When is a bail-in still a bailout?

The answer to that question is, almost always. The bankers' revolution known as "bail-in" was supposed to prevent taxpayers and governments footing the bill for collapsing banks, as when some US$29 trillion was pumped into "too-big-to-fail" banks following the 2008 global financial crisis. In Europe, however, which has seen the widest use of the new tool over the last several years, most instances of its use have resulted in public bailouts of one form or another.

There are seventeen European nations—sixteen European Union members plus the United Kingdom—which have used the resolution procedures devised by the Bank for International Settlements' Financial Stability Board (FSB) in its EU-wide Banking Recovery and Resolution Directive (BRRD), which became law in January 2016. (Many nations started implementing the policy before that time, Greece as early as 2011, but particularly once it had been tested on depositors in Cyprus in March 2013.)

The European Banking Authority (EBA) is required to provide public notice of all instances of the use of bank resolutions and Deposit Guarantee Scheme (DGS) funds. As such it provides close to a full list of all historical resolution procedures,[1] involving various resolution tools from bail-in to the activation of DGSs. Deposit Guarantee Schemes are governed by the Deposit Guarantee Scheme Directive (DGSD), a supplement to the BRRD overseen by the EBA.

Bail-in forces bank losses onto private bank creditors, from bondholders to depositors. In some cases depositors are spared; in others, their funds are used to recapitalise the bank and they are reimbursed by the Deposit Guarantee Scheme. In almost all cases customers have experienced an interruption of access to their deposits or to banking services.

The tools provided by the resolution regime allow just about any option you can imagine. Furthermore, national resolution agencies—usually the central bank or financial regulator—have been provided extraordinary crisis management powers, meaning they are literally able to make up the rules as they go along.

Cyprus, Italy, Denmark, the Netherlands, Slovenia and Spain have experienced classic cases of bail-in. Cyprus in 2013 was notable because it was the first case in which depositors *per se* lost money. (Previously, in Spain in 2012 "preferred stocks" were wiped out, which had been marketed as high-rate fixed-term deposits, but technically were not.) The two largest Cypriot banks saw deposits over the guaranteed level of €100,000 wiped out by up to 95 per cent (pending the announced repayment of Laiki Bank deposits over €100,000 of five to six cents of every euro lost, after the sale of bank assets).

In Denmark, as Andelskassen J.A.K. bank was put into resolution in 2015, the country's resolution agency Finansiel Stabilitet (FS) warned that "all members, subordinated creditors and ordinary unsecured creditors" would be written down to zero, and that all further transactions would be subject to FS control, meaning that "it will not be possible for creditors or depositors to take actions to avoid losses". In the event, the bank was sold to another institution, so assets were transferred across. In the 2018 case of Københavns Andelskasse, which did see bail-in of subordinated and unsecured creditors, including depositors, it was made clear that contracts (and their terms) to which the bank was party could be cancelled or amended by FS as necessary in order to implement the plan.

In the case of one Greek resolution, the Bank of Greece admitted that the public were not kept informed of the process, which involved bids for a potential takeover, as "such communication would pose risks to financial stability". The Bank of Greece has a page on its website on the "History of bank resolutions" which claims that it conducted 14 bank resolutions in 2011-15 "without anyone losing even one euro from their deposits". Case studies of the resolutions of the Cooperative Bank of Peloponnese and Panellinia Bank S.A. reveal the Bank of Greece's approach. Both were taken over by other banks, following the use of resolution to improve their capital positions.

A Bank of Greece statement said that if a bank were allowed to collapse, only guaranteed deposits would be saved; however with a resolution and transfer of assets to another bank, all deposits would be transferred across to the new bank, including the amount to be covered by the Hellenic Deposit and Investment Guarantee Fund (HDIGF). In other words, rather than cleaning up banks, resolution invokes a government payout via the DGS, which effectively becomes a bailout for the bank that takes over the failed entity, while bringing about a greater concentration of the sector.

The way this works in practice is less assuring than the Bank of Greece claims. Guaranteed deposits are written off to resolve the financial status of the collapsed bank. The takeover bank receives a credit from the government to the same value, against which it can lend. However, depositors do not receive their guaranteed funds immediately, in fact this can take up to five years.

The establishment of such a deposit-insurance scheme EU-wide, as part of the completion of the banking union, would in effect create a new supranational bailout facility to save banks *in the name of saving depositors*.

Reimbursement of DGS payouts to depositors in Estonia from a 2018 bank resolution was expected to take three years. Payments to Croatian depositors from a 2015 resolution were still ongoing three years later. In Lithuania in 2017, seven credit unions were liquidated after their licenses were revoked due to “unavailability of deposits”. DGS reimbursements were scheduled to take five years! The timeline was similar for a Luxembourgish bank that ran into trouble in 2018. Five Polish banks with capital deficiencies faced the same fate, all with DGS payouts expected to take five years. Like the infamous cases of Greece and Cyprus, depositors at Nemea Bank in Malta had withdrawals restricted to €250 per day for three months in 2016. Deposits were ultimately frozen altogether before the bank was shut down.

In Hungary “sale of business” and “asset separation” resolution tools were used to resolve MKB Bank Zrt. While shareholders lost everything, the state was still forced to partially subsidise the resolution of the bank, as has been the case in all of Italy’s seven bail-ins. Portugal used the “bridge institution” tool to recapitalise Banco Espirito Santo S.A, but state loans were required. in 2014. Shareholders and other creditors bore losses. The resolution of Austria’s Hypo Group in 2014 also required a €5.5 billion injection by the state. In 2013 the UK Co-operative Bank was recapitalised with a so-called “consensual bail-in” arrangement or “liability management exercise”. Through negotiation, lower-tier bondholders agreed to recapitalise the bank by accepting a share offer and new securities issue.

It is well past time for nations to truly resolve banking problems by banning them from speculative activities that jeopardise deposits, with Glass-Steagall bank separation.

Footnote:

1. A handful of additional cases, cited here, are reported in the World Bank’s “ Bank resolution and ‘bail-in’ in the EU: Selected case studies pre and post BRRD”.

By Elisa Barwick, Australian Alert Service, 4 March 2020
