

BANKRUPTCY AND REORGANIZATION PROCEDURES FOR CROSS-BORDER BANKS IN THE EU

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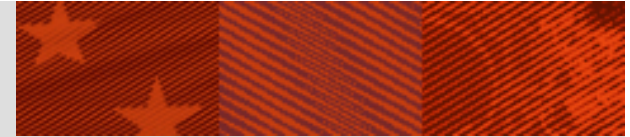


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OUTLINE



- Motivation
- What should the objectives of the policy maker be in the banks' reorganization and winding up?
Review of the literature
- Does the existing EU institutional framework guarantee those objectives?
- Conclusions



Policy Challenges in the Financial Sector:

Provide necessary public support for resolution of distressed assets and recapitalization

... Viable banks should then be quickly recapitalized, with public money if necessary. Insolvent institutions (with insufficient cash flows) should be closed, merged, or temporarily placed in public ownership until private sector solutions can be developed.

***Global Economic Policies and Prospects
Note by the Staff of the International Monetary Fund
G-20 Meeting of the Ministers and Central Bank Governors
March 13–14, 2009
London, U.K.***

MOTIVATION



- First, it assesses the economic efficiency of the institutional framework defined by the Reorganization and Winding-Up Directive (2001/24/EC) in light of the relevant literature
- Second, it explores areas of coordination with other EU directives that also deal with relevant aspects in the bank financial crisis management
- Third, identifies aspects that can hamper efficient cross-border bank resolutions, on which policy makers should focus at the time of reforming the present framework.

MOTIVATION

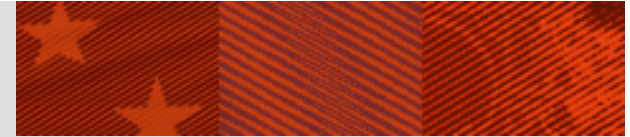


- Under a threat to the systemic stability, EU Ministers of Finance committed to the recapitalization of sound “*vulnerable systemically relevant financial institutions*”
- However, in this new environment, it should still be possible that cross-border banks may be reorganized and/or wound up

OUTLINE



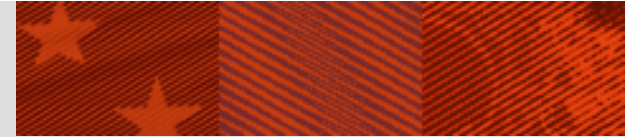
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A REVIEW OF THE LITERATURE

- What should the objectives of the policy maker be in the banks' reorganization and winding up?
 - Efficient resolution “the sum of their aggregate credit to and liquidity losses is at, or close to, zero.” (Kaufman , 2004)
 - The public policy objective of resolving banks should be to reduce costs (public and private) and permit free entry and exit of failed banks at minimal cost to society (Eisenbeis and Kaufman,2006)

A REVIEW OF THE LITERATURE



- What should the objectives of the policy maker be in the banks' reorganization and winding up ?

- Two legal approaches for dealing with banks in crisis (Hüpkes, 2003):

- *Lex generalis* (general insolvency law with exceptions)

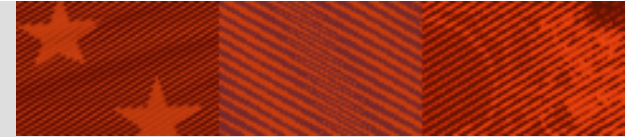
- * "Rush to the exit" that bankruptcy attempts to avoid (Bliss, 2007)

- *Lex specialis* (special laws designed for banks, which still may include some involvement of the courts of Justice in the actual insolvency procedures)

- * Recognizes the informational superiority of PS ...confidence in the banking system

- The main obstacle to achieving major progress towards the international harmonization of bank insolvency laws as deciding whether to utilize a "special resolution regime" or a general bankruptcy law (Campbell, 2003).

A REVIEW OF THE LITERATURE



- What should the objectives of the policy maker be in the banks' reorganization and winding up?
 - **Recent challenge: systemically important non-bank institutions**
 - *Should the safety net be extended beyond banks to other systemically important financial institutions?*
 - *Should they also be subject to a "lex specialis" that would allow for the efficient management of their reorganization and winding up?*

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DOES THE EXISTING EU INSTITUTIONAL FRAMEWORK GUARANTEE THOSE OBJECTIVES?

- **Directive 2001/24/EC:**

Objectives are rather narrow: *“elimination of any obstacles to the freedom of establishment and the freedom to provide services within the Community”* (Preamble)



DOES THE EXISTING EU INSTITUTIONAL FRAMEWORK GUARANTEE THOSE OBJECTIVES?

- **What Directive 2001/24/EC does?**

- It ensures mutual recognition and co-ordination of these procedures by the Member States, based upon the principle of home-country control
- It embraces the principles of unity and universality, single entity approach to liquidation, and the equal treatment of creditors ([Campbell, 2003](#), [Hadjiemmanuil, 2005](#) and [Nierop and Stenström, 2002](#))



DOES THE EXISTING EU INSTITUTIONAL FRAMEWORK GUARANTEE THOSE OBJECTIVES?

•What Directive 2001/24/EC does not do?

- Harmonize national legislation concerning re-organization measures and winding-up proceedings
- Harmonize the authority (administrative or judicial) and the grounds that trigger the reorganization and winding up procedures
- Define a common rule of bank closure
- Establish the obligation to inform third parties (OJ of the EU)
- Have a group-wide approach to winding up and reorganization
- Have a consistent approach with the other two safety net regulators: prudential supervision, and deposit insurance...particularly relevant when reorganization /winding up authorities excluded from 2008 MoU



DOES THE EXISTING EU INSTITUTIONAL FRAMEWORK GUARANTEE THOSE OBJECTIVES?

The Directive is neither particularly aimed at preserving EU financial stability nor at limiting public and private costs of cross border banks crisis resolution

DOES THE EXISTING EU INSTITUTIONAL FRAMEWORK GUARANTEE THOSE OBJECTIVES?



Table : Coordination between supervision, deposit insurance and crisis resolution

Issue	Capital Requirement Directive	Reorganization and Winding Up Directive	Deposit Insurance Directive
Scope	Branches and subsidiaries	Branches	Branches
Coordination of regulators	"Colleges" (home and host country supervisors)	No "colleges". Resolution authorities act independently from each other and from supervisors. Implicit via principles of unity, universality and single entity (applies only to branches).	No "colleges". Deposit insurers act independently from each other and from resolution authorities.
Information sharing	Information sharing within colleges is subject to minimum requirements, including formats.	Bilateral obligation to inform to Member States' prudential supervisors of branches, but is not specific about the time, format and means.	No obligation to share information, but there is a need to inform depositors.
Time of Intervention	Defines minimum regulatory capital. (But Pillar 2 lacks a definition of "triggers".)	There is no threshold for the initiation of bank insolvency proceedings.	Compensation is to be paid when a deposit becomes "unavailable."
Coordination of regulatory action	Lack of convergence of supervisory powers and disciplinary actions.	Differences on the definitions; which authority is responsible and the grounds for initiation.	Minimal convergence. There is no requirement for coordination.

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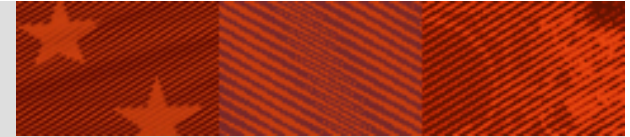
Table: Supervisor's remedial powers as the situation deteriorates

	The Supervisor Can	Needs Government or Court Approval	The Supervisor Does Not	No Information Available
Issue Cease and Desist Orders	27			
Levy Fines and/or Penalties	24 (fines are inconsequential in 3)		3	
Remove Managers	21		6	
Demand stricter capital requirements	25		2	
Require a Remedial Plan	24		3	
Appoint a Special Inspector	20		7	
Prevent Asset Transfers	27*			
Power to Require Shareholders to Support the Institution if Needed with Cash	15	1	12	
Impose Conditions on License	22	3	1	
Restrict Activities/Lending	25		2	
Restrict, Place Conditions on Business	27 (4 only when a breach of legal provisions occurs)			
Restrict Voting Rights	22		5	
Initiate Reorganization /Winding Up	18	1	9	
Appoint Conservator	14	6	5	2
Revoke the License	23	8	3	

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- Need of a **comprehensive approach** to the reform of the reorganization and winding up of cross border banks (ECOFIN acknowledges)
- Priority to **ensuring the convergence of supervisory powers and disciplinary actions** → framework for early intervention by colleges of supervisors based on common triggers (acknowledging limitations in the case of systemic crisis)
- Greater **harmonization of depositor protection schemes** is also warranted and, among other aspects, in relation of their role as resolution agencies

CONCLUSIONS



•The reform of the reorganization and winding Directive should focus, in the short term, on:

- (a) The **broad and clear definition of reorganization and winding up** that encompasses the varied existing procedures;
- (b) The **common definition of bank insolvency** → Trigger the deposit guarantee;
- (c) The inclusion of **subsidiaries** and, possibly, of systemically important investment firms;
- (d) The creation of a **coordinating structure** among resolution authorities and deposit guarantee schemes that would facilitate a coordinated action inclusion in the 2008 MoU;
- (e) **Common and precise information requirements** to host member states (including time limits and common formats) even before the intervention.

CONCLUSIONS

- The reform of the reorganization and winding Directive should focus, **in the medium term**, on:
 - (a) Establishing a "special resolution regime" for cross-border EU banks in which prudential supervisors of the home and hosts countries (colleges) would be heavily involved
 - Confer upon the competent authorities a **wide range of tools** that can be applied with flexibility and regulatory discretion
 - (b) Contemplate the possibility of **delegation** of the host resolution authority (if the scope of the Directive is widened to include the subsidiaries) **to the home country** resolution authority