“The choice between judicial and administrative sanctioned procedures to manage the liquidation of banks: a transatlantic perspective”
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Disclaimer: The views expressed in this presentation are the speaker’s.
Outline

Recall the objectives and some findings of the paper
Offer observations on how the paper reflects on
(i) the effectiveness of regimes
(ii) the resolution vs insolvency dichotomy
(iii) the duality (or trinity) of regimes
Objectives of the Paper

The authors describe the objectives of the paper as follows

(1) “to reflect on the effectiveness of insolvency procedures for banks”

(2) “to reflect on the advantages and disadvantages of a dual system that includes administrative and court-based procedures”

(3) “to analyse the need for coordination through harmonization [...] with the view to the development of the European Deposit Insurance System (EDIS)”
The Paper’s findings

“The EU and US frameworks create a clear policy demarcation between resolution and insolvency”

In the US
- **Administration resolution procedure for all banks** (FDIA)
- **Optional dual resolution framework (DFA) for non-bank financial companies** with a strong preference for the judicial insolvency framework
- The **SPOE strategy** make the insolvency law that might apply less relevant.

In the EU
- **No common EU approach** on the fundamental choice between administrative and court based procedures due to lack of political consensus and the diversity of banking systems and administrative law traditions
- **National regimes differ in efficiency** as measured in terms of loss rates of the respective DGS which impacts the financial position of DGS and ultimately EDIS.
- **“The ‘public interest’ test** opens the door for degrees of discretion and inconsistency of approach in regard to the application of national bankruptcy proceedings for banks which would not qualify for resolution.”
The Paper’s conclusions

- “Need to be cautious” when approaching the question what works best
- Differences in residual national insolvency regimes could lead to differences in economic outcomes which contradict the objectives of a common market such as the equal protection of insured depositors throughout the BU.
- Need for reform in the EU to improve consistency and predictability of outcomes, particularly of certain substantive aspects of legal frameworks, such as the definition of ‘public interest’ and in insolvency ranking.
Discussion

(1) How does the paper define and measure the ‘effectiveness’ of regimes? In the view of its authors, what regime yields the better outcomes?
How measure effectiveness? (1)

- Is the measure solely that of efficiency as measured in terms of loss rates of individual DGS?

- What about loss rates of creditors and counterparties across different home/host jurisdictions?

- Does predictability matter more than the type of regime? E.g., Is the existence of a resolution plan that is effective and executable under relevant legal regimes more relevant than the type of regime (e.g., whether administrative or court-based)?
How measure effectiveness? (2)

- What **other considerations** for assessing effectiveness?

  - **Market confidence** in the ability, **operational capacity** and **willingness** of authorities to resolve a cross-border bank in orderly manner?

  - **Resolution-related disclosures to enhance credibility**
    - In the end, resolution is only as effective as market participants believe it to be.

- **Track record of authorities**
  - During the crisis, around 500 banks were resolved in the **US** without triggering financial instability.”
  - So far **limited experience in the EU** under the new regime
How measure effectiveness? (3)

- **What about cross-border effectiveness?** Does the type of regime matter?
  - For **global systemically important banks**, home and key host authorities have set up institution-specific crisis management groups (CMGs).
  - **CMGs** consist of home and key host resolution authorities and enable authorities to plan for and execute a resolution in an orderly and coordinated manner.
  - **Judicial authorities are not members of CMGs.** In the US regulators will be afforded the status of ‘parties of interest’ in bankruptcy proceedings and their views will form part of the evidentiary record.

Can court-led procedures and administrative procedures be equally effective
Discussion

(2) ‘Continuity vs. liquidation’ and ‘resolution vs. bankruptcy’ and ‘judicial vs. administrative’ – false dichotomies or change in paradigm?
Shift toward financial stability focus post crisis

Pre-crisis policy makers debated ‘Lex specialis vs. lex generalis’ and ‘administrative vs. judicial regime’ in light of speed, efficiency and depositor protection considerations.

Post-crisis policy makers focused on minimizing the public costs of containing bank crises through resolution procedures for systemically important financial institutions to maintain the continuity of their vital economic functions and preserve financial stability.
Resolution – continuity : insolvency - liquidation

- **Resolution** and **insolvency** procedures are defined by reference to their objectives
  - Maintaining the continuity of critical functions and protecting financial stability (‘resolution’) vs.
  - Maximising creditor value (and minimizing cost for example for the deposit insurer) (‘insolvency liquidation’)

- The Preamble to the Key Attributes stresses that any resolution regime should provide for both:
  - **Stabilisation powers** that achieve continuity of critical functions; **AND**
  - **Liquidation options** that provide the orderly closure and wind-down of all or parts of the firm’s business in a manner that protects insured depositors.

- **Can the objectives be combined in a single regime?**
Discussion

(3) Bankruptcy vs. resolution vs. bail-out - unity, duality or trinity of procedures?
Unity and duality in US procedures

- **Banks** are subject to a **single proceeding under the US FDIA** that
  - combines both resolution (continuity) and insolvency (wind-down) powers (purchase & assumption, bridge bank, liquidation)
  - Applies the ‘least cost test’ to determine whether a resolution yields a better outcome than a liquidation.

- **Financial holding companies** are resolved
  - In bankruptcy proceedings (Title I)
  - by the FDIC if a **financial stability test** indicates that proceedings under the US bankruptcy code would pose a problem to financial stability (‘Orderly Liquidation Authority’ as **back-stop**).
A trinity (rather than duality) in EU procedures?

1. **Resolution** ‘Banks (as well as financial holding companies) are resolved within the BRRD framework if it is determined that there is an ‘EU public interest’.

2. **National insolvency law** - In the absence of ‘public interest’ they are dealt with at national level either under a bank-specific regime (which may be administrative or court-based) or general insolvency law.

3. **EU State Aid** rules foresee the possibility to use public resources to mitigate economic disturbance at regional level.
Unfinished business in the EU?

- **Misalignment between regimes**
  - Could give rise to incentives to prefer liquidation over resolution, in particular if there are prospects for public support.
  - Results in different outcomes given that the *conditions to determine that a bank is ‘failing or likely to fail’* are not necessarily aligned to the criteria for liquidation at national level.
  - Complicates the **assessment of the no-creditor-worse-off principle** (comparing the treatment of creditors in resolution to the one they would have received under insolvency proceedings) due to partial harmonisation of creditor hierarchy only.
Conclusion

- Great paper!
- Effectiveness is multi-faceted
- Dichotomies may not so stark
- Unity, duality, trinity ...

...or still a patchwork in Europe?
THANK YOU
FOR YOUR ATTENTION

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