks (the 'too-big-to-fail doctrine').[1] This paper focuses on the issue of bank insolvency proceedings and leaves aside the issues of lender of last resort, deposit insurance, and other government policies. However, it is important to point out that in practice those insolvency proceedings are often part of a 'rescue package' that is also likely to include the provision of emergency liquidity assistance and some degree of explicit (or implicit) deposit protection.

The growth in cross-border banking activities presents a number of challenges for regulators around the world. These challenges become particularly evident in the field of cross-border insolvency. Though the markets have grown international, regulation remains nationally based, constrained by the domain of domestic jurisdictions. In the absence of an international insolvency legal regime, the solution to the liquidation of a bank with branches and subsidiaries in several countries needs to be based on national legal regimes and on the voluntary co-operation between different national authorities.

[1] I have discussed these issues elsewhere. See, e.g., Central Banking and Banking Regulation (London: Financial Markets Group, London School of Economics, 1996), at 124–56; 'Lender of Last Resort. An International Perspective', 48(2) International and Comparative Law Quarterly (1999), at 339–60; and a co-authored paper with Joseph J. Norton and Douglas Arner on 'Legal Aspects of Depositor Protection Schemes: Comparative Perspective', presented at an International Seminar on Legal and Regulatory Aspects of Financial Stability in Basle in January 2002.

The challenge is further compounded by the fact that bank insolvency laws differ greatly from country to country. In the USA, for instance, bank failures are not subject to general corporate bankruptcy procedures (such as Chapter 11 of the US bankruptcy code) but to special bank insolvency proceedings that take into account the nature of bank deposits and the possible systemic implications of bank failures. In the UK, on the other hand, bank insolvencies are treated under the same rules as other companies. The result of the US approach, according to some commentators, is that the objectives of general corporate bankruptcy law are somewhat different from the objectives of special bank insolvency law.[2]

According to Schiffman[3] insolvency laws should seek to fulfil two principal objectives: fair and predictable treatment of creditors and maximization of assets of the debtor in the interests of creditors. I would add another objective that is specific to banking: the bank should be closed as soon as the market value of its net worth reaches zero, because at this moment, direct losses are only suffered by shareholders. If the bank is declared legally insolvent when the market value of its net worth is already negative, losses will accrue not only to shareholders, but also to uninsured creditors and/or to the insurance fund/the government.

I. LIQUIDATION OR REHABILITATION[4]?

In banking, the definition of insolvency is sometimes a matter or controversy,[5] and the line of demarcation between illiquidity (lack of liquid funds) and insolvency is not always clear. An economically insolvent bank is not always declared legally insolvent by the responsible authorities and may instead be offered financial assistance. A bank is considered to have failed when the competent authorities order the cessation in its operations and activities. However, the authorities are often wary of liquidating a bank (in part because an 'orderly liquidation of assets' is not always easy, due to the possible contagion effect on other institutions) and therefore choose instead to rehabilitate the bank.

[2] See, e.g, Gerald N. Olson, 'The Inadequacy of Bank Insolvency Resolution', in Rosa M. Lastra and Henry N. Schiffman (eds), *Bank Failures and Bank Insolvency Law in Economies in Transition,* (The Hague: Kluwer Law International 1999) at 112–13. According to Olson, while the primary objective of bank insolvency law is to maintain public confidence in the banking system, bankruptcy laws seek to achieve three objectives: (1) protect creditors from each others; (2) protect creditors from dishonest debtors; (3) protect honest debtors from creditors by discharge.

[3] See Henry N. Schiffman, 'Legal Measures to Manage Bank Insolvency', in Rosa M. Lastra and Henry N. Schiffman (eds), above, n 2, at 89–90.

[4] This section draws on Chapter 2, Section 2 of my book, *Central Banking and Banking Regulation*, above n 1.

[5] As acknowledged, there are two traditional definitions of insolvency in commercial bankruptcy laws: failure to pay obligations as they fall due (equitable insolvency insolvency) and the condition when liabilities exceed assets (balance sheet insolvency). See e.g., Schiffmann, above n 3, at 96–97.

Indeed, though a clear policy that banks that have failed ought to exit the banking system might appear desirable in some cases, the social cost of closing a bank is significant, as banks are often – particularly in emerging economies – the main repository of the savings of the public and a major source of credit to the economy. That is why failed banks are often not liquidated, but subject to reorganization or rehabilitation.

The Basel Committee on Banking Supervision acknowledges that in a market economy, failures are part of risk-taking[6] and that a prompt and orderly liquidation of institutions that are no longer able to meet supervisory requirements is a necessary part of an efficient financial system, as forbearance normally leads to worsening problems and higher resolution costs.[7] However, the Committee explicitly states that 'in some cases the best interests of depositors may be served by some form of restructuring, possibly takeover by a stronger institution or injection of new capital or shareholder. Supervisors may be able to facilitate such outcomes. It is essential that the end result fully meets all supervisory requirements, that it is realistically achievable in a short and determinate timeframe and, that, in the interim, depositors are protected.'[8]

A. Liquidation

Though this option is the simplest resolution procedure, it is not necessarily the least costly, as a valuable depositor base gets dissipated, vital banking services in a community may be disrupted, and confidence in the banking system may be seriously damaged. Occasionally, the liquidation of one institution may trigger runs on other institutions. However, in the presence of massive frauds, such as the BCCI affair, liquidation is the only solution available.

In banking, liquidation typically entails a system of depositor preference, i.e., depositors' claims are typically paid before those of general creditors. If the country has a deposit guarantee scheme, the insured depositors are paid off up to the insurance limit; uninsured depositors and other creditors are likely to suffer losses in their claims.

I discuss below the implications of the liquidation of multinational banks with branches and subsidiaries in different jurisdictions.

B. Rehabilitation

In the case of bank rehabilitation, reorganization, or restructuring, the laws vary widely from country to country. Indeed, as Schiffmann points out,

[6] Basel Committee on Banking Supervision. Core Principles for Effective Banking Supervision (Basel Core Principles), http://www.bis.org/publ/bcbsc102.pdf, (visited 10 March 2002), at 10.

[7] Ibid, at 12.

[8] Ibid.

'Under some bankruptcy laws there is still an opportunity for bank reorganisation or rehabilitation as part or bank insolvency proceedings, while in others the only measure contemplated is the liquidation of bank's assets, payment of liabilities and dissolution of the bank.'[9]

When an institution is offered a program of *open bank assistance* (also referred to as a *'rescue package'*), the institution is not closed but is rescued on an 'open bank' basis through the infusion of new funds. 'Rescue packages' can take a variety of forms including new loans, soft loans, deposits, asset or securities purchases, assumption of liabilities, and capital injections. In many cases the management of the institution is revamped in a program of open bank assistance.[10]

The granting of 'state aid' (i.e., funding coming directly or indirectly from the government) in a 'rescue package' is controversial. A delicate balance between the interests of taxpayers on the one hand and the interests of depositors as well as other bank creditors and bank shareholders on the other hand, needs to be reached. Ruth de Krivoy, former central bank governor in Venezuela, points out that crisis management can be more effective if an early decision is made as to how the cost of the crisis is to be shared between shareholders, depositors, and taxpayers. She argues that improvisation as the crisis unfolds often leads to the most damaging result for the taxpayers, as illustrated by the Venezuelan case.[11]

In some cases an implicit or explicit 'too big to fail' policy is applied. That was the case in Continental Illinois in the USA and in Credit Lyonnais in France. Government-led rescue packages may not only induce moral hazard behaviour, but may also pose questions of fair competition, particularly when the too-big-to-fail doctrine is applied, as other smaller or less troubled institutions may have to navigate through crises or problems on their own. In the US, FDICIA (1991) requires the resolution of bank failures on a 'least cost basis' to the insurance fund, unless it threatens to trigger a payment system breakdown, in which case FDIC and Fed may recommend a more costly solution.[12] The abandonment of a too-big-to-fail policy tries to encourage market discipline in the resolution of bank failures and to reduce moral hazard incentives.

Another action that may be taken by the authorities in dealing with a

[9] See Schiffman, above n 3 at 81.

[10] It is important to differentiate – at least in theory – between rescue packages that imply bank recapitalization and the provision of emergency liquidity assistance or (lender of last resort) to an illiquid but solvent institution. I have dealt with this issue in an article I wrote on 'Lender of Last Resort. An International Perspective,' above n 1.

[11] See Ruth de Krivoy, 'An Agenda for Banking Crises Avoidance in Latin America', paper presented at the Inter-American Development Bank Group of Thirty Conference on Banking Crises in Latin America, Washington DC, October 1995.

[12] See US Federal Deposit Insurance Corporation Improvement Act (FDICIA), 12 USC 1823 (c)(4).

financially distressed bank is a *take over* or *merger* (also called purchase and assumption, that is the purchase of assets and assumption of liabilities). Because the co-operation of other market participants is typically required, this regulatory option has a 'private' flavour, as opposed to the typical 'public' character of most rescue packages. A take over generally preserves the going-concern value of an institution, as the acquirer succeeds both to a deposit base and to a base of loan customers. As opposed to a straight liquidation, it eliminates the danger that vital banking services in a community will be disrupted. A merger can be 'unassisted' when the acquirer assumes all assets and liabilities (also called 'whole bank's acquisition'), and 'assisted', when all the liabilities but only the good assets go to the acquirer (also referred to as 'clean bank's acquisition'). In an assisted transaction, the bad assets are subject to special administration.

Sometimes, failed banks may be placed under *special administration*, in the form of bridge banks, new banks, special funds, or other arrangements. This is often meant to be a temporary solution in order to take over the operations of a failed bank and preserve its going-concern value while the government fiduciary seeks a more permanent solution to the problems or until an acquirer is found.

A *system crisis* (a generalized banking crisis) is treated by the supervisory authorities differently from an isolated individual bank failure in a sound economy. When confronting a system crisis, the government can choose to deal with each troubled bank on a case-by-case basis, using a mix of strategies: takeovers and rescue packages in some cases, liquidation in others; or the government can choose an overall strategy to deal with all the actual or potential troubled institutions. The difficulty of calculating *ex ante* the total amount of the losses and the speed with which a system crisis unfolds add to the complexity of its resolution; moreover, a system crisis tends to be a result or a reflection of the deterioration of the economic environment or of poor macroeconomic management. At the beginning of a system crisis, the authorities may provide emergency liquidity assistance to banks under stress, hoping for an early restoration of confidence. However, if banks start failing, the government will often be compelled to provide solvency assurances to depositors and to design a coherent policy – with an expeditious decision-making process and a clear voice – to overcome the crisis. The government also faces the delicate and difficult policy choice of whether and when to commit fiscal resources to recapitalize banks.

Though crises are costly and difficult to resolve in developed countries, their effects are even more severe in the developing world. Rojas-Suárez and Weisbrod (1995) demonstrate that banking crises in Latin America last longer, are more costly and hurt the local economies more than banking crises in the industrial countries, because of the fragility of their financial systems. They argue that this fragility is the result of 'frequent periods of destabilizing

economic policies and structural problems in the market, which include inexact legal and accounting standards and weak supervision.'[13]

There are two extreme solutions available to governments when dealing with a system crisis: the government can inject capital into all troubled institutions and the government can do a large-scale liquidation.

1. Direct government injection of capital

Direct government injection of capital into the troubled institutions, as happened in Sweden in 1992 or in Venezuela in 1994, often leads to a *de facto* nationalization of the assisted banks (or of the whole banking system); it also complicates the conduct of monetary and fiscal policies.

2. Liquidation

Liquidation on a large scale, on the other extreme, is seldom considered a viable option, because of its detrimental effects on the workings of a market economy, because of a potential 'domino effect' on other [sound] financial institutions (the very malaise the government is trying to avoid) and because of the difficulty in judging whether the problems are permanent or merely cyclical or temporary. The banking crisis in Russia in the summer of 1995 illustrates how liquidation of a large number of small institutions can, under certain circumstances, be beneficial for the restoration of confidence in the system.[14]

Between these two radical options, *de facto* nationalization (saving all institutions) and liquidation (letting all institutions fail), there are a variety of solutions and policies available to governments to confront a system crisis:

3. Debt restructuring techniques

Debt-to-debt conversions and debt-to-equity conversions have been applied in the resolution of the Latin American debt crisis of the 1980s. Brady instruments – named after the former US Secretary of Treasury – proved to be a successful way of securitizing previously non-marketable loans.

4. Mix of government assistance and private assistance

The government can also ask other private institutions to provide assistance to troubled banks. In the UK, such a scheme was named a 'lifeboat' operation and was applied following the secondary banking crisis of 1974. The lifeboat –

[13] Liliana Rojas-Suárez and Steven R. Weisbrod, 'Banking Crises in Latin America: Experience and Issues', paper presented at the Inter-American Development Bank Group of Thirty Conference on Banking Crises in Latin America, Washington, DC, 1995.

[14] See Anders Aslund, 'When a Banking Crisis Is a Good Thing', *Financial Times* (13 September 1995): 'A government-ordered inspection of the banks could not possibly clean up the wild Russian banking sector. Fortunately, the market is doing the cleaning up instead.'

in the form of loans to the secondary banks – was co-ordinated by the big four clearing banks and the Scottish clearing banks.

5. Creation of a centralized agency to dispose of the assets of the failed institutions
Such a centralized solution was adopted in the resolution of the US thrift crisis of the 1980s. The Resolution Trust Corporation (RTC) was created by the 1989 Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) to manage the assets of the failed savings and loan associations.

II. SUPRANATIONAL RULES ON CROSS-BORDER INSOLVENCY

A. International rules

Though there is no international treaty on insolvency law, there have however been some attempts at reaching some commonly agreed international rules. In particular, it is important to mention the Model Law on Cross-Border Insolvency that the United Nations Commission on International Trade Law (UNCITRAL) adopted in Vienna in May 1997. However, this model law contains an optional clause whereby special insolvency regimes applicable to banks may be excluded from its scope.[15]

Another example of international rules is the International Bar Association's (IBA) Cross-Border Insolvency Concordat, which was approved by the Council of the Section on Business Law of the IBA in September 1995.[16] This Concordat sets out some essential principles that can assist insolvency practitioners faced with concurrent proceedings in relation to the same debtor in two or more jurisdictions.

B. Regional rules

1. The Montevideo Treaties of 1889 and 1940 and the Bustamante Code of 1928
In Latin America, two multilateral treaties, the Montevideo Treaties of 1889 and 1940, and the Bustamante Code sanctioned by the sixth Panamerican Conference (Havana Conference) of 1928 establish private international law rules concerning bankruptcy.[17] These treaties provide for the recognition and enforcement of foreign bankruptcies.[18]

[15] Article 1(2) of the Uncitral Model Law.

[16] See Erwin Nierop and Mikael Stenström, 'Cross-Border Aspects of Insolvency Proceedings for Credit Institutions – A Legal Perspective', paper presented at an International Seminar on Legal and Regulatory Aspects of Financial Stability in Basel in January 2002, at 7 and 9.

[17] This section of the paper, regarding the Bustamante Code and the Montevideo Treaties, draws on Juan M. Dobson, 'Treaty Developments in Latin America', published as Chapter 15 in Ian Fletcher (ed), *Cross-Border Insolvency: Comparative Dimensions* (The Aberystwyth Insolvency Papers, United Kingdom Comparative Law, Volume 12, United Kingdom National Committee of Comparative Law, 1990), at 237–62.

[18] See also K. Lipstein, 'Early Treaties for the Recognition and Enforcement of Foreign Bankruptcies', published as Chapter 14 in Ian Fletcher (ed), above n 17, at. 228–30.

With regard to the Montevideo Treaties, State signatories to the 1889 Treaty that have ratified it were Paraguay, Peru, Uruguay, Argentina, Bolivia, and Colombia, but not Chile or Brazil. State signatories to the 1940 Treaty that have ratified it were Uruguay, Argentina, and Paraguay. Both treaties establish procedural rules regarding bankruptcy. These rules sustain the extraterritorial effect of bankruptcy in those countries where the Treaties are in force. The principles of unity and universality of bankruptcy were considered as general features in both treaties, though the principle of plurality of bankruptcy is adopted in some cases. According to Dobson,[19] 'both treaties determine that the Court with international bankruptcy jurisdiction over the debtor . . . shall be that of his *commercial domicile*' [of the parent entity]. Further, 'the Court of the domicile shall retain jurisdiction even in the cases where the debtor had traded – in an occasional way – in other state or states, or had opened branches or kept agents in one or more states. But if the bankrupt has two (or more) economically autonomous businesses [a reference to subsidiaries] in different states, then the court of each domicile shall have international bankruptcy jurisdiction.'

According to Article 42 of the 1940 Treaty, advertisements for the opening of the bankruptcy proceedings, that shall be published according to the law of the State where the bankruptcy order has been made, shall also be published in all of the States where the bankrupt has kept agencies, branches, or establishments.

The Montevideo Treaties contain provisions that deal with a wide array of issues such as the authority of the 'administrators' and their agents, the rights of 'special priority' and secured creditors and mortgagees and other procedural issues.

According to Dobson 'the laws of Latin American countries present a marked similarity in the basic categories of their insolvency laws. Following mainly the notions received from the Napoleonic Commercial Code, they have instituted the traditional Italian-French [I would add: and Spanish] bankruptcy proceeding.'[20] Categories such as (1) cessation of payments as the condition for opening the bankruptcy; (2) disqualification of the bankrupt; (3) the appointment of an administrator ('Síndico') and others are common across Latin America.[21]

Dobson also points out that a feature that is quite widespread in Latin American national insolvency laws is the discrimination against the foreign creditor.

For Dobson, the Bustamante Code, also referred to as the Havana

[19] Dobson, above n 17, at 239.

[20] Ibid, at 249.

[21] Ibid.

Convention of 1928,[22] represents – together with the Montevideo Treaties – a step towards a possible Pan-American Insolvency Law.

Though both the Montevideo treaties and the Bustamante Code assign extraterritorial effect to the bankruptcy order, the degree of recognition of a cross-border insolvency varies widely amongst the internal laws of Latin American countries. According to Dobson, this disparity goes from full recognition (full extraterritoriality) in El Salvador to strict territoriality, with exception of specific Treaties, in Argentina.[23]

2. The EU insolvency regime

The new EU insolvency regime consists of one regulation on insolvency proceedings (Council Regulation (EC) No 1346/2000 of 29 May 2000) and of two directives: a directive on the reorganization and winding up of credit institutions (Directive 2001/24/EC of 4 April 2001), and a directive concerning the reorganization and winding-up of insurance undertakings (Directive 2001/17/EC of 19 March 2001).

The EU insolvency regime is binding for all EU Member States, as opposed to the Bustamante and Montevideo Treaties that are only binding for the Latin American States that have ratified them. As such, the EU regime is the clearest example of binding supranational/regional rules in the field of insolvency law in general and of bank insolvency law in particular. However, the EU rules are mainly of a private international law character. They introduce the principles of unity and universality of bankruptcy (further discussed below), but they do not seek to harmonize in a substantive way national legislation concerning insolvency proceedings, which remain different across the Member States of the EU.

The difficulty in reaching some common standards in this area of law is illustrated by the hurdles and delays that the EU has faced over the years in

[22] Twenty Latin American Republics were signatories to the Bustamante Code, and only fifteen ratified it (even though some did it with great reservations): Bolivia, Brazil, Costa Rica, Cuba, Chile, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Peru, Republica Dominicana. The countries that did not ratify the Bustamante Code were Argentina, Colombia, Mexico, Paraguay, and Uruguay.

[23] Above n 17, at 253. However, with regard to Argentina, Dobson refers (ibid, at 254–55) to the Argentina case law, as set out in the Panair do Brasil case of 1971–1972, whereby the Brazilian airline Panair do Brasil went bankrupt in Rio. Because the Montevideo Treaties did not apply as Brazil was not a party to them, the insolvency judge requested international judicial co-operation in order to sell the airline's office in Buenos Aires. To that effect, the Brazilian administrator appointed an agent in Buenos Aires. Even though Argentina does not accept the extraterritoriality of a foreign bankruptcy order, however, there is an ancillary proceeding that can be opened at the request of a foreign insolvency court. According to this procedure, the Argentine judge will appoint a local administrator, but will not open bankruptcy proceedings in Argentina. This is in fact an ancillary proceeding to the foreign bankruptcy. A foreign administrator ('Síndico') will be recognized as an agent of the debtor and can remit the remnant funds to the foreign court.

trying to agree on some common principles on bank insolvency. Indeed, only recently[24] has the Directive on the Winding Up and Liquidation of Credit Institutions been adopted (Directive 2001/24/EC), though the proposed directive was published in 1988. This Directive does not seek to harmonize national legislation concerning reorganization measures and winding-up proceedings, rather it ensures mutual recognition and co-ordination of these procedures by the 15 Member States of the EU, based upon the principle of home-country control.

C. Bilateral rules

In the absence of a formal international insolvency legal regime, countries resort to bilateral agreements, often in the form of a Memorandum of Understanding, to establish some principles of co-operation in the regulation of cross-border establishments.

For instance, Banco Central do Brasil has signed co-operation agreements in the fields of banking supervision with Argentina (Superintendencia de Entidades Financieras y Cambiarias del Banco Central de la Republica Argentina), Cayman Islands (Cayman Islands Monetary Authority), and Panama (Superintendencia de Bancos de la Republica de Panama). Such agreements govern the co-operation with foreign authorities with regard to the supervision of financial institutions with simultaneous presence in the undersigned countries. Though, generally, such agreements do not cover specifically the issue of the joint management of bank crises, such joint management is possible under the generic engagement in co-operation that guides the agreements.

Banco Central do Brasil also co-operates and regularly exchanges information with other foreign supervision authorities, such as the Federal Reserve Board and the Office of the Comptroller of the Currency (USA), Financial Services Authority (United Kingdom), Banco de España, De Nederlandsche Bank (Holland), and the Comission Bancaire de Luxembourg (Luxembourg), despite the fact that there are no formal agreements with such authorities.

In Colombia, the banking supervisory authority ('Superintendencia Bancaria de Colombia') has signed Memoranda of Understanding with several countries such as Peru, Venezuela, Ecuador, Panama, and Spain.[25] These MoUs typically follow the principles issued by the Basel Committee on Banking Supervision.

[24] An analysis of this new regime can be found in the paper by Nierop and Stenström, above n 16.

[25] Though the contents of these MoUs are broadly similar, it is important to point out that in the MoU signed with Panama, both authorities established principles of co-operation and exchange of information with regard to the prevention and control of money laundering.

D. International law principles governing insolvency

We have already mentioned, when talking about the Montevideo Treaties and the EU rules, that they generally subscribe to the principles of unity and universality of bankruptcy, though in the case of the Montevideo Treaties they sometimes adopt the principle of plurality of bankruptcy. Given the importance of these principles for the liquidation of banks with branches and subsidiaries in various jurisdictions, I discuss them further in the ensuing paragraphs.[26]

The principle of the *unity and universality of bankruptcy* – which typically resembles the unitary or 'single entity' approach to liquidation – means that there is only one competent court to decide on the bankruptcy of the bank (unity), and that the bankruptcy law of the country in which the insolvency has been initiated is effective in all other countries in which the bank (parent entity) has assets or branches (universality). Thus, this principle assigns *extra-territorial effect* to the adjudication of bankruptcy. All assets and liabilities of the parent bank and its foreign branches are wound up as one legal entity (single entity approach).[27] Under this unitary system it is impossible to start separate insolvency proceedings against a domestic branch of a bank that has its head office in another country.

It is important to point out that US law applies this unitary principle to the liquidation of a US bank with foreign branches. The Federal Deposit Insurance Corporation as receiver of a failed bank collects and realizes all assets, and responds to all claims of the institution regardless of their situs.[28] However, US law applies a dramatically different regime to the liquidation of US branches of a foreign bank, as I explain below.

The principle of *plurality of bankruptcy* – which typically goes hand-in-hand with the 'separate entity' approach to liquidation – means that bankruptcy proceedings are only effective in the country in which they are initiated and that therefore there is a plurality of proceedings, as they need to be initiated

[26] I draw in this section on the paper by Nierop and Stenstrom, above n 16, at 11–12, and on a BIS document – that I further analyse below in section III – entitled 'The Insolvency Liquidation of a Multinational Bank' (December 1992). This document is included in the Compendium of Documents produced by the Basel Committee on Banking Supervision (February 2000), Volume III, *International Supervisory Issues*, Chapter III, Other Supervisory Issues, http://www.bis.org/publ/bcbsc333.pdf (visited 14 February 2002).

[27] The single entity approach is '[f]ollowed by Luxembourg and the United Kingdom. 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 realization 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.' See 'The Insolvency Liquidation of a Multinational Bank' (December 1992), above n 26, at 2.

[28] See C. T. Curtis, 'The Status of Foreign Deposits under the Federal Deposit Preference Law', 21(2) University of Pennsylvania Journal of International Economic Law (2000), at 254.

in every country in which the insolvent bank holds realizable assets or branches. Thus, this principle assigns *territorial effect* to the adjudication of bankruptcy. Under a separate entity approach a domestic branch of a foreign bank receives a liquidation preference, as local assets are segregated for the benefit of local creditors.

The US applies the separate entity approach to the liquidation of US branches of a foreign bank. According to Curtis,[29]

> [U]pon the insolvency of a foreign bank or the inability of its US branch to meet claims against it, the receiver takes possession of all assets of the bank in the United States and uses the proceeds to pay claimants who did business with the bank in the United States. Proceeds are turned over to the foreign bank's home country liquidator for distribution to other claimants against the bank only if there is value left over after claimants in the United States are made whole. This manner of segregating local assets to pay local claims is known as the 'separate entity' approach to multinational bank liquidation. 'Balkanization' might be a more appropriate term . . .

The inconsistency of the US legal approach to the liquidation of multinational banks, depending on whether it is dealing with foreign branches in the US or with US branches of a foreign bank, illustrates the difficulties of reaching a common international platform with regard to the liquidation of multinational banks.

III. THE INTERNATIONAL REGULATION OF BRANCHES AND SUBSIDIARIES

A. The work of the Basel Committee on banking supervision

Whenever one surveys the legal issues related to the regulation of cross-border banking, one needs to refer to the work of the Basel Committee on Banking Supervision as the *de facto* informal 'international bank regulator'. Given the difficulties the EU has faced in reaching any agreement on cross-border bank insolvency, it is small wonder that the Basle Committee has not published any agreed guidelines on this issue [or cross border insolvency] yet.[30] Of course, a number of principles developed by the Basel Committee throughout the years to deal with the cross-border supervision of branches and subsidiaries can be applied when dealing with cases of insolvency of a bank operating in different jurisdictions. In particular, the principle of '*parental responsibility*' (or home country control) *in the supervision of branches* – as legally dependent units – and the consideration that *subsidiaries become independent legal entities under the*

[29] Ibid.

[30] As acknowledged, the recommendations of the Basel Committee are 'soft law' in that they are not legally binding rules. See e.g., Mario Giovanoli, 'A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting', in Mario Giovanoli (ed), *International Monetary Law* (Oxford: Oxford University Press 2000), at 33–44.

laws of the country of incorporation (i.e., under the laws of the host country) are principles observed generally and often included in Memoranda of Understanding between supervisory authorities in different countries.

Principles for the supervision of branches and subsidiaries were first developed in 1975 and refined in 1983. Following the collapse in 1974 of the German bank Bankhaus I.D. Herstatt and of the US bank Franklin National Bank, the Committee issued in September 1975 a paper (subsequently known as the Basle Concordat) outlining some principles – in the form of recommended guidelines of best practice – regarding the supervision of banks operating internationally through branches, subsidiaries, and joint ventures.[31] The Concordat was revised in 1983 following the collapse of the Luxembourg-based Banco Ambrosiano Holdings in 1982, under the title of 'Principles for the Supervision of Banks' Foreign Establishments'.[32]

According to the Basel Committee, there are two basic principles that are fundamental to the supervision of banks' foreign establishments: that no foreign banking establishment should escape supervision; and that the supervision should be adequate.[33] An adequate supervision is one in which the host authorities are responsible for the foreign bank establishments (subsidiaries) operating in their territories as individual institutions, while the parent authorities are responsible for them as parts of larger banking groups.

Parent authorities should be informed immediately by the host authorities of any serious problems which arise in a parent bank's foreign establishment and similarly, parent authorities should inform host authorities when problems arise in a parent bank which are likely to affect the parent bank's foreign establishment.[34]

Thus, the principles related to the management of crisis and bank insolvency of foreign establishments should be analysed within this context of mutual co-operation between supervisory authorities. In some jurisdictions, supervisory authorities have responsibility for managing pre-insolvency situ-

[31] The 1975 'Concordat' was reproduced as an Annex ('Supervision of Banks' Foreign Establishments') to Williams and Johnson's paper, 'International Capital Markets: Recent Developments and Short-Term Prospects,' IMF Occasional Paper No 7 (1981). See Lastra (1996), above n 1, at 175.

[32] Principles for the supervision of banks' foreign establishments (the 'Concordat'), May 1983, http://www.bis.org/publ/bcbsc312.pdf (visited 10 March 2002).

[33] The Committee has published other documents and standards regarding the supervision of cross border banking. In April 1990 it published a supplement to the 1983 Concordat on 'Information flows between banking supervisory authorities'. Following the collapse of BCCI in July 1992, the Committee published the 'Minimum Standards for the Supervision of International Banking Groups and Their Cross-border Establishments'. In October 1996 the Committee published a document entitled 'The Supervision of Cross-Border Banking' (October 1996). In September 1997 the Committee published the 'Core Principles for Effective Banking Supervision' that I refer to below. See also the Compendium of documents produced by the Basel Committee on Banking Supervision (February 2000), Volume III *International Supervisory Issues*, Chapter I: 'The Basel Concordat and Minimum Standards', http://www.bis.org/publ/bcbsc004.htm (visited 10 March 2002).

[34] Above n 32.

ations, and when insolvency occurs there is another authority in charge of the actual liquidation of the institution.[35]

In 1997 the Basel Committee published the 'Core Principles for Effective Banking Supervision',[36] which have important implication for the supervision of international banks. The following principles are particularly relevant for the subject I elaborate in this paper:

(i) An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banking institutions.[37]

(ii) Bank supervisors must practice *global consolidated supervision*, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.[38]

The principle of consolidated supervision[39] means that parent banks and parent supervisory authorities monitor the risk exposure of the banks or banking groups for which they are responsible, as well as the adequacy of their capital on the basis of the totality of their business wherever conducted.

Consolidated supervision is based on the assumption that financial groups form a *single* economic entity. However, when one comes to the question of the resolution of a failed multinational bank, or of a complex financial group with activities and business units with different legal entities incorporated in Latin America, the assumption that

[35] According to the Colombian Financial Legislation (Estatuto Orgánico del Sistema Financiero – EOSF, articles 114, 115, 116, and 296) the Banking Superintendency manages the crisis using different legal tools but the actual liquidation of a credit institution is the responsibility of the Financial Institutions Guarantee Fund, FOGAFIN. Article 262 of the General Banking Act 1993 of Venezuela establishes that the Fondo de Garantía de Depósitos y Protección Bancaria will act as the liquidator of the financial institutions. In the Chilean case, article 130 of the General Banking Act 1997 the Superintendent is responsible for designating a liquidator, unless the Superintendent assumes the liquidation himself. In Peru, article 114 of the General Law of the Financial and Insurance Systems 1996 (Law 26702, December 1996) determines that the Superintendency shall establish the regulations and procedure applicable to the dissolution and liquidation of companies. Argentina and Brazil are different cases. According to the Argentinean Law of Financial Institutions (Law 21.526 of 1977 articles 44, 47, 48, and 49) there is judicial liquidation of the financial institution which authorization has been withdrawn by the Central Bank of the Argentine Republic. In the same direction, Banco Central do Brasil is the supervisory authority, and can use its powers to liquidate a financial institution – Law No 6.024/74 and Decree-law 2.321/87.

[36] Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision (Basel Core Principles), http://www.bis.org/publ/bcbsc102.pdf (visited 10 March 2002). The Basel Core Principles for Effective Banking Supervision are intended to serve as a basic reference for supervisory and other public authorities worldwide to apply in the supervision of all banks within their jurisdictions.

[37] Ibid, at 4 and 11–12. Principle 1 determines the preconditions for effective banking supervision.

[38] Ibid, at 6–7 and 41, Principle 23.

[39] Consolidated supervision was first emphasized in the [revised] 1983 Concordat, above n 32.

financial groups form a *single* economic entity appears to be not always valid in a bankruptcy scenario where the group is split up into its many legal entities and where foreign branches are some times liquidated as *separate units*.[40]

(iii) The Basel Committee recommends that the supervisory authority be *responsible for* or *assist in* the orderly exit of problem banks in order to ensure that depositors are repaid to the fullest extent possible from the resources of the bank (supplemented by any applicable deposit insurance) and ahead of shareholders, subordinated debt holders, and other connected parties.[41]

(iv) Close co-operation with other supervisors is essential and particularly so where the operations of banks cross national boundaries.[42]

B. 'The Insolvency Liquidation of a Multinational Bank'

This subsection presents some observations with regard to the closure of a multinational bank according to a document entitled 'The Insolvency Liquidation of a Multinational Bank' (December 1992), published in the Compendium of Documents of the Basel Committee on Banking Supervision.[43] The paper discussed the liquidation of a multinational bank using the BCCI as a case study, based upon the insolvency laws in Luxembourg, the United Kingdom, and the United States. The purpose of the analysis was to help supervisors deal with the various issues surrounding the closure of multinational banks with branches and subsidiaries in various jurisdictions, in the absence of an international insolvency legal regime. The following observations remain a valuable source of reference for supervisors:

(1) When closing a bank, supervisors should pay attention to the nature and

[40] See Daniel Zuberbuhler, 'The Financial Industry in the 21st Century. Introduction', Swiss Federal Banking Commission, 21 September 2000, http://www.bis.org/review/rr000921c.pdf (visited 10 March 2002) at 2.

[41] See Basel Core Principles for Effective Banking Supervision, section II 'Preconditions for Effective Bank Supervision', above n 36 at 12. According to the Basel Committee, banking supervision is only part of wider arrangements that are needed to promote stability in the financial markets. One of these arrangements should include precisely procedures for efficient resolution of problems in banks. When problems are not remediable, the prompt and orderly exit of institutions that are no longer able to meet supervisory requirements is a necessary part of an efficient financial system.

[42] Ibid at p 11 (Preconditions) and at pp 8 and 39 (Principle 24).

[43] Above n 26. The reviewer (JIEL editorial board) of my article observes that nothing in this document, 'The Insolvency Liquidation of a Multinational Bank,' clarifies the messy legal terrain in terms of responsibilities, priorities, etc, with regard to the closure of a bank with branches and subsidiaries in various jurisdictions. In part, this is due to the nature of the document, a reference paper, and, in part, to the nature of the Basel Committee on Banking Supervision. For an analysis of the shortcomings of the Basel Committee (with emphasis on the work done by the Committee with regard to capital regulation), see, *inter alia*, Wendy Dobson and Gary Clyde Hufbauer, *World Capital Markets, Challenge to the G-10* (Washington, DC: Institute for International Economics 2001).

timing of communications amongst themselves as well as with creditors, shareholders, and management.

> The decision of closing 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 co-ordinates with other supervisors ahead of the closure. Supervisors may wish to consider whether they have adequate measures or procedural ability 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.[44]

Communication amongst supervisors may be affected by some additional factors. In particular:

> [T]he home supervisor might have existing co-operation 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 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 SA case. The potential for temporal settlement risk suggests there might be some times than others for supervisors to act jointly to close a multinational bank.[45]
>
> The uncertainty and confusion associated with the insolvency liquidation of a multinational bank, particularly one that has a significant number of retail depositors, emphasise the need for the supervisors involved to have open and reliable channels of communication. Given the possibility that there could be many liquidation proceedings related to the multinational bank, as the bankruptcy progresses, it would be desirable for the 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.[46]

(2) Co-ordinating actions to protect equal treatment for creditors

> The home supervisor may require co-ordinated 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.[47]
>
> 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

[44] 'The Insolvency Liquidation of a Multinational Bank' (December 1992), above n 26, at 5.

[45] Ibid.

[46] Ibid at 6.

[47] Ibid at 5.

fail to exchange information and documents, which could inhibit the prosecution of third-party claims and reduce the amount distributable to creditors.[48]

(3) The effective winding up of the bank requires a significant amount of sharing of information and documents by liquidators

The failure to share information or documents may be due to: (a) certain liquidators being required by law to pursue the interests of creditor 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 of 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.[49]

(4) The importance of effective consolidated supervision

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.[50]

(5) The problem of capital location

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.[51]

The solution to the problem of capital location varies depending on whether the law follows the single-entity approach to bankruptcy or the separate-entity doctrine.

Under the single-entity doctrine that I have already mentioned in Section II above,

> the starting point 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 bank's worldwide creditors.[52]
> If a multinational bank has a branch in a separate-entity jurisdiction and there is a surplus of assets over the general liabilities of the branch, it is possible to

[48] Ibid at 13.

[49] Ibid.

[50] Ibid at 7.

[51] Ibid at 7.

[52] Ibid.

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.[53]

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.[54]

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 a 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.[55]

(6) Inter-branch claims

Insolvency laws tend not to recognize inter-branch claims for purposes of liquidation, whereas claims between a branch (or the bank) and a failed bank's affiliates are so recognized.[56]

(7) Supervisory ring-fencing

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.[57]

A general principle that has been applied in several jurisdictions is that the home office is *ultimately liable for a deposit placed in its foreign branch*, rejecting with it the doctrine of separate entity, which implies that the deposit would be legally payable only at the foreign branch. With regard to the liability of the bank's home office for deposits placed in a foreign branch, it is important to mention some legislative developments in the USA.[58] In particular,

[53] Ibid. '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.'

[54] Ibid at 8.

[55] Ibid at 11–12.

[56] Ibid at 8.

[57] Ibid at 8–9. '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 (. . .). Supervisors also may seek to protect the assets of a branch or to limit the exposure of a bank to the rest of the bank.'

[58] I thank Lee Buchheit for bringing this issue to my attention and for providing me with useful materials and case law on the subject matter.

The US 'ring-fencing' legislation deserves a very critical appraisal, as the reviewer (JIEL editorial board) of my article rightly observes: It seems unconscionable that a large US multinational bank can trade worldwide on its brand name, and then walk away from foreign depositors when the local government takes misguided action (which falls under the category of 'political risk'). Indeed, as the reviewer points out, unless the multinational bank is willing to accept the political risk, it shouldn't be doing business in the country. In turn, this means that US national bank supervisors (the Federal Reserve System and the Office of the Comptroller of the Currency) should recognize that their

amendments to the New York Banking Law (NYBL)[59] and to the Federal Reserve Act (FRA)[60] were introduced in 1994, providing that the home office of a bank located in the USA will not be required to repay a deposit made at a foreign branch if the branch cannot repay the deposit due to an act of war, insurrection, or civil strife, or an action by the foreign government in which the branch is located, unless the bank has expressly agreed in writing to repay the deposit under such circumstances.

Both amendments apply only to *deposits that cannot be repaid due to political risk*. Traditionally, home offices have been responsible for credit risks of their foreign branches, such as losses due to insolvency, fraud, theft, fire, natural disaster, and so forth. These traditional home office liabilities will not be affected by the amendments. Thus, though the general rule remains that a depositor placing funds in the foreign branch of a US bank is a creditor of the bank as whole and not merely of the branch or office where the deposit was made, and that therefore has recourse – for the repayment of his/her deposit – against the bank at its home office, this general rule has now an exception in the case of political risk

Both amendments (to the NYBL and to the FRA) were legislative responses to two court decisions[61] which held that a bank domiciled in New York was responsible to a depositor for funds deposited in a foreign branch when the deposits were expropriated or frozen by the foreign country in which the branches were located. In response to these decisions, some banks began lobbying for legislation that would protect the home office assets of US banks from claims by foreign branch depositors where those deposits could not be

supervisory regulatory responsibilities follow the global reach of US banks, with implications in the case of lender of last resort operations. See e.g., Wendy Dobson and Gary Clyde Hufbauer, above n 43.

[59] Amendment to Sections 138 and 204-a of the New York Banking Law, which took effect on 6 July 1994.

[60] Amendment to Section 25 of the US Federal Reserve Act, which took effect on 23 September 1994.

[61] In *Trinh* v *Citibank*, 850 F.2d 1164 (6th Cir. 1988), the Sixth Circuit of Appeals held Citibank, New York, liable for Vietnamese piaster deposits placed by a Vietnamese resident with Citibank's Saigon branch at the end of the Vietnam War. The Saigon branch was abandoned five days before the fall of Saigon, and the branch assets were seized and nationalized by the North Vietnamese. Despite the fact that the account opening forms used by the Saigon branch contained a clause that specifically allocated political risks to the depositor, the Court of Appeals held that the depositor had legitimate expectations that Citibank, 'with its worldwide reputation', would repay the deposit.

In *Wells Fargo, Ltd.,* v *Citibank*, 936 F.2d 723 (2d Cir. 1991), Wells Fargo Asia had placed a US dollar deposit in Citibank's Manila branch just prior to the announcement by the Philippine Government of an external debt moratorium. In October 1983, the Philippine Government issued a decree preventing the transfer of foreign currency deposits outside of the Philippines without the prior consent of the Philippine Central Bank. The depositor, Wells Fargo Asia, subsequently sued Citibank, New York, claiming that the deposit was recoverable from Citibank's worldwide assets. The Second Circuit Court of Appeals held that confirmation slips calling for settlement of the deposit through New York correspondent bank accounts provided an adequate basis for requiring Citibank to repay the obligation at its head office in New York.

repaid as a result of local government action. This practice is sometimes referred to as the *'ring-fencing'* of foreign branch deposits.

IV. THE REGULATION OF BRANCHES, SUBSIDIARIES, AND JOINT VENTURES IN LATIN AMERICA

Banks operating internationally usually operate through different types of foreign banking establishments. From a legal viewpoint, these organizational forms can be grouped under three categories: branches, subsidiaries, and joint ventures.[62] The choice between the three options depends upon a variety of factors, including the legal framework applied by the home and host countries; the type of activity banks intend to undertake; and a bank's appreciation of the relative advantages in economic terms of the alternative organizational forms. A representative office is another vehicle by which foreign banks can penetrate a foreign market. It can provide introductions and contacts, credit analysis, and product promotion for its parent bank, but is prohibited from engaging in any profit-making activities.[63]

In the ensuing paragraphs I will survey the regulation and supervision of branches and subsidiaries (as well as a brief reference to joint ventures) in Latin America, with particular emphasis on those issues which become more relevant following the liquidation of a multinational bank. This section is complemented by some appendixes at the end of the paper, in which I make a cross-country study of the normative applicable in Peru, Chile, Venezuela, Colombia, Brazil, and Argentina to: (1) branches of local banks overseas; (2) branches of foreign banks; (3) subsidiaries of local banks overseas; and (4) subsidiaries of foreign banks. There is a further appendix (Appendix 4) on the powers of supervisors, in particular with regard to bank liquidation, in these six jurisdictions (Peru, Chile, Venezuela, Colombia, Brazil, and Argentina).

A. Branches

Branches are dependent legal units and as such they do not have separate legal personality. They are integral parts of the parent bank and act as a legal

[62] See article 46 of the General Law of the Financial and Insurance Systems of Peru 1996, article 33 of the Chilean General Banking Act 1997, article 114 of the General Banking and other Financial Institutions Act of Venezuela, Circular Externa 07 de 1993 of the Colombian Banking Superindentency or Circular Basica Juridica Titulo I Capitulo 5 numeral 2.

The reviewer (JIEL editorial board) of my article is of the opinion that the legal distinction between branches and subsidiaries should be reassessed, because from the standpoint of ordinary customers (individuals or business firms), it is irrelevant whether the multinational does business as a branch, as a subsidiary or even as a joint venture.

[63] See Zhongfei Zhou, *Chinese Banking Law and Foreign Financial Institutions*, (The Hague: Kluwer Law International 2001) at 82.

and functional extension of the head office.[64] The legal definitions of a branch found in some of the statutes within the Latin American region share the same characteristics. For example, the Peruvian legislation explicitly states that a branch does not have an independent legal status from its parent corporation, and that the parent company is responsible for all obligations of its branch (any agreement which discharges the parent entity of this responsibility is void).[65] A similar definition of a branch is adopted, for instance, in Colombia, according to Article 263 of the Colombian Commerce Code.[66]

For branches, supervision of solvency is primarily a matter for the parent authority,[67] though the host authority should also monitor the financial soundness of foreign branches. Attitudes towards a branch's minimum capital requirement vary widely from country to country. The UK does not impose endowment capital on a branch treating a branch as an integral part of the group to which it belongs.[68] However capital endowment for a foreign branch is sometimes required by the host country.

B. Subsidiaries

Subsidiaries are independent legal entities under the laws of the country of incorporation. They are wholly owned or majority-owned by a parent bank that is incorporated in a country other than that of the subsidiary.[69] The various Latin American statutes that I have surveyed include a definition of subsidiary that is broadly similar.[70] For instance, according to the Peruvian

[64] As defined by the Basel Committee on Banking Supervision. Principles for the supervision of banks' foreign establishments (the 'Concordat'), above n 32, http://www.bis.org/publ/bcbsc312.pdf.

[65] See articles 396 and 397 of the Peruvian General Corporations Act 1997 (Ley No. 26887 de 1997). 'Es sucursal todo establecimiento secundario a través del cual una sociedad desarrolla, en lugar distinto a su domicilio, determinadas actividades comprendidas dentro de su objeto social. La sucursal carece de personería jurídica independiente de su principal. Está dotada de representación legal permanente y goza de autonomía de gestión en el ámbito de las actividades que la principal le asigna, conforme a los poderes que otorga a sus representantes. Artículo 396, Ley General de Sociedades (Ley No 26887 de 1997) de Perú, Responsabilidad de la principal. La sociedad principal responde por las obligaciones de la sucursal. Es nulo todo pacto en contrario'. (Ley General de Sociedades Ley No 26887de 1997 artículo 397).

[66] Código de Comercio Art. 263 – Son sucursales los establecimientos de comercio abierto por una sociedad, dentro o fuera de su domicilio, para el desarrollo de los negocios sociales o de parte de ellos, administrados por mandatarios con facultades para representar a la sociedad.

[67] Principles for the supervision of banks' foreign establishments (the 'Concordat') above n 32. The solvency of the branches is indistinguishable from that of the parent bank as a whole. See also Lastra, (1996), above n 1, at 175. The committee reiterated that though the solvency of branches is the responsibility of the parent authorities, the host authorities can also demand endowment capital for foreign branches.

[68] See Zhou, above n 63, at 83.

[69] As defined by the Basel Committee on Banking Supervision. Principles for the supervision of banks' foreign establishments (the 'Concordat'), above n 32.

[70] See Peruvian General Corporations Act (Law No 26887 de 1997), the Chilean Joint Stock Companies Act 1981 (Ley sobre Sociedades Anónimas, Ley No. 18.046 of 22 October 1981) articles 86 and 87, and the Colombian Code of Commerce, article 260.

legislation[71] a subsidiary is an independent entity from the parent company that has created it, and is responsible for its own activities with its own capital.

Subsidiaries – as legally independent units – are separate entities, legally incorporated in the country of the host authority. The supervision of solvency is a joint responsibility of both host and parent authorities.[72] Host authorities are responsible for those subsidiaries incorporated in their territory, while the home authorities are responsible for them as part of larger banking groups.[73] Local subsidiaries of international banks are stand-alone entities with their own capital. Reputable international banks closely monitor the activities of their subsidiaries so as to preserve the parent's good name and solid standing.[74]

C. Joint ventures or consortia

These are legally independent institutions incorporated in the country where their principal operations are conducted and controlled by two or more parent institutions, most of which are usually foreign and not all of which are necessarily banks.[75]

There is little normative in the Latin American statutes I have surveyed in relation to the specific regulation of joint ventures as such, because, typically, foreign investment laws govern this type of operation.[76]

For joint ventures, the supervision of solvency should be primarily the

[71] 'Subsidiaria, para efectos jurídicos responde por sus actos con su propio patrimonio, por considerarse un ente independiente de la matriz que pudiera haberla constituido'. (Ley General de Sociedades, Ley N 26887 de 1997).

[72] Principles for the supervision of banks' foreign establishments (the 'Concordat'), above n 32. See also Lastra (1996), above n 1, at 175–77. The parent country should take account of the exposure of their domestic bank's foreign subsidiaries and joint ventures because of the parent bank's moral commitments to those foreign establishments. Furthermore, when a foreign entity is classified as a bank by the home country, but not by the host, the supervisory responsibility lies with the home authority.

[73] Lastra (1996), above n 1, at 178.

[74] See J. Hawkins and D. Mihaljek, 'The Banking Industry in the Emerging Market Economies: Competition, Consolidation and Systemic Stability,' BIS papers, 4 August 2001, available at http://www.bis.org/publ/bispap04a.pdf (visited 10 March 2002) at 29.

[75] As defined by the Basel Committee on Banking Supervision. Principles for the supervision of banks' foreign establishments (the 'Concordat'), above n 32. Joint ventures are, most typically, owned by a collection of minority shareholders.

[76] The Chilean legislation calls 'coligada' of a Joint Stock Company, the entity in which the latter also called 'coligante' – owns (without control) directly or indirectly (through another physical or legal person) 10 percent or more of its capital with voting rights Article 87 of the Chilean Joint Stock Companies Act 1981 (Ley sobre Sociedades Anónimas, Ley No. 18.046 of 22 October 1981): 'Es sociedad coligada con una sociedad anónima aquella en la que ésta, que se denomina coligante, sin controlarla, posee directamente o a través de otra persona natural o jurídica el 10% o más de su capital con derecho a voto o del capital, si no se tratare de una sociedad por acciones, o pueda elegir o designar o hacer elegir o designar por lo menos un miembro del directorio o de la administración de la misma. La sociedad en comandita será también coligada de una anónima, cuando ésta pueda participar en la designación del gestor o en la orientación de la gestión de la empresa que éste ejerza.'

responsibility of the authorities in the country of incorporation,[77] although the Basel Committee cautioned that the parent (home) authorities of the shareholder banks should be involved in cases where dominant shareholdings prevail.

V. THE RESPONSE GIVEN BY NATIONAL AUTHORITIES TO THE PROBLEMS OF LIQUIDATING BANKS WITH BRANCHES AND SUBSIDIARIES IN OTHER JURISDICTIONS.[78] THE CASE OF BRAZIL[79]

The Brazilian legislation and practice provides an example of the challenges that national law faces when confronted with issues of cross-border insolvency. It is important to point out that in Brazil there is specific legislation concerning bank insolvency (Law 6.024/74 and Decree-law 2.321/87).[80] The general commercial bankruptcy law (Decree-law 7661/45) is applicable to bank insolvency only if there is no specific rule in Law 6.0274/74 and Decree/law 2321/87. According to Brazilian law, the Banco Central do Brasil has the power to declare an institution insolvent and to appoint an intervenor/liquidator to follow the resolution procedure.

A. The Brazilian normative and practice with regard to the regulation of branches and subsidiaries

Though there are significant legal differences between branches and subsidiaries, since the former are a part of the Brazilian financial institution, branches and subsidiaries of Brazilian banks abroad are subject to a double regulatory and legal regime.[81] Considering that they represent a portion of the assets of national financial groups or institutions, they must follow Brazilian legislation regarding commercial companies, as well as banking rules and accounting

[77] Principles for the supervision of banks' foreign establishments (the 'Concordat'), above n 32. Practical reasons are considered to determine the responsibility of supervision of joint ventures.

[78] The reviewer (JIEL editorial board) of my article pointed out that readers would expect that a paper on cross-border bank insolvency in Latin America would have at least a short section on recent events in Argentina. However, I am of the opinion that the analysis of such events would require detailed and careful consideration (exceeding the scope of the present article), in order to understand properly the various legislative and regulatory measures undertaken by successive governments in Argentina in a short period of time: abandonment of the currency board, freezing of deposits, transformation of dollar assets, and liabilities of the banking system into devalued pesos at different rates, etc.

[79] This section draws on the responses to a questionnaire that I sent to Carlos Eduardo de Freitas at the Banco Central do Brasil. The answers I received assembled information provided by the Liquidation Department (of Banco Central do Brasil) with the collaboration of other areas [within the Banco Central do Brasil], such as Norms, Operations and Supervision.

[80] See www.bcb.gov.br/ingles/bankrupt.shtm (visited 10 March 2002).

[81] Resolutions 2.723, of 31 May 2000, and 2.743, of June 28, 2000, rule the subject in Brazil. The integral version of such norms can be obtained at the Banco Central do Brasil website: [www.bcb.gov.br].

principles for financial institutions. According to Brazilian law, supervision is made on a consolidated basis. Consolidated accounts are also prescribed by Brazilian accounting rules.

Authorization to operate abroad, accorded by foreign authorities, demands observation of local regulations with regard to operational modalities and conditions, as well as civil and commercial law applicable to relations with customers and third parties, including public, monetary, administrative, and fiscal authorities.

According to the Brazilian Federal Constitution (article 52 of the Transitory Constitutional Provisions Act) 'the establishment in the country of new branches of financial institutions seated abroad' and 'the increase of participation rate in the capital of financial institutions seated at the country, from natural or legal person resident or established abroad', must be authorized by a Presidential decree, which considers the interest of the Brazilian government, according to economic criteria proposed by Banco Central do Brasil and the National Monetary Council.

B. Provision of emergency liquidity assistance to branches and subsidiaries

In the case of branches of Brazilian banks abroad, and for branches of foreign entities in Brazil, the principle of parental responsibility typically applies. There is a generalized understanding and a tacit engagement of the monetary authorities of each country in providing the necessary liquidity support to the mother companies, in order to maintain adequate levels of protection of their branches abroad.

In the case of subsidiaries of Brazilian banks abroad and of foreign banks in Brazil, the general rule is that such subsidiaries are able to resort, in the same conditions that apply to national banks, to discount operations and emergency liquidity assistance offered by the monetary authorities in the country where they operate.

C. If the Brazilian bank fails, what rules govern the treatment of the branches and subsidiaries established abroad?

Considering that subsidiaries are autonomous legal entities and are incorporated according to laws of the country where they operate, liquidation of a Brazilian institution does not necessarily reach them.

Nevertheless, in the case of an extra-judicial liquidation, the general rule has been, both to branches and to subsidiaries abroad, that the liquidator of the Brazilian financial institution authorizes legal representatives abroad to proceed with the liquidation (in the ordinary or judicial way) of assets and liabilities, according to convenience, rules, and conditions in the host country, and the subsequent reversion of eventual remaining credits to the head

company. If obligations abroad remain unpaid, they must follow a procedure of inscription in the list of creditors in the head company in Brazil.

There have been a few precedents of liquidation of Brazilian banks that had branches abroad. In particular, the case of Banco Economico, which had branches in New York and Cayman Islands, is worth mentioning. In such case, the liquidator in Brazil nominated representatives in New York and Cayman Islands to proceed to the closure/liquidation of local operations. (Such procedures had to observe local rules, too.) In Brazil, Banco Economico's operations were assumed by Excel Banco (a 'good bank–bad bank' solution). Mr Getulio Pessoa, who was the liquidating agent of the branch of Banco Economico, S/A in New York ('the Branch') made available the following information to me: Banco Economico S/A – Salvador (BA) – Brazil ('BESA') was put under intervention by the Central Bank of Brazil, on 11 August 1995, and then in extra-judicial liquidation on 9 August 1996. On 25 August 1995 Mr. Getulio Pessoa was appointed as the General Manager of the Branch to oversee it during the intervention period which was done initially under a 'Temporary Order of Cease and Desist' issued by the Branch's primary regulator, the Office of the Comptroller of the Currency ('OCC') as the Branch had a Federal License. In November 1995, the Temporary Order was replaced by a 'Permanent Order of Cease and Desist'. Under this Order, the Branch had to maintain liquid assets equivalent to 120 percent of its liabilities to third parties. The Branch was also monitored by the Federal Reserve Bank of New York, through weekly and quarterly reports.

As the Branch was solvent, BESA's Intervenor decided to liquidate and close the branch voluntarily. If the branch was not solvent, then it would be liquidated by the OCC. As there were no specific rules for the liquidation of a local branch of a foreign bank, it was then communicated to the OCC that the Intervenor intended to effect this voluntary closing by generally following the framework provided by statute for the voluntary dissolution of national banks. The OCC agreed with this voluntary liquidation and required BESA to present a plan of liquidation of the Federal Branch. The voluntary liquidation of the branch should be announced in a local newspaper on three occasions. Therefore a statement to this effect appeared three times in *The New York Times*. The process of liquidation was officially started on 12 August 1996 and Mr. Getulio Pessoa was appointed as the Liquidating Agent.

As the Liquidating Agent, Mr. Pessoa had local complete power of administration to wind up the affairs of the Branch and was responsible to do it orderly and 'by the book'. The Branch filed monthly report of progress of the liquidation with the OCC. In addition, the Branch filed regular weekly and quarterly reports with the Federal Reserve Bank of New York.

This voluntary liquidation process was expected to be completed in three to six months. Nevertheless, two legal actions were started in New York against the branch. The first by Transworld Bank and Trust Limited (a related party), which was dismissed, and the second by a Swiss company.

The case of the Swiss company versus the Branch was filed in the Federal Court in New York. The judgment was in favor of the branch. The Swiss company appealed to the Second Federal Circuit, which confirmed the first decision. Because this litigation took three years to conclude, the License of the branch was only surrendered on March 2000, and the Branch was considered officially closed by the OCC on 26 July 2000.

D. In the case of insolvency of a branch of a foreign bank, who is responsible for dealing with the consequences of the resolution/ liquidation? What happens in the case of a subsidiary?

Banco Central do Brasil is responsible for closing/liquidating financial institutions in Brazil. A few precedents exist where foreign financial institutions that were liquidated in their countries had branches in Brazil. In such cases, ordinary liquidations were conducted by a nominee representative of the mother companies in Brazil, and followed up by Banco Central do Brasil, once it had cancelled their authorization to operate and until the final closure of their operations.

In the case of a subsidiary authorized to operate in the country according to local rules, Banco Central do Brasil is the competent authority, and can use its powers to liquidate a financial institution, since the national legislation applicable to liquidation in Brazil – Law No 6.024/74 and Decree-law 2.321/ 87[82] – does not make any distinction between a subsidiary of a foreign bank and a Brazilian private financial institution. But there are no such precedents, and the rule is that the Brazilian supervisory authorities make previous contact with the authorities where the mother companies are based, in order to prevent situations of insolvency.

CONCLUDING OBSERVATION

The need for a co-ordinated liquidation of multinational banks would be best served by the adoption of an international convention or regime on cross-border insolvency.

[82] See http://www.bcb.gov.br/ingles/Bankrupt.shtm (visited 10 March 2002).

APPENDIX 1

BRANCHES OF FOREIGN BANKS	PERU	CHILE	VENEZUELA	COLOMBIA	BRAZIL	ARGENTINA
1. General authorization to open a foreign branch in a local market	Superintendency (Opinion Central Bank Articles 12 and 39 GLFIS[a])	Superintendency (Provisional/Definitive Articles 27 and 32 GBA[b]	Superintendency (Opinion Central Bank Article 107 GBA[c]	Not authorized[d]	Central Bank (Law No. 4,595 of 1965 Article 18).	Central Bank Law 21526 of 1977 Articles 7, 9 (a) and 13 LFI[e]
2. **Authorization conditional on prudential supervision by home country**		Expressly by articles 29 and 32 GBA				
3. Minimum capital required	Same as other financial institutions. Should be kept in the Country. Article 42 GLFIS					Articles 13 and 32 LFI
4. Law applicable	Peruvian Law no diplomatic claims allowed. Article 291 GLFIS	Chilean Law. No diplomatic claims allowed. Article 42 GBL	Venezuelan Law. Article 110 GBL. Article 354 Code of Commerce		Brazilian Law Resolution 2,723 of 2000. Central Bank of Brazil.	Argentinian Law 21526 of 1977. Article 9(a) LFI
5. Liability of foreign parent bank		Expressly established. Article 34 GBA	Expressly established. Article 34 GBA			
6. Special rules when liquidated		Preference to Chilean creditors				
7. Equal treatment to foreign investors	Article 291 GLFIS	Article 34 GBA				
8. Special rules for conducting business	According to their customary practices Article 292 GLFIS	According to their practices Article 47 GBA				

[a] GLFIS, General Law of the Financial and Insurance Systems 1996.
[b] GBA, General Banking Act 1977.
[c] General Banking Act 1993.
[d] According to article 53 (1) of the Colombian Financial System Organic Statute 1993, financial institutions have to be incorporated as Joint Stock Corporations. Article 374 of the Colombian Commercial Code requires these companies be incorporated with a minimum of five shareholders.
[e] LFI, Law of Financial Institutions 1977.

APPENDIX 2

BRANCHES OF LOCAL BANKS OVERSEAS	PERU	CHILE	VENEZUELA	COLOMBIA	BRAZIL	ARGENTINA
1. General Authorization	Superintendency Opinion Central Bank Articles 11, 30 and 32 GLFIS[a]	Superintendency. Article 76 GBA[b]	Superintendency. Article 41 GBA[c]	Superintendency. Article 92 FSOS[d]	Central Bank Resolution 2,723 of 2000 article 2	Central Bank Law 21.526 of 1997 article 17 LFI[e]
2. Supervision of home country authority		Articles 80 and 81 GBA			Resolution 2,723 of 2000 articles 3, 4	
3. Minimum capital		Article 81 GBA			Resolution 2,723 of 2000 article 2	
4. Application of foreign law to the branch		Articles 81 and 82 GBA	Article 41 GBA		Resolution 2,723 of 2000 article 1	
5. Parent deposit insurance or State Guarantee available to the foreign branch		Not available to branches. Article 81 GBA				
6. Limits to operations		Articles 80 and 81 GBA	Articles 42 and 432 GBA		Resolution 2,723 of 2000 article 12	Law 21.526 of 1997 article 17

[a] General Law of the Financial and Insurance Systems 1996.
[b] General Banking Act 1997.
[c] General Banking Act 1993.
[d] Financial Institutions Organic Statute 1993.
[e] Law of Financial Institutions 1997.

APPENDIX 3

SUBSIDIARIES OF FOREIGN BANKS	PERU	CHILE	VENEZUELA	COLOMBIA	BRAZIL	ARGENTINA
1. General authorization	Superintendency Central Bank opinion Articles 11 and 39 GLFIS[a]	Superintendency Articles 29 and 32 GBA[b]	Superintendency Central Bank opinion. Articles 106–107 BGA[c]	Superintendency Article 91 FSOS[d] Act as a local bank. Joint stock company	Central Bank. Article 18. Law 4595 (1964)	Central Bank Article 7. Law 21.526 (1997) LFI[e]
2. Authorization subject to prudential supervision by home country authority and exchange of information		Articles 29 GBA				
3. Authorization subject to prior authorization and business license by parent supervisor	Articles 11 and 35 GLFIS	Articles 29 and 32 GBA				
4. Equal treatment	Article 6 (3) GLFIS					
FOREIGN SUBSIDIARIES OF LOCAL BANKS						
1. General authorization	Superintendency. Articles 11, 53, and 36 GLFIS[a]	Superintendency. Articles 36, 66, 76, 81 and 69 GBA[b]	Superintendency. Article 43 GBA[c]	Superintendency. Article 91 FSOS[d]	Central Bank. Resolution 2,723 of 2000 Art. 2	Central Bank Law 21.526 (1977)
2. Reporting to home supervisor, special authorizations and consolidated supervision					Art 10–12 Res. 2,723 of 2000 Central Bank	

[a] General Law of the Financial and Insurance Systems 1996.
[b] General Banking Act 1997.
[c] General Banking Act 1993.
[d] Financial Institutions Organic Statute 1993.
[e] Law of Financial Institutions 1997.

APPENDIX 4

SUPERVISORS	PERU	CHILE	VENEZUELA	COLOMBIA	BRAZIL	ARGENTINA
POWERS	**Superintendency of Banking and Insurance**	**Superintendency of Banks**	**Superintendency of Banks and other Financial Institutions**	**Superintendency of Banks**	**Central Bank do Brazil**	**Central Bank of the Argentine Republic**
1. To authorize organization and operation of financial establishments[f]	Article 349 (1) GLFIS[a]	Article 27,29,32 GBA[b]	Articles 161(1,2) GBA[c]	Articles 326(1)(a) (b) 326 (2)(n) FIOS[d]	Law 4595 (1964) Article 18	Law 21,526 (1997) Articles 13–17 LFI[e]
2. To practise consolidation supervision	Article 349 (11) (GLFIS)	Article 66 GBA Art. 2 Tran. Provisions	Article 141 GBA Article 141(7) GBA	Article 326(8) 325(1)(f) FIOS	Resolution 2723(00) Article 3	Law 24144 (1992) art. 43 Superintendency[g]
3. To enter into co-operation agreements	Article 349 (14,15) GLFIS GLFIS	Articles 10, 82 GBA		Article 326(8) FIOS	Resolution 2723(00)	
4. Supervision as a parent authority		Article 82 GBA	Article 141(7) GBA		Resolution 2723(00) Article 9	
5. To intervene	Articles 103,361 GLFIS Report to Central Bank	Article 118 et seq. GBA	Articles 161(5) 251 and 254 GBA	Article 115 FIOS	Law 6024 (1974)Articles 1,2,12(a)	Law 21,526 (1997) Revocation Art. 44

[a] General Law of the Financial and Insurance Systems 1996.
[b] General Banking Act 1997.
[c] General Banking Act 1993.
[d] Financial Institutions Organic Statute 1993.
[e] Law of Financial Institutions 1997.
[f] Foreign establishments: Foreign branches (except Colombia) and subsidiaries in local financial markets and branches and subsidiaries of local financial institutions overseas.
[g] The Central Bank of the Argentine Republic supervises through the Superintendency of Financial and Foreign Exchange Institutions. Article 43 Law 24.244 (1992).

APPENDIX 4—*Continued.*

SUPERVISORS	PERU	CHILE	VENEZUELA	COLOMBIA	BRAZIL	ARGENTINA
6. To order liquidation	Article 114 GLFIS	Forced Liquidation Article 130 GBA	Articles 161(5) and 260 et seq. GBA	Article 116 FIOS	Extrajudicial liquidation. Art. 12 Law 6024 (1974)	JUDGE
7. To liquidate banks	Appoints Liquidator Articles 115,361 GLFIS	Appoints liquidator or Superintendent himself Art. 25, 130 GBA	Fondo de Garantía De Depósitos y Protección Bancaria	Fondo de Garantías De Instituciones Financieras	JUDGE	JUDGE
8. Reciprocity with home country supervisory authority (foreign bank's branches) – information exchange	Article 5 GLFIS Title III Econ. Regime National Constitution	Articles 29, 82 GBA		Article 326(8) FIOS		
9. To co-ordinate with the Central Bank	Article 349 (16) GLFIS	Article 130 GBA				

[a] General Law of the Financial and Insurance Systems 1996.
[b] General Banking Act 1997.
[c] General Banking Act 1993.
[d] Financial Institutions Organic Statute 1993.
[e] Law of Financial Institutions 1997.