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INSOLVENCY TREATMENT FOR BANKS AND FINANCIAL INSTITUTIONS
IN URUGUAY

Ricardo Olivera García
Uruguay

1. Uruguayan Insolvency Regime Overview

1.1. Introduction

Before treating the specific insolvency regulation for banks and financial institutions, we will do a brief overview of the whole Uruguayan insolvency regime.

The legal framework for insolvency proceedings in Uruguayan Law is contained in the Code of Commerce of 1866, which reproduced almost verbatim the Code prepared for the Province of Buenos Aires by Eduardo Acevedo and Dalmacio Vélez Sarsfield in 1859. This Code regulated exclusively the situation of traders and companies, providing a single proceeding for insolvency actions against debtors' property, bankruptcy; a single preventive proceeding (i.e. to avoid bankruptcy), moratoriums; and a single procedure available for debtors adjudicated in bankruptcy (i.e. resolutive), arrangement with creditors after adjudication in bankruptcy (*concordato en la quiebra*).

The Code of Commerce, however, contained no proceeding applicable to non traders, for whom the 1869 Civil Code provided the proceedings of voluntary

and involuntary insolvency proceedings (respectively, *concurso voluntario* and *concurso necesario*).

The regime applicable to traders and companies later underwent subsequent reforms.

In 1893, Law N° 2,230 was passed, introducing a different insolvency action regime applicable to corporations, which is termed judicial liquidation and gives corporations the possibility of avoiding said judicial liquidation by initiating a preventive arrangement with creditors (*concordato preventivo*), and of ending such state by way of a resolutive arrangement with creditors (*concordato resolutorio*).

In the year 1900, the possibility of requesting a preventive arrangement with creditors was extended to all traders and companies. Said regime was later modified in 1916 and expanded in 1926, with the legal provision of private arrangements with creditors (*concordatos privados*) and arrangements based on liquidation by creditors (*concordatos de liquidación*).

Attention is also drawn to the regulation of civil insolvency proceedings (i.e. applicable to non traders) under the General Code of Procedure, the amendments concerning insolvency proceedings contained in Law N° 17,292, and the regulation of administrative liquidation of financial intermediation entities and their collateral companies, recently modified by Law N° 17.613, dated December 27, 2002, which constitutes the core of this speech and will be extensively treated below.

There are, therefore, multiple proceedings applicable to situations of financial distress, which can be grouped in the following categories: (i) insolvency collection actions against a debtor's assets: bankruptcy, judicial liquidation and involuntary bankruptcy; (ii) proceedings to avoid insolvency collection actions: preventive arrangements with creditors for traders and companies, preventive arrangements with creditors for corporations, private arrangements with creditors, arrangements based on liquidation by creditors, moratoriums, and

voluntary insolvency proceedings; and (iii) resolutive proceedings for insolvency collection situations: arrangements with creditors in bankruptcy and in judicial liquidation of corporations.

Of these insolvency proceedings, the most widely used among businesses are those tending towards insolvency or collective actions against the debtor's assets (bankruptcy and judicial liquidation).

These are complex proceedings involving provisions of a substantial and procedural nature, aimed at arranging the liquidation of the assets of traders or companies that find themselves in an economic situation which is specifically characterized by law, wherein they are unable to meet their overall obligations. In this sense, the regime of individual actions to recover credits is replaced with a regime of collective actions to recover credits, with the purpose of distributing the debtor's assets equally among its creditors.

These proceedings are governed by three basic principles: (i) the principle of unity of assets, whereby all of the debtor's assets are claimed for the payment of credits; (ii) the principle of generality, which entails that the assets will be applied to satisfy all the creditors; and (iii) the principle of equality, known as "*par conditio creditorum*", which determines that all creditors are given equal treatment, excepting any preferences established by law.

2. Insolvency treatment for banks and financial institutions

2.1. Introduction

Banking activities affect three vital economic variables: savings, credit and money supply. Banks are the natural holders of public savings. Their interest rates and the reliability of their investments directly influence individuals' choices between consuming and saving, as well as communities' choices between consuming and investing. Banks are also the managers of credit, both for individuals and companies, supplying resources necessary for the development of all productive activities. Finally, through their management of

means of payment, banks have a direct influence on the monetary base, by creating book money.

These circumstances motivate the thorough and careful regulation of their operations, the strict control of their management, the extraordinary measures taken by the State in order to solve the problems caused by crises in these companies and, in connection to this, the special regulations governing their liquidation.

2.2. *Specific Regulation*

The laws governing the liquidation of banking institutions have evolved from the 1866 Code of Commerce to the recent Law N° 17,613 dated December 27, 2002, which provides special regulations for the process of liquidation of banking institutions.

This is the first time in the history of banking laws in Uruguay that a complete regime is adopted for the liquidation of banking institutions.

The regime established by Law N° 17,613 reinforces the ruling principle of the previous law,¹ regarding the administrative nature of the liquidation procedure for financial intermediation institutions and the jurisdiction of the Central Bank of Uruguay (BCU by its acronym in Spanish) as the liquidator. In fact, the law maintains BCU as the liquidator of companies from the financial intermediation system and their respective related companies. The law also introduces a new ruling principle: the powers of BCU as the liquidator shall be exercised with the main purpose of *“protecting savings, for reasons of general interest.”*²

Likewise, and in order to confirm the administrative nature of the liquidation procedure, the new law establishes that (administrative) acts by the BCU as the liquidator may be opposed through the general appeal system for administrative

¹ Decree-Law N° 15,322, section 41, in the wording of section 4 of Law N° 16,327.

² Law N° 17,613, section 13.

acts. Then, they may also be reviewed by the High Administrative Court.³

Regarding the liquidation procedure, the law establishes that BCU shall have the power to declare the dissolution of financial intermediation companies and their subsequent liquidation status.

The liquidation procedure is governed by the provisions of Law N° 17,613 and is supplemented whenever relevant by the legal provisions on liquidation of corporations.⁴

As the liquidator, BCU is in charge of the verification of credits, the identification of solvency and insolvency, the conversion of liabilities into national or foreign currency or indexed units (or other forms of monetary update), the determination of the order of preference of payments, the prorating of funds and all other actions necessary for the fulfillment of its objectives.

These actions shall be notified by making them available for consultation for a period of ten days, which shall be announced by publication of legal notices.

As the liquidator, BCU shall have broad powers for administration and disposition, without any limitation whatsoever, of the property, credits, rights and obligations of the corporations and companies comprised in the liquidation. To such effects, BCU may release existing attachments and prohibitions.⁵

Without detriment to their inclusion within the broad powers aforementioned, the law clarifies the scope of these powers of administration and disposition, stating that BCU as the liquidator shall have the necessary powers in order to achieve a better management and recovery of the credits against third parties. This includes the powers to make reductions and grant extensions of time, to renew credits and to enter into payment agreements in connection with the credits, as well as to keep portfolios of credit cards and similar instruments in operation.

³ Law N° 17,613, section 14, subsection 3.

⁴ Law N° 2,230.

⁵ Law N° 17,613, section 15.

2.2.1. Innovation of Law N° 17.613

However, the true innovation in this matter is to be found in those provisions contained in sections 16 to 19 of Law N° 17.613.

One of the outstanding features of the new Banking Law is the creation of the Funds for the Recovery of Banking Assets.

In the first subsection of section 16 it is stated that *“the Central Bank of Uruguay, in its capacity as the liquidator, may decide that with the assets and liabilities of the intermediation institution under liquidation identified to such effects, a fund or funds for the recovery of banking assets be established. Said funds shall be governed by the relevant provisions of Law N° 16,774 dated September 27, 1996, and its supplementary Law N° 17,202 dated September 24, 1999...”*

Under Law N° 16,774, investment funds are considered independent affected assets, they are not legal entities and they are formed by the contributions of their members (participation holders), who are co-owners of the fund's assets in an undivided manner. The funds are managed by a BCU approved investment fund managing company, which is granted ownership powers over the assets and rights that make up the fund, without it becoming the owner.⁶

In order to adapt investment funds to their role in the liquidation of banking institutions, Law N° 17,613 introduces the following adjustments to their structure:⁷

- All credits against the corporation under liquidation shall be transferred to the fund, invested on the credits of said corporation against third parties. For these purposes, the requirements of homogeneity or analogy or

⁶ Law N° 16,774, sections 1 and 3.

⁷ Section 16.

security required by the law for closed credit investment funds⁸ shall not apply.

- Credits against the corporation (liabilities) shall be turned into contributions to the fund, for their amount calculated as of the date of commencement of the fund as originally agreed with the intermediation company.
- Holders of the credits shall be considered participation holders of the affected assets as prorated from that amount. The law provides for the issuance of joint ownership participations -credits or mixed-, according to the relevant regulation.
- Participation holders may receive payment means or securities for their participation, according to the relevant regulation.
- The publication of the establishment of the recovery fund in the Official Gazette and two other national newspapers shall result in the transfer into the fund, as a matter of law, of all the rights and obligations, their titles and securities. Such transfer shall be expressly stated in all publications.
- The assets of the funds for the recovery of banking assets shall not be affected by the debts of participation holders, or managing or depositing companies.⁹ Said assets shall not be affected by the debts of the financial intermediation company under liquidation either.

This last statement of the law aims at excluding any joint and several liability of the fund for the liabilities of the liquidated banking institution, in its capacity as a successor of the latter. This provision follows section 38, which establishes that *“Transfer of universitas juris as per this act does not imply universal succession but merely substitution, exclusively in juridical situations of assets and liability involved in delimitation of universitas juris transmitted. Consequently the*

⁸ Law N° 16,774, section 30, subsection 1, in the wording of Law N° 17,202.

⁹ Solution already included in Law N° 16.774.

property included in universitas juris shall not respond to obligations not included in their delimitation. No measures shall be adopted, be they cautionary, provisional, anticipated or executed for protection or compensation of rights not involved in the universitas juris transmitted”.

In principle, BCU shall be in charge of the management of those funds, or it may entrust said management to a banking institution or one of the investment funds managing companies governed by Law N° 16,774.¹⁰

Section 18 of Law N° 17,613 introduces another legal innovation to be used by BCU in its capacity as the liquidator. Such innovation is the power of the liquidator to dispose of a set of assets, *universitas juris*, from the assets of the entity under liquidation. Thus, instead of having to sell the assets that will make up the liquidation individually, the liquidator is allowed to sell a set of assets, *universitas juris*, with the clear purpose of obtaining the best possible financial results for the benefit of the creditors.

The law provides that the sales of the participations in the assets of the corporations under liquidation, to such purpose identified by the liquidator, shall be effected through the competitive procedure established by BCU on the basis of good management, maintaining the principles of equality of the interested parties and of publicity. For said sales, the bidder that proposes the best consideration shall be selected.

The law also establishes that if the assets or liabilities comprised within the participation or participations sold were included in a fund for the recovery of banking assets, BCU, in its capacity as the liquidator, or the fund manager if it were the case, may separate them from the same and transfer them to the buyer in the manner established by the applicable regulations, provided that the proportion between the fund's contributions and assets at the time of commencement of the same is reasonably maintained. This may be done by depositing the price received into the recovery fund which those assets and

¹⁰ Law N° 17.613, section 17.

liabilities were part of, or by means of another form of compensation. All this must be done in compliance with BCU's or the generally accepted accounting and valuation rules for assets and liabilities of financial intermediation entities.

Furthermore, the law establishes that BCU, in its capacity as the liquidator, may enter into agreements with the creditors of the banks under liquidation or with a certain category or categories of said creditors.¹¹

This power may be used by BCU for any of the following purposes:

- To transfer the respective liabilities to other financial intermediation entities.
- To contribute the liabilities to the establishment of a fund for the recovery of banking assets.
- To divide those liabilities from a recovery fund already established, maintaining the proportion of contributions and assets provided for in section 18 of the law.

The agreements may be proposed to the creditors of the corporation under liquidation by BCU, by the financial intermediation entity to which the transfer is made or, if applicable, by the manager of the fund for the recovery of banking assets.

The agreements may be entered into with the creditors of the corporation under liquidation or with certain categories of the same. In this respect, the law breaks the *par conditio creditorum* principle on which our insolvency proceedings were traditionally based.

Collective agreements to be entered into with creditors may include:

¹¹ Law N° 17.613, section 19.

- Substitution of the debtor.
- Reductions or rescheduling of maturity dates of the credits with the new debtor.
- Contribution of the credits to the establishment of investment funds.
- Capitalization of credits.
- All other solutions combined.

Proposals may consider different solutions for the benefit of certain categories of creditors or of credits up to a certain absolute value, maintaining equality among creditors within the same category and without altering the prorating corresponding to all creditors.

It is established by the law that proposals may only be presented to creditors upon favorable opinion of the Superintendency of Financial Intermediation Institutions of BCU. Said opinion must be based upon the present and future feasibility of the target entity.

BCU, in its capacity as the liquidator, shall invite those creditors the proposal is intended for to adhere to the collective agreement, through publications in the Official Gazette and in two other national newspapers and establishing the manner and timeline for creditors to present their consent.

The required majorities for approval of the agreement are as follows:

- General solution: adherence of creditors representing 66% of the liabilities affected by the agreement.
- Negotiable liabilities: consent of holders representing the majority of the circulating capital.

The agreement proposed, with the consent of the majorities thus established, shall be binding for all creditors affected by the same, regardless of whether they adhere to it or not.

One of the most controversial aspects of the new law is the provision contained in section 20. Said provision is a declarative provision aiming at including situations generated before the coming into force of the provision.

This provision establishes that *“It shall be declared that the discontinuance of activities of financial intermediation institutions covered by article 1 of Decree-Law N° 15,322, dated 17 September, 1982, issued by the Central Bank of Uruguay, shall have the effect of suspending enforcement of all credits against the suspended institution throughout the duration of the proceedings”*.

By beginning with the expression *“It shall be declared”*, it intends to be an authentic construction of the effects of the discontinuance of activities of financial intermediation entities, provided for in Decree-Law N° 15,322. As a consequence of this constructive effect, the provision applies to situations that occurred as from its coming into force.

It is established that the effect of such discontinuance of activities is the suspension of the enforcement of all the credits against said suspended entity. This consequence, besides suspending any execution that may have been started against the suspended entities, also excludes the possibility of compensation of the credits against it, since both the provisions of the Civil Code (section 1497 and subsequent sections) and the provisions of the Code of Commerce (section 975 and subsequent sections) require the existence of liquid and collectible credits for legal compensation to operate.

A problem may arise in the case of offsets with credits against the suspended banks, which may have happened before the coming into force of Law N° 17,613, where the provisions governing suspension did not exclude enforcement of credits during this process. It may be construed that the declarative effect of the provision makes it retroactive to those situations prior to

the law, thus revoking the setoffs generated and reestablishing the credits.

In our legal system, the non retroactive effect of the law is a legal provision that may be annulled by another legal provision of the same hierarchy (Civil Code, section 2). It will be for the judicial authorities to decide whether this partial annulment renders the provision unconstitutional or if it somehow generates the responsibility of the state for the legislative act approved.

The law also contains some provisions on the application of insolvency regulations regarding financial intermediation entities. The applicability of insolvency laws for the judicial liquidation of financial intermediation entities established as corporations had generated a conflict of criteria between BCU and the Insolvency Courts.

The law aims at solving this issue as follows:¹²

- It construes that the provisions of Law N° 17,292 (save minor exceptions) are not applicable in the case of companies that are part of the financial intermediation system and their related companies.
- With the same scope, it establishes that the liquidation of said companies shall be administratively declared and processed exclusively, under the jurisdictional control typical of administrative acts.
- The Insolvency Courts have competent jurisdiction for pending processes or processes commenced where the financial intermediation company is sued, and for corporate actions for liability and recovery against it.

It is difficult to understand the grounds on which all the provisions of the reform of the insolvency system by Law N° 17,292 are declared inapplicable, other than for the fact that, among said provisions, there is a modification to the moratorium system (section 1771, part XIX of the Code of Commerce), which

¹² Law N° 17,613, section 41.

caused the conflict between BCU and the Insolvency Courts (section 23).

What seems to be evident, however, is the intention of the lawmaker of excluding the possibility of the Justice declaring the liquidation of financial intermediation entities, whatever the reason for its applicability, turning this declaration into an administrative purpose only, to be carried out by BCU.

In turn, it is declared that Insolvency Courts shall have competent jurisdiction for all those processes where they would normally have jurisdiction in compliance with their ability to attract insolvency actions.