



BANK OF ENGLAND

News release

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25 October 2012

The role of deposit insurance in building a safer financial system

Speaking in London today, Paul Tucker – the Bank’s Deputy Governor for Financial Stability, a member of the Bank’s Financial Policy Committee (FPC) and Monetary Policy Committee (MPC), and Chair of the G20 Financial Stability Board’s Steering Group on Resolution - updates on the FSB’s progress in its work on resolving distressed financial institutions, and outlines how deposit insurance fits in to that endeavour.

Paul Tucker underlines the key role played by deposit insurance in international efforts to build solid foundations for global finance, though he says the UK “has not been alone in learning the hard way that it is not enough simply to have a deposit insurance system”. He underlines the importance of public awareness and understanding, and notes that in the UK, deposit takers are being required by bank supervisors – with encouragement from the Bank of England – to advertise prominently the availability and terms of deposit insurance, “in every branch, on every ATM, on every key webpage”. Meanwhile, the UK’s Financial Services Compensation Scheme will ensure they can deliver rapid payout, ideally within 7 days. He states that the deposit insurance regime “has the potential to revolutionise retail banking”, lowering barriers to entry. And in terms of who pays for this, “it isn’t government and the taxpayer but the industry itself”.

Paul Tucker highlights that liquidation and payout to insured depositors can be a “seriously inferior” way of handling the failure of some deposit-takers. Some of the spillovers can be avoided, he says, if the insured deposit book and some good assets can be transferred to another bank (or other purchasers). He notes that in many major jurisdictions, including the UK, this is typically aided by an injection of resources by the Deposit Insurer, with the most critical services – transactions deposits and payments – thus maintained. But he points out that in both approaches to resolution, uninsured depositors and other creditors, including bondholders, take losses after equity is exhausted. By becoming a claimant creditor, the Deposit Insurer stands to lose money, with any losses later recouped by a levy on the surviving insured banks. So for banks funded by insured deposits, some of the costs of failure will fall on their peers. “Over time, I suspect that that will increase pressure for a funded deposit-guarantee scheme with risk-based levies”.

On resolution for systemically important firms, Paul Tucker says “the objective is, of course, to get to a position where public money is never used to provide solvency support for a failing bank, however large or complex”. He acknowledges the difficulty of drawing up resolution plans until the precise legislation is in place, and that different jurisdictions are at different stages in legislating to enforce the Key Attributes, the international standard on resolution regimes endorsed by the G20. In this vein, he says the EU’s recovery and resolution directive will be “an enormous step forward”. A broadly

common statutory framework will, he says, help home and host authorities work together on resolution planning. He underlines the cultural change involved for supervisors and says the FSB appreciates the need to provide more guidance. He points to a consultative paper on resolution planning forthcoming from the FSB in the next few weeks.

Paul Tucker says the most important of the three areas of the FSB consultation is that on the development of Resolution Strategies and Operational Resolution Plans, which seeks to provide guidance for the authorities on the key issues to address. But he cautions that what turns out to be the best approach in the event of distress will depend on the circumstances. And the feasibility of different options at the planning stage will, he says, depend upon a group's organisational and financial structure; "it is likely that some groups will need to adapt themselves in order to remove impediments to resolution". Both the UK's plans and the Liikanen report proposals in the EU for ringfencing work with the grain of the FSB's approach to resolution, he says.

Paul Tucker emphasises a central theme of the endeavour: that, after equity is exhausted, losses should fall next on uninsured debt holders. But while all resolution tools put losses on bondholders, by applying losses upfront based upon a valuation bailin prospectively avoids an unnecessary destruction of value. For those groups that issue debt from the holding company and downstream the proceeds to operating subsidiaries, he says it should be possible to bail in debt at the holding company and recapitalise distressed parts of the group. But "it is not a case of one size fits all". For example, he says, it would not work so easily for groups funded to a very large extent from insured deposits, with limited or no bond holders to bail in. A way of cutting through that would, he says, be for each Deposit Insurer to be bailed in, an approach which could, if necessary, be applied in different regions to different distressed subsidiaries of the group.

Paul Tucker says the FSB are putting in place a process where the most senior officials will talk to each other to reassure themselves of resolvability of globally significant firms, from which will follow detailed operational planning, and requirements to remove impediments to executing resolution strategies. "You shouldn't doubt that this will happen. Don't listen to siren voices who question our capability or will".

Paul Tucker underlines that the international authorities are committed to maintaining global finance. "The balkanisation of finance would cut against the extraordinary historical changes towards a much more globalised real economy". But a world in which public money is used to bail out banks or dealers is, he says, a world in which balkanisation is likely because the authorities that deploy public money are accountable to domestic tax payers. In "delivering the FSB's global agenda ... by making finance safe and orderly failure possible, I think we can take off the stage the most basic force towards balkanisation. The stakes are high".

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