Conference on Core Principles for Effective Deposit Insurance Systems

Effective Resolution Processes

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Presentation Outline

I. Core Principles

II. Application of Principles

III. Turkish Case

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Effective Resolution Processes (Principle)

Effective Resolution Processes (Principle)

- Effective failure-resolution processes should:

– facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly and accurately and on an equitable basis;

– minimize resolution costs and disruption of markets;

– maximize recoveries on assets; and,

– reinforce discipline through legal actions in cases of negligence or other wrongdoings.

Effective Resolution Processes (Principle)

- In addition, the deposit insurer or other relevant financial system safety-net participant
  - should have the authority to establish a flexible mechanism to help preserve critical banking functions
  - by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank
  - (eg providing depositors with continuous access to their funds and maintaining clearing and settlement activities).

Effective Resolution Processes (Explanation)

- The resolution of troubled banks involves three basic options:
  - liquidation and reimbursement of depositors’ claims (which typically involves the closure of the bank)
  - purchase-and-assumption transactions (sales)
  - open-bank financial assistance

Effective Resolution Processes (Explanation)

- Bankruptcy/insolvency and other laws may heavily influence the choice of resolution methods
  - since such laws vary considerably among countries and,
  - in some cases, may make a particular resolution method difficult to implement.
- Because of the special significance of banks and bank failures, policymakers may wish to review whether bankruptcy/insolvency laws facilitate the orderly exit of troubled banks.
- In this regard, establishing a separate insolvency regime for banks should be considered.

Application of Principles

Minimize Resolution Costs

- Deposit insurer may develop a Least Cost Test (LCT) to determine minimum resolution cost of a bank, using resolution methodologies of liquidation or purchase-and-assumption.
- The LCT is the analysis performed by the resolution authority through comparing all resolution options in order to select the least costly resolution alternative.
- Countries such as USA, Canada have well designed LCT methodology.
- In LCT, an estimate is made of the value of the bank to an acquirer, in terms of quality of asset and whether deposit accounts being value to acquirer and operating expenses of the receiver.
- However, Core Principles requires minimum disruption of markets while minimizing the resolution costs.

Disruption of Markets

- Compliance with the minimum resolution cost may have adverse affect on financial stability cause systemic risk or disrupt the market. Therefore, Special Resolution Exceptions (SRE) should be used.

- Countries such as USA, Canada and Japan have legal regulations identifying the situations for the use of SRE.

- During the recent global financial crisis, some countries used SRE. For instance, nationalization of Northern Rock and the Temporary Liquidity Guarantee Program (TLGP) could be considered within SRE although they were very costly for the government.

Purchase and Assumption Transactions

- Purchase and assumption transaction (P&A) is a sale of banks or banks' asset and liabilities.
- The viable parts of businesses or assets of the bank together with selected liabilities are transferred to another bank. The remaining parts of assets and liabilities are liquidated.
- P&A transactions present benefits such as lower transaction costs and greater flexibility enabling the official administrator to separate the non-viable from the viable operations.

Bridge Bank

- Establishment of a Bridge Bank can be considered as a way of P&A application. The newly chartered bank (Bridge Bank) acquires the good assests, assumes the liabilities and performs the critical functions of a failed bank until a final resolution is accomplished.

- This technique can be appropriate when a P&A cannot be complied in a short time frame and when authorities want to protect crtical banking services. Bridge Bank is managed by the resolution authority.

- The relationships of ex-owners and managers are abolished through chartering the new bank.

- The assets left in the failed bank are liquidated and in most cases uninsured depositors, general creditors, debtholders and shareholders bear the cost.

- Deposit insurers such as FDIC, CDIC and KDIC have the authority to establish a Bridge Bank for the resolution of a failed bank.

Open Bank Assistance

- Open Bank Assistance (OBA) is used when failure of the bank would likely cause systemic problems for the banking system and/or disrupt economic activity.

- Under OBA, capital injection, providing of long term loans, guarantee for the liabilities and sales of non-perfoming loans could be used.

- The use of OBA may cause moral hazard, accountability problems and transparency issues.

- In the recent global financial crises OBA is used for banks.

Cross Border Resolution

- Cross border issues are handled under the subject of deposit insurance and reimbursement process in the Core Principles. Especially the issue of the coordination among the foreign safety net players is emphasized.
- Resolution for cross border banking has limited regulation such as UNCITRAL Model Law (United Nations Commission on International Trade Law), EU Directive 2001/24/EC and MOU's among financial institutions.
- G20 accepted World Bank's "Effective Insolvency and Creditor Right System" as one of the FSB Compendium of Standards .
- FSB established "Cross – Border Crises Management Working Group" and BCBS established "Cross Border Resolution Group".
- The cross border resolution is the new challenge for financial safety net players.

Turkish Case

Banks Transferred to SDIF: Main Indicators

Date of Transfer	Number of Banks	Total Assets (USD millions)	Deposits (USD millions)	Market Share (Total Assets)	Market Share (Deposits)	Number of Depositors
1994	**3**	**3.050**	**2.165**	**%4,1**	**%6,7**	**55.137**
1997	1	1.745	1.446	%1,86	%2,38	1.028.677
1998	1	826	487	%0,70	%0,63	91.061
2000-2001	**18**	**25.456**	**19.101**	**19,07%**	**21,75%**	**6.871.177**
2002	1	6.661	4.924	%5,16	%5,99	993.893
2003	1	5.935	6.059	%3,44	%5,49	398.568
Total	**25**	**43.586**	**34.155**	**%34,31**	**%42,89**	**9.429.245**

- During the resolution process of **25 banks**, SDIF covered losses of more **than 9 million depositors** and guaranteed **USD 34 billions** of deposits.
- Government extended its blanket guarantee to off-balance sheet liabilities in addition to on-balance sheet liabilities.
- After the crisis of **1994** a more severe crisis was experienced in **2000-2001** and **18 banks** failed with a market share of **22 percent.**

Resolution Methodologies Applied

	Method	Number of Banks
P&A	Sold	4
	Merged and Sold	6
	Transferred to a Public Bank	1
Partially P&A	Merged under the Bad Bank	8
Liqudiation	Bankruptcy processes	6
	TOTAL	25

– After 2001 crisis, OBA is declared for the banking system as a part of the bank capital restructuring program in Turkey.

SDIF Resolution Responsibilities

- Banking Regulation and Supervision Agency (BRSA) has the authority to revoke the banking license of a bank or to transfer the bank to SDIF.
- If BRSA revokes the banking license of a bank, SDIF has to pay insured deposits and to liquidate assets of the bank.
- If BRSA transfers a bank to SDIF, SDIF has the powers
  - to take over the shares of the bank,
  - to make purchase and assumption,
  - to ask BRSA to revoke the license of the bank or bad bank.
- Indemnifications and penalties with regard to misuse of funds of banks are set in the rules and regulations.

Maximize Recoveries

- To use more flexible laws developed for public claims such as taxes -other than ordinary legal framework- to accelerate asset sales processes.
- To have the authority to reschedule the debts with any debtor.
- To offer special discount programs in order to accelerate collection processes.
- To sell non-performing loan portfolios.
- To take over managemet of corporations that misused banks funds and defaulted their payment to SDIF.
- To sell the assets of the corporations including all business contracts and client base in the form of an “economic unity” rather than selling the shares of the corporations.

Conclusion

- Effective resolution processes are the responsibility of financial safety net participants regardless of their mandate of supervision, intervention, deposit insurance and resolution.
- Countries may have special solvency and resolution regimes to increase effectiveness of the resolution processes.
- Resolution methodologies vary based on legal framework and market structure of the country.
- Cross-border banking is a challenge for diverse resolution regimes around the world.

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Thank You…