

**COMMENTS ON EISENBEIS
AND KAUFMAN
*CROSS-BORDER BANKING
CHALLENGES FOR DEPOSIT
INSURANCE AND FINANCIAL
STABILITY IN THE EU***

David G Mayes
Bank of Finland

AT LEAST 3 PAPERS



- 1. A Survey of the Deposit Insurance Provisions and Insolvency Procedures in the EU**
- 2. The Agency Problems and Potential Inter-institutional Conflicts in the EU**
- 3. Possible Routes for the Better Handling of Problems especially Insolvency**

PAPER 1

A Survey of the Deposit Insurance Provisions and Insolvency Procedures in the EU

- **Shows the huge range of arrangements**
- **Common features**
 - **deposit insurance (but in varying amounts)**
 - **Inability to resolve cross-border institutions before insolvency – expectation of bail out for most institutions (a) because no effective alternative to major crisis (b) because DI payout provisions inadequate – cannot wait 3 months**
 - **Liquidity (not LOLR) and solvency problems**
- **Fascinating resource but needs updating**

PAPER 1

A Survey of the Deposit Insurance Provisions and Insolvency Procedures in the EU

- **Implicit conclusion – there is no great problem about inter-agency co-operation in good times**
 - But it may be insubstantial
 - Poor effective co-operation in good times leads to blame when something goes wrong and an unwillingness to share burdens on predetermined rules – despite the prior agreement
- **Explicit conclusion – if you don't sort out crisis actions in advance the expected result is ad hoc and protects most stakeholders against loss**
 - That is what the EU actually wants?

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The Agency Problems and Potential Inter-institutional Conflicts in the EU

- **Home-host arrangements in the EU are a recipe for trouble. Lead (home) regulator can impose costs on hosts and vice-versa.**
 - **Problem complicated by different rules for subs and branches**
- **No one has clear duty to manage overall risk to some standard nor to minimise losses nor to allocate losses**
- **Fire brigade role for Eurosystem/ESCB**

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The Agency Problems and Potential Inter-institutional Conflicts in the EU

- **Problem and solutions depend on size and location of the problem**
 - Size of parent and importance in home country
 - Size of sub and importance in host country
 - Size of sub relative to parent
- **Where institution is small authorities will not care very much**
 - Coincidence of wants is likely to be the exception?
- **What bothers the parent? Reputation risk.**
 - Argentina
 - Table 9

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The Agency Problems and Potential Inter-institutional Conflicts in the EU

- **Information not the problem but the ability to act**
 - **Cross-border banks are not divisible into free-standing parts on a jurisdictional basis – exploiting cross-border synergies is much of the point – legal structure is largely irrelevant for determining the capabilities of a branch or sub**
- **How likely is it that authorities will use asymmetry of information against each other?**
 - **Ville Mälkönen**
 - **System encourages cooperation – single database**

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The Agency Problems and Potential Inter-institutional Conflicts in the EU

- **Two main issues**
 - **To act or not to act when there is a problem that is not yet fatal**
 - **To save or not to save when it is fatal**
- **To act**
 - **Is it possible to shift the burden of adjustment?**
 - **Makes small problems become big ones**
- **To save**
 - **Is it possible to free ride?**
- **Two uncertainties**
 - **How big is the problem**
 - **What will other authorities actually be prepared to do – no definitive answer as they do not know in advance either?**

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THE 4 'PROMPTS'

- **Excellent idea – similar in character to the Mayes, Halme, Liuksila proposals BUT**
- **We thought takeover at positive value impossible so went for early involvement but intervention when net worth was zero**
- **We do not require legal closure, just takeover by the authorities from the shareholders**
- **We write down claims to remove losses. (Do not assume existence of DI). No public sector contribution**
- **One question – if the problem is systemic what should be minimised? Problem is losses outside the insured depositors**
- **How fast should prompt be on initial action fast enough to galvanise but long enough to stand a chance**
- **Need equal treatment and single proceedings – universality not territoriality**
- **Do all claims need to be handled immediately, only those falling due?**

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Possible Routes for the Better Handling of Problems especially Insolvency

Responsibility without Power

- **Take control – NZ solution**
 - **Outsourcing policy**
 - **All significant foreign-owned institutions must be subs and self-sufficient if needed**
 - **Particularly computer systems, back offices etc**
 - **Authorities must have power to intervene and means of doing so.**
 - **Runs against point of integration in EU**

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Possible Routes for the Better Handling of Problems especially Insolvency

- **Use EU level**
 - **Does not solve power to intervene but internalises conflict**
 - **Does internalisation help? In US do not have same worry about localised impact**
 - **Not total loss minimisation. Should one do that and compensate? Current prejudice is handle localised systemic effects**

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Possible Routes for the Better Handling of Problems especially Insolvency

- **Co-operate through prior agreement**
 - What would it look like?
 - Extended MoU is declaration of intent – cannot claim compensation ex-post – soft law
 - Hard law? Whose law? Deposits with ECB?
 - Government by committee impossible need to delegate to lead authority under predetermined rules (committees could have over 100 members for an LCFI)
 - But very incomplete contract

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Possible Routes for the Better Handling of Problems especially Insolvency

- They suggest could offer a DI contribution discount for adopting the ‘prompt’ framework
- Nice idea – but many funds already paid up. Other banks have to agree to it. In any case further subscriptions will be because of others’ failures not their own
- Does not cover the switching of jurisdictions problem (Nordea case)
- Can it be done under existing law?
- Need EU level – could have US style EDIC
 - Need to separate supervision and problem resolution to ease conflict of interest
 - Only large banks (30-50?)
 - IMF (yesterday’s FT) suggests ECB role – also conflict of interest?

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Possible Routes for the Better Handling of Problems especially Insolvency

- **Is the EU DI system likely to fail like some US states (Ohio, Rhode Island)?**
 - No because there is no federal system to look to
 - Nordic example – there will government guarantees or other loans to prop the system up
 - But it may be changed in the sense of how it is recapitalised in the event of a major loss
- **Too Big to Save**
 - Home country cannot cope on its own because it is a major exporter of banking services (Switzerland)
 - Is there a plausible limit to undetected losses?

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Possible Routes for the Better Handling of Problems especially Insolvency

- **EU DI problem is liquidity?**
 - **Systems not in place to make comprehensive payouts under closure within a few days**
 - **3 months renewable twice**
 - **Implies continuance through conditional open bank assistance or purchase and assumption for all but the small**
 - **Bridge banks might be a solution – effectively purchase and assumption by the authorities**
 - **Legal closure not needed?**

THE EU PROBLEM TODAY



- **Need to have something working now**
 - under existing law – what can be achieved through regulation?
- **Therefore has to be co-operation route Case-by-Case**
 - some US-style PCA – try to avoid insolvency
 - cannot takeover before insolvent
 - how can authorities run functions of bank that must be continued to avoid crisis
 - ex ante burden sharing and action agreement in as binding a form as possible
- **What E&K offer is a new idea. Can we get banks to assign power to the authorities for cheaper DI – because risk falls?**
 - Can we do it in the existing legal framework?