The UK approach to resolution of failed banks in the crisis

Presentation to EBRD conference on Operational Aspects of Bank Resolution and Restructuring, 19 March 2012

Peter Brierley, Head of Policy, Special Resolution Unit, Bank of England
Outline

• The **Northern Rock** failure and its aftermath, 2007-08
• The **Banking (Special Provisions) Act** 2008 and its applications
• Resolutions of **Northern Rock** and **Bradford and Bingley**, 2008-2012
• **Recapitalisations** of major UK banks, 2008
• **Market-wide initiatives** to support bank recapitalisations
• **UK Special Resolution Regime** (SRR), February 2009
• **UK SRR toolkit**
• Applications of the SRR: **Dunfermline** (March 2009) and **Southsea** (June 2011)
• **FSB Key Attributes** (KAs) of Effective Resolution Regimes, October 2011
• **Enhancements needed to UK SRR** to implement KAs
The Northern Rock failure and its aftermath

- NR grew balance sheet 6x 1998-2007 in **rapid expansion** primarily funded through wholesale markets (securitisations and short-term inter-bank loans).
- Growing **funding crisis** in August-September 2007, NR unable to raise new short-term funds or roll over existing loans, forced to seek financial support from Bank.
- **No option for authorities to seize control** of NR while it continued to meet regulatory capital requirements.
- First **UK bank retail run** for over 140 years – depositors withdrew 20% of deposits over 4 days. Outflows did not stop even when UK Government guaranteed deposits.
- Three options: corporate **insolvency**; private **sale**; or **nationalisation**.
- In February 2008 **NR nationalised**, using emergency legislation to pass Banking (Special Provisions) Act
The Banking (Special Provisions) Act 2008 and its applications

• Act enabled UK Treasury to carry out directed transfers of securities, property, rights and/or liabilities of a failed authorised deposit-taker

• Debate in Parliament on whether to limit Act to nationalisation of NR or extend applicability to future bank failures: Government opted for latter course, subject to one-year sunset clause

• Act subsequently used in two main cases:
  – Bradford and Bingley, Sept 2008: UK Government took bank into temporary public ownership and immediately transferred deposits and branches to Abbey National (UK subsidiary of Santander)
  – Icelandic banks’ operations in UK (Kaupthing Edge and Heritable Landsbanki), Oct 2008: UK Government froze UK assets of Icelandic banks, funded transfer of £3bn of UK retail deposits to ING Direct and placed remaining UK businesses of both banks into administration
Resolutions of NR and B&B, 2008-12

- **NR restructuring** 2008-09 with view to repaying Government loans
- NR split into **good bank** and **bad bank**, 1 January 2010
- **NR bad bank** (NR Asset Management plc) and **B&B** combined under single holding company wholly owned by UK Government, March 2010
- **Combined bad bank** (UK Asset Resolution Ltd) to focus on orderly run-down of closed mortgage book and repayment of Government loans and creditor claims over 10-15 year period
- Chancellor announces **sale process for NR good bank**, June 2011 (note EC requirement for UK Government to end majority ownership of NR good bank by end-2013).
- **Four exit options** explored for NR good bank: sale of whole bank; deposit sale/loan book run-down; IPO; and remutualisation
- **NR good bank sold** to Virgin Money, 1 January 2012
Recapitalisations of major UK banks, 2008

• Resolution of Royal Bank of Scotland
  – RBS Group largest bank in world by assets in 2008
  – Ill-timed acquisition of ABN Amro in 2007, huge rights issue in 2008
  – UK Government forced to recapitalise bank, October 2008
  – UK Government sold RBS emergency insurance on assets via Asset Protection Scheme (APS), early 2009
  – RBS now 84% owned by UK Government, which paid c £45bn for stake.

• Resolution of HBOS/Lloyds Banking Group
  – HBOS largest UK mortgage lender in 2008
  – Following severe liquidity strain, HBOS acquired by Lloyds-TSB to form Lloyds Banking Group (LBG), September 2008
  – UK Government subsequently recapitalised LBG and sold it emergency insurance on assets via APS
  – LBG now 43% owned by UK Government
  – LBG required to divest 600 branches to comply with EU State Aid requirements
Market-wide initiatives to support bank recapitalisations

- **Asset Protection Scheme (2009):** provides participating institutions with protection against future losses on defined portfolios of assets in exchange for a fee and legally binding agreements to increase lending to creditworthy businesses and households.

- **Credit Guarantee Scheme (2008):** provides guarantees on short- to medium-term debt issued by eligible banks in wholesale markets, in return for a commercial fee. Window for new issuance closed in February 2010, although debt issued under the scheme can be rolled over with further guarantee.

- **Bank Recapitalisation Fund (2008):** enables institutions eligible for CGS to utilise Government subscription as means of raising Tier 1 capital to level enabling them to qualify for CGS.

- **Special Liquidity Scheme (2008):** allows financial institutions to swap with Bank of England high-quality but temporarily illiquid assets for more easily tradeable assets.

- **Other Bank of England liquidity facilities:** permanent Discount Window Facility introduced in 2008 and extended to wider range of assets subsequently.
UK Special Resolution Regime (SRR)

- Introduced under **Banking Act**, February 2009
- **Bank of England** becomes lead resolution authority
- **Triggers for SRR** are regulatory determinations by FSA that (1) bank no longer meets threshold conditions for authorisation; and (2) it is not reasonably likely that bank will once again meet threshold conditions after remedial action
- **Objectives** are to protect: (1) financial stability; (2) confidence in banking sector; (3) depositors; (4) public funds; and (5) avoid interfering with property rights in manner inconsistent with ECHR
- Bank will seek to **achieve objectives** in a manner that preserves continuity of access to systemically important functions of failed bank, while seeking to avoid risks to UK taxpayer
UK SRR toolkit

- Directed transfer of part or all of bank’s business to one or more private sector purchasers
- Directed transfer of part or all of bank’s property to temporary bridge bank
- Placing bank into temporary public ownership (TPO)
- Liquidation of bank in manner that fully protects insured depositors through either rapid payout of accounts or transfer of accounts to another bank – bank insolvency procedure (BIP)
- In a partial property transfer (PPT), that part of bank not transferred is placed into special insolvency procedure – bank administration procedure (BAP)
- PPTs subject to creditor safeguards to protect secured creditors, netting and set-off agreements (no “cherry picking”) and ensure no creditor is worse off than in whole-bank liquidation
- Different conditions apply to different tools; BIP to be used in non-systemic cases, PSP/Bridge Bank tools only possible in public interest; TPO a last resort if only that can mitigate serious threat to financial stability
Applications of the SRR

• **Dunfermline Building Society** (March 2009)
  – Largest building society in Scotland
  – Expansion into non-core areas, eg commercial real estate and loans, buy-to-let
  – Resolved through **3-way split**:
    (1) deposits, branches and core residential mortgage portfolio transferred to Nationwide;
    (2) social housing loans transferred to bridge bank (subsequently also sold to Nationwide in July 2009);
    (3) rest of business, including commercial loans, acquired mortgages, subordinated debt and treasury assets put into version of bank administration procedure.

• **Southsea Mortgage and Investment Company** (June 2011)
  • Very small bank failure (250 depositors and £7.4mn deposits)
  • Bank’s failure clearly not systemic so **placed into BIP** and bank liquidator appointed
  • Liquidator worked with Financial Services Compensation Scheme to **pay out insured deposit claims** up to limit of £85,000
  • **Uninsured depositors** not fully protected
  • Liquidator now working to **liquidate assets**
FSB Key Attributes of Effective Resolution Regimes

• **Endorsed by G20 Leaders** in November 2011

• Sets out **responsibilities and powers national resolution regimes should have** to resolve failing systemically important financial institutions (SIFIs) in orderly manner

• Orderly resolution defined as a resolution that protects **critical economic functions**, with mechanisms for losses to be shared between **shareholders, unsecured and uninsured creditors** of failed SIFI without putting **taxpayer/public funds** at risk

• For global-SIFIs approach to resolution based on **“modified universalism”**

• For G-SIFIs **recovery and resolution plans, resolvability assessments** and specific cross-border **cooperation agreements** need to be in place by end-2012
Enhancements needed to UK SRR to implement KAs

- Scope of SRR transfer powers widened to include other financial institutions whose failure could be systemic
- SRR extended to cover branches in UK of (non-EU) foreign banks
- SRR toolkit extended to include explicit bail-in tool
- SRR statutory objectives widened to require resolution authority to pay due regard to implications for financial stability in other countries
- Short stay on exercise of early termination rights with respect to financial contracts held by counterparties of failed bank
- Some of these reforms have also been advocated by ICB
- EU Recovery and Resolution Directive is expected shortly and this may deliver several of these reforms