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News release

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Regimes for Handling Bank Failures: Redrawing the Banking Social Contract

Speech by Paul Tucker

In the third of a series of recent speeches on reshaping the 'social contract' for banking in the light of the financial crisis, Paul Tucker - Deputy Governor for Financial Stability - discusses today at the British Bankers' Association's Annual International Conference the need for banks to run themselves in a way that facilitates the orderly management of crises, including through deposit insurance and the resolution of distressed firms.

Paul Tucker considers how the banking system should bear the cost of insuring retail depositors against loss. He explains the Bank of England's reasons for preferring a risk-based, pre-funded system of deposit insurance. To head off risk-taking by banks on the back of de facto 100% deposit insurance for retail depositors, contributions to the deposit insurance system should be risk-based to offset the incentives otherwise created. And, he says, "..any such insurance scheme must be pre-funded; it is no good trying to collect levies from riskier banks after they have gone bust".

Paul Tucker goes on to discuss the need for banks to structure themselves to permit their orderly resolution should that be required. He highlights the need for better information from banks, to facilitate rapid payout to retail depositors by the Financial Sector Compensation Scheme, to aid the Bank of England's choice of resolution tools under the UK's Special Resolution Regime, and for potential bidders for part of or all a failed bank. He emphasises the extent of the Bank's need for information from banks getting into distress. He says, "In delivering its resolution responsibilities under the 2009 Banking Act, the Bank is ready to work with banks and the FSA in helping to specify in more detail what is needed in practice. we need to engage together constructively on what information the authorities need to handle incipient or actual distress."

Commenting on the issue of 'Too Big To Fail', Paul Tucker says large institutions have an interest in planning their orderly resolution and there needs to be ". a radical simplification of some group structures. This will not be easy. But it is important to bring about the kind of regime shift necessary to restore confidence and trust in the industry without a government prop."

In relation to the cross-border aspects of bank resolutions, he notes the potential tension between the regulatory division of labour in normal times and insolvency or resolution regimes, which in distressed times can effectively split banks into a series of de facto ring-fenced entities.

Paul Tucker notes that the difficulties of winding down large, complex financial institutions are not new concerns but he stresses that action needs to follow reports in the wake of the crisis. He highlights the Financial Stability Board's 'Principles for Cross-Border Co-operation on Crisis Management', which were endorsed by the G20 Heads of Government. For banks, the Principles ".have the potential - indeed, are intended - to bring about material changes in the way you structure your businesses, in how you interact with the authorities; and in the wider environment in which you operate".

Concluding, Paul Tucker says:

"This crisis has reminded a generation of some old truths. Banks can fail. But they matter enormously to our economies, and so the authorities cannot afford to stand back and allow disorderly systemic failure. Going forward, we cannot have a regime where the upside for risk taking goes to shareholders and management, but the downside falls to the general taxpayer." He says, ".we want banks and the financial sector more generally to thrive. The financial sector has played an enormous role in the development of modern economies. But a regime in which banks can thrive standing on your own feet would be a better market - for all of us.

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech396.pdf

Notes for editors

1. Paul Tucker's first speech on the theme of the social contract for banking discussed the micro and macro supervision of banks -
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech384.pdf

Panel session at The Turner Review Conference, The Queen Elizabeth II Conference Centre, London on 27 March 2009

A second speech addressed the liquidity insurance provided by central banks to banks and markets –
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech390.pdf

Bank of Japan's 2009 International Conference in Tokyo, 28 May 2009.

2. Paul Tucker chairs the Financial Stability Board Working Group on the Principles for Cross-Border Co-operation on Crisis Management.