

The UK approach to resolution of failed banks in the crisis

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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