Documentation

BOE/FDIC/Dodd-Frank Plan To Save the Banks

"Resolving Globally Active, Systemically Important, Financial Institutions" (G-SIFIs) a joint paper by the U.S. Federal Deposit Insurance Corporation and the Bank of England, was published on Dec. 10, 2012. The following are the four relevant policy topics identified in the lead article of this package:

1. "The unsecured debt holders can expect that their claims would be written down to reflect any losses that shareholders cannot cover, with some converted partly into equity in order to provide sufficient capital to return the sound business of the G-SIFI to private sector operations.... In all likelihood, shareholders would lose all value and unsecured creditors should thus expect that their claims would be written down to reflect any losses that shareholders did not cover.... The new equity holders would take on the corresponding risk of being shareholders in a financial institution.

"Under a top-down resolution, shareholders and certain creditors at the top of the group absorb losses and recapitalize the group as a whole. For a top-down approach to work, there must be sufficient loss-absorbing capacity available at the top of the group to absorb losses sustained within operational subsidiaries."

Paragraph 47 is ambiguous as to whether depositors are to be considered "unsecured creditors": "Retail or corporate depositors should not have an incentive to 'run' from the firm under resolution insofar as their banking arrangements, transacted at the operating company level, remain unaffected."

2. "The resulting new private sector operations would be smaller, more manageable—and perhaps more profitable.... Ring-fencing of a banking group's retail banking activities from the group's investment banking activities would prove particularly valuable in facilitating such a restructuring.... The newly resolved group would be solvent and viable, and should be in a position therefore to access market funding or, if necessary, funding from the authorities as discussed above.... The contingency plans are designed to minimize the triggering of cross-defaults or closeout of netting arrangements at the operating companies."

3. "Once the Financial Services Bill comes into force in 2013, the Financial Services Authority will be replaced by two new regulatory bodies, the PRA [Prudential Regulation Authority] and the Financial Conduct Authority. The PRA, a subsidiary of the Bank of England, will become the prudential regulator of deposit takers, insurers, and the largest investment firms.

"In both the U.S. and the U.K., legislative reforms already made [Dodd-Frank in the U.S.—ed.] or planned in response to the financial crisis provide new powers for resolving failed or failing G-SIFIs ... to impose losses on shareholders and unsecured creditors—not on taxpayers."

4. "The strategies will be translated into detailed resolution plans for each firm during the first half of 2013.... Subsequently, firm-specific resolvability assessments will be developed by the end of 2013."

The G-SIBs (Global Systemically Important Banks) listed by the BOE-FDIC document are: Citigroup, Deutsche Bank, HSBC, JPMorgan Chase, Barclays, BNP Paribas, Bank of America, Bank of New York Mellon, Crédit Suisse, Goldman Sachs, Mitsubishi, Morgan Stanley, Royal Bank of Scotland, UBS, Bank of China, BBVA, Groupe BPCE, Groupe Crédit Agricole, ING Bank, Mizuho FG, Nordea, Santander, Société Générale, Standard Chartered, State Street, Sumitomo Mitsui, Unicredit Group, and Wells Fargo.

EC To Use Deposits To 'Bail-In' Failing Banks

Here is EIR's transcript of the Q&A at the March 26, 2013 European Commission briefing on the Commission's response to the banking crisis. Chantal Hughes,

a spokeswoman for Michel Barnier, the European Commissioner for Internal Market and Services, responded to a question on the EC's June 2012 proposal for a bail-in mechanism. The exchange was in English.

Q: The resolution proposals from the Commission from last year—there is a bail-in instrument in this proposal. What would that mean concretely in a case like Cyprus, where there are not many bondholders? Would it be possible under this proposal to bail in depositors?

Chantal Hughes: One very, very clear statement to start with: At no point is it possible to bail in depositors under EU100,000, neither now, or in the future. At no point is that possible. When we're talking about uninsured depositors, you quite rightly point out that, in the resolution framework which was proposed last year in June, one of the tools is indeed bail-in.

What does bail-in do? Bail-in allows a bank to be recapitalized, with shareholders wiped out or diluted, and creditors will have their claims reduced or converted to shares. As part of that framework, there will be a predefined order in terms of the seniority of claims, in order for the institution to regain viability. Now, in the Commission's proposal, which is currently, as I say, under discussion, so I can't tell you what the final agreement will be, it is not excluded that deposits over EU100,000 could be instruments eligible for bail-ins. I repeat, it's not excluded, it is a possibility. At the moment, in terms of the proposal made by the Commission, that the uninsured depositors *over* EU100,000—only *over* EU100,000—could be bailed-in.

From the June 6, 2012 European Commission document, "A Proposal for a Directive of the European Parliament and of the Council":

Insolvency laws are not always apt to deal efficiently with the failure of financial institutions insofar as they do not appropriately consider the need to avoid disruptions to financial stability. Resolution constitutes an alternative to normal insolvency procedures [and] limit taxpayer exposure to loss from solvency support. In the process, it should also ensure legal certainty, transparency and predictability regarding the treatment of shareholders and bank creditors, and preserve value which might otherwise be destroyed in bankruptcy. In addition, by removing the implicit certainty of a publicly funded bailout for institutions, the option of resolution should encourage uninsured creditors to better assess the risk associated with their investment. . . .

[Once the] trigger conditions for resolution are satisfied, resolution authorities will have the power to apply the following resolution tools: (a) sale of business; (b) bridge institution; (c) asset separation; (d) bail-in. . . .

The resolution authorities should have the power to bail in all the liabilities of the institution. There are, however some liabilities that would be excluded *ex-ante* (such as secured liabilities, covered deposits and liabilities with a residual maturity of less than one month).

[By subtraction, this means that "non-covered" deposits (above the EU100,000 mark) would not be excluded—ed.]

From Title II of the Dodd-Frank Act, passed by the U.S. Congress in June 2010:

Similar to the rules governing other insolvency regimes, the Act requires that all claimants who are similarly situated be treated in a similar manner (except that, as noted above, claims of the United States are paid first).

Unlike other insolvency regimes, however, the FDIC may deviate from this principle as necessary *to maximize the value of the assets* of the covered financial company; to initiate and continue operations essential to implementation of the receivership or any bridge financial company; to maximize the present value return from the sale or other disposition of the assets of the company; or to minimize the amount of any loss realized upon the sale or other disposition of the assets of the company. . . .. In disposing of assets, the FDIC must use best efforts to maximize returns, minimize losses and mitigate the potential for serious adverse effects to the financial system. In deciding upon a course of action, the FDIC also must determine that such action is necessary for the financial stability of the United States. . . . [And it must] ensure that *unsecured and uninsured creditors* bear losses in accordance with the priority of claim provisions [emphasis added].