

GUIDELINES FOR CHICAGO CONFERENCE PRESENTATION

Dear Ladies and Gentlemen,

It is my pleasure to address a forum of such a great international magnitude. To share my point of view with those who are involved in financial stability issues both locally and internationally. I would also like to point out to a notable contribution made by scholars and intellectuals to the in-depth research of these issues.

I represent an agency engaged in deposit insurance and bank liquidation. Therefore, I will focus on issues well known to me – cross-border regulation in these areas.

The current session objective is to try summarizing conference key presentations.

The first conclusion is on the surface – majority countries are well aware of financial markets' cross-border issues. Otherwise we would not be sitting in this room. This is an obvious globalization outcome.

The second conclusion – expanding banks' cross-border operations gives rise to more acute issue of interaction refinement among various countries banks' regulators.

Major issues arise in the following situation: when one country allows for opening up branches of other countries' banks on its territory. According to general rules, the bank's home regulator usually carries out supervision over such branches. But host country regulator cannot stay aside. Therefore, home/host supervisory arrangements ensue. The above process is not always unconditional and free of conflicts. But it is ongoing.

However, in deposit insurance area these approaches are only in the initial stage of development. There are different practices, for example, European Union is implementing "topping-up" arrangements. There are disputes and differences with regard to definitions of insured deposits, protection of depositors' rights, as well as to the total deposit amounts and offsetting counterclaims.

We are thoughtful people and have to answer a fundamental question – which direction to follow.

My proposal is as follows. We have to start developing unified approach to deposit insurance in cross-border banks' operations. This will be necessary to ensure transparency in legal and economic relationship. Depositors, banks and politicians will need this as well. We all have to be prepared for pragmatic actions in crisis situations.

Thus, what kind of unified approach could be used, if a country's legislation allows for opening up foreign banks' branches on its territory? Let's review two random countries A and B. Bank's branch from country A starts operations on B's territory.

The first question – whose deposit insurance system should guarantee deposit compensation in such branches? In my opinion, it should be A.

The second question – what should be done if insured deposit coverage is higher in country B? To resolve the issue – country A bank's branch should be allowed participating in deposit insurance system of country B. This should be done to guarantee indemnity for the difference in

coverage levels. In this way we will ensure unified competition conditions and consumer protection rules.

The third question: the opposite situation - what should be done if insurance coverage is lower in country B? In this case it would not be appropriate to obligate country A bank's branch participate in the local deposit insurance system. Moreover, it would be wrong to restrict the coverage for branch's depositors by country B limit.

The above three rules I would consider as optimal and reasonable. For example, such rules are applicable with EC members.

The fourth condition may be the most difficult. We all are interested in financial markets free development. To achieve this objective we should be able to ensure equal opportunity for owners of deposits denominated both in national and foreign currencies, as well as for residents and non-residents. In the Russian Federation we decided to follow this way of development.

Now I would like to pass on to the issues related to insolvent banks' resolution. This morning we discussed that topic. The issue is critical for a deposit insurer as it is directly linked with reimbursement of depositors. In this area - in developing basic approaches - there has been done much more than in deposit insurance. Bank for International Settlements pays significant attention to these issues. In 2002 BIS issued its paper "Supervisory Guidance of Dealing with Weak Banks". It is an excellent document focused on supervisory agencies' problems in relation to cross-border banks.

Unfortunately the current format of discussions did not cover issues of banks' liquidation and settlements with their creditors. Hopefully efforts in this direction will be continued.

In connection with the above, I would like to draw your attention to another outstanding paper. It is "General Guidance for the Resolution of Bank Failures" developed by International Association of Deposit Insurers (IADI). The paper was completed at the end of 2005. It contains a survey of 34 countries experience in the area of banks' resolution and combating banking crisis. The paper also includes deposit insurers' best practices and their interaction with other safety net participants.

I would like to draw your attention to the fact that among countries under survey only three had legislation covering cross-border banks' resolution procedures. Therefore, a new IADI project headed by FDIC deserves overall support. The project is called "Cross Border Issues". We hope to summarize practical experience in this area within the framework of this project. It would be appropriate to define optimal mechanism for deposit insurers operations in case of closing cross-border banks.

There is another project capable to become intellectual Klondike for us. It is a joint undertaking of the World Bank, IMF and Bank for International Settlements within "Global Bank Insolvency Initiative" project, whose one of the main goals is to progressively create an international consensus regarding the framework, including best practices and alternatives to deal with bank insolvency. It would be wonderful to research within the framework of this project issues connected with cross-border banks' insolvency and deposit insurance. I believe that experts with practical experience should be invited to participate in the project. By practitioners I have in mind deposit insurers with mandate and experience in bank resolution area. I propose to request the World Bank and IMF to include IADI representatives in preparation of the addendum called "Cross Border Aspects of Bank Insolvency".

Now I would like to say a few words about approaches that might be used when our views on cross-border banks' resolution are getting closer. The approaches are based on my personal experience in liquidating cross-border banks.

For example, we had insolvency cases for banks with branches located in other countries, specifically in Cyprus. We had to deal with situations when bank's creditors took into custody its branch's property or appointed a separate branch liquidator. Local creditors' claims were satisfied at the expense of branch's property outside the framework of single entity insolvency procedures. As a result equal treatment of all creditors was infringed.

This principle – “ring fencing” – is used in other countries as well, specifically in the USA. It would not allow banks' creditors who are not branch's creditors claiming assets located in this particular country. The bank's liquidator is unable to include these assets in single bankruptcy estate; as a result he would be unable to distribute their value on fair basis among all creditors in accordance with the bank's home country rules. That is, creditors with claims against the branch located in Cyprus will get more compensation compared to other creditors. I do not think it would be fair.

In my opinion such practice is contradictory to the interests of cross-border banking development. It is outdated and would require actions aimed at matching with current reality.

I consider the following approach would be fair: all insolvent bank's assets, including its overseas branches' assets should be included in single entity estate. Funds obtained as a result of asset disposition should be distributed among depositors and other creditors in accordance with unified rules and regulations. Such rules should be set forth in home country legislation.

In connection with the above, single entity approach adopted in the EC countries is worth following. Banks' creditors, including host country creditors, should be given the right to monitor receiver's activities efficiency and appropriateness. I understand it may sound too optimistic, and even categorical, but we are discussing which direction we should be moving. It is harmonization of approaches, sharing best practices, reciprocal acknowledgement of law and awards of the court – that should be set as key goals to fulfill in the near future.

Thus, to sum up the above stated. To successfully handle issues related to cross-border financial instability - it is necessary to stick to the following:

- Trace and identify potential conflict zones and seek ways for their preliminary solution;
- Follow harmonization of legislation and practices in the area of financial markets regulation and institutional restructuring;
- Establish mutual interests infrastructure among safety net participants on international basis.

We will have to work hard in order to implement the most valuable ideas and proposals developed internationally and those we heard during discussions yesterday and today.

Thank you for attention.