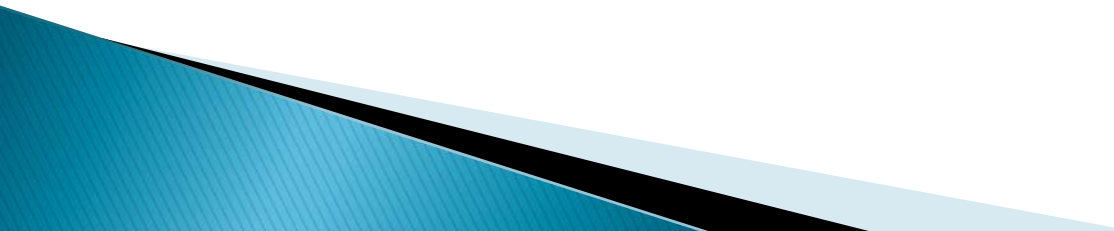
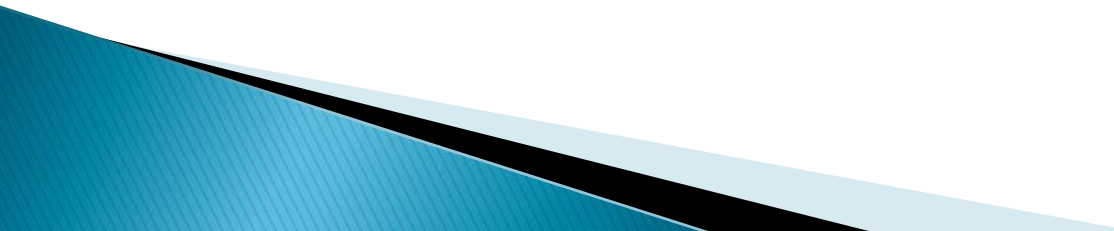


Protecting Creditors of Insolvent Banks

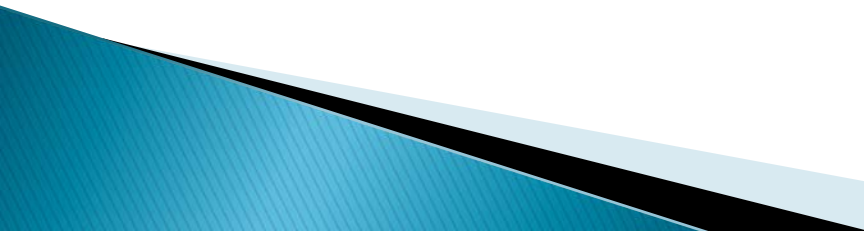
How should the rights of different types of creditors be best managed?

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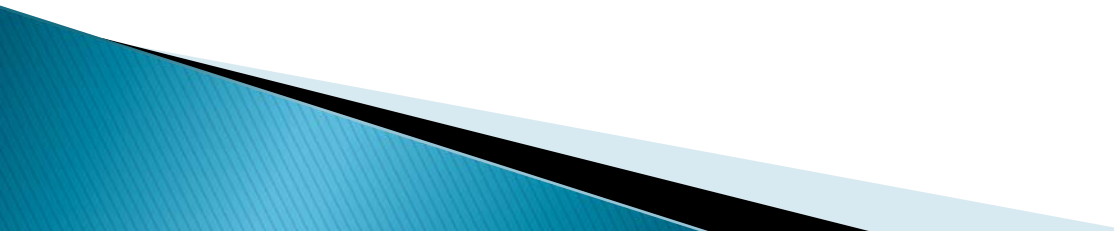
Who are the creditors?

- ▶ Depositors – in most countries will receive some form of preferential treatment
 - ▶ Others – usually no specific protection provided
- 

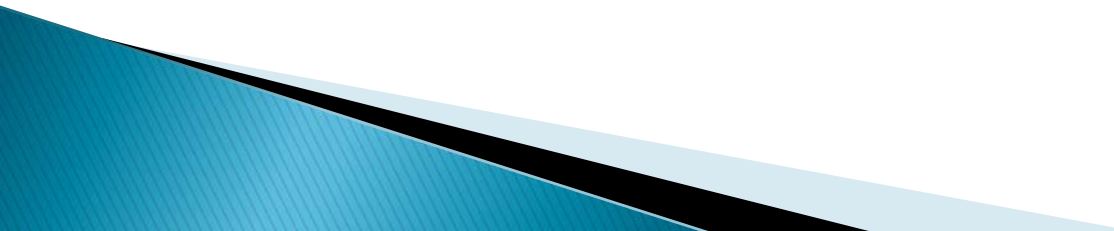
Protecting depositors

- ▶ The legal status of bank depositors
 - ▶ Unsecured creditors – see *Foley v Hill* [1848]
 - ▶ Last in line if bank becomes insolvent
 - ▶ Problems with this? Social, political, economic and legal
 - ▶ Most jurisdictions have, at various times, provided some form of special treatment for bank depositors
- 

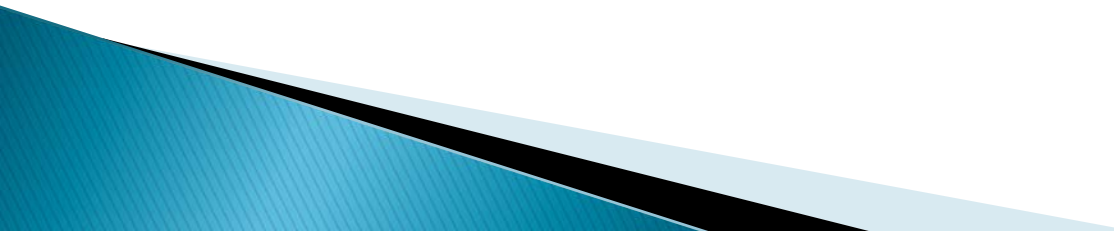
Special treatment

- ▶ Priority on insolvency
 - ▶ Government intervention – ranging from implicit guarantees to depositor protection schemes
 - ▶ What effect has the recent financial crisis had?
- 

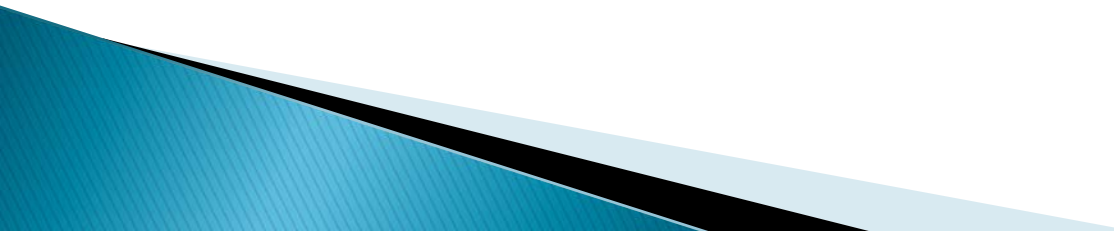
Deposit insurance

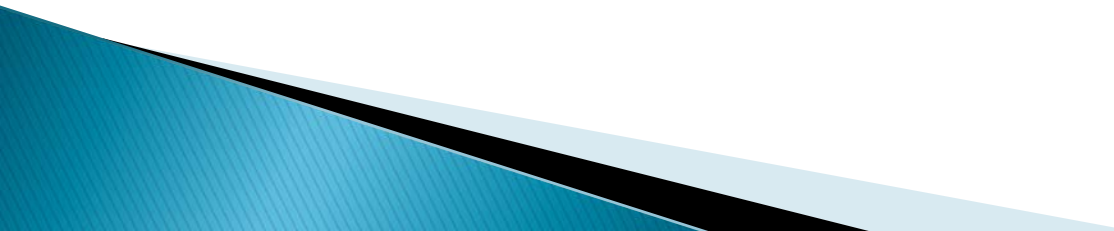
- ▶ Now very common to have explicit/limited deposit insurance schemes
 - ▶ Many countries have introduced these recently and some are in the process of reforming existing schemes
 - ▶ What about deposit insurance and the recent crisis?
- 

DI – some issues

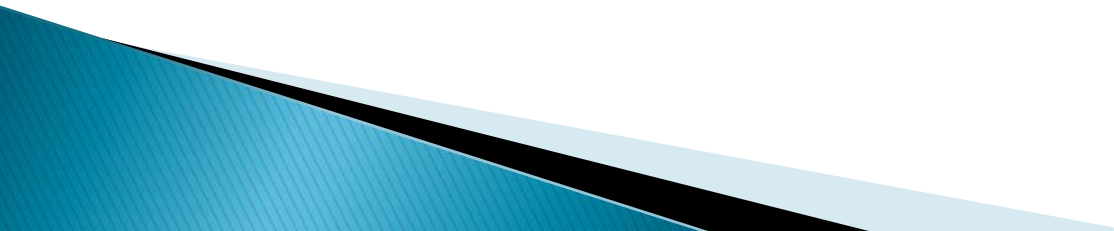
- ▶ How much cover to provide?
 - ▶ Who should receive protection? Individual consumers? Business customers?
 - ▶ What about co-insurance?
 - ▶ Funding – ex ante or ex post?
 - ▶ The role of the deposit insurer?
- 

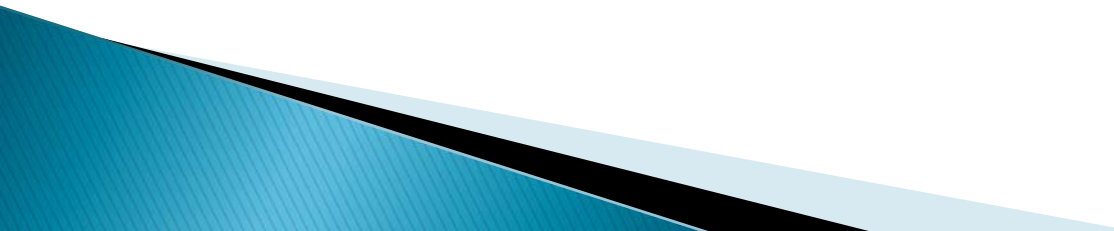
Other creditors

- ▶ Individual depositors above the DI level
 - ▶ Customers with other products which do not come within the scope of DI
 - ▶ Business customers
 - ▶ Public bodies e.g. Local authorities, universities etc.
 - ▶ Business creditors e.g. Suppliers
- 

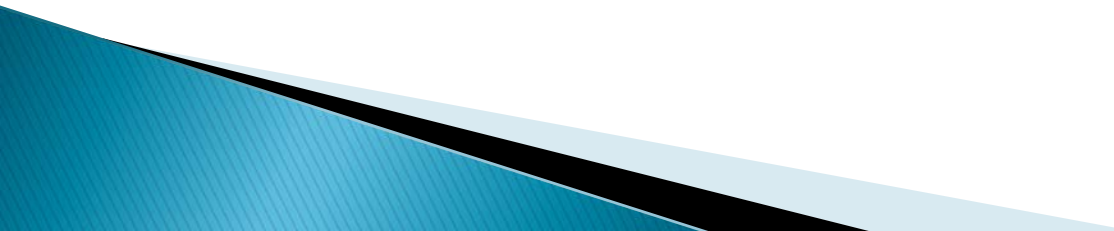
- ▶ Other banks
 - ▶ The deposit insurer – subrogated claim when payout has been made
 - ▶ The central bank – where a bank has borrowed via discount window or ELA (LOLR)
- 

Legal status

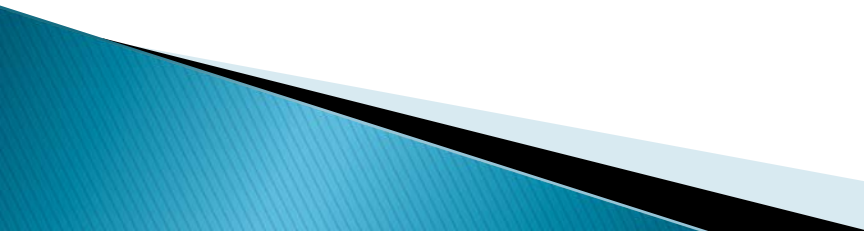
- ▶ All of these will normally be unsecured creditors and therefore at the end of the queue of creditors for payment
 - ▶ The exception is likely to be the central bank which will normally only provide liquidity against security (see for example the special liquidity scheme in United Kingdom)
- 

- ▶ Where a country does not have a deposit insurance scheme it is quite possible that depositors, up to a specified limit, will be given priority over other creditors
 - ▶ So most creditors who do not fall within the limits and eligibility of a deposit insurance scheme will receive no particular protection
- 

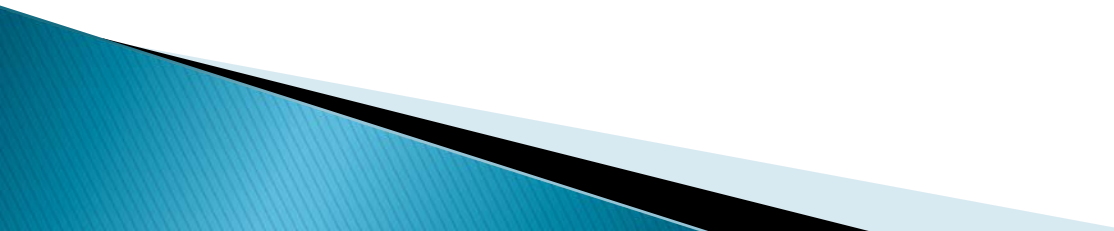
How to protect creditors?

- ▶ Effective regulation/supervision
 - ▶ Capital adequacy
 - ▶ Liquidity adequacy – including central bank assistance
 - ▶ Risk management strategies
 - ▶ Effective bank insolvency law framework
- 

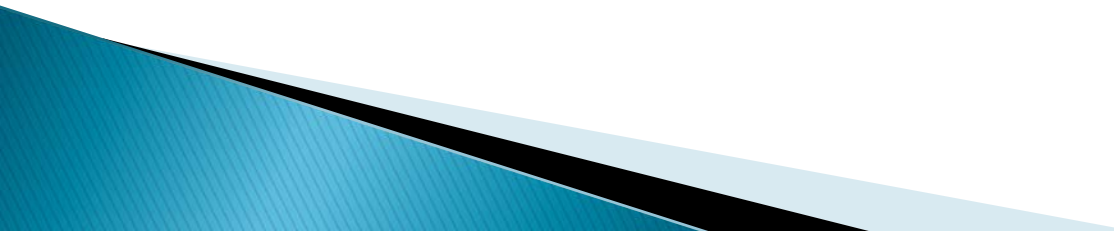
The Position up to February 2009

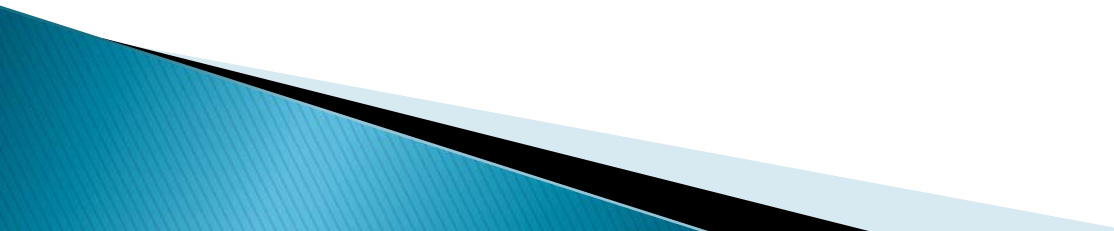
- ▶ First, the former UK position
 - ▶ Banks subject to the general corporate insolvency legislation
 - ▶ FSMA 2000
 - ▶ Administration orders – Barings Bank and now Lehman Brothers (UK) and London & Scottish. Why not NR?
 - ▶ Liquidation
- 

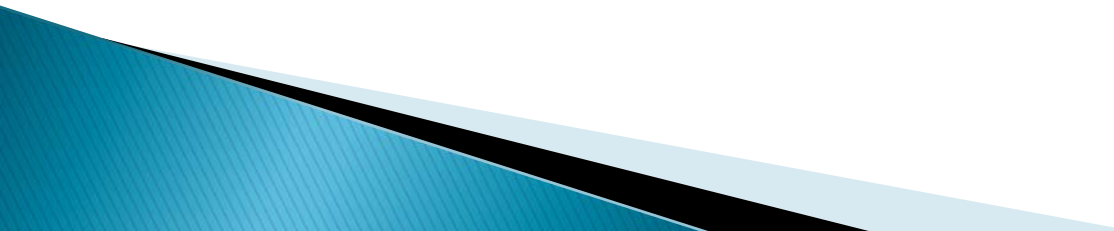
Banking Act 2009

- ▶ This came into force in February
 - ▶ Introduced special resolution regime for banks
 - ▶ UK bank insolvency law for the first time
 - ▶ Creates an environment where prompt corrective action can be taken by the authorities
 - ▶ Allows a quick strike
- 

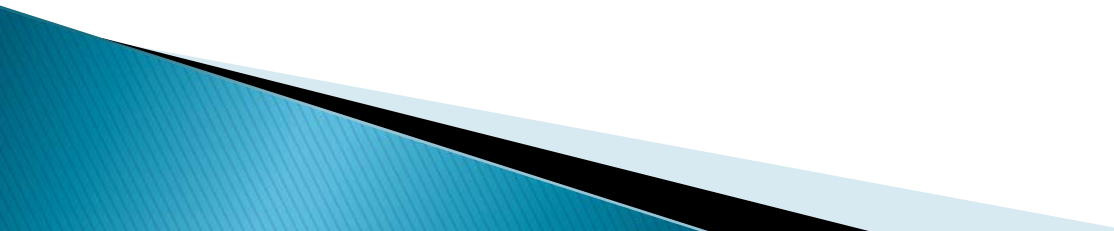
Objectives

- ▶ To protect & enhance stability of UK financial systems
 - ▶ To protect and enhance public confidence
 - ▶ To protect depositors
 - ▶ To protect public funds
 - ▶ Ensuring continuity of banking services?
 - ▶ Also an objective but do the proposals make this more likely?
- 

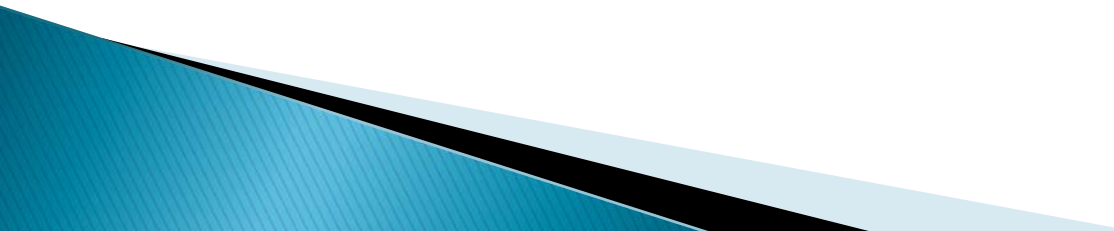
- ▶ No mention in in the objectives about protecting creditors other than depositors
 - ▶ Why is this?
 - ▶ But will the new framework achieve a better deal for creditors?
- 

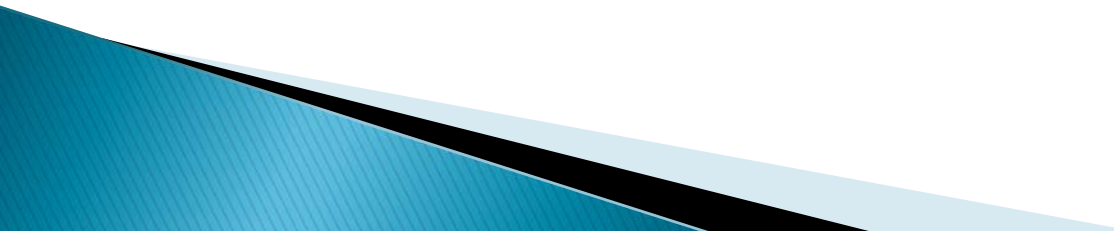
- ▶ It is arguable that this new piece of legislation, with the special resolution regime for banks, should, if operated effectively, provide significant protection for bank creditors
 - ▶ Why is this? The authorities are given power to act quickly and without court involvement
 - ▶ Can intervene at an early stage
- 

Concluding Observations and Questions

- ▶ Northern Rock crisis was handled poorly (ex ante and ex post)
 - ▶ reassuring that action has been taken to strengthen the financial sector safety net
 - ▶ Recognition of the need for a better bank insolvency law framework
- 

Some Matters of concern

- ▶ How will the authorities work together?
Problematic in Northern Rock
 - ▶ Division of labour – is this set out in sufficient detail?
 - ▶ Is the SRR trigger point appropriate?
- 

- ▶ SRR marks a culture shift
 - ▶ Possibility of a pre-emptive strike by the authorities in an attempt to ensure that banks are subjected to remedial action before the point of formal insolvency has been reached
 - ▶ This has to be of potential benefit to all creditors
 - ▶ This can be done without court involvement – is this likely to be controversial?
- 

Conclusions

- ▶ Where do we go from here?
 - ▶ How do we get back to some sort of normality?
 - ▶ What is 'normal'?
 - ▶ When was 'normal'?
- 