# Bank Resolution: National Legislation and Frameworks

The resolution of systemically important financial institutions (SIFIs) is an important part of the political discourse on shaping the future financial system. For example, EU countries are currently working on the legislation and the institutional framework to resolve banks within a banking union. This article summarises the main reasons why bank resolution deserves special attention and provides an overview of the legislation and bank resolution frameworks in different countries between 2008 and 2010 based on statistics provided by the World Bank (2012).

Resolving banks is more difficult than the resolution of non-financial firms because of the role that banks play in an economy. They take in deposits from savers and supply credit to investors, they provide payment services and are also important participants in financial markets. If a bank is what is commonly referred to as "systemically important", its failure to perform these functions can destabilise the entire banking system. In the past, it was generally expected that governments would intervene and save SIFIs under distress to avoid the costs of their failure. This implicit bail-out guarantee, also known as the "too big to fail" phenomenon, may have distortionary effects on the risk-taking and resource allocation incentives of banks (Stern and Feldman 2004).

One potential way to solve the "too big to fail" problem is the establishment of a credible resolution mechanism for SIFIs. As far as its design is concerned, it is worth looking at the national resolution frameworks that are already in place and are applied in the resolution of smaller banks. The first question that is answered in Table 1 is whether the 37 countries have separate bank insolvency frameworks in addition to the framework for non-financial firms. In fact, 12 countries do not have a separate insolvency framework for banks. In many countries there are also differences in the resolution frameworks for banks and bank holding companies.

For the resolution of banks different mechanisms are put in place in different countries. Firstly, open market assistance exists in all but six of the countries listed in Table 1. Open market assistance implies that authorities step in and help to operate the failing bank. Often the management of the failing bank is replaced. The main goals of open market assistance are the minimisation of costs for tax payers and deposit insurance funds by continuing the banks' business, thereby keeping the assets of a failing bank intact, which facilitates the subsequent selling of the bank, or at least its healthy assets, to financial institutions that are not under distress.

Another mechanism is the so-called "purchase and assumption transaction" whereby some or all of the failing bank's healthy assets are purchased by a financial institution that is not under distress. The healthy institution also takes over all or some of the liabilities of the bank in resolution. It is the mechanism most commonly used to resolve banks in the US (FDIC 2003) because uninsured deposits are usually assumed by the purchasing institution. All but five countries listed in Table 1 have a purchase and assumption mechanism in place.

Bridge banks are less common with 22 countries not using this instrument of bank resolution. Bridge banks are financial institutions that are authorised to run the business of the bank in resolution until the purchase of the failing banks' assets to a healthy institution is completed. They can be considered a specialised form of purchase and assumption transaction.

During the recent financial crisis some governments intervened by conserving or nationalising banks. Mechanisms for such government intervention are put in place in 25 countries. They come into play when selling off a bank's assets to other healthy institutions is not achievable.

As Table 1 shows, although there are some countries that do not have separate legislation for the resolution of banks in addition to the rules for resolving non-financial firms, all countries have different mechanisms to resolve banks in place already. The problem is that they have not been applied to large complex financial institutions. Transforming the existing mechanisms so that they make it possible to credibly wind down such SIFIs is a major challenge for governments and regulators.

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**References**


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**Table 1**

**Bank insolvency / resolution: legislation and framework, 2008 – 2010**

| | Is there a separate bank insolvency framework that is distinct from that of non-financial firms? | Is the insolvency framework the same for bank holding companies and banks? | Which mechanisms are provided in existing legislation to resolve a problem bank prior to its closure and liquidation? | | | |
|---|---|---|---|---|---|---|
| | | | Open bank assistance | Purchase and assumption transaction (with or without government support) | Government intervention (e.g., via conservatorship or nationalization) | Bridge bank |
| Austria | No | Yes | Yes | Yes | Yes | No |
| Belgium | No | Yes | Yes | Yes | Yes | No |
| Bulgaria | Yes | No | Yes | Yes | No | No |
| Croatia | Yes | No | Yes | Yes | Yes | No |
| Cyprus | Yes | No | Yes | Yes | Yes | Yes |
| Denmark | Yes | Yes | – | Yes | Yes | Yes |
| Estonia | Yes | Yes | Yes | Yes | Yes | Yes |
| Finland | No | Yes | No | No | Yes | No |
| France | Yes | No | Yes | Yes | Yes | No |
| Germany | No | Yes | No | Yes | No | Yes |
| Greece | No | Yes | No | Yes | No | No |
| Hungary | No | Yes | No | Yes | Yes | No |
| Ireland | No | Yes | Yes | Yes | Yes | No |
| Italy | Yes | No | Yes | Yes | No | No |
| Latvia | Yes | No | No | Yes | Yes | Yes |
| Lithuania | No | No | No | No | Yes | No |
| Luxembourg | Yes | No | No | No | No | No |
| Malta | No | Yes | Yes | Yes | Yes | Yes |
| Netherlands | Yes | No | Yes | Yes | No | No |
| Poland | Yes | No | Yes | Yes | Yes | Yes |
| Portugal | Yes | No | Yes | No | Yes | No |
| Romania | Yes | No | Yes | Yes | No | No |
| Slovak Republic | Yes | Yes | No | Yes | Yes | No |
| Slovenia | Yes | No | Yes | Yes | No | No |
| Spain | No | Yes | Yes | Yes | Yes | Yes |
| United Kingdom | Yes | No | No | Yes | Yes | Yes |
| Iceland | Yes | No | Yes | Yes | Yes | Yes |
| Montenegro | Yes | Yes | Yes | Yes | No | No |
| Serbia | Yes | No | Yes | Yes | Yes | Yes |
| Norway | Yes | Yes | Yes | No | Yes | Yes |
| Switzerland | Yes | Yes | Yes | Yes | Yes | No |
| Turkey | Yes | No | No | Yes | Yes | No |
| Australia | No | Yes | No | Yes | No | No |
| Canada | Yes | No | No | Yes | No | Yes |
| Korea | No | Yes | Yes | Yes | Yes | No |
| New Zealand | Yes | Yes | No | No | No | No |
| United States | Yes | No | Yes | Yes | Yes | Yes |

Note: The table draws on a more detailed version, available for download in the DICE Database under Business and Financial Markets / Banking and Insurance / Bank Regulation and Legal Framework, www.ifo.de/w/VcC76czJ.

Source: Čihák et al. (2012); World Bank (2012).