

*RESOLUTION METHODS FOR
CROSS-BORDER BANKS IN THE
PRESENT CRISIS*



David G Mayes

University of Auckland

OBJECTIVE

- We now have the first evidence of what ~~techniques authorities use when resolving cross-~~border banking problems
- Do they overturn the previous theory?
- This paper reviews the experience and reflects on what this implies for better policy in future
- Focus is only on banks that are of systemic importance in at least one country
 - i.e. vital functions have to be kept operating
 - Simple insolvency creates a crisis

NO SURPRISES

- **Outcome only straightforward if**
 - Home country handles the problem
 - Bank readily divisible into functioning national parts
(legal and operational requirement)
 - Open bank assistance favoured
 - Home country large compared to bank
 - Early intervention possible
 - Legal certainty from special resolution regime
- **Same principles for efficient and effective resolution apply as for domestic banks**

CASES




- **Lehman Brothers**
- **Dexia**
- **Fortis**
- **Icelandic banks**


CASES

- **Lehman Brothers**
 - **Dealt with by US - failure caused major contagion round the world (surprise)**
 - **Not a bank so insolvency not SRR**
 - **Many parts successfully purchased (Barclays, Nomura)**
 - **Major investment banks now inside banking regime**
 - **Global entities need global treatment**
- **Dexia**
- **Fortis**
- **Icelandic banks**

CASES

- **Lehman Brothers**
 - **Dexia**
 - **Capital injection by public sector stakeholders – i.e. resolved before reaching failure**
 - **(would have been ideal if they had been private sector)**
 - **Fortis**
 - **Icelandic banks**
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CASES

- **Lehman Brothers**
 - **Dexia**
 - **Fortis**
 - **Initial attempt via 49% investment, in effect in respective national parts**
 - **Nationalisation of Dutch parts led to control and partial resale by Belgium of theirs (not holding company) Belgian discontent as impaired group assets in Belgium**
 - **Businesses still divisible not integrated group**
 - **Still being challenged by shareholders – led to fall of Belgian government, Dutch state aid under EU investigation**
 - **Need SRR**
 - **Icelandic banks**
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CASES

- **Icelandic banks – Glitnir, Kaupping, Lanðsbanki**
 - Only domestic operations rescued by home country; foreign branches/depositors left out, DI insufficient funds to pay out
 - Needed special law to permit govt takeover (Passed in 1 day)
 - Ring fencing branches unpleasant – UK used unfortunately named Anti-terrorism, Crime and Security Act 2001
 - Host countries effectively have ‘loaned’ home funds for depositor payout
 - IMF rescue of country + Nordic loans
 - Subsidiaries easier but foreign branches of subsidiaries a problem; IOM cannot afford full DI payout - £500mn locked up in UK insolvency proceeding
 - Finland did deal with FME so 3 Finnish banks could take over deposits (100mn legal risk insurance against other claims on collateral)

CASES

- **Icelandic banks – Glitnir, Kaupping, Landsbanki**
- **implications**
 - Rules need to change over branches (home/host)
 - Home country must be able to cope (DI credible)
 - SRR needed
 - Ring-fencing, whether ex ante or real time is needed but contentious

TECHNIQUES APPLIED

- **For key functions to be maintained, parts of bank have to keep operating without a material break**
 - Open bank assistance (loans, preferential shares, guarantees)
 - Nationalisation
 - Assisted break up and transfer
- **Not bridge banks**
 - But bridge bank successfully applied to
 - Indy Mac (US) \$32bn assets
 - Dunfermline Building Society (UK) more time needed for sale of part

IMPLICATIONS FOR REFORM

- **UK change to SRR is right answer**
 - **Need resolution agency with powers to**
 - **Transfer to private sector purchaser**
 - **Transfer to a bridge bank**
 - **Transfer to temporary public ownership**
 - **Need to be able to transfer shares, property, rights, liabilities, without triggering close out clauses and without ability of shareholders to contest – need right to sue after if badly priced**
 - **Act early before all value is eroded**
- **Legal framework for ring fencing has to be compatible**

HOW CAN CROSS-BORDER ASPECTS BE HANDLED?

- **Ex ante removal of most conflicts – legal and operational separation of systemic entities**
 - Australia-New Zealand solution (but not yet used in practice) – still some problems: name, key cross group services
 - Safety net must work for parts that can be closed
- **Is there another structure?**
 - Higher level resolution authority? Equivalent of FDIC – what is minimand? Not simple cost to fund
 - Cooperation and harmonisation of tools and powers?

HOW CAN CROSS-BORDER ASPECTS BE HANDLED?

- **Ex ante removal of most conflicts – legal and operational separation of systemic entities**
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 - **Higher level resolution authority? Equivalent of FDIC – what is minimand? Not simple cost to fund**
 - **Cooperation and harmonisation of tools and powers?**
 - **Long way away from it - CEBS review of position shows huge variation; Garcia-Lastra-Nieto (2008); BIS Cross-border group helpful review of issues and problems to focus on; de Larosière mentions it as area for action but not in their framework**
 - **In short run each college will have to come to its own conclusion – problem of mixture of supervisors and resolvers – not a clear incentive structure**

KAY (2009)



‘The likely outcome of present discussions is that everyone will agree they will regulate better and that there should be more co-operation between national regulators. This might prevent anything like the Icelandic problem occurring again. It is more likely that the tooth fairy will agree to provide compensation for future bank failures.’