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Press Release

--- Embargo: 15 October 2013, 8.00 am ---

Germany and France no role model for bank restructuring

In the cases of Hypo Real Estate and Dexia potential for creditor participation has been wasted / Expected loss for European governments from bank bailouts at about 75 percent

FRANKFURT, 15 October 2013. Germany and France cannot serve as a role model in bank restructuring when comparing the most striking examples of Hypo Real Estate and Dexia to similar cases in other European countries. This is the key message of a study about "The Capital Structure of Banks and Practice of Bank Restructuring", written by Hans-Joachim Duebel of Finpolconsult and commissioned by the Center for Financial Studies, which was published today.

For fear of negative systemic consequences, Germany and France focused on repeated recapitalizations with public money while leaving private creditors largely spared. Against the background of the wasted creditor participation potential, the classic European approach to the banking crisis, mainly driven by these two countries, – targeting a soft landing through forbearance combined with a prevalence of public bailouts – must be seen as discredited. Taxpayers elsewhere, e.g. in Ireland and most recently in Greece, were held hostages to this approach. It is smaller European countries like Denmark and the Netherlands that have developed best practice in bank restructuring. Spain, under tremendous political pressure through the mis-selling scandal of junior bank bonds to households, has reached a reasonable compromise.

The study provides an empirical analysis of the capital and liability management in eight cases of bank restructurings and resolutions: Alpha Bank (Greece), Amagerbanken (Denmark), Anglo Irish Bank (Ireland), Bankia (Spain), Cyprus Popular Bank/Laiki (Cyprus), Dexia (Belgium/France), Hypo Real Estate (Germany) and SNS Reaal Group (Netherlands). The case selection follows considerations of their model character for the European bank restructuring and resolution policy discussion

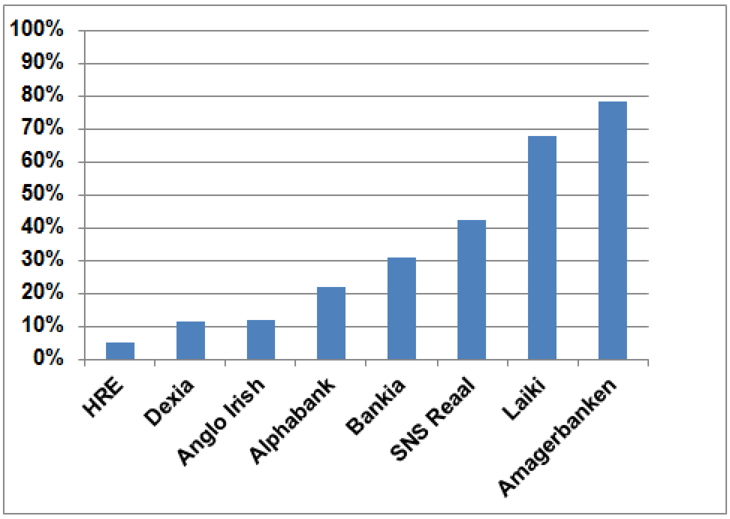
For each case, the study draws a timeline between the initial credit event and the (most recent) restructuring. It assesses the respective extent of creditor participation as well as the expected losses by governments. Also, a discussion is provided of what could have been a least cost restructuring approach.

For essentially all cases (in particular for Hypo Real Estate, Dexia, Anglo Irish and Alpha Bank) the study shows that significant potential for creditor participation has been wasted. However, differences are striking: whereas the creditor participation rate in the cases of Laiki or Amagerbanken exceeds 65% and 75% respectively, this rate is only at about 5% in the case of Hypo Real Estate (see Figure 1). Frequently, governments must be expected to lose almost all of their investment (Hypo Real Estate, Anglo Irish Bank) with the median expected loss being at about 75%. The exception is the Dutch case of SNS Reaal where the government may expect to break even.

The study suggests a number of policy lessons. The most important are minimizing restructuring delay (which usually causes evasion and thus reduces the bail-inable capital substantially) and increasing the depth of participation through suitable legislation. The relevant legislation has still not been adopted in many countries as the relevant European directive was postponed to 2018. For the future European bank resolution rulebook, a number of rules follow: avoid paying cash to shareholders and junior debt investors, stop guaranteeing historic senior bond cohorts to keep future options for bail-in open, invest government funds, if anything, into senior hybrid capital instead of shares, and only after junior bond investors have been bailed in, and generally use restructuring and resolution concepts that tie the fate of historic assets to the fate of historic liabilities. This means preferring the “good bank” approach (horizontal balance sheet split with dubious asset pricing to be determined in the future) over the fiscally highly risky “bad bank” approach (asset swaps at arbitrary current valuations of dubious assets) and use other direct linkage options such as debt to equity or credit default swaps.

The study has been published as CFS Working Paper and is available for download here: xxx

Figure 1 Estimated Participation of Bank Creditors in Financing the Capital Gaps of the Case Banks



Source: Bank reporting, Finpolconsult assumptions and computations.

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