Prologue the management of distressed banks in developing economies: an overview

Chapter 1

Prologue

The Management of Distressed Banks in Developing Economies: An Overview

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Introductory

If we accept that business or commercial activities are the primary drivers of economic growth,[1] banks as institutional providers of commercial capital are key facilitators of the desired economic growth and stability in society. Thus, bank regulation, stability and insolvency are not trivial subjects. This is particularly so, more than a decade after the global financial crisis (GFC) of 2007-2009. The importance of these interconnected subjects is self-evident in current literature, much of which reflects upon the position in developed countries on issues such as enhanced regulatory response to internal and macro-economic risk, streamlined role of bank regulators or central banking authorities, the introduction of bespoke bank insolvency law as well as a shift in the focus of bank insolvency law.[2]

In this context, the discourse on the subject in many developing countries, such as African states, has been decidedly limited. This, in part, is due to the fact that these jurisdictions were insulated from the GFC, given their lack of engagement in sophisticated transactions such as subprime mortgages. Nevertheless, the state of banking law in these developing economies, particularly those that relate to their fiscal stability and resolution of insolvency events, is also critical and deserving of tailored consideration for several reasons.[3] First, and an obvious point, is that the economies of these nations are also acutely dependent on capital and other banking provision of banks. A second point is that due to the proliferation of cross-border commerce, banks, non-financial institutions, and the economies in other jurisdictions have pecuniary exposures in these developing states that could be protected by effective regulation of banking entities. A third point, and closely linked to the second, is that

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[1] A point that is often captured using Gross Domestic Product (GDP) as a metric of economic growth in a time period.

[2] For a general overview, readers may consult: J Black, 'Paradoxes and Failures: New Governance' Techniques and the Financial Crisis', The Modern Law Review 75 (6) 2012, 1037-1063; A Lui, 'Financial Stability and Prudential Regulation: A Comparative Approach to the UK, US, Canada, Australia and Germany,' Routledge 2016; B Wessels and M Haentjens, 'Three Paradigm Shifts in Recent Bank Insolvency Law' (2016) 31 JIBLR 396-400; R Lastra, I*nternational Financial and Monetary Law* (OUP 2017); G Moss, B Wessels and M Haentjens, *EU Banking and Insurance Insolvency* (OUP 2017); U Volz, P Morgan, and N Yoshino, *Routledge Handbook of Banking and Finance in Asia* (Routledge 2018); D Arner et al, *Research Handbook on Asian Financial Law* (Edward Elgar 2020); D Singh, *European Cross Border Banking and Banking Supervision* (OUP 2020).

[3] For a recent overview of bank regulation in Africa, see F Adeyemo, Banking Regulation in Africa: The Case of Nigeria and Other Emerging Economies (Routledge 2021).

many developing states remain strategic economic partners for developed nations, more so in a post-Brexit and -pandemic world.

This book presents a nuanced discussion of issues that impair bank stability in selected developing countries. Critically, it examines the law's response to the downside of a banking enterprise in those jurisdictions - insolvency. In so doing, it analyses some critical questions, including: how can the law of these jurisdictions preclude and resolve bank insolvencies?[4]; when insolvency does occur, as it often does - or could - with legal-commercial enterprises, what ought to be the priority of the law in this regard?; should the priority of the bank insolvency law in developing economies be stratified along the lines of peculiar-structural attributes of developing states?; what aspects of the regime of bank insolvency law in developed nations could be adopted by these developing states, bearing in mind limitations associated with legal transplantation?;[5] and given the inter-economic dependence of developed and developing states highlighted above, how could developing states be best aligned with international standards when dealing with cross-border bank insolvencies? Unless otherwise indicated, the discussion of banks in this book relates to the activities of clearing, commercial and merchant banks as opposed to those of investment banks.

Bank Insolvency Law: A Case for Developing Economies

Developing economies are acutely dependent on their banks for the functioning of their economies, which are conventionally cash-based. Recent events, however, suggest a weakness in the long-term viability of some of their banks and a mixed-bag regulatory approach to redress this weakness. Despite credible sentiment expressed in the aftermath of the GFC that, on average, many banks in Africa are well capitalised and liquid,[6] we examine recent cases of bank failures and the associated local context, including the legal framework, to evaluate aspects of bank insolvency law that should be introduced or streamlined. This book also presents the issue of bank insolvency law in these developing states as a continuum: the legal structure of a bank, its operational and managerial structure, and its stakeholder structure all inform the cause, priority and resolution of a bank's insolvency. This is worthy of cursory amplification. As we shall see in the next section of this chapter, the legal/commercial vehicle of a banking business might raise the question of whether its insolvency ought to be resolved according to the ordinary insolvency norms that apply to non-bank businesses that use a similar vehicle. Further, the peculiar ownership of banks in these developing nations, particularly banks with dominant foreign ownership, opens the question of whether bank

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[4] For a general discussion of the role of the law in preventing banks from failing and in resolving bank failures when they do occur, see A Campbell and P Cartwright, *Banks in Crisis: The Legal Response* (Ashgate 2002).

[5] For an overview of legal transplants, see A Watson, Legal Transplants: An Approach to Comparative Law (2nd edn, University of Georgia Press 1993).

[6] See T Beck, S M Maimbo, I Faye, and T Triki, Financing Africa: Through the Crisis and Beyond (The World Bank 2011). Available at <https://documents1.worldbank.org/curated/en/633671468194645126/pdf/646640PUB0fina00Box361543B00PUBLIC0.pdf> last accessed 30 April 2022.

resolution mechanisms such as bail-in, rather than bail outs, ought to be *de rigueur* in such insolvencies. In addition, where should the priority of bank insolvency law in these developing economies lie? Which of the spread of stakeholders dependent on banks should be accorded priority by the law in an insolvency scenario - creditors or shareholders? If creditors, should priority of protection go to financial or depositor creditors? Should bank insolvency law in these states, rather than prioritise private interests, give precedence to fiscal stability?

At a time of global economic uncertainty, this book will prove to be a valuable resource to the discourse on the viability of banks, businesses, and economies in developing economies. It also draws attention to the significant impact that these states, functioning with well-calibrated bank insolvency laws that offer improved investor and systemic protections, could have on a post-Brexit and -pandemic world by way of enhanced trade partnerships.

Managing Distressed Banks and their Stakeholders

We now briefly turn attention to the legal nature of banks, and how this nature impacts upon current and proposed treatment of bank-stakeholder interests in developing economies in an insolvency scenario. It is evident that many banks are structured as companies. This verity ought not be taken for granted for at least <u>four</u> reasons. The first is that, even in developed economies, the business of banking was not always carried out through the corporate vehicle. For example, in the United Kingdom (whose laws were and are still routinely transplanted into the legal framework of many developing economies in the African region), banks were routinely structured as partnerships until the statutory recognition of the joint stock company and the associated twin concepts of separate legal personality and limited liability.[7] One should, of course, appreciate that the use of an ordinary partnership (which lacks the risk minimising devices of separate legal personality and limited liability)[8] as a vehicle for a commercial enterprise with acute economic dependencies was not sustainable, if not imperceptive. It therefore accords with reason that many bank proprietors swiftly transferred their business to newly incorporated companies in order to limit their personal and pecuniary liability as soon as the joint stock company was introduced in that jurisdiction.[9] That said, much of commercial life, and the law's response to the use of companies to further commercial activities, is about allocation of loss: if the corporate vehicle minimises the risk involved in a commercial enterprise, it would normally do so by allocating that risk to other stakeholders connected to that enterprise. Indeed, while separate legal personality of a company and the limited liability of its shareholders may be seen as enterprise promoting devices as they minimise commercial risk, it is also arguable that the company's commercial counterparts see them as risk redistributing devices as they (the counterparts) will have to bear some or all of that risk in an insolvency scenario. This brings us to the second reason for highlighting the innate connection between companies and banks.

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[7] See, for example, See Joint Stock Companies Act 1856, s 2; Companies Act 1862, ss 3 and 4.

[8] By separate legal personality, we mean that the legislature of a country recognises a company validly incorporated according to the laws of its land as a separate legal (juristic) person, different to its officers, shareholders and other stakeholders. By limited liability, we generally mean that, in a company whose share capital is limited by shares, the liability of shareholders to contribute to the repayment of the company's debt is according to the law of the land limited to the amount, if any, unpaid on the shares held by the shareholder ('limited by shares' in contradistinction to 'limited by guarantee').

[9] For a judicial discussion of this point in *Salomon v Salomon* in relation to the Companies Act 1862, see [1897] AC 22, at 23-27.

A company is a network of interests or "nexus for contracts".[10] For example, a corporate firm like a bank will encompass the interests of shareholders, the company itself, corporate managers, suppliers, consumers, employees, the state, to name a few. It is often convenient to categorise these interests in three forms: managers; shareholders; and creditors. The corporate construct is therefore acute in this context due to the trade-off engendered by separate legal personality and limited liability, as well as the fundamentally divergent nature of these interests. The law's base response to these issues is to manage the corporate construct through contractual rights accentuated by legal provisions. In the context of banks, this response will include banking regulations. For example, in the European Union, there are rules that require banks to set aside enough equity capital to cover unexpected losses and keep themselves solvent in a crisis.[11]

This translates to the third reason for underscoring the legal nature of banks. Many banks, particularly those of systemic importance,[12] would be structured as public companies. The public company structure accentuates the trade-off engendered by separate legal personality and limited liability concepts. This is so because there is no restriction on the transfer of shares of such companies in the sense that they could be offered to the public. Moreover, such companies are more suited to trade on a cross-border basis, which increases their risk profile. Thus, the classic agency problem (that is, the potential conflict of interest between shareholders and managers/directors, or shareholders and managers/directors as insiders on the one hand and creditors or other external corporate participants on the other) that much of corporate law seeks to redress is not trivial in the context of a public commercial enterprise. Indeed, directors, as trustees, typically owe a fiduciary duty to the company which shareholders may seek to enforce whenever a corporate decision threatens the survival of the company. The economic impacts of the GFC have caused some bank shareholders to pursue enforcement of this duty.[13] It is, however, plain that traditional corporate law, despite its heightened regulation of public companies relative to private companies (which are largely deregulated) might not be sufficient to address economic and other aspects of the agency problem in the context of banks. For example, in many European nations, the minimum capital requirement for a public company is 25,000 Euros.[14] This level of capital requirement, and the rules that underpin the corporate use of capital,[15] is at odds with the pecuniary exposures of

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[10] See J Armour, H Hansmann, R Kraakman and M Pargendler, 'What is Corporate Law?' in R Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, OUP 2017), ch 1.

[11] These rules implement the Basel III agreement on bank capital adequacy standards and include: (a) Capital Requirements Regulation - CRR I and II; and (b) Capital Requirements Directive - CRD IV and V. As a basic rule, the amount of capital required depends on the risk attached to the assets of a particular bank.

[12] For a brief consideration of the policy and legal response to systemically important banks or the notion of "too big to fail", see the next section titled 'Bank Insolvency Law: Precis'.

[13] See, for example, an unsuccessful suit for breach of fiduciary duty brought by the shareholders of Lloyds TSB Group Plc against directors of the bank in relation to the takeover of Halifax Bank of Scotland (HBOS) on the back of the 2008 financial crisis in *Sharp v Blank* [2019] EWHC 3096 (Ch).

[14] See Directive (EU) 2017/1132, Art 45. In the UK, this minimum requirement was transposed as £50,000 – Companies Act 2006, s 763. By way of comparison with some developing economies: Nigeria – ₦2,000,000, Companies and Allied Matters Act 2020, s 27(2)(a); Ghana – abolished the minimum capital requirement and replaced it with the concept of 'stated capital' in Companies Act 2019 (Act 992), s 68. Foreign entities with a trading company, however, may have to invest a minimum capital of up to not less than $1,000,000 (USD) – Ghana Investment Promotion Centre Act 2013 (Act 865), s 28; Uganda – similar to the position of stated capital in Ghana, Companies Act 2012, ss 6-7.

[15] Subject to rules on distribution and reduction of capital, a company's capital is, generally, to be applied in furtherance of its business.

banks. To take a very basic example, the deposits held by many banks would far exceed this sum, thus highlighting the value of some of the bank capital adequacy standards mentioned above.[16]

Whether structured as a public or private company, some of the interests that make up a bank network are also deserving of bespoke attention. This leads us to the fourth reason for highlighting the underlying nature of banks: the peculiarity of bank creditors. While many modern company and bank insolvency frameworks are engineered to rescue the financially distressed company and/the whole or part of its underlying business,[17] insolvency law in its core seeks to rationalise the interests of creditors.[18] Credit gives insolvency meaning; for an enterprise is typically insolvent due to its inability to meet its credit obligations. When a company is insolvent, or in the zone/vicinity of insolvency (twilight period),[19] it is not unusual to find that the law would impose upon corporate managers or directors a duty to the company to have regard to the interests of the company's creditors.[20] A rationale for this rule being that, since the insolvency of an enterprise would notionally signify a paucity of assets that may be used to satisfy outstanding pecuniary obligations to creditors,[21] it behoves the managers of the enterprise to enact strategies that could minimise the detriment to creditors whenever insolvency is reasonably foreseeable or does occur. In pure banking contexts, this state of events suggests that bank regulations (for example those that require maintenance of adequate capital referred to above) are not, on their own, sufficient to deal with incidences of bank insolvencies. Indeed, custom-built bank insolvency laws of many countries, some of which are presented in this book, attest to this.

Of equal importance, however, is the fact that creditors of a bank would include other banks (for example, due to the use of a payment or clearing house system) and depositors. The knock-on effect of a bank's insolvency on its bank-creditors may, therefore, generate a systemic crisis and will not be trivial from a macro-economic standpoint. In relation to depositor-creditors, we ought to briefly deal with <u>two</u> scenarios where a bank is insolvent: (a) the depositor/customer holds a deposit balance in their account; and (b) the depositor/customer is expecting a deposit payment in their account by way of fund transfer from another party. In the first scenario, it is trite law that the relationship between a customer and the bank is contractual or personal, not proprietary. It is for this reason that monies deposited into a bank account may be utilised by the bank as it deems fit, albeit ringfenced by a promise by the bank to return the money on demand (or other set condition)

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16 See fn.11 above and accompanying text..

17 For an overview of bank insolvency law, see 'Bank Insolvency Law: Precis' below.

18 See, generally, K Akintola, *Creditor Treatment in Corporate Insolvency Law* (Edward Elgar, 2020).

19 This expression is, admittedly, nebulous. In common law jurisprudence for example, it has been taken as admitting the following contexts: 'doubtfully solvent' – *Brady v Brady* [1988] BCLC 20, p 40 (Nourse LJ); 'parlous financial state' - *Facia Footwear Ltd v Hinchliffe* [1998] 1 BCLC 218, p 228f–228g (Sir Richard Scott V-C); 'in financial difficulties' – *Re MDA Investment Management Ltd* [2004] 1 BCLC 217 [70] (Park J); 'near insolvency' – *Liquidator of Wendy Fair Ltd v Hobday* [2006] EWHC 5803 (Ch) [66] (Peter Smith J); and 'borderline solvency' – *Eastford Ltd v Gillespie* [2012] BCC 303 [15] (Lord Hardie). A review of the authorities will also be found in *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112, [2019] 2 All ER 784.

20 See for example, *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30; *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112; Companies Act 2006, s 172(3).

21 In law, the balance sheet test (where liabilities exceed assets) and cash-flow insolvency test (where the entity is unable to pay its debts as they fall due) are 'deemed' indicators of insolvency. A commercial approach to the use of these tests will be found in the UK Supreme Court decision in *BNY Corporate Trustee Services v Eurosail-UK 2007-3BL Plc* [2013] UKSC 28.

by the customer. This makes a customer's deposit balance property of the bank.[22] A bank, without more (such as a specific instruction from a customer) does not hold the funds in the account on trust for the customer.[23] It follows, therefore, that in this first scenario a bank customer with deposits in their account has loaned money to the bank. Where the bank is insolvent, the customer, subject to a unique insolvency law treatment that will be highlighted in the next subheading, will be an unsecured creditor. Many unsecured creditors get nil or paltry returns in an insolvency scenario.[24] This is tied to the verity that insolvency typically signifies inadequate assets to offset liabilities noted earlier, and the treatment of unsecured creditors in insolvency which would, ordinarily, require them to share any available assets rateably (*pari passu*) *inter se* following the satisfaction of prior claims (such as secured claims and insolvency expenses) according to statutory order of priority in the relevant jurisdiction.[25] With these in mind, while average retail customers may not be sophisticated commercial players, they are rational enough to make a run on a bank at the first signal of financial instability. To this end, many jurisdictions endeavour to preclude this incidence by non-insolvency policies that insure or automatically protect deposit amounts in bank accounts.[26]

We now briefly turn to the second scenario where a bank depositor/customer is expecting a deposit payment in their account and its receiving bank enters an insolvency procedure. A few legal-cum-commercial questions arise in this scenario. Is the customer/payee a creditor of the receiving-insolvent bank to the extent of the sum expected in its account? The answer to this ought to be that the receiving-insolvent bank will be liable where it has unconditionally accepted the payee as its creditor or unconditionally accepted the transfer from the paying bank.[27] Thus, the fact that the payee's bank account has not been credited should not dislodge the existence of the payee's credit claim against the bank. In this scenario, it is also apposite to ask whether the payer is a creditor of the receiving-insolvent bank? The logical response to this ought to be 'no'. For the payer, as illustrated in the first scenario above, does not own the monies in its bank account. At best, the payment instruction to its bank (the paying bank) triggers a personal claim against the paying bank to complete the instruction or restore the payer's position if payment is possible without fault on the part of the payer.[28] The payment instruction, in principle, simply involves adjustments of balances in

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[22] See *Foley v Hill* (1848) 2 HLC 28 (HL); *Foskett v McKeown* [2001] 1 AC 102 (HL) at 127 (Lord Millett).

[23] See also *Zumax v FCMB & Ors* [2019] EWCA Civ 294.

[24] For an overview of unsecured creditor outcomes in insolvency proceedings, see R Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005), ch.5; K Akintola, 'The Prescribed Part for Unsecured Creditors: A Pithy Review' (2017) 30 Insolvency Intelligence 54; K Akintola, 'The Prescribed Part for Unsecured Creditors: A Further Review' (2019) 32 Insolvency Intelligence 67; Akintola, *Creditor Treatment in Corporate Insolvency Law*, chs 3-4.

[25] On the question of priority of creditors in bank insolvencies, see also the brief discussion of the Financial Stability Board's (FSB) international standards for resolution regimes for banks and other financial institutions (Key Attributes, particularly Key Attribute 5) in the next section below.

[26] See for example the Financial Services Compensation Scheme in the UK (https://www.fscs.org.uk/what-we-cover/) and other deposit insurance schemes presented in subsequent chapters of this book. It is also worth noting that customers in common law jurisdictions with a recognised system of equity and trusts may, pre-insolvency, seek to retain a proprietary interest in the deposit by giving the funds to the bank for a particular purpose (other than in the ordinary course of ordinary banking activities) on the understanding that the bank is not free to apply the money for any other purpose. See *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567; *Cf Zumax v FCMB & Ors* (*supra*). This, of course, would hardly be convenient for routine bank customers seeking to make regular deposits.

[27] *Tayeb v HSBC* [2004] EWHC 1529 (Comm).

[28] Such restoration may not be possible where the payer has provided wrong bank account details and the payment is made to a wrong person, who has now absconded with the funds – see *Tidal Energy Ltd v Bank of*

the relevant bank account and clearing house systems the banks use to effect the payment. If the preceding analyses are correct, then one ought to also ask whether the paying bank is a creditor of the receiving bank? The answer to this could depend on how payment by fund transfer between bank accounts is effected in the relevant jurisdiction. Let us take a domestic payment in England as an example, where the common systems for effecting such payments are the Clearing House Automated Payment System (CHAPS) and Bankers Automated Clearing Services (BACS). In these systems, the Bank of England (BOE) serves as intermediary between the banks and performance of the payment instruction should result in a concomitant debit and credit of the paying and receiving banks' accounts at the BOE. Ordinarily, because CHAPS facilitates same day payment, one could speculate that the receiving insolvent bank's account with the BOE might not have been credited with the payment amount and that failure to make such payment due to insolvency should not give rise to a credit claim in favour of the paying bank although other credit claims may arise due to loss suffered as a result of the insolvency-triggered default. However, it would appear that the receiving bank's account is credited following settlement on the Real-Time Gross Settlement (RTGS) System with funds received by the receiving bank before crediting the payee on the same day.[29] Similarly, BACS payment facilitates actual payment or credit to the payee's account by the third clearing day, and first requires the receiving bank to have been paid by the payer's bank on the second clearing day. As such, in either case, where the insolvency of the receiving bank precludes performance, then two alternative credit claims ought to arise against it in ordinary commercial contexts: one from the paying bank whose account in the BOE has been debited for the payment amount; or one from the payee expecting the deposit payment since it is plausible that receipt in the receiving bank's BOE account leads to unconditional acceptance of the payee as its creditor in respect of the amount transferred. We have only presented these scenarios to illustrate nuanced questions of credit and rationalisation of the creditors' interests that arise in ordinary corporate insolvencies, and how they could be more acute in bank insolvencies.

These are key private law questions on contract/proprietary rights that sit alongside critical macro-economic questions of financial stability. Thus, still using the example of a payment in England, it is clear that one response to this quandary is that the payment rules enable the BOE to suspend a bank if it appears likely that an Insolvency Event will occur in relation to that bank.[30] Moreover, and in relation to bank insolvency law, since payment systems like CHAPS are 'designated systems' for the purpose of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999[31] (which apply in the European Union through Directive 98/26/EC of the European Parliament), there are rules to reduce risks associated with participation in payment and securities settlement systems by minimising the disruption caused by insolvency proceedings brought against a participant in such a system. For example, a 'transfer order', which will instruct a bank-participant in the payment system to place at the disposal of a recipient an amount of money by means of a book entry on the

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Scotland Plc [2014] EWCA Civ 1107. In England, a 'Confirmation of Payee' scheme has been introduced which allows a payer to check whether the details provided by the payee matches the name associated with the account number and sort code they are paying, and decide not to make the payment if necessary. Thus, the onus is still on a payer to ensure they are satisfied to continue the payment transaction.

[29] Information available on <https://www.bankofengland.co.uk/payment-and-settlement/chaps?msclkid=3c86986cd11d11ecad4c49ae1a7f19d0> last accessed 30 April 2022.

[30] See, for example, Bank of England, *CHAPS Reference Manual* (January 2022), 6.8(f). A list of insolvency events are specified in 8.6(a) to 8.6(e) inclusive and 8.6(g).

[31] UK SI 1999/2979.

accounts and which results in the assumption or discharge of a payment obligation, cannot, generally, be invalid under ordinary insolvency law.[32]

Bank Insolvency Law: Précis

In this section, we briefly introduce typical bank insolvency procedures or systems that will be amplified in subsequent chapters of this book in the context of developing economies. The systemic importance of banks to economies often gives some banks the tag: *too big to fail*.[33] Contemporary events, such as the GFC, have taught us that this label reflects desperation more than reality. For the reality is that, like any corporate entity, banks may not always enjoy the perpetual succession associated with separate legal personality due, in part, to liquidity problems.[34] Moreover, big scalps of the GFC redress the fallacy that some banks were "too big to fail"; for it cannot be assumed that governments would always provide a bail-out – an orthodox resolution strategy for financially distressed but systemically important banks.[35] Our preceding discussion on the nature of banks *qua* corporate entities suggests that the insolvency of banks poses a legal quandary in terms of the objective of bank insolvency laws, *viz*:

- should the legal framework focus on the rationalisation of creditor interests by, for example, effecting an optimum and fair distribution of the distressed bank's assets (a traditional objective of ordinary insolvency law)?;
- should the legal framework prioritise rescue or rehabilitation of the financially distressed bank (a modern objective of ordinary insolvency law)?; or
- should the legal framework prioritise systemic and financial stability (an objective of bank resolution regimes, particularly where the insolvent entity is a systemically important bank).

A preliminary point to note, however, is that the first objective, which is creditor-centric, is hardly conducive to resolving bank insolvency outcomes due to the nature of dependencies on these institutions, including those that might not fit the label of systemically important/too big to fail. Nevertheless, as we shall see below, this is not to say that the critical 'allocation of

[32] *ibid*, part III, Regs 13-19. Regulation 20 provides that the modifications to the law of insolvency cease to apply to a transfer order which is entered into a designated system after insolvency, unless the transfer order is carried out on the same day as the insolvency and the relevant persons do not have notice of the insolvency at the time of settlement.

[33] Useful reflections on the notion of 'too big to fail' will be found in G Tett, *Fool's Gold: how the bold dream of a small tribe at J.P. Morgan was corrupted by Wall Street greed and unleashed a catastrophe* (New York: Free Press, 2009); AR Sorkin, *Too Big to Fail: inside the battle to save wall street* (London: Penguin, 2010).

[34] See G Farrell, *Crash of the Titans: Greed, Hubris, the fall of Merrill Lynch, and the near collapse of Bank of America* (Crown Business 2010), p 267.

[35] See again *Sharp v Blank* [2019] EWHC 3096 (Ch) at [128].

loss'[36] will fall on creditors in bank insolvencies due to a safeguard that ensures *no creditor in a bank insolvency is worse off than they would be in ordinary insolvency proceedings*.

In many jurisdictions, alongside regulatory measures such as adequate capitalisation or recapitalisation, transparent balance sheets, bail-in measures and structural reforms (ring-fencing) sit a bank resolution regime which will manage the insolvency of banks. The bank resolution regime is largely driven by the Financial Stability Board's (FSB) international standards for resolution regimes for banks and other financial institutions.[37] The standards set out 12 key attributes that should be part of the resolution regimes of all jurisdictions, and are primarily aimed at systemically important banks or financial institutions in order to preclude severe systemic disruptions occasioned by bank failure,[38] although the resolution regime in countries like the UK, which also apply the FSB's international standards, have extended their resolution regime to cover all banks, building societies and certain investment firms.[39] In the context of a bank's insolvency, the nub of the resolution regime is three-fold:[40] (a) rescue or restoration of the insolvent bank; (b) orderly winding-up (or 'wind-down') of the whole or part of the bank; and (c) effective cross-border cooperation and coordination in cross-border insolvency contexts.[41] Thus, bank insolvency procedures in many jurisdictions include terminal procedures such as **liquidation**, which facilitates orderly and timely realisation of available assets, distribution to creditors like depositors and closure of the bank. It will also include rescue procedures such as **administration.**[42] This procedure is used to either effect a rescue of the bank or its business and restore it to viability, for example through a sale of the business. Being part of the wider bank resolution regime, it is important to note that these procedures: (a) are normally modified to ensure that relevant objectives of the resolution regime (e.g. protecting insured deposits) can be achieved despite the firm entering insolvency. Once such objectives are fully achieved, the procedures revert to ordinary liquidation or administration; and (b) once modified, might involve the exercise of the broad and non-exhaustive list of resolution powers in the international standards, including overriding rights of shareholders, use of asset management vehicles, use of bail-in within the resolution regime to recapitalise, imposition of a moratorium, and temporary stay on exercise of contractual termination rights like *ipso facto* clauses.[43]

Given the impact of insolvency on creditors, it is worth noting that the bank insolvency and resolution regime's treatment of creditors is propitious. There are at least two reasons for this assertion. First is that the bank resolution regime is designed to be used at an early

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[36] We have already made the point in the preceding section that the fundamentals of corporate law, which also applies to banks, is about allocation of loss.

[37] FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (15 October 2014). Available at <https://www.fsb.org/wp-content/uploads/r_141015.pdf> last accessed 30 April 2022.

[38] *ibid*, preamble and Key Attribute 1.

[39] More information available at <https://www.bankofengland.co.uk/financial-stability/resolution> last accessed 30 April 2022.

[40] FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions,* Key Attributes 3 and 7.

[41] For a discussion of cross-border bank insolvencies and the UNCITRAL Model Law, see ch.8 below.

[42] An example is the UK Bank Administration, see Banking Act 2009, part 3.

[43] FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions,* Key Attribute 3.2

stage before the bank is balance-sheet insolvent (though it may be cash-flow insolvent),[44] and before all equity has been fully wiped out. This could ring-fence assets that could be used to satisfy creditor claims, which is made possible by a commercial reality where liabilities do not exceed assets. The second is the safeguard alluded to above that, in modified bank insolvency or resolution procedures, creditor hierarchy should be respected (including maintaining the subordination of equity to debt in bank insolvency proceedings) and no creditor should be worse off than they would be in ordinary insolvency proceedings.[45] Given that a key cog of these international standards is flexibility, this safeguard may, however, be altered to achieve designated aims, such as protection of depositor-creditors who are generally unsecured creditors and should, ordinarily, rank as junior claimants in insolvency. An example of this flexibility is to be found in the UK's treatment of uninsured deposits. Deposit amounts not covered by the Financial Services Compensation Scheme are now treated as secondary preferential debts in a bank's insolvency ranking above the prescribed part fund for unsecured creditors, claims covered by a floating charge security and ordinary unsecured creditors.[46]

Bank Insolvency Law in Developing Economies: The Outline

This edited book culls together contributions from subject experts, including academics, legal practitioners, and insolvency practitioners. The mix of subject experts ensures the perspectives set out in the book are nuanced and appeal to a broader audience. The contributors bring with them varied experiences, which are instrumental in achieving the main themes and issues raised. In this text, we focus on selected African, Middle Eastern and European countries. Segments of the book are also devoted to harmonisation issues in bank insolvency law by reviewing model frameworks on cross-border insolvency law. The selected economies and frameworks, though not exhaustive, provide a veritable account of typical legal and commercial issues encountered in these regions when bank insolvencies occur, and allow for further analysis of their regulatory responses. The core of this text consists of two parts, the contents of which we now briefly outline.

Part I of this book explores bank insolvencies and associated laws or policies in a selection of developing economies in Africa. As with any text, it would be difficult to cover all the countries in this region. Therefore, the contributions to this text have been selected from Nigeria, Uganda, Kenya, Tanzania, and Ghana. The choice of these countries was informed by various factors. Crucially, these countries have been at the forefront of legislative change in the region, given that the GFC and global pandemic have precipitated overdue-but-necessary changes to the way business is conducted in a region that is conventionally wedded to legislative inertia. Some of these countries have had specific changes to their (or simply introduced) banking, company, and insolvency regulatory regimes, which should,of course, have a bearing on the stability of banks or resolution of their pecuniary challenges in the long

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44 For a discussion of a pragmatic approach to the question of balance sheet and cash-flow insolvency tests, see the UK Supreme Court decision in *BNY Corporate Trustee Services v Eurosail-UK 2007-3BL Plc* [2013] UKSC 28.

45 Otherwise the creditors would be entitled to compensation. See FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions,* Key Attribute 5.

46 See Banks and Building Societies (Depositor Preference and Priorities) Order 2014 (SI 2014/4386).

term. The first contribution in this part, Chapter 2, examines Nigeria. It provides a rigorous scrutiny of the efficacy of asset management companies (AMCs), bridge banks and securitisation in resolving financially distressed banks in the country often caused by non-performing loans (NPLs). Nigeria has introduced copious legislations that affect the business, solvency and the insolvency of banks. For example, there is the Banks and Other Institutions Act (BOFIA) 2020. BOFIA 2020 departs from the previous regulatory approach adopted by BOFIA 1991, including the way banks were licensed,[47] the revocation of bank licences,[48] redefining the role of the Nigerian Deposit Insurance Corporation (NDIC) in the resolution of banks in distress,[49] the creation of resolution tools,[50] and establishing a bank sector fund which provides funds for the operation of bridge banks.[51] From a company law perspective, Nigeria has introduced the Companies and Allied Matters Act 2020 (CAMA) 2020, an overdue change from CAMA 1990. The new Act introduced new measures designed to fast-track the process of registration and regulation of corporate vehicles, and to condense the compliance requirements for small and medium enterprises (SMEs) - a constituency that ordinarily brings much of the banking business in that jurisdiction. This piece of legislation also introduces governance controls that will impact the stability of banks *qua* public companies. These include the requirement of disclosure of multiple directorships and the introduction of a minimum requirement of three independent Directors on the board.[52] It also introduces an extensive insolvency regime, which includes Company Voluntary Arrangements and Administration as rescue/restructuring tools in insolvency;[53] these tools may operate in bank insolvencies following the attainment of resolution objectives in bespoke bank insolvency procedures. We ought also to point out the introduction of the Secured Transactions in Moveable Assets Act (STMA) 2017, which streamlines the process of creating, attaching and perfecting security interests in Moveable assets. This piece of legislation enables banks and businesses, particularly SMEs, to unlock the value of varied moveable assets in debt finance transactions. This is also critical to the viability of the banking business in the jurisdiction given the role of banks as the largest providers of debt capital.

The next contribution in Part I, Chapter 3, focuses on the East African Community (EAC). It analyses the collapse of banks and financial institutions in three African countries, namely, Uganda, Kenya and Tanzania. This chapter provides a historical analysis of the business and regulation of banking and its evolution in these member states, pre- and post-GFC. The chapter provides a structured analysis of the causes of bank insolvency, including NPLs, poor governance controls, and perceived abuse of the privileges of separate legal personality and limited liability in the context of foreign ownership of local banks. The chapter also examines effective legal responses to these issues, and makes a case for a regional cross-border banking

[47] BOFIA 2020, s 41.
[48] BOFIA 2020, s 12 (1)-(9).
[49] BOFIA 2020, S 34 (2) .
[50] BOFIA 2020, s 41.
[51] BOFIA 2020, ss 74-94.
[52] See, generally, CAMA 2020, ss 275, 278 and 307.
[53] CAMA 2020, chs 17-18.

resolution framework in the EAC as a measure that would combat bank insolvencies and harmonise the resolution tools in the region.

Part I, Chapter 4, of the book contains a contribution on bank insolvency law in Ghana. In the case of Ghana, the Banks, and Specialised Deposit Taking Institutions Act (BSDIA) was enacted in 2016. This Act significantly improved the regulation and scrutiny of banks, one of the failings of the previous legislation, the Banking Act 2004. BSDIA 2016 operates in a similar way to the position adopted by Nigeria under BOFIA 1991 in relation to the issuance of directives or soft law to regulate banks in the system. In relation to resolution measures, this chapter juxtaposes causes of bank distress in the country and a rigorous scrutiny of formal options for resolving bank insolvency that may be found under the BSDIA 2016, including early intervention mechanisms, official administration, and liquidation.

The final contribution in Part I of this book is Chapter 5, which contains an exclusive and rigorous examination of the position in Kenya. It provides a useful accompaniment to Chapter 2 due to Kenya's proactive legislative response to bank stability and general insolvency law in the region. This chapter considers the role of insolvency law in safeguarding the financial stability of banks. The chapter examines the 'paradigm shift'[54] in the priority of international and local bank insolvency regimes. The chapter argues that effective balancing of the competing interests of creditors, depositors, and the public trust is necessary for addressing bank failures. The chapter also contextualises the role of the Kenyan Deposit Insurance Act 2012 in light of significant bank failures in the country since the 1980s.

Part II of this collection considers bank insolvency law using paradigms from the Middle East, Europe and Model Law. It therefore consists of three contributions to the subject. This part opens with Chapter 6, which examines the value of the relatively nascent institutional models of the Dubai International Financial Centre (DIFC) and the Qatar Financial Centre (QFC) to financial stability in the United Arab Emirates, Qatar and neighbouring regions. This is approached in three ways. The first is a comparison of the common law regulatory underpinnings of the centres with UK law in order to ascertain the degree of protection afforded to market participants, particularly on the occurrence of an event of default such as insolvency. The second is a robust examination of the centres' rules and regulations in order to underscore a perceived regulatory gap between the two systems. The third is an appraisal of the DIFC and QFC's approach to transplanting insolvency law to deal with the pecuniary problems of financially distressed bank participants. In this regard, the point is made that the region is yet to adopt bespoke bank insolvency law regimes and, to that extent, there is a case to be made for a sophisticated general insolvency regime and a competent application of such regime to bank insolvencies.

Chapter 7 is the following contribution in Part II of this text. This chapter focuses on Cyprus. Cyprus is a useful exemplar of an European system with experience of the direct systemic shocks associated with bank insolvency, which drove a raft of regulatory responses

[54] See again, Wessels and Haentjens, 'Three Paradigm Shifts in Recent Bank Insolvency Law', fn.2 above.

to redress the system. The Chapter critically examines the high incidence of NPLs in Cyprus as one of the root causes of the Cypriot banking crisis of 2013. Thus, we are in this chapter introduced to Cyprus as the country with the second highest number of NPLs in Europe, as well as how bank resolution tools in the EU Bank Recovery and Resolution Directive, such as bail in, could resolve NPLs-associated bank insolvency for the benefit of a range of stakeholders.

Chapter 8 is the final contribution in Part II of the text. The chapter explores bank insolvencies and the UNCITRAL Model Law. The thrust of this chapter is the global/multi-jurisdictional disruption that could be engendered by the insolvency of banks that operate on a cross-border basis, thus necessitating effective cross-border controls and cooperation in the resolution of such insolvencies. While admitting the hackneyed-but-critical point that the systemic importance of banks justify a special regime for bank insolvency, it makes the case that, in cross-border bank insolvencies, there is scope to enhance outcomes through tailored application of controls and cross-jurisdictional cooperation to be found in the principles of the UNCITRAL Model Law on Cross-Border Insolvency - operating alongside other international standards such as the FSB's principles discussed above.

Further Thoughts

This book is designed to explore the nexus between developing economies, their banking institutions, and bank insolvency frameworks. The book, through the carefully selected contributions, evaluates the regulatory frameworks in place to prevent or resolve insolvency. The selection of economies in this text is timely, as these economies have been at the forefront of legislative change and have also initiated change in terms of their commercial regimes. The issue of bank insolvency law in the context of developing economies is a sparsely covered subject. Thus, the diverse contributions help to provide a more holistic overview, and should serve as a panacea for further reforms on the law in those regions and reflections on best banking and governance practices. In that regard, readers of this text are treated to an analytical mix of views that are based on empirical, comparative, socio-legal, doctrinal, inter-disciplinary and commercial perspectives. Readers are therefore enjoined to enjoy this text at their own risk; afterall, the business of banking is all about risk taking!