MEMORANDUM

Re: **Legal principles and practices concerning distributions and payment of claims by financial undertakings in winding-up proceedings, together with a discussion of possible arrangements for distributions in such instances**

This memorandum concerns primarily the rules of Icelandic insolvency law in respect of distributions from insolvent estates to creditors and how they interact with the rules of Act No. 161/2002, on Financial Undertakings, as subsequently amended. In particular, this memorandum sets out how such distributions could be arranged in the winding-up proceedings of Glitnir banki hf., cf. specifically the provisions of the sixth paragraph of Art. 102 of the Act on Financial Undertakings. In addition, an examination is made as to how such distributions could be implemented and what potential points of contention must be borne in mind.

The memorandum includes an overview of the principal rules on distributions to creditors in the case of financial undertakings in winding-up proceedings, but should not be regarded as an exhaustive discussion of the subject.

I.
Introduction

The rules of Chapter XII of the Act on Financial Undertakings, No. 161/2002 apply to the winding-up of financial undertakings. The provisions of Chapter XII, on winding up of financial undertakings refer, however, to a considerable extent to Act No. 21/1991, on Bankruptcy etc. Thus the latter Act applies to the winding-up of financial undertakings to the extent that the Act on Financial Undertakings does not provide otherwise.

Although the Act on Financial Undertakings states in numerous locations that the general rules of the Act on Bankruptcy shall apply to the winding-up of financial undertakings, and it is stated explicitly in the first paragraph of Art. 101 that the same rules apply to measures taken by a Winding-Up Board as apply to administration of an insolvent estate by the administrator, there are nonetheless important deviations in the Act on Financial Undertakings. Two points differ especially.

Firstly, due to the extraordinary circumstances which have arisen in connection with the winding up of financial undertakings, a special authorisation was adopted for the Winding-Up Board of a financial undertaking to be able to pay claims, in the manner described in the sixth paragraph of Art. 102 of the Act on Financial Undertakings, following the first creditors' meeting after the expiration of the deadline for lodging claims. In making such a distribution, the principal point is that the Winding-Up Board should ensure equal treatment of creditors holding claims of equal priority which have not been finally rejected.

Secondly, this same provision of the sixth paragraph of Art. 102 states that derogations may be made from the requirement that all creditors holding recognised claims with the same priority receive payment at the same time with the consent of those who do not receive payment or pursuant to a decision by the Winding-Up Board if a creditor offers to waive its claim in return for partial payment thereof, the amount of which is regarded as definitely lower than other creditors of equal rank would receive at a later stage, taking into consideration, for instance, whether their claims will bear interest until paid.

II.
Rules which apply to distributions to creditors in the winding-up of financial undertakings

Art. 102 of the Act on Financial Undertakings specifically provides for the same rules to apply in the winding-up of a financial undertaking as apply to priority of claims against an insolvent estate, cf. the following in the third paragraph of Article 102:

> "The same rules apply to the winding-up of a financial undertaking as apply to priority of claims against any estate under liquidation, with the exception that claims to deposits, as defined in the Act on Deposit Guarantees and an Investor Compensation Scheme, shall be included in priority claims as referred to in the first and second paragraphs of Art. 112 of the Act on Bankruptcy etc. To the extent that the priority of claims can be determined under that Act by the date the court ruling on liquidation is issued, the date of the court ruling on the winding-up of a financial undertaking shall apply."

It is also stated in the fourth paragraph that the effect of improper lodging of claims is the same as under the Act on Bankruptcy, i.e. if a claim is not lodged within the time limit for lodging claims it will not be considered in the winding-up.

Following the expiration of the time limit for lodging claims, the Winding-Up Board is obliged to take a decision on the priority of claims, unless it is considered probable that the undertaking's assets will suffice to pay its debts in full.

The provisions which primarily need to be examined and which apply to distributions from insolvent estates, and to which the provision of Art. 102 of the Act on Financial Undertakings indirectly refers, are the provisions of Art. 156 of Act No. 21/1991 on Bankruptcy etc. These state that the administrator must, if winding-up does not conclude with composition or the revocation of all claims, fulfil those claims against the estate which have already been recognised and can be fulfilled completely according to their priority in ranking of claims. This shall not, however, be done unless funds are at the same time set aside to fully cover payment of conditional or disputed claims which could enjoy the same or higher priority in ranking; their payment shall then be made, as the case may be, as soon as the condition is satisfied or disputes are resolved. Thereafter, the administrator may make payment on all claims ranking next in priority towards the distributions expected to be made to them, while at the same time ensuring that funds are set aside to pay conditional or disputed claims.

The substantial provision that the administrator is obliged to retain funds to pay conditional or disputed claims of equal ranking to the claims paid is furthermore reflected in the provisions of Art. 103 a of the Act on Financial Undertakings, which describes how the Winding-Up Board can conclude the winding-up proceedings, assuming that the Winding-Up Board has, as necessary, converted the financial undertaking's assets to cash, completed payment of all recognised claims against the financial undertaking and, as appropriate, set aside funds for payment of disputed claims. As discussed in more detail below, the Icelandic parliament *Althingi* recently adopted legislation authorising distributions as provided for in the sixth paragraph of Art. 102 also to those creditors holding claims which are the subject of dispute. This amendment was deemed appropriate to ensure equal treatment of creditors, having regard for the general rule of the Act on Bankruptcy that interest on claims lodged is ranked as a subordinate claim and therefore it could be discriminatory if creditors holding recognised claims were to receive payment immediately while other equally ranked creditors had to wait until disagreements were resolved.

According to the above, the first step of the Winding-Up Board, following the expiration of the time limit for lodging claims, if there is no probability that a financial undertaking's assets will suffice to cover its liabilities, is to take decisions on the claims lodged. The claims become either recognised, disputed or rejected. Creditors may object to the rejection of their claims, in which case they are referred to the courts for resolution. It should be noted that other creditors can also turn to the courts if they are of the opinion that a decision by the Winding-Up Board on other claims is unjustified and affects their rights. It is evident that a large number of creditors have already requested that the courts resolve such disputes and still others have declared that they will contest all decisions by the Winding-Up Board, making it clear that a large number of disputes will be brought before the Icelandic courts in connection with decisions by the Winding-Up Board of Glitnir banki hf.

III.
Principles from which the Winding-Up Board may not deviate

An examination of the above-mentioned rules makes it evident that the legislation sets out several apparently iron-clad principles from which the Winding-Up Board of a financial undertaking may not deviate concerning distributions to creditors. These principles are: a) non-discrimination between equally ranked creditors and their entitlement to payment at the same time, b) priority of claims according to ranking and c) the obligation of the Winding-Up Board to set aside funds for payment of disputed and conditional claims.

a) Non-discrimination of equally ranked creditors and entitlement to payment at the same time

As winding-up is a joint enforcement action by creditors, the primary emphasis is on their equal treatment, as non-discrimination is a basic principle in winding-up of insolvent

estates. The principle of creditor equality is reflected both in Act No. 21/1991, on Bankruptcy etc., as subsequently amended, and Act No. 161/2002, on Financial Undertakings, as subsequently amended, as well as in the rules of Directive 2001/24/EC, of 4 April 2001, on the reorganisation and winding up of credit institutions. Amendments to the Act on Financial Undertakings made by Act No. 44/2009 were to a considerable extent based on the above Directive.

Icelandic law is therefore clear in prescribing that the Winding-Up Board may not discriminate between equally ranked creditors in making distributions to creditors. This means that equally ranked creditors must be paid the same portion of their claims if full payment is not made, in addition to which payment must be made at the same time and must be in the same form to all equally ranked creditors.

The principle of equal treatment of creditors, in fact, is clearly set out in the provisions of Art. 102 of the Act on Financial Undertakings, which provides for distributions to creditors. The sixth paragraph states, for instance:

> Following the conclusion of the first creditors' meeting held after the expiry of the time limit for submission of claims, the winding up committee may pay recognised claims, in full or in part, in one or more payments. Care must also be taken to ensure that all creditors holding recognised claims with the same priority receive payment at the same time, ..."

The Winding-Up Board is therefore restricted to making payments, whether in full or in part, concurrently to all equally ranked creditors. The provision of the sixth paragraph, however, provides for possible exceptions from this principle, which are possible if those creditors who do not receive payment agree to distributions to other equally ranked creditors, in addition to which the Winding-Up Board may decide to pay creditors who offer to waive their claims in return for their partial payment. The condition is set, however, that the Winding-Up Board may only pay individual creditors in such a manner if it is considered certain that they will in fact receive less than others who elect to wait for a higher return from the assets of the financial undertaking, resulting in a higher payment to creditors. In assessing this, regard must also be had for interest which the funds could earn in the possession of the creditor who enjoys payment once such a distribution has been made. The Winding-Up Board therefore must tread a narrow path in approving such offers, unless it is clear that payment to creditors, together with accrued interest until the final distribution, will not be higher than the final payment to other equally ranked creditors. If such partial payment including interest is higher than the eventual distribution to other equally ranked creditors, this distorts their equal treatment and could conceivably lead to liability on the part of the Winding-Up Board towards other equally ranked creditors.

It is appropriate to discuss in particular the authorisation to the Winding-Up Board to pay creditors immediately following the first meeting with creditors. The explanatory notes accompanying the parliamentary bill which was adopted as Act No. 44/2009 state that this concerns a derogation from the rules of the Act on Bankruptcy and that it was necessary to grant the Winding-Up Board such authorisation since it could be important for a financial undertaking to conclude payment to specific creditors or groups of creditors. This was

deemed to be especially important in view of the possibility that winding-up of financial undertakings could take a long time.

The grounds for this authorisation to the Winding-Up Boards of financial undertakings are stated in the explanatory notes to the bill which would become Act No. 44/2009, amending Act No. 161/2002, on Financial Undertakings. This states:

> "The reason for this proposal is that the situation of creditors may vary greatly. Some creditors may prefer to allow the winding-up proceedings to take a longer time while attempts are made to maximise the value of the financial undertaking's assets, so that in the end they would receive as large a share of their claims as possible and would perhaps even receive their claims paid in full. Other creditors may be in a position where they wish to be paid as soon as possible and would be prepared, if this were available, to be satisfied with receiving a lower proportion of their claims than they would receive upon the final settlement. It must be considered important to provide a legal basis for such flexibility for the Winding-Up Board to have regard to creditors' varying situations in this respect."

This exception was considered to comprise a certain derogation from the principle of non-discrimination among creditors, since such a decision by the Winding-Up Board would result in some creditors receiving payment immediately, although only partial payment, while others would have to wait, even for a number of years, for their final distribution. Thus creditors who received payment immediately would enjoy interest on the payment from the date payment was made while those waiting for a disagreement on disputed claims to be resolved by the courts would not enjoy interest on their claims during this period. For this reason, the Act on Financial Undertakings was amended by an Act approved by the *Althingi* in mid-June 2010. In its opinion, the parliamentary Trade Committee states:

> "According to existing rules, interest on claims lodged is a subordinate claim and therefore the real value of claims decreases as time passes without payment being made towards them. On the other hand, the estate of a financial undertaking earns a return on its existing assets in the form of interest, rental income, etc. The position could easily arise where one group of creditors has interests at stake in delaying a final decision on recognition of claims. At the same time, there are strong arguments based on the principle of equality, to the effect that disputes on the legitimacy of a claim which is subsequently recognised in full or in part should not result in the creditor in question actually receiving a lower payment than other equally ranked creditors. This would in fact happen if no special action is taken to either authorise payment towards claims or to an escrow account when payment is made towards other undisputed and equally ranked claims. There are grounds for preventing payments to creditors, which are delayed for the reasons stated above, and income on the funds involved from being used otherwise than to compensate creditors for their losses in the order of priority of their claims and ensure their full equality of treatment. For this reason it is deemed appropriate to expand the authorisation to Winding-Up Boards to make payments towards claims, even if disagreement concerning decisions on these claims has not yet been resolved by the courts."

Two sentences were therefore added to the sixth paragraph of Art. 102 of the Act on Financial Undertakings, authorising the Winding-Up Board to make distributions towards disputed claims, but insofar as the claim is disputed such distributions shall be paid into an escrow account for that portion of the claim which is disputed. Thus, the same proportion shall be paid as is paid towards undisputed claims. Once a dispute has been resolved, the balance in the escrow account shall either be returned to the financial undertaking or turned over to the creditor, together with interest, in direct proportion to the conclusion of the dispute. This was regarded as promoting non-discrimination between equally ranked creditors and the Trade Committee considered it a necessary measure in view of the extraordinary circumstances which have arisen in winding-up the estates of financial undertakings.

b) Ranking of claims by priority

Claims lodged against an insolvent estate enjoy varying priority according the nature of the claim as provided for in Act No. 21/1991 on Bankruptcy etc. It is clearly stated in the third paragraph of Art. 102 of Act No. 161/2002, on Financial Undertakings, that the same rules apply to priority of claims in winding-up of a financial undertaking, with the exception that claims for deposits, as defined in the Act on Deposit Guarantees and an Investor Compensation Scheme, shall be included in priority claims as referred to in the first and second paragraph of Art. 112 of the Bankruptcy Act. Reference is made in this connection to Chapter XVII of the Act on Bankruptcy etc.

As a result of these rules, certain claims enjoy priority when distributions are made by a financial undertaking being wound-up. The main principle is that the Winding-Up Board is completely prohibited from paying creditors with lower ranking unless all other creditors holding claims of higher priority have been paid in full, with additional funds set aside to fully cover payment of conditional or disputed claims which could enjoy the same or higher priority in ranking, as will be discussed in more detail later. The provisions which should be considered especially in this connection are in Art. 156 of the Act on Bankruptcy and Art. 103 a of the Act on Financial Undertakings; however, it must be borne in mind that they apply to distributions upon the conclusion of both insolvency and winding-up proceedings.

The general principle applies in accordance with the Act on Bankruptcy etc. that recognised claims are to be paid in full or in part, as justified by the circumstances, as promptly as possible and thus the estate’s assets will be distributed to those parties with legitimate claims against the insolvent estate concerned. The conclusion of winding-up is not a premise for payments. This shall not, however, be done unless funds are at the same time set aside to fully cover payment of conditional or disputed claims which could enjoy the same or higher priority in ranking; their payment shall then be made, as the case may be, as soon as the condition is satisfied or disputes are resolved.

The provisions of the second paragraph of Art. 156 of the Act on Bankruptcy then state that upon conclusion of payment as referred to in the first paragraph of Art. 156 the administrator may pay all creditors ranking next in priority towards the distributions

expected to be made to them, while still taking care to set aside funds for conditional or disputed claims which could enjoy the same priority.

From the provisions quoted, it should be clear that the Winding-Up Board has little room to manoeuvre in making distributions to creditors, even though the provisions of the Act on Financial Undertakings give it some leeway as to when distributions are to take place. It is evident that Winding-Up Boards are restricted by the provisions of Art. 156 of Act No. 21/1991 to making distributions to creditors based on their ranking in priority. It is not authorised, according to the provisions of Art. 156, to make distributions to creditors whose claims are of lower priority unless all recognised claims of higher priority have been paid and sufficient funds set aside for the payment of disputed and conditional claims. The Winding-Up Board therefore would not be authorised to make distributions to those creditors holding general claims unless all recognised priority claims had been paid and funds set aside for disputed and conditional claims ranked equally in priority.

The Winding-Up Board can also, according to the provisions of Art. 103 a of the Act on Financial Undertakings, conclude winding-up proceedings in the manner stated in the Article if payment of all recognised claims against the financial undertaking has been completed and, as appropriate, funds set aside for payment of disputed claims.

The principle is therefore clear – distributions may not be made to creditors with claims of lower priority unless those creditors ahead of them in priority have previously received full payment.

In other words, the priority of creditors' rights according to their ranking is a rule without exception which is clearly stated in both the Act on Bankruptcy and the Act on Financial Undertakings. If the Winding-Up Board were to make distributions to creditors without complying with the above requirements, the Winding-Up Board could be liable if the result was that distributions were made to creditors of lower priority while creditors of higher priority did not receive full payment of their claims.

c) Obligation to set aside funds to cover conditional and disputed claims

As previously mentioned, payments are be made to creditors as provided for in the Act on Bankruptcy insofar as the Act on Financial Undertakings does not provide otherwise. In both of these Acts it is stated that, if distributions are made, whether in full or in part, funds must be set aside to cover conditional and disputed claims.

It is clear from these legal provisions that the Winding-Up Board of a financial undertaking is obliged to set aside sufficient funds to pay in full conditional and disputed claims. In this connection the Winding-Up Board must consider all those claims which have been lodged and which are either conditional or disputed. There is no authorisation in law for the Winding-Up Board to decide to set aside a lower amount, for instance, due to claims which may have been lodged in duplicate, etc. The obligation of the Winding-Up Board is clear according to the law, which provides for the Board to assume that all claims could be upheld, since if this were to prove to be the case and a distribution had been made as a result of which insufficient funds remained to pay such claims, the Winding-Up Board,

which was supposed to ensure that sufficient assets were set aside to pay such claims, could be held responsible.

It should be reiterated that the newly adopted amendments to the Act on Financial Undertakings provide the Winding-Up Board with broader authorisation to make distributions also to creditors where the Board's decision on their claims is disputed. The following two sentences were added to the sixth paragraph of Art. 102 pursuant to this amendment:

> "If the Winding-Up Board avails itself of the authorisation in accordance with the above to pay claims in part or in full, although a dispute on recognition of a claim which could rank equally in priority, has not been resolved, the Winding-Up Board shall deposit in a special escrow account an amount equivalent to payment of the claim or towards it representing its maximum amount according to the claim of the creditor in question. Once a final outcome has been obtained in the dispute the balance on the escrow account, together with accrued interest, shall be paid to the creditor insofar as its claim has been recognised, while any remaining funds in the account shall be returned to the financial undertaking.

Here the obligation is placed on the Winding-Up Board in making distributions to creditors to make distributions also to creditors holding disputed claims of equal priority. However, it is clear according to the above that sufficient funds must be placed in the said escrow account to enable full payment to be made towards the claim in equal proportion to that paid to equally ranked creditors with recognised claims.

Furthermore, it is important to examine whether the Winding-Up Board of a financial undertaking is only authorised to set aside monies to cover conditional and disputed claims and, as the case may be, claims with higher priority, i.e. whether it is authorised to retain non-cash assets, such as real estate or as the case may be other assets which the financial undertaking may own, although from the above-mentioned amendment to the sixth paragraph of Art. 102, it can be concluded that funds set aside in connection with distributions to creditors holding disputed claims must always be in cash, since any other means of payment cannot be deposited into an escrow account.

The Winding-Up Board's obligation in distributing the assets of a financial undertaking in winding-up proceedings is clear according to the authorisation in the sixth paragraph of Art. 102 of the Act on Financial Undertakings; it must set aside funds which are sufficient to pay equally ranked claims which have not been finally rejected, as well as to set aside payment for claims of higher priority if they have not already been paid. Should the Winding-Up Board fail to respect this obligation, or should the value of those assets set aside fail to cover payments to creditors, this could as the case may be result in the liability of the Winding-Up Board if it results in a loss to creditors who would otherwise have received payment.

IV.
Making partial distributions by a financial undertaking in winding-up proceedings

a) There are no statutory provisions on how distributions should be made to creditors during the winding-up of a financial undertaking.

The main principle of insolvency law, cf. Art. 156, is that recognised claims shall be paid, in full or in part, as justified by the circumstances, as promptly as possible. This principle is furthermore included in the sixth paragraph of Art. 102 of the Act on Financial Undertakings, where the Winding-Up Board is authorised to commence payment of recognised, as well as disputed, claims following the first creditors' meeting after the expiration of the time limit for lodging claims. However, the difference must be acknowledged between the role of administrator of an insolvent estate and that of the Winding-Up Board of a financial undertaking, with regard to the obligation to realise the value of the assets of the party concerned. Because the winding-up of a financial undertaking can be so complex and extensive, and because of the enormous interests which are at stake, the Winding-Up Board is granted additional time to maximise the value of the financial undertaking's assets, guided by the interests of its creditors.

There are no provisions in the Act on Financial Undertakings as to how distributions as provided for in the sixth paragraph of Art. 102 should be arranged and therefore it must be assumed that the Act on Bankruptcy shall apply where instructions are lacking in the Act on Financial Undertakings. Although the provision of Art. 156 admittedly provides for making payment to those creditors who hold recognised claims as promptly as possible, the Act on Bankruptcy only provides for an administrator to prepare a proposal for distributions upon the conclusion of administration and the Act actually provides for the proposal for distributions to include in effect the final accounts of the insolvent estate concerned.

Similar perspectives obviously do not apply without alteration in the case of winding-up of financial undertakings.

Making distributions pursuant to the sixth paragraph of Article 102 of the Act on Financial Undertakings.

If regard is had for the Act on Bankruptcy etc. as well as judicial practice in Icelandic insolvency law, the conclusion is to use the rules of the Act on Bankruptcy as a basis in drafting a proposal for distributions and prepare a sort of provisional proposal, which is subject to the same rules as a traditional proposal for distributions from an insolvent estate. Creditors are thereby given the opportunity to comment upon the proposal and seek the assistance of the courts, as appropriate, if they do not wish to accept the measures of the Winding-Up Board as manifest in the proposal.

In view of the interests at stake, the large number of creditors and the large number of disputes which have resulted from winding-up of the Icelandic financial undertakings, however, it appears evident that every effort must be made to ensure equal treatment of creditors both with regard to distributions to creditors and the requirement set that

intentions concerning such actions be comprehensively publicised to all creditors and that they be given an opportunity to comment on them.

b) Provisional proposal for distribution drafted having regard for general rules of the Act on Bankruptcy etc.

The provisions of Art. 158 of the Act on Bankruptcy apply concerning what must be included in a proposal for distribution. According to the Act, the following information shall be included in a proposal for distribution:

a) a statement of the estate's assets, indicating the original amount of cash, amounts obtained for individual assets, collected on claims, acquired as dividends or interest, etc.;
b) a statement of the cost of winding-up and other expenses borne by the estate, and any payments made towards claims as referred to in the first paragraph of Article-156;
c) a statement of any assets not yet subject to distribution and funds provisionally set aside, cf. Article-157;
d) the amount to be paid to each creditor who has not already been paid in full and the amount each of them may have previously received towards their claims.

After examination of these points, information can be added and, as the case may be, substituted as appropriate in the case of distributions made by a financial undertaking in winding-up proceedings, cf. the sixth paragraph of Article 102 of the Act on Financial Undertakings.

Where there are no legal provisions on making distributions to creditors according to the sixth paragraph of Art. 102 of the Act on Financial Undertakings, the void can be filled by using the provisions of the Act on Bankruptcy as a basis. Based on those provisions, the preparation of such a provisional proposal and implementation of distributions to creditors as referred to in the sixth paragraph of Art. 102 of the Act on Financial Undertakings can be expected to be roughly as described below.

The following information at least can therefore be deemed to be required in such a provisional proposal for distribution:

a) a statement of the asset position of the financial undertaking. A statement of the financial undertaking's assets, indicating the amount of cash, amounts obtained for individual assets of the financial undertaking which have already been disposed of, amounts already collected on claims, acquired as dividends or interest, etc.;
b) a statement of assets which have not been realised in cash and their proposed handling. Furthermore, an account shall also be provided of assets which have not been realised in cash and are therefore not yet available for distribution, together with the Winding-Up Board's plans for disposal of these assets;
c) a statement of the cost of winding-up. A summary of cost and other expenditure which has already been incurred in the winding-up proceedings and which the

financial undertaking has had to bear. Furthermore, the Winding-Up Board shall publish a budget providing a realistic picture of the cost which the winding-up proceedings can be expected to cost, since the Winding-Up Board must ensure that sufficient assets remain to cover such expenses, as well as to pay all other equally ranked claims which have not been finally rejected in the winding-up, cf. the sixth paragraph of Article 102 of the Act on Financial Undertakings;

d) a statement of assets which have been set aside to cover conditional or disputed claims. A statement of assets or cash which has been set aside provisionally to cover conditional or disputed claims, as referred to in Art. 103 a of the Act on Financial Undertakings, cf. Art. 156 of the Bankruptcy Act;

e) a statement of payments to creditors. A statement of the amount to be paid to each creditor according to the proposal, together with information as to the amount each of them may previously have received as provided for in the sixth paragraph of Article 102 of the Act on Financial Undertakings, cf. Art. 156 of the Act on Bankruptcy, if distributions have previously been made in this manner.

The provision of Art. 159 of the Act on Bankruptcy concerns the convening by the administrator of a creditors' meeting to discuss the proposal. Having regard for the issues of contention which exist concerning the winding-up of financial undertakings in Iceland, it is suggested that the convening of a creditors' meeting to take a decision on the provisional proposal would have to be done in the following manner.

Once the Winding-Up Board has prepared a provisional proposal for distribution, the Winding-Up Board will convene a creditors' meeting to discuss the proposal with an advertisement published in the *Legal Gazette* and in foreign media as appropriate in those states where there are known creditors. The advertisement must state the purpose of the meeting, that creditors will be able to obtain the proposal from the financial undertaking's website or, as appropriate, a website for the winding-up proceedings, during the last two weeks prior to the creditors' meeting and acquaint themselves with its contents. This proposal unamended can be expected to form the basis of a preliminary distribution if no objections are raised to it. The Winding-Up Board shall furthermore publish an announcement to this same effect in a conspicuous location on the financial undertaking's website or, as appropriate, on the website of the winding-up proceedings.

At the creditors' meeting which is to discuss the provisional proposal for distribution, as provided for in the sixth paragraph of Art. 102 of the Act on Financial Undertakings, the Winding-Up Board shall present such a proposal and provide such information as requested by those persons attending the meeting. All parties who have lodged claims with the Winding-Up Board which have not been finally rejected shall be entitled to attend the meeting, cf. Art. 125 of the Bankruptcy Act.

If those parties who have lodged claims against the financial undertaking do not raise objections to the proposal referred to in the sixth paragraph of the Act on Financial Undertakings, at the creditors' meeting, it shall be deemed to be finally approved on their part, whether they have attended the meeting or not. The Winding-Up Board shall then

add to the proposal a statement that it has been approved as a legal basis for a preliminary distribution of the financial undertaking's assets.

If objections are raised at the creditors' meeting to the provisional proposal for distribution as referred to in the sixth paragraph of Art. 102 of the Act on Financial Undertakings, concerning points which the creditor concerned has not already lost the right to object to, the Winding-Up Board shall demand that the party raising objections state what amendments it wishes to make to the proposal.

If only amendments which the Winding-Up Board sees cause to accept are requested, the Winding-Up Board may amend the proposal accordingly and conclude the matter, if only obvious or insignificant discrepancies are corrected, or if the creditors' meeting is attended by half of all parties affected by the amendment and they approve it. If this cannot be done the Winding-Up Board shall convene a new meeting in the same manner, where the proposal will be presented with those amendments agreed to by the Winding-Up Board.

If the Winding-Up Board does not see cause to agree to creditors' objections and their proposals for amendments to the provisional proposal for distribution, the Winding-Up Board shall call a meeting with the creditors concerned by the objections, if they are not present at the creditors' meeting, and seek to resolve the disagreement. If disagreement cannot be resolved, the Winding-Up Board shall refer the question to the District Court, as provided for in Art. 171 of the Act on Bankruptcy. Once the dispute has been resolved by the court, the Winding-Up Board shall prepare a new provisional proposal for distribution and convene a meeting to discuss it, unless the courts have upheld the Winding-Up Board's position, in which case the previous provisional proposal is deemed to be finally approved.

c) Advantages and possible disadvantages in practice

It is clear that enormous interests are at stake and therefore it is necessary to examine both the advantages and disadvantages thoroughly before undertaking a distribution to creditors on the above-mentioned premises.

Firstly, the provisions of the Act on Bankruptcy etc. are used to supplement the authorisation granted to the Winding-Up Board to make payment to creditors in the sixth paragraph of Article 102 of the Act on Financial Undertakings. The Winding-Up Board is responsible for actions it takes and, should the implementation turn out to be flawed, or if the courts decide that the Winding-Up Board's interpretation of the Act on Bankruptcy was not correct, it could result in the liability of those members of the Winding-Up Board who decide to undertake such measures.

Secondly, this could comprise a protracted and drawn-out process, which would take a considerable amount of time. The creditors' meeting needs to be advertised and the content of the proposal needs to be reliably presented to all creditors, since they are entitled to acquaint themselves with its contents. Since there are a significant number of creditors involved, in a large number of states, the slightest defect could result in some creditor feeling disadvantaged. This could, furthermore, result in the liability of the

Winding-Up Board if the distribution carried out in this manner resulted in a loss to a creditor.

In the third place, creditors' rights to object to the measures proposed by the Winding-Up Board need to be ensured. Creditors' objections need to be presented no later than at the creditors' meeting to discuss the proposal, cf. Art. 128 of the Bankruptcy Act.

Fourthly, the Winding-Up Board's obligation to set aside sufficient assets to cover all unpaid claims of a priority higher than or equal to those receiving a distribution presents certain problems. It implies that sufficient assets need to be set aside to pay claims of higher priority and to cover the cost of winding-up, as the cost of winding up enjoys the status of claims for the administration of the estate, as referred to in Art. 110 of the Act on Bankruptcy. The Winding-Up Board therefore has to estimate what the final cost of the winding-up proceedings will be before undertaking a distribution to creditors. This could obviously involve some difficulties when the conclusion of the proceedings is as yet undetermined and unforeseen cost could arise in the operations of the financial undertaking. In drafting the provisional proposal for distribution the Winding-Up Board will have to account for this estimated expenditure.

Finally, the Winding-Up Board has to decide whether those legal provisions which apply to the winding-up of financial undertakings authorise payment to creditors in a form other than cash. In this connection the difference must be reiterated yet again between the winding-up of financial undertakings and traditional insolvency proceedings, that the Winding-Up Board does not have the same obligation as the administrator in insolvency to realise assets immediately but rather has certain authorisations to wait if the Winding-Up Board deems this a more cost-effective option. The general principle which derives from the Act on Bankruptcy is that a distribution shall be made in the form of cash after the administrator has realised the assets of the estate. However the possibility of making payment to creditors by other means of payment than cash is not excluded, although this involves a certain risk for the Winding-Up Board. If certain creditors are paid in equities or bonds, to take an example, then this raises questions of discrimination among creditors. If those assets used as payment fall in value, then the creditors who have accepted them could consider themselves disadvantaged. Similarly, creditors who do not receive payment in the form of such assets could regard themselves as cheated if the development is the opposite, i.e. if the assets rise in value. In this connection, it is necessary to tread carefully and arrange matters so as to ensure non-discrimination among creditors and enable all creditors to become involved in such non-traditional plans. The approval of a lawfully convened creditors' meeting must be ensured, and a special agreement even drafted with creditors receiving payment by other means, in particular, in the case of risky assets and where their ownership involves risk, such as equities. It would therefore be advisable to state clearly in such an agreement that the parties have agreed to accept such non-traditional payment and will furthermore bear any losses in the value of the asset concerned if developments are in this direction.