Home-Host Issues
in Supervision of cross-border banks

Workshop on Cross-Border Supervision
Beirut, Lebanon
April 25, 2012
Some Cases highlighting home-host conflicts

- Fortis
- Dexia
Fortis

• Belgian/Dutch Financial Conglomerate:
• substantial subsidiaries and systemically relevant in:
  – Belgium
  – Netherlands
  – Luxembourg
• Consolidating Supervisor: Belgium’s CBFA
Fortis

• 2007: Acquisition of ABN AMRO operations through consortium with RBS and Santander

• 2008: financial crisis:
  – Difficulty in realizing plans to strengthen financial positions and finance acquisition and integration of its acquisitions of portions of ABN AMRO
June 2008
- Increasing uncertainty in realizing intended steps

Summer 2008
- Decreasing share price
- Liquidity concerns

Sep. 2008
- Rapid decline in share price
- Substantial deposit withdrawal
- Lost access to O/N interbank market
- Euro system Marginal Lending Facility by NBB
Fortis

• Solution had to be found by intervention of public authorities

• Dutch government purchased:
  – Fortis Bank Netherlands
  – Fortis Insurance Netherlands
  – Fortis Corporate Insurance
  – Fortis share in ABN AMRO

• Belgian government
  – increased holding in Fortis Bank Belgium to 99%
  – then sold 75% to BNP Paribas in return for new BNP shares keeping a blocking minority of 25%
Fortis

• BNP also acquired:
  – Belgian insurance operations of Fortis
  – Majority stake in Fortis Bank Luxembourg

• A portfolio of structured products was transferred to a financial structure owned by Belgium, BNP and Fortis Group
Fortis

• Dec. 2008: Brussels Court of appeal:
  – suspended the sale to BNP that was not finalized yet
  – Decided that finalized sales to Dutch state, Belgian state as well as subsequent sale to BNP need to be approved by Shareholders’ General Assembly to be valid

• Initial rejection by Shareholders

• Approval was later granted in May 2009 after transaction with Belgian State and BNP was renegotiated
Fortis

• What are the lessons learnt?
Fortis

• Tension between cross-border nature of a group and domestic focus of national frameworks

• Formal supervisory crisis management tools are of little use if institution needs to be stabilized rapidly

• Conflict between the need to maintain financial stability and position of shareholders
Fortis

• Currently, Belgian and Dutch financial supervisory legislation does not permit resolution banks for urgent financial stability purposes through overriding the rights of shareholders.

• Despite long-standing cooperation and coordination between Dutch and Belgian supervisory authority, there were differences in assessing available information and the sense of urgency of the situation.
Dexia

• Established in 1996 through merger between a Belgian and a French bank

• Difficulties in 2008:
  – Financing of long-term assets by short-term funding
  – US subsidiary Financial Security Assurance (FSA)

• Increase in the capital by 6.4 EUR Billion
  – 3 EUR Billion by each of Belgian and French private and public sectors
  – 376 EUR million of convertible bonds by Luxembourg
Dexia

• October 2008: agreement on a joint guarantee mechanism between Belgium, France & Luxembourg to facilitate access to financing:
  – 60.5% by Belgium
  – 36.5% by France
  – 3% by Luxembourg
What are the lesson learnt?
Dexia

• Tension between cross-border nature of a group and responsibilities for crisis management does not necessarily lead to break-up of firm along national lines

• The division of burden of guarantees was based on the proportion of ownership held by the institutional investors and public authorities
Dexia

• While centralization of liquidity management can lead to some tensions in terms of liquidity management, the tensions can be overcome by adequate coordination between relevant central banks.

• The cross-border nature of the group makes the resolution process more time-consuming. This process can be made smoother if home and host authorities clearly state joint support to the group.
Findings from the crisis

• Ring Fencing / territorial approach: National interests most likely drive decisions in absence of pre-existing standards for sharing the losses from cross-border insolvency
  – National authorities will seek to minimize loses on stakeholders in jurisdiction where they are accountable
Findings from the crisis

• Supervisory Ring-Fencing:
  – Asset pledge to ensure sufficient assets are available in case of failure of parent bank
  – Limitations imposed on inter-affiliate transactions, including transfers of assets
    • To prevent contagion
    • To protect creditors of a given legal entity
Findings from the crisis

Resolution of a cross-border bank

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Universal Approach

• Resolution of insolvency based on law of a single country

• Decisions of home authority apply to branches, other operations and assets of the financial institution
Territoriality Approach

• Each national authority applies its own law which governs loan proceedings for the entities, operations and assets of the insolvent firm.

• Requires declaration of insolvency in each country

• Each insolvent branch is governed by local insolvency law
Recommended Approach

• Middle ground approach
  – Possibility of ring fencing
  – Home and host countries as well as financial institutions focus on needed resiliency within national borders

• This approach aims at:
  – Improving the ability of different national authorities to facilitate continuity in critical cross-border operations
  – Protecting the systemically significant functions performed by failing institution but not the institution itself.
Alternative Approach

• Establish a comprehensive universal framework for resolution of cross-border financial groups

• Requirements:
  – Terms and conditions for financial burden sharing arrangements
  – Determination of competent authority for resolution proceedings
  – Determination of applicable rules governing crisis management and resolution stage
Alternative Approach

- Requirements:
  - Process to ensure coordination for administration and supervision of the affairs of the group entities
  - Process to ensure equitable treatment of all stakeholders
  - Compatible deposit insurance level to ensure equal treatment of all depositors
  - Agreement having full force and effect to decisions and actions across borders
Alternative Approach

• This framework requires major changes to current national legal frameworks
• Need to address many practical problems in a complex cross border resolution
Recommendations

- Effective national resolution powers
- Frameworks for coordinated resolution of financial group
- Convergence of national resolution measures
- Reduction of complexity of group structures and operations
- Planning for orderly resolution
- Cross border cooperation and information sharing
- Strengthening risk mitigation mechanisms
Effective national resolution powers

• Appropriate tools to deal with all types of financial institutions in difficulties
  – Helps maintain financial stability and minimize systemic risks
  – Promote the continuity of systemically important financial institutions

• Example: bridge financial institutions, transfer assets and liabilities and other business operations to other entities, etc...
Frameworks for coordinated resolution of financial group

• Each jurisdiction needs to establish a national framework to coordinate resolution of the legal entities of financial groups within the jurisdiction
Convergence of national resolution measures

• Similar tools for national resolution & Similar early intervention thresholds facilitate coordinated solutions across borders

• Better coordination among national authorities in cross-border resolution:
  – Mutual recognition of crisis management
  – Resolution proceedings and measures
Reduction of complexity of group structures and operations

• Work closely with home and host resolution authorities to understand how group structures work in a crisis

• If structure is too complex, consider imposing regulatory incentives though capital and other prudential requirements
Planning for orderly resolution

• Address as a contingency a period of severe financial distress or instability

• Provide a plan to
  – preserve the firm as a going concern
  – Promote resilience of key functions
  – Facilitate the resolution or wind-down if necessary

• Plan should be regular component of supervisory oversight
Cross border cooperation and information sharing

• Clear understanding of supervisory authorities’ responsibilities for regulation, supervision, liquidity provision, crises management and resolution

• Agreement on arrangements that ensure timely production and sharing of needed information for contingency planning during normal times and for crisis management during times of stress
Strengthening Risk mitigation

• Enforceable netting arrangements
• Collateralization
• Segregation of client positions
• Questions / Comments?