



The Case for Bail-ins

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3 May 2012

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The case for bail-ins: summary

- ▶ Too big to fail is too costly to continue
 - ▶ Bail-ins are superior to bail-outs
- ▶ Bankruptcy doesn't work for banks
 - ▶ Bail-ins may be superior to insolvency/liquidation
- ▶ Banks need a special resolution regime
- ▶ How Private Markets Have Solved Similar Problems
- ▶ How Bail-in Could Work
 - ▶ For groups organized as holding companies
 - ▶ For unitary banks

➤ **Conclusions**

Too big to fail is too costly to continue

- bail-outs strain the public finances
- bail-outs distort competition
- bail-outs undermine market discipline
- bail-outs are not an option

Bankruptcy doesn't work for banks

- banks cannot operate whilst in insolvency
- liquidation destroys value and diminishes the recovery that creditors can make
- for systemic banks liquidation would have large adverse knock-on effects on financial markets and the economy at large

Banks need a special resolution regime

- To avoid bail-outs and to avoid liquidation banks need a special resolution regime.
- This empowers the resolution authority to intervene at the point where the bank no longer meets threshold conditions and to employ the tools in its “resolution tool kit” to resolve the bank in a manner that
 - Does not require taxpayer support for the bank’s solvency; and
 - Does not result in significant social costs (disruption to financial markets, reductions in output and employment)
- The first question is whether bail-ins should be in the tool kit at all.
- If so, when should the resolution authority utilise the tool?

What tests does bail-in need to meet?

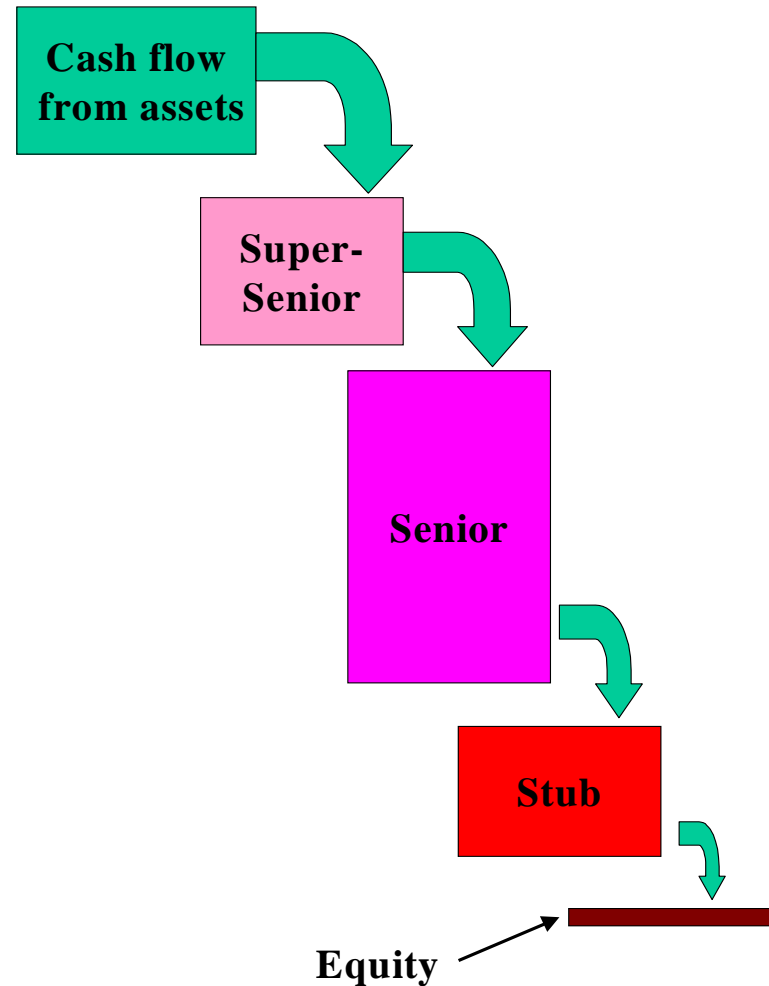
- bail-in must be better than bail out
- bail-in must be better than insolvency/liquidation
- bail-in must be workable

But

- bail-in need not be the only solution
- bail-in can be used in conjunction with other tools

Banks have used bail-in to solve similar problems in private markets

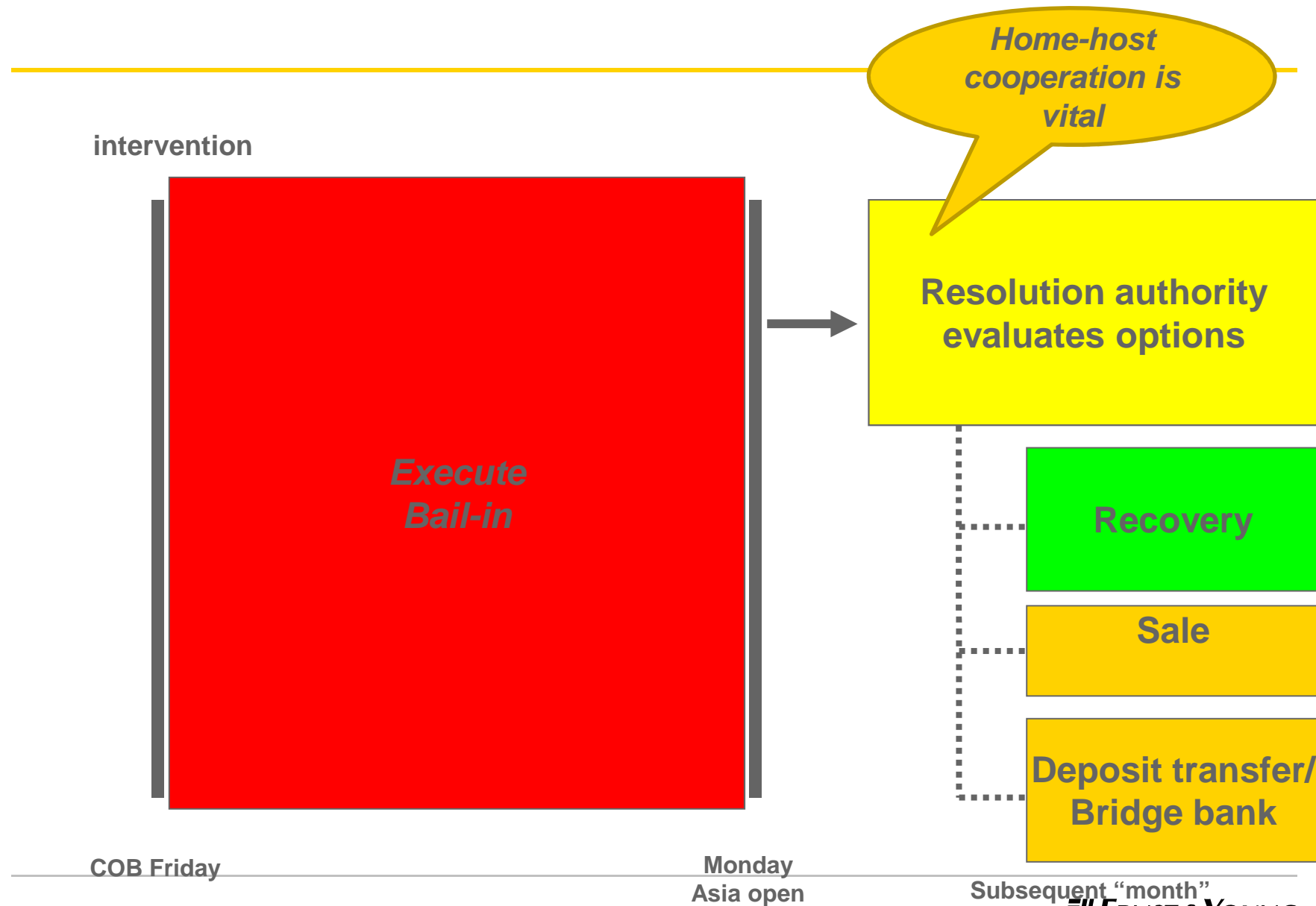
- Securitization structures are designed to avoid bankruptcy.
- Securitization structures effectively bail-in junior creditors in reverse order of seniority as cash flows dry up.
- Securitization structures are designed to go into solvent wind-down if asset and liquidity tests are not met.



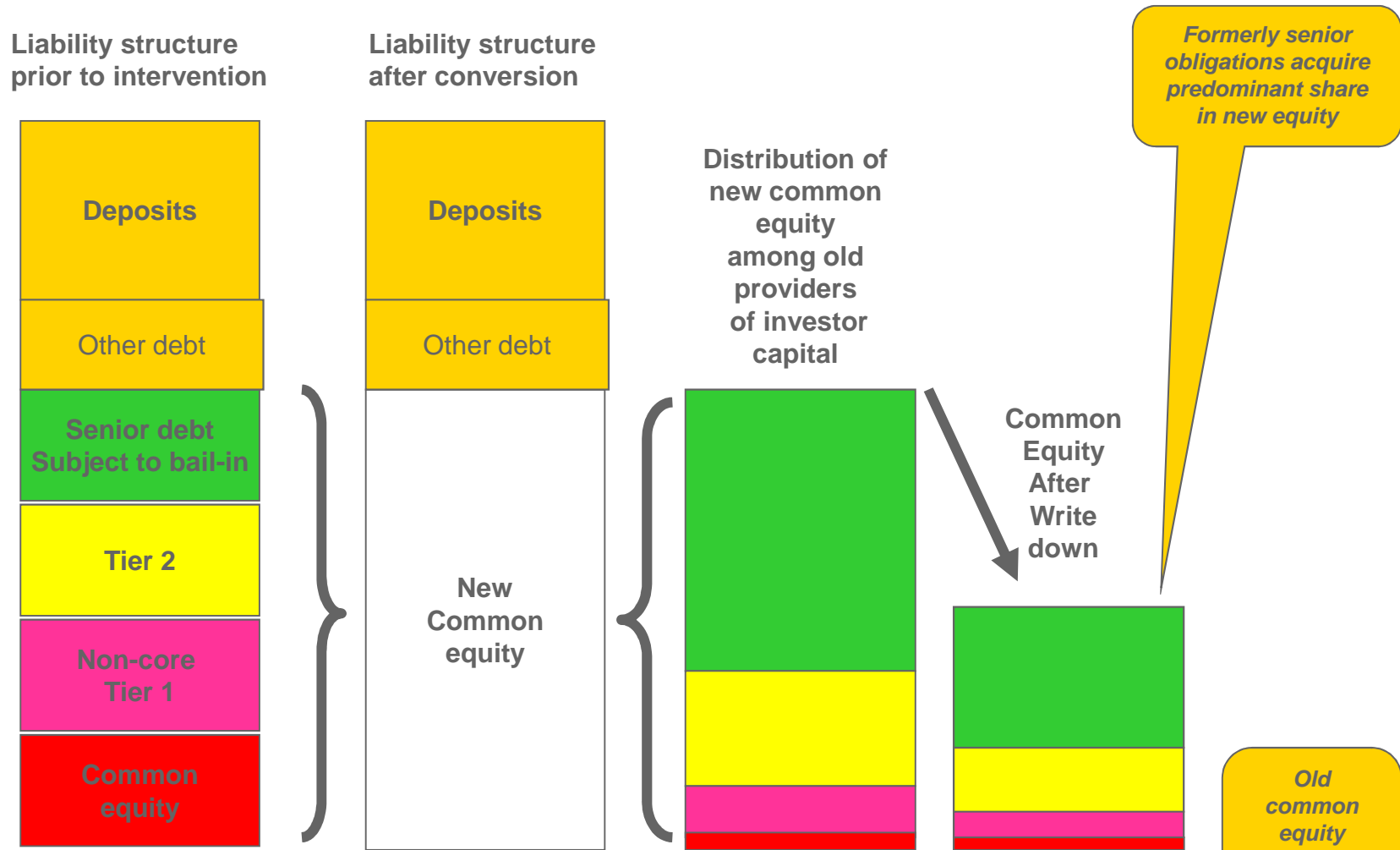
➤ What should a solution involving bail-ins deliver?

- continuity of critical economic functions
 - This minimises social cost.
 - This requires that the institution in resolution have access to adequate liquidity. Bail-in will not produce a “Lazarus effect”.
- **no taxpayer support for solvency**
 - This eliminates drain on the public finances.
- sufficient certainty with respect to process that authorities will employ in resolution with respect to each element in the capital stack to enable investors to estimate loss given resolution
 - This helps assure that the bank can issue the instruments that will be subject to bail-in.

How bail-in could work

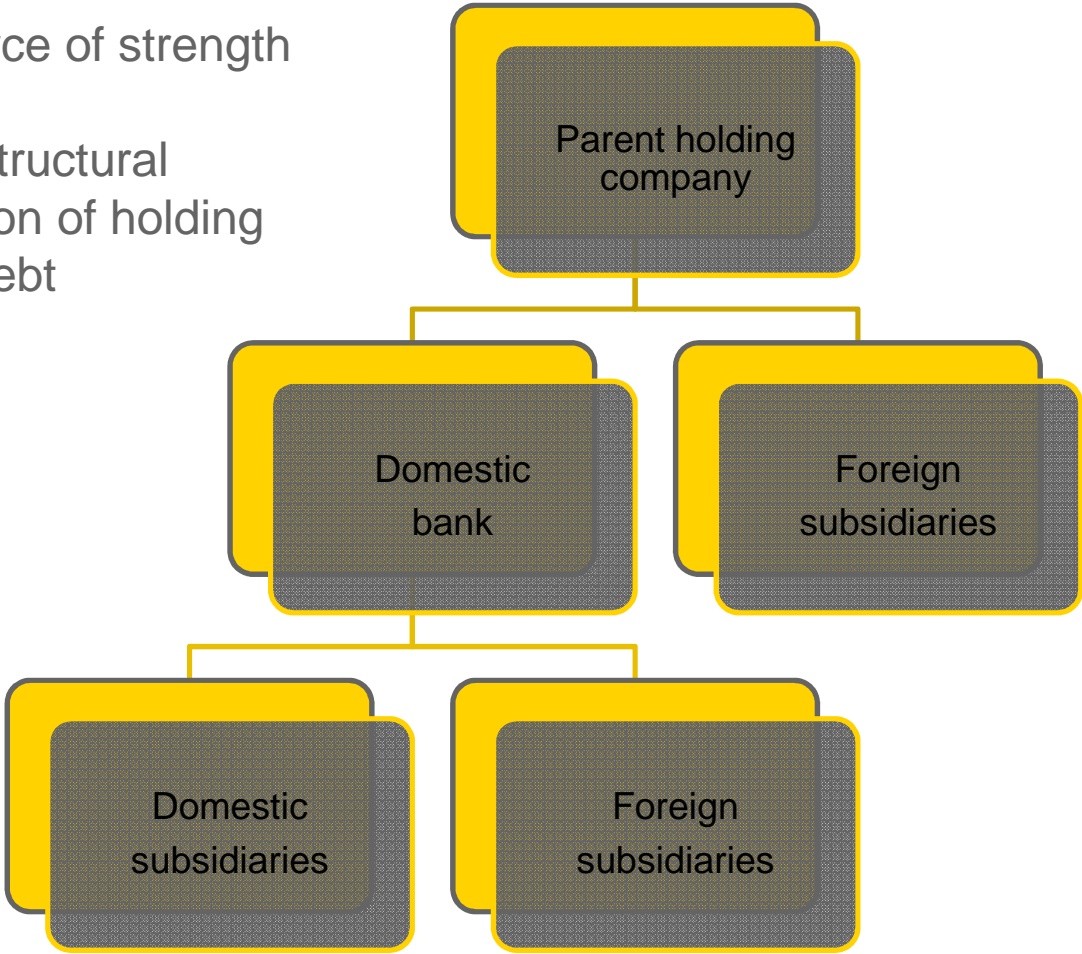


Bail-in via conversion at unitary bank



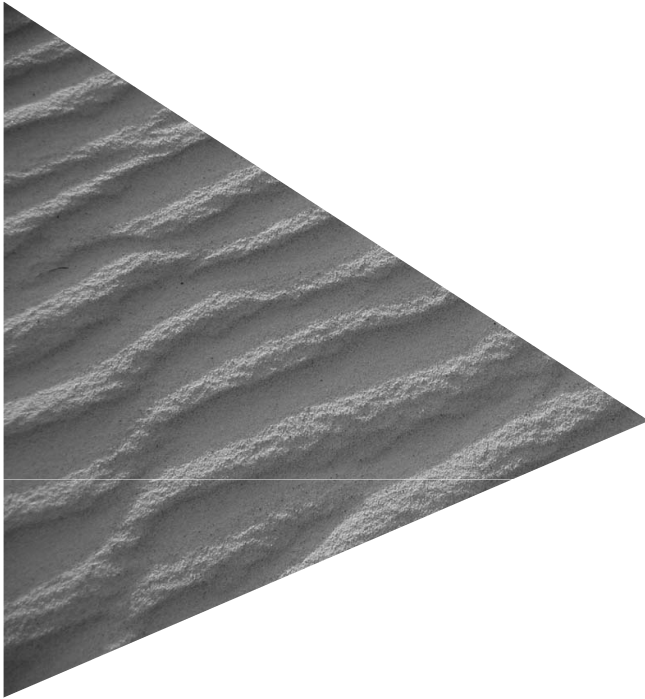
How bail-ins could work: holding companies and the “single point of entry”

Global source of strength doctrine?
Based on structural subordination of holding company debt
Liquidity?



Conclusions

- bail-ins are superior to bail outs
- bail-ins are superior to liquidation
- bail-ins may be an effective resolution tool. They merit inclusion in the resolution tool kit under a special resolution regime.
- some key questions remain
 - How to assure that there will be outstanding an amount of instruments subject to bail in sufficient to recapitalise the institution whilst assuring continuity of critical functions
 - Treatment of foreign branches and subsidiaries/cooperation among authorities
 - Provision of liquidity to institution in resolution
 - How to restore the institution post bail-in to private investor control/exit from resolution/constraints on discretion of resolution authority



Thank you