

# RESOLUTION CASE STUDIES SERIES

LESSONS FROM GLOBAL BANKING AND INSURANCE FAILURES



**Perbadanan Insurans Deposit Malaysia**  
Protecting Your Insurance And Deposits In Malaysia



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*Resolution case studies series – lessons from global banking and insurance failures*

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## FOREWORD

Since the 2008 Global Financial Crisis (GFC), major disruptions have repeatedly stopped us in our tracks. These challenges have come in the form of climate disasters, geopolitical tensions, technological disruptions, trade wars, armed conflicts and pandemics, to name a few. In early 2020, COVID-19 infiltrated our world and ran rampant, followed by supply chain woes, inflationary pressures and other emerging issues. Concepts such as ‘polycrisis’ - where disparate crises interact such that the overall impact far exceeds the sum of each part - are becoming mainstream. In short, a world in crisis is fast becoming the new normal.

While we are not always able to avert a crisis, what we can do is mitigate its risks and consequences. Recent and past failures of financial institutions (FIs) – including those in Asia, Europe and the United States (US) – are reminders of the need to be prepared across multiple dimensions. History shows us that risks within financial systems can originate in many ways and that crises are not easily prevented.<sup>1</sup>

Recent failure events also bring to bear the critical importance of on-going crisis preparedness by authorities and the financial industry. Some commentators surmised this to be a ‘crisis hiding in plain sight’. Regardless of the causes, emerging risks – such as digital and social-media-driven bank ‘sprints’ – have prompted global reviews of deposit insurance and bank resolution frameworks, as well as prudential standards.

Returning to the GFC, the best thing that came out of it were reforms to strengthen the resolution regime for FIs. In 2011 and 2014, the Group of 20’s Financial Stability Board introduced and updated the “Key Attributes of Effective Resolution Regimes for Financial Institutions”. These global standards focus on the need to deal with the critical issues that would impede an orderly resolution of a FI, including legal complexities and cross-border issues.

On that note, it gives me great pleasure to share valuable insights from PIDM’s comprehensive study of 25 bank and insurance resolution cases across the Asia Pacific, US and European regions. The experience of tackling FI failures demonstrate that pre-emptive resolution powers and actions to deal with crises can alleviate otherwise disastrous outcomes on the economy, financial industry, individual banks, society, and the public.

This study offers us key lessons on managing risks and strategies for more effective resolution of FIs. It covers banks and insurance companies, reflecting complexities in designing and executing resolution that fits the business model of institutions in the respective sectors.

In our context, Perbadanan Insurans Deposit Malaysia (PIDM) is the deposit insurer and resolution authority for its Member Institutions (MIs). To achieve its strategic objectives, PIDM has among others, embarked on Resolution Planning (RSP). Following the release of our RSP guidelines in September 2023, PIDM will work together with our MIs in advance to ensure readiness to tackle severe challenges and pressures faced by any troubled institutions, and the broader system.

As it stands, the Malaysian financial system is stable and resilient. It will continue to evolve in meeting the changing needs of society and our nation into the future, bringing opportunities as well as risks. On that note, I hope that you will find these case studies to be a useful resource for deciphering lessons as well as applying foresight to navigate the terrains ahead of us.



A handwritten signature in black ink, appearing to be 'Rafiz' followed by a stylized flourish.

**Rafiz Azuan Abdullah**  
Chief Executive Officer

<sup>1</sup> Carmen M.R., Kenneth S.R. (2011). *This Time is different: Eight Centuries of Financial Folly*. Princeton University Press  
William Q., John D.T. (2020). *Boom and Bust: A Global History of Financial Bubbles*. Cambridge University Press

## Executive Summary

### PIDM as deposit insurer and resolution authority for its MIs

*As a resolution authority, PIDM's powers enable it to take pre-emptive measures and resolution actions. PIDM focuses on being resolution-ready during Business As Usual (BAU) times through resolution planning.*

Since the Asian Financial Crisis 25 years ago, the Malaysian financial system has evolved significantly. Considerable measures have been taken to ensure the robustness of the financial system, including strengthened institutional arrangements. In 2005, PIDM was established as the nation's deposit insurer, as set out in Bank Negara Malaysia's (BNM) Financial Sector Masterplan 2001 - 2010. PIDM's roles are to protect consumers in case of a MI failure, incentivise sound risk management and promote financial system stability. These work together to enhance the confidence of financial consumers in FIs and the system as a whole.

PIDM also fulfils its public policy objectives by establishing an effective regime for the resolution of its member banks and insurers. As resolution authority for its MIs, PIDM has a broad range of powers and tools to maintain public confidence in the financial system, during BAU as well as in times of crisis. Depending on the situation, PIDM's powers can be deployed either pre-emptively to avert a risk to the financial system, or to resolve a MI that has been declared to be non-viable by BNM.<sup>2</sup> At a broader level, PIDM's policy apparatus include a blanket government deposit guarantee as a stabilisation measure (introduced during the GFC until December 2010). In times of crisis, these collective powers provide options for expedient decision making. Through regular simulations within PIDM and with domestic and foreign authorities, PIDM attains higher levels of operational readiness and strengthens the efficacy of its resolution framework.

PIDM works closely with BNM and the Ministry of Finance to strengthen the bank resolution framework and financial safety net. The composition of PIDM's Board of Directors includes ex-officio members, namely the Governor of BNM and the Secretary General of the Treasury, which facilitates the coordination of interventions and resolution actions involving troubled MIs. Inter-agency arrangements are continually tested and reinforced via joint simulation exercises. Additionally, the Strategic Alliance Agreement between PIDM and BNM ensures continuous collaboration in key areas, including timely exchange of information and policies such as the Recovery and Resolution Planning framework.

### Preparing to be prepared in uncertain times - the best time to repair the roof is when the sun is shining

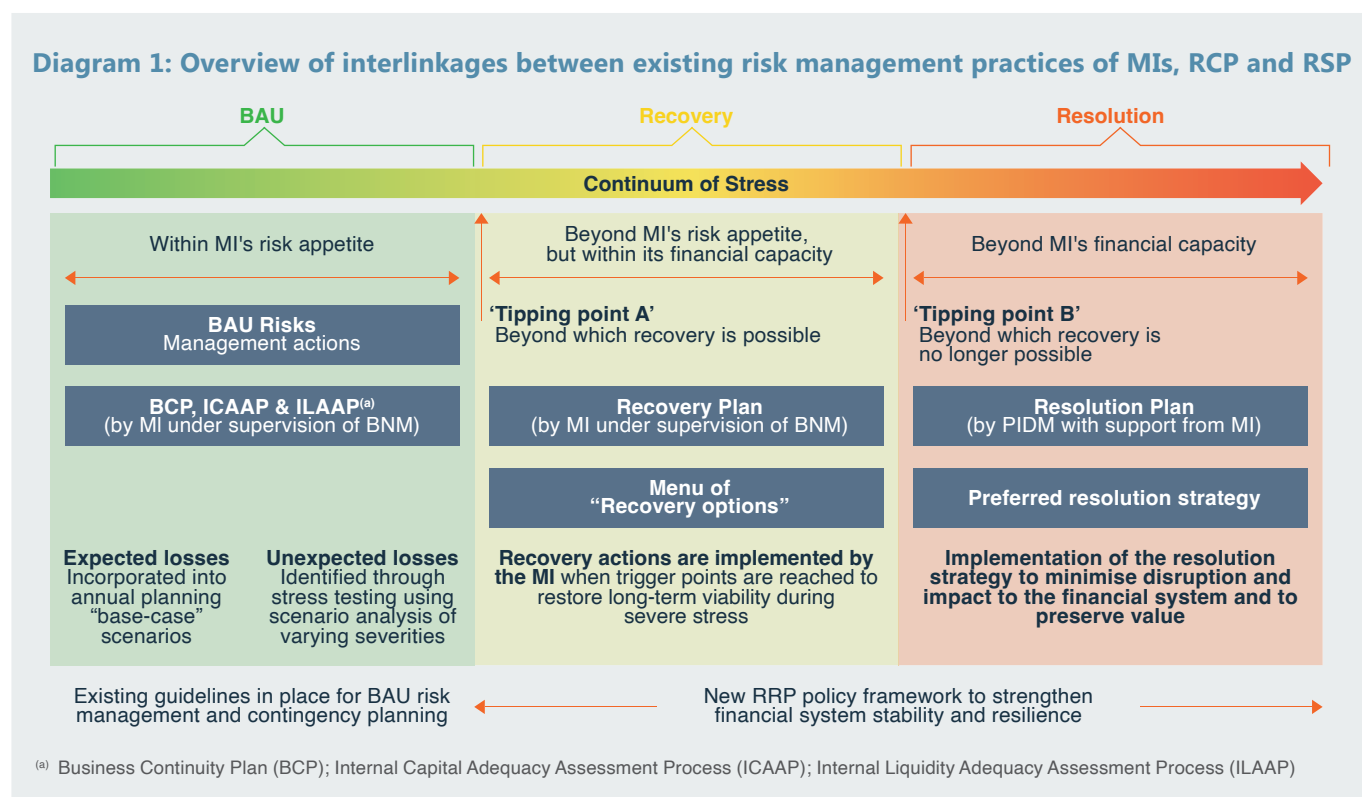
*Recovery and Resolution Planning (RRP) interacts with other BAU frameworks to build the resilience of MIs and the financial system through robust planning.*

RRP is a key component of post-GFC reforms to build the resilience of FIs and the financial system. Many recall the chaos from the abrupt bankruptcy of Lehman Brothers on 15 September 2008. The ensuing resolution proved to be a highly complex exercise requiring more than a decade and counting. Here, RRP lends credence to the counterfactual scenario of distressed FIs being well-prepared for crisis and preventing contagion to the rest of the system.

Recovery Planning (RCP) aims to restore the long-term viability of an institution and return it to BAU when it comes under severe stress. RCP is under BNM's purview and the policy for banks was issued in July 2021, with a phased implementation approach. If recovery options fall short in addressing the long-term viability of an institution, the focus shifts to achieving a prompt and orderly resolution of the failing MI. This is where RSP comes into play, as a policy tool and process used by PIDM to prepare in advance for resolution. With such crisis preparedness arrangements in place, MIs can fail in a safe manner irrespective of their size, with minimal disruptions to the market, financial system and economy. PIDM issued its guidelines on RSP requirements to member banks in September 2023.

<sup>2</sup> PIDM's loss mitigation powers allow it to undertake early intervention actions on MIs to reduce or avert a risk to the financial system or a threatened loss to PIDM. These include acquiring the assets of an MI, and acquiring or subscribing to its shares or capital instruments. Save for purposes of liquidity assistance, PIDM may extend or guarantee loans, advances or financing to an MI. PIDM's failure mitigation powers can be applied once BNM issues a non-viability notice for an MI. These include powers to transfer assets and liabilities to an existing entity, bridge institution or asset management company; to appoint an administrator to assume control of and manage or restructure the MI; to temporarily stay early termination rights or proceedings; to close and liquidate the failed bank with timely reimbursement of deposits and others

As part of inter-agency coordination, RRP policies have been streamlined by BNM and PIDM to minimise regulatory burden on the industry.<sup>3</sup> As depicted in Diagram 1, the interaction of RRP within an institution's risk management and contingency planning framework can be framed through the overarching lens of a stress continuum on the institution. It covers the condition from BAU operations to when recovery actions are triggered, and further deterioration leading to the activation of resolution strategies.



## Resolution planning for institutions to be 'transfer-ready'

*Ideally, the most suitable resolution strategy depends on the structure, financial and operational dependencies, as well as idiosyncrasies of the MI. In Malaysia, 'transfer-ready' is the primary resolution strategy.*

Through RSP, PIDM aims for member banks to be transfer-ready and resolvable, ensuring that critical economic functions performed by the institution can continue with minimal disruption to the financial system and economy. The institution's franchise value can also be better preserved. In essence, the going concern resolution strategy involves transfer of shares, businesses and / or portfolio of assets and liabilities of the institution to a private sector purchaser (commonly referred to as purchase and assumption or P&A) or in the absence of acquirers, to a temporary bridge institution run by PIDM. Restructuring of the institution is another option, which covers possible assets carve-out through an asset management vehicle. For smaller and less complex institutions, an alternative gone concern strategy is to wind up and liquidate the failed institution, while ensuring timely reimbursements to depositors.

<sup>3</sup> An example is PIDM leveraging existing data gathered from the strategic analysis exercise during the RCP process to support RRP requirements



## Benefits derived by financial institutions from enhanced planning for crisis

*Being transfer-ready helps institutions to unlock strategic value during BAU times, including for Mergers and Acquisitions (M&A)*

It is important to recognise that crisis preparedness yields on-going, beneficial outcomes to institutions. Through RSP, if done right, being transfer ready improves the ability to affect a transfer at BAU and at resolution, thereby facilitating better and swifter valuation of the institution. By building this capability during peacetime, institutions can quickly act on any opportunities for M&A, which will enhance their overall value. In addition, when the business is viewed from the perspective of resolution, institutions can uncover new insights.

For instance, the Board and senior management will have greater clarity of roles and responsibilities to guide decisive actions in times of very severe stress. When identifying impediments to resolution, institutions can also improve operations and risk management in areas such as Management Information Systems capabilities, legal certainties, crisis communications plans, and others. Moving forward, more resolvability criteria will be incorporated into PIDM's differential premium systems framework (in addition to the three resolution centric criteria) to further incentivise the resolvability of institutions.

## Gleaning insights from global case studies of resolution

*The case studies of the resolution of troubled banks and insurance companies enable us to draw new insights from global experiences, adapted for domestic situations or needs*

To highlight actual scenarios and experience from the implementation of various resolution strategies, PIDM has developed 25 case studies of bank and insurance resolution (refer Table 1 and Table 2).

**Table 1: List of case studies of bank resolution**

	Resolution strategy	Jurisdiction(s)	Financial Institution	Year
Banking	P&A and Bridge bank	United States	Silicon Valley Bank	2023
	P&A	United States	Washington Mutual Bank	2008
	Sale of business; Insolvency	Croatia, Slovenia; Austria	Sberbank d.d., Sberbank banka d.d.; Sberbank Europe AG	2022
	Sale of business	Spain	Banco Popular Español	2017
	Bridge bank	Japan	Incubator Bank of Japan	2010
	Moratorium and restructuring	India	YES Bank	2020
	Temporary capital placement	Indonesia	PT Bank Century	2008
	Nationalisation and restructuring	China	Baoshang Bank	2019 - 2020
	Nationalisation and restructuring	United Kingdom	Royal Bank of Scotland	2008
	Nationalisation and restructuring	Korea	Woori Financial Group	1998
	Precautionary recapitalisation <sup>4</sup>	Greece, Italy	National Bank of Greece, Piraeus Bank, Banca Monti dei Paschi di Siena	2015 - 2017
	Insolvency	Germany	Wirecard AG	2020
	Bankruptcy	Netherlands	Amsterdam Trade Bank N.V.	2022
	Voluntary market exit <sup>5</sup>	Australia	Xinja Bank	2020 - 2021

<sup>4</sup> Although precautionary recapitalisation is not a resolution tool, it has been included in the case studies due to the relevance of early interventions in steering solvent but troubled institutions towards recovery, and pre-emptively averting the failure of such institutions

<sup>5</sup> The experience of a voluntary market exit by a digital bank was included to highlight the commercial decision by Xinja to surrender its banking license and return deposits to customers

## Transfer approaches including P&A as the key strategy for the resolution of banks

The cases of bank resolution include actions using the transfer approaches (comprising the P&A and the sale of business mechanisms), which enabled effective execution of the resolution strategy by authorities in the US and Europe. Recent cases of bank failure in the US also demonstrate that the capability to execute transfers expeditiously proved to be crucial. The speed of deposit runs and large withdrawals were unprecedented,<sup>6</sup> pressuring authorities to act urgently as liquidity risks pushed banks over the edge.

The transfer or P&A tool is widely considered as the most efficient and least disruptive resolution method. Among others, it preserves critical functions performed by the institution, protects depositors by ensuring continued access to banking services, and minimises the contagion of risks to the rest of the banking system. Advanced planning for transfers during BAU times also yield benefits such as managing buyer-seller expectations of the transfer price, minimising friction costs associated with the transaction, or estimating the exposures of DIs towards facilitating a conducive market for clearance of the transaction.

In the US, since 2007, P&A represented about 95% of the Federal Deposit Insurance Corporation's (FDIC) total resolutions, which generally involved a single acquirer assuming most of the liabilities of the failing bank.<sup>7</sup> Additionally, recent research of P&A transactions for failed US commercial banks over 30 years demonstrated that the combined entity improved over a long-term in the areas of bank profitability, capital strength and portfolio risk.<sup>8</sup> A study of bank failures in the US from 2008 to 2013 also highlighted total estimated savings of \$42 billion using loss sharing transactions (as part of P&A), when compared to the estimated costs of reimbursement to depositors.<sup>9</sup>

At a broader level, resolution toolkits (going and gone concern) provide authorities with a range of resolution options, which can be used by themselves or in combination. A recent resolution strategy that has been added in some jurisdictions internationally is the "bail-in" regime. However, in Asia, it remains relatively new and untested.<sup>10</sup> Selecting the optimal resolution approach will depend on, among others, the size, complexity, interconnectedness and substitutability of the institution and its businesses.

As for liquidation and reimbursement, these are typically applied for smaller banks that do not perform critical economic functions. Across the Asia Pacific region, this tool has been widely used in several jurisdictions with a larger presence of rural banks (since the inception of various deposit insurance schemes, there has been 1,656 cases which were resolved via liquidation and reimbursement).<sup>11</sup>

**Table 2: List of case studies of insurance resolution**

	Resolution strategy	Jurisdiction(s)	Financial Institution	Year
Insurance	Transfer of business and run off	Germany	Mannheimer Life	2003
	Supervised run off, liquidation and payment of claims	United States	Lumbermens Mutual Casualty Company	2003
	Bridge institution and transfer of business	Japan	Nissan Mutual Life	2007
	Nationalisation, bridge institution, and restructuring	China	Anbang Insurance Group	2018
	Liquidation and payment of claims	Australia	HIH Insurance Group	2001
	Bankruptcy	Netherlands	Conservatrix N.V.	2020
	Insolvency	United States	Merced Property & Casualty Company	2018

<sup>6</sup> Justin R., Federal Reserve Bank of St. Louis (2023). *Understanding the Speed and Size of Bank Runs in Historical Comparison*. Economic Synopses 2023, No. 12

<sup>7</sup> Martin J. G., FDIC (2019). *An Underappreciated Risk: The Resolution of Large Regional Banks in the United States*

<sup>8</sup> Spokeviciute L., Jahanshahloo H., Keasey K., and Vallascas F. (2021). *Three Decades of Failed Bank Acquisitions*

<sup>9</sup> FDIC (2017). *Crisis and Response: An FDIC History, 2008-2013*. Washington, DC: FDIC

<sup>10</sup> The South East Asian Central Banks (SEACEN) Research and Training Center (2021). *To Bail-in or Not to Bail-in: A Question for Asian Financial Policymakers*

<sup>11</sup> IADI (2020). *Membership Profile of the Asia-Pacific Regional Committee – Research Paper*

## Differences in the resolution of failed insurers for life and non-life segments

Compared to bank failures, the nature of insurer failures is typically less time-sensitive. The resolution approach for insurers reflects this ‘slow-burn’ characteristic by prioritising continuity of coverage to protect policy-owners (particularly for the life segment) through transfer of business or portfolio run-off.

According to the International Associations of Insurance Supervisors (IAIS) – “the resolution strategy needs to recognise that resolution schemes play out very differently depending on the type of business involved; for example, the difference between contracts where premium is calculated year-to-year and claims are closed shortly after the end of the policy period; long-duration claims that might be paid out for decades after the losses have incurred; and long-term contracts where the premium paid in early years is intended to subsidise the insurer’s long-term obligations when claims are much more likely to occur. This distinction is important for liquidation as well as for non-liquidation alternatives”.<sup>12</sup>

Global research on the failures of insurance companies and resolution approaches have yielded many useful insights. A comprehensive study of 437 cases (150 life and 287 property and casualty insurers) in 2019 concluded that for the life sector, asset mix was a significant factor in predicting an impairment, with no influence from operating efficiency. Conversely, for non-life insurers, operating efficiency was prominent (as opposed to asset mix).<sup>13</sup>

Another study across the European landscape (180 insurance undertakings from 31 countries) in 2018 also delineated primary causes that led to the failure or ‘near misses’ of failure, of life and non-life insurers. For the life segment, the key risks (listed in order) were from management and staff, investment (asset-liability management), market, evaluation of technical provisions and the economic cycle. For the non-life segment, the top five risks that emerged were evaluation of technical provisions, internal governance and control, management, and staff, as well as underwriting and accounting.<sup>14</sup>

Meanwhile, in the US and Japan, research findings from insolvency cases of selected life insurers show that the adverse impact of failure on policy owners were mitigated through several resolution actions – imposing immediate suspensions of surrenders, changing contract provisions, avoiding the fire sale of assets, and finding other healthy institutions to take over assets and liabilities of the failed life insurer.<sup>15</sup> Lastly, research by the Canadian Property and Casualty Insurance Compensation Corporation (PACICC) identified common primary and contributing causes of Property & Casualty (P&C) insurance company failures as stemming from internal operations, organisational structure, adequacy of regulatory oversight as well as natural disasters.<sup>16</sup>

## The new mantra of ‘just-in-case’

***Low probability, high-impact events are a fact of life ... humanity reveals instead a preference to ignore them until forced to react – even when foresight’s price-tag is small***

The Economist

In response to crisis events of the past few years, corporate and governmental mindsets alike have shifted from a ‘just-in-time’ to ‘just-in-case’ posture. Crisis preparedness and management is increasingly recognised as a strategic capability to tackle challenges ahead.<sup>17</sup>

In the context of the financial sector, the last decade has seen many institutions working with authorities in their jurisdictions on RRP and resolvability assessments. These collective efforts have contributed towards stronger risk management for those institutions, as well as greater stability and resilience of the financial system against crisis. With advanced planning, authorities are able to better assess the possible systemic impact, risks and complexities of an FI’s failure, and to respond appropriately. This offers alternative options to bail out during a crisis, with the strategic aim of making the financial system more resilient and sustainable.

Going forward, technological innovations, climate-related risks and new developments will see the financial sector evolve towards greater market dynamism. Equally important is the focus on building resilience and preserving the stability of financial systems. PIDM will continue to stay abreast of emerging challenges and global experiences, in developing potential solutions to the complexities of the Malaysian financial system.

<sup>12</sup> IAIS (2021). *Application Paper on Resolution Powers and Planning*

<sup>13</sup> Oliver B., George O., Banque de France (2019). *Why do insurers fail? A comparison of life and non-life insolvencies using a new international database. Note: the authors of the paper used the definition of ‘impairment’, which includes some firms that have returned to financial health after interventions (major restructuring or large-scale government bail-out)*

<sup>14</sup> European Insurance and Occupational Pensions Authority (EIOPA) (2018). *Failures and near misses in insurance – overview of the causes and early identification*

<sup>15</sup> Geneva Association (2015). *US and Japan Life Insurers Insolvencies Case Studies – lessons learned from resolutions*

<sup>16</sup> Peng Z., Campbell I., & Kelly G., PACICC (2022). *Why insurers fail. Mapping the road to ruin: Lessons learned from four recent insurer failures*

<sup>17</sup> BSI (2018). *Crisis Management – Building A Strategic Capability. PD CEN/TS 17091: 2018 standard*

## Overview of Case Studies

### Banking institutions

	Case studies		Reasons for distress / failure	Overview of resolution actions
1	Silicon Valley Bank (SVB) (2023, United States)	Non-systemic. However systemic risk exception was triggered due to concerns of broader risk contagion	Rapid growth in deposits and investments in securities (unrealised losses in rising interest rate environment), poor risk management of business model and balance sheet strategies, liquidity crisis from significant deposit withdrawals / bank run by uninsured depositors	<b>Purchase and Assumption of SVB Bridge Bank</b> by First Citizens Bank & Trust Company (First Citizens), including \$72 billion of assets, and a loss sharing transaction between the FDIC and First Citizens. FDIC also provided First Citizens with a credit facility of \$70 billion and a loan of \$35 billion, and received equity appreciation rights for common stocks of First Citizens (valued up to \$500 million); systemic risk exception was applied by US authorities to protect all deposits (including uninsured) in SVB; and the SVB Bridge Bank was established to provide time for the FDIC to source for prospective acquirers for SVB.  In the UK, the Bank of England sold Silicon Valley Bank UK Limited to HSBC UK Bank Plc for £1.
2	Washington Mutual Bank (WaMu) (2008, United States)	Failure during GFC / systemic crisis <sup>18</sup>	Aggressive expansion into subprime mortgages, substantial deposit outflows	<b>Purchase and Assumption</b> of WaMu by JPMorgan Chase Bank (JPMorgan Chase) for \$1.9 billion; WaMu's bondholders, shareholders and investors bore losses of about \$30 billion. Prior due diligence by JPMorgan Chase contributed to the swift resolution.
3	Sberbank Europe AG (Sberbank Europe), Sberbank d.d. (Sberbank Croatia), Sberbank banka d.d (Sberbank Slovenia). (2022, Austria, Croatia, and Slovenia)	Resolution of Sberbank Croatia and Sberbank Slovenia was in public interest to maintain financial stability	Geopolitical crisis - Russian invasion of Ukraine. Sberbank Europe was a fully-owned subsidiary of Sberbank of Russia <sup>19</sup>	<b>Sale of business</b> – transfer of shares from Sberbank Croatia to Hrvatska Poštanska Banka d.d. (Croatian Postbank) for HRK71 million (€9.4 million / \$10.5 million) and from Sberbank Slovenia to Nova Ljubljanska Banka d.d. (NLB) for €5.1 million (\$5.7 million); <b>insolvency</b> of parent entity, Sberbank Europe in Austria and payout by Austrian Deposit Guarantee System; <b>moratorium</b> (suspension on payments, enforcement and termination rights) applied by the EU Single Resolution Board (SRB) for 48 hours.
4	Banco Popular Español (Banco Popular) (2017, Spain)	Resolution was in public interest to maintain financial stability	Spanish financial crisis, high Non-Performing Loans (NPLs), bank runs / liquidity crisis	<b>Sale of business</b> - transfer of shares to Banco Santander for €1; Banco de España (Spanish Central Bank) provided Emergency Liquidity Assistance (ELA) of €3.5 billion (\$4 billion) to Banco Popular prior to its failure. <b>Write-down</b> of Additional Tier 1 and Tier 2 bondholders of €2 billion (\$2.25 billion).
5	Incubator Bank of Japan (IBJ) (2010, Japan)	Non-systemic	Over-expansion and risky business model	A <b>bridge bank</b> was established by the Deposit Insurance Corporation of Japan (DICJ) to take over IBJ's good assets and insured deposits (uninsured deposits and general claims remained with IBJ and were reimbursed through civil rehabilitation procedures over a period of six years). DICJ provided financial assistance to the bridge bank and IBJ. Shares of IBJ were transferred from the bridge bank to AEON Bank 15 months after IBJ's failure.

<sup>18</sup> The systemic risk exception was not applied to WaMu

<sup>19</sup> The largest bank in Russia and majority-owned by the Russian Federation

	Case studies		Reasons for distress / failure	Overview of resolution actions
6	YES Bank (2020, India)	Non-systemic, but was India's fourth largest private lender	Aggressive growth, depositor run, default on bond coupon payment, management and governance crisis	<b>Restructuring – moratorium</b> on depositor withdrawals and prohibition on granting loans or payments; <b>Reconstruction scheme</b> drawn up within 14 days including new investments by a government-owned commercial bank and a consortium of seven private FIs totalling INR100 billion (\$1.35 billion); write down of INR84 billion (\$1.1 billion) of AT1 bonds; Reserve Bank of India extended credit line of INR600 billion (\$7.9 billion) to YES Bank.
7	PT Bank Century (2008, Indonesia)	Failure during GFC (adverse contagion impact)	Negative capital position	<b>Temporary capital placement</b> – renamed as PT Bank Mutiara; total capital injections of IDR8 trillion (\$658 million) by Indonesia Deposit Insurance Corporation (IDIC); sale of Bank Mutiara to a Japanese finance company, J Trust Co for IDR4.4 trillion (\$360 million) in 2014.
8	Baoshang Bank (Baoshang) (2019-2020, China)	Non-systemic. However, broader concern on overall health of regional / small banks	Fraud and related party transactions (linked to Tomorrow Group)	<b>Nationalisation and restructuring</b> – blanket guarantee of all Baoshang's retail and corporate deposits, and interbank debts up to CNY50 million (\$7.2 million); liquidity support of CNY23.5 billion (\$3.38 billion) by People's Bank of China (PBOC); appointment of China Construction Bank to manage Baoshang's day to day operations; transfer of business, assets and liabilities to Mengshang Bank (new entity) and Huishang Bank (with financial assistance of CNY34.4 billion (\$5 billion) from PBOC); liquidation of bad bank; write down of Tier 2 bonds of CNY6.5 billion (\$984 million).
9	Royal Bank of Scotland (RBS) (2008, United Kingdom)	Failure during GFC / systemic crisis	Capital, funding and governance issues, over-expansion, uncertain asset quality, credit trading losses	<b>Nationalisation and restructuring</b> – total capital injection of £45.5 billion (\$75.8 billion) by Her Majesty's Treasury resulting in ownership of 84% of RBS; Bank of England provided ELA in USD and £ (usage peaked at \$25 billion and £29.4 billion (\$47.9 billion), and was repaid in December 2008); RBS established internal non-core division to manage £258 billion (\$426 billion) of bad assets. The UK government still holds 38.6% in RBS with plans for full disposal by 2026.
10	Woori Financial Group (Woori) (1998, Korea)	Systemic, failure during Asian Financial Crisis (AFC) (adverse contagion impact)	High NPLs during AFC	<b>Nationalisation and restructuring</b> – Open Bank Assistance / capital injection of \$7.9 billion by Korea Deposit Insurance Corporation (KDIC); MoU between KDIC and Woori for oversight; restructuring and listing of Woori on Korea Stock Exchange and New York Stock Exchange; Korean government owns remaining stake of 3.6% in Woori with plans for full divestment.
11	National Bank of Greece (NBG), Piraeus Bank (2015, Greece)	Systemic <sup>20</sup>	Severe economic downturn in Greece	NBG and Piraeus: <b>Precautionary recapitalisation</b> totalling €5.4 billion (\$6 billion) by Hellenic Financial Stability Fund in the form of contingent convertibles and ordinary shares.
	Banca Monti dei Paschi di Siena (MPS) (2017, Italy)		Losses from acquisitions, risky derivative trades, high NPLs	MPS: <b>Precautionary recapitalisation</b> of €5.4 billion (\$6 billion) by way of capital injection and compensation to retail investors for the mis-selling of financial products by MPS, <sup>21</sup> as well as comprehensive restructuring plan.

<sup>20</sup> These banks are deemed to be systemically important institutions by authorities in the relevant jurisdictions

<sup>21</sup> This case study focuses on precautionary recapitalisation for the resolution of MPS. Other actions included restructuring and NPL divestments

	Case studies		Reasons for distress / failure	Overview of resolution actions
12	Wirecard AG (2020, Germany)	Non-systemic, but key payments / card provider (Europe's largest Fintech)	Accounting fraud, gap in regulatory oversight	<b>Insolvency</b> of Holding Company providing Fintech services; regulators ring-fenced subsidiary (Wirecard Bank); UK Financial Conduct Authority suspended the e-money license of Wirecard UK. Wirecard Bank carried out private sector wind down in 2021.
13	Amsterdam Trade Bank N.V. (ATB) (2022, Netherlands)	Non-systemic	Operational failure due to sanctions imposed on ATB and its parent (Alfa Bank) <sup>22</sup> from Russian invasion of Ukraine	<b>Bankruptcy</b> – ATB was declared bankrupt by the Amsterdam District Court (pursuant to ATB's filing). The Deposit Guarantee Scheme for account holders of ATB was activated by the Dutch Central Bank (DNB).
14	Xinja Bank Limited (Xinja) (2020-2021, Australia)	Non-systemic, newly licensed neo / digital bank	Funding and business model concerns	<b>Voluntary market exit</b> – commercial decision by Xinja to surrender its banking license in mid-December 2020. Deposits of AUD252 million (\$191 million) were successfully returned to customers within 1 month after the exit was announced. This includes the use of the Australian Prudential Regulation Authority's (APRA) powers to effect the voluntary transfer of remaining tail deposits to the National Australia Bank.

## Insurance companies

	Case studies		Reasons for distress / failure	Overview of resolution actions
1	Mannheimer Life (2003, Germany)	Life	Challenge in meeting guaranteed investment returns, significant equity investments / slump in capital markets	<b>Transfer of business</b> to Protektor Lebensversicherungs-AG (Protektor), a private safety net scheme by Germany's life insurers – about €240 million (\$285 million) was allocated from Protektor to meet Mannheimer Life's solvency requirement; Protektor undertook <b>run-off scheme</b> to protect policy owners and after 15 years, transferred remaining policies to Entis, which was then sold to Viridium Group, a specialised insurance portfolio manager.
2	Lumbermens Mutual Casualty Company (2003, United States)	Non-life	Asbestos claims from workmen compensation policies, difficulty in raising capital (as mutual insurer)	<b>Supervised run-off</b> successfully implemented – surplus and liquidity enhancing transactions, staff retention, and close supervision by Illinois Department of Insurance (over 500 corrective orders, allowances for accounting practices); orderly transition towards <b>liquidation</b> after about 10 years in 2013. The liquidation then triggered <b>payment of claims</b> by insurance guarantee funds for liabilities up to coverage limits.
3	Nissan Mutual Life (Nissan Life) (1997, Japan)	Life	Economic recession, prolonged low interest rates, poor stock market performance, default on loans to real estate developers	Setup of <b>bridge insurer</b> (Aoba Life Insurance Co) under the Life Insurance Association of Japan to take over Nissan Life's assets and existing policies; Insurance Policyholders Protection Fund provided ¥200 billion (\$1.8 billion) with balance of losses borne by policy owners; suspension of policy surrenders to manage liquidity; <b>transfer of business</b> / sale of Aoba to Artemis (French retailer group), which then sold Aoba to Prudential Life Insurance (US) after five years.

<sup>22</sup> Alfa Bank was the largest private bank and fourth largest financial institution in Russia



	Case studies		Reasons for distress / failure	Overview of resolution actions
4	Anbang Insurance Group (Anbang) (2018, China)	Composite	Aggressive expansion: overseas acquisitions of loss-making insurers and property assets, high guaranteed yield / equity investments and mismanagement	<b>Nationalised:</b> China Banking and Insurance Regulatory Commission assumed control of Anbang for two years, including restructuring efforts with PBOC and other authorities; the China Insurance Security Fund injected fresh capital of CNY60.8 billion (\$8.6 billion) into Anbang, owning 98.2%; established new entity (Dajia Insurance Group) / <b>bridge institution</b> to acquire Anbang's core businesses of life insurance, general insurance, pension insurance and asset management.
5	HIH Insurance (HIH) (2001, Australia)	Non-Life	Improper reserving practice, aggressive pricing, rapid business expansion, conglomerate complexity, poor governance, abuse of reinsurance, others	Placed into <b>liquidation</b> ; liquidator worked with other insurers to cover protection gaps (e.g. builder's warranty insurance); government and industry setup a claims support scheme (HIH Scheme) for <b>payouts</b> / compensation of losses to policy owners – this scheme was worth more than AUD500 million (\$318 million); Royal Commission established to look into the failure of HIH – the Australian government adopted an Insurance Guarantee Scheme (IGS) for general insurers in 2008, administered by APRA.
6	Conservatrix N.V. (Conservatrix) (2020, Netherlands)	Life	Unable to sustain high guaranteed returns and profit-sharing policies	<b>Bankruptcy</b> declared in 2020 as Conservatrix was unable to meet future obligations to policy owners; DNB appointed a trustee, to look into supporting the continuity of insurance coverage for policy owners which were eventually assumed in July 2022 by Waard, Chesnara PLC's Dutch closed book operation; previous action taken by DNB in 2017: transfer of Conservatrix shares to a new owner, which then recapitalised the institution.
7	Merced Property & Casualty Company (Merced) (2018, United States)	Non-life	Climate / natural disaster risk (wildfires), over-concentration of geographical risks	<b>Insolvency</b> – California State Insurance Commissioner declared Merced insolvent and initiated liquidation proceedings. The IGS: California Insurance Guaranty Association (CIGA) assumed covered policies and reimbursed almost 90% of total losses suffered by owners of Merced's insurance policies.



# Bank Resolution

Case Studies

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## Purchase and Assumption and Bridge Bank *Silicon Valley Bank (2023)*



### Background and context

Founded in 1983 by a bank executive and university professor, Silicon Valley Bank (SVB) had focused on lending to start-ups from its establishment. As the technology industry boomed, SVB grew over the years to become the 16<sup>th</sup> largest bank in the US. As at 31 December 2022, it held total assets of about \$209 billion and total deposits worth \$175.4 billion, with about 8,500 employees. Headquartered in Santa Clara and with 17 branches in California and Massachusetts, SVB was a state-chartered regional bank providing financing in the San Francisco Bay Area to Venture Capital (VC) and private equity firms, technology and health care companies (including early-stage and start-up companies), as well as mortgages to high-net-worth individuals (HNWI). SVB was regulated and supervised by the Federal Reserve Bank of San Francisco / US Federal Reserve System (Fed) as well as the state bank regulator - the California Department of Financial Protection and Innovation (CDFPI).

SVB is the main subsidiary of SVB Financial Group (SVBFG), a financial holding company listed on the S&P 500 index. SVBFG is also involved in VC and investment management, securities, and private banking, and had subsidiaries including in the UK, Germany and Canada.

SVB registered high returns on equity of up to 20% in 2019. While making gradual progress over the years, its growth trajectory spiked from 2018 to 2021. Total assets of SVBFG rapidly rose by 271% (industry average of 29% over the same period) as low interest rates fuelled rapid growth in the VC and technology sector, in turn leading to record-high deposit inflows. In terms of profiles, there was high concentration of large deposits among VC-backed technology and life-sciences companies (Figure 1). Concomitantly, about 94% of total deposits were uninsured (amounts exceeding the US statutory deposit insurance limit of \$250,000). SVB did not

have a substantial retail deposits business. In many ways, the business model of SVB was an outlier compared to its peers in terms of loans, deposits and securities holdings (Table 3).

A large proportion of the record inflow of deposits were invested in long term Held to Maturity (HTM) securities (weighted average duration of 6.2 years). These HTM securities were accounted for at amortised historical costs instead of mark-to-market values. However, as interest rates rose, SVB accumulated increasing unrealised losses on its securities portfolios (Figure 2).<sup>23</sup> Moreover, SVB did not manage its interest rate risk exposures well. Hedges to protect its growing securities portfolio against rising rates were removed in prior years.

As a result of the sharp rise in US interest rates in 2022 (from the target range of 0 – 0.25% to 4.25 – 4.50%) and concerns about the US economy, investors turned cautious and technology investments dried up. This led to higher deposit outflows from SVB, as VC-backed clients withdrew funds for business operations.

To meet increasing deposit withdrawals, SVB restructured its balance sheet. On 8 March 2023, it announced that \$21 billion of Available For Sale (AFS) securities were sold at a loss of \$1.8 billion, and additional equity capital of \$2.2 billion would be raised. Furthermore, there were future expectations

of a slowdown in the technology sector and potential rating downgrades on SVBFG. The voluntary liquidation of Silvergate Bank also occurred on the same day, affecting the confidence of depositors.

*My ask is to stay calm because that's what is important. We [SVB] have been long-term supporters of you – the last thing we need you to do is panic*

Greg Becker, former Chief Executive Officer of Silicon Valley Bank

On 8-9 March, the Chief Executive Officer (CEO) of SVB announced the restructuring of SVB's balance sheet and urged its VC depositors to remain calm and avoid panic, amid growing concerns surrounding SVB. Fuelled by social media and the concentrated network of VC investors and technology firms, these negative news flows culminated in an unprecedented large, fast-paced, digitally driven bank run by SVB's uninsured depositors. On 9 March, \$42 billion was withdrawn with an expectation of another \$100 billion outflow the next day. Taken together, SVB would have potentially shed 87% of its total deposits in 2 days. Consequently, SVB was closed on the morning of 10 March by the CDFPI, which also appointed FDIC as the receiver.

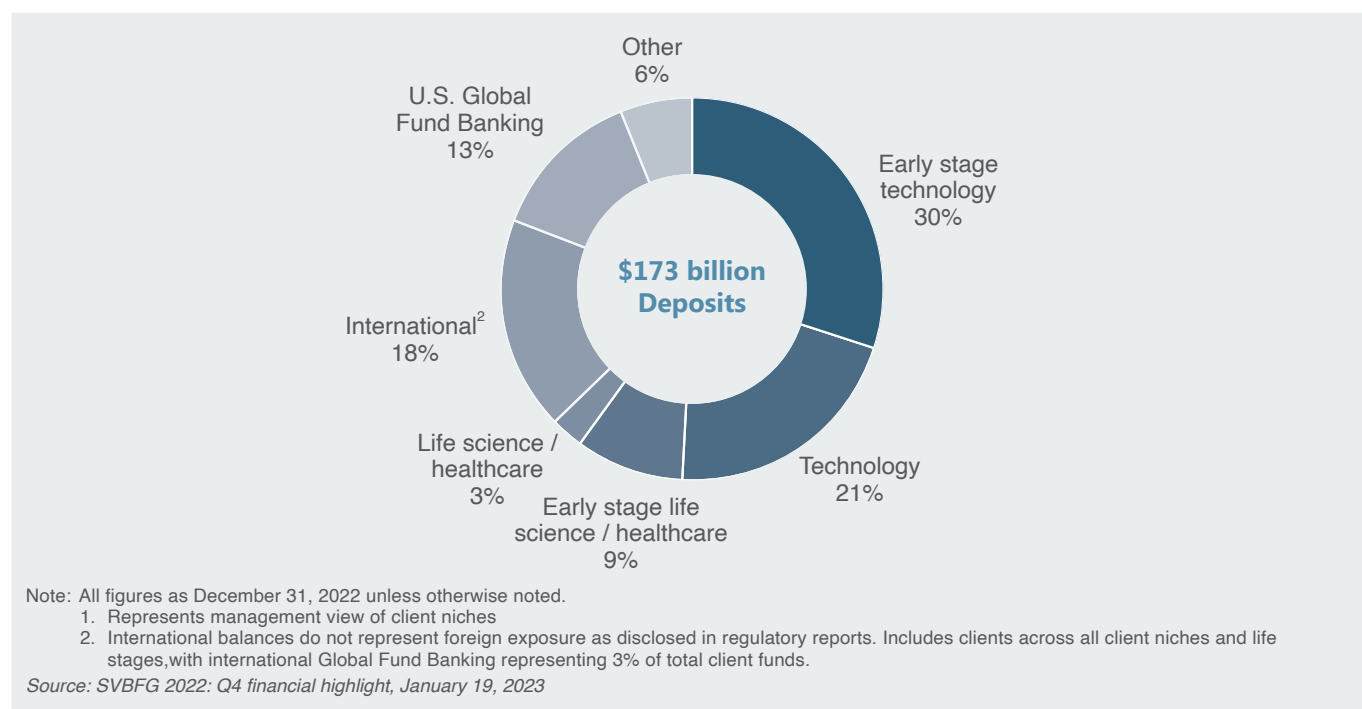
### **Silicon Valley Bank UK Limited (SVB UK)**

SVB UK, a subsidiary of SVB, also specialised in financing early and high-growth start-ups in the UK. According to reports, it served a large base of companies forming the innovation economy (3,300 customers) including British start-ups backed by VC, which held an estimated £2.5 billion (\$3.0 billion) of total deposits in SVB UK. At a broader level, SVB UK was not a large bank – its total asset size was £8.8 billion (\$10.6 billion), with deposits and loans of about £6.7 billion (\$8.1 billion) and £5.5 billion (\$6.6 billion) respectively.

On 10 March, as SVB was being resolved in the US, SVB UK experienced a deposit run, losing £2.9 billion (\$3.5 billion) or 30% of its overall deposits. It then applied to access £1.8 billion (\$2.2 billion) from the Bank of England (BoE) discount window / short term funding facility to banks. Subsequently, on the evening of 10 March, the BoE announced that 'absent any meaningful further information', it intended to place SVB UK into insolvency.

<sup>23</sup> "Unrealised gains or losses" refers to the difference between the value of the security at the time of purchase and the price of the security today, if it were sold on the market. Since HTM securities are meant to be held until maturity, any decline in the value from the purchase date is considered an unrealised loss. While unrealised losses must be disclosed in financial statements, they do not change the assets' value on the balance sheet itself

**Figure 1:**  
SVBFG client funds by client type / niche<sup>1</sup>

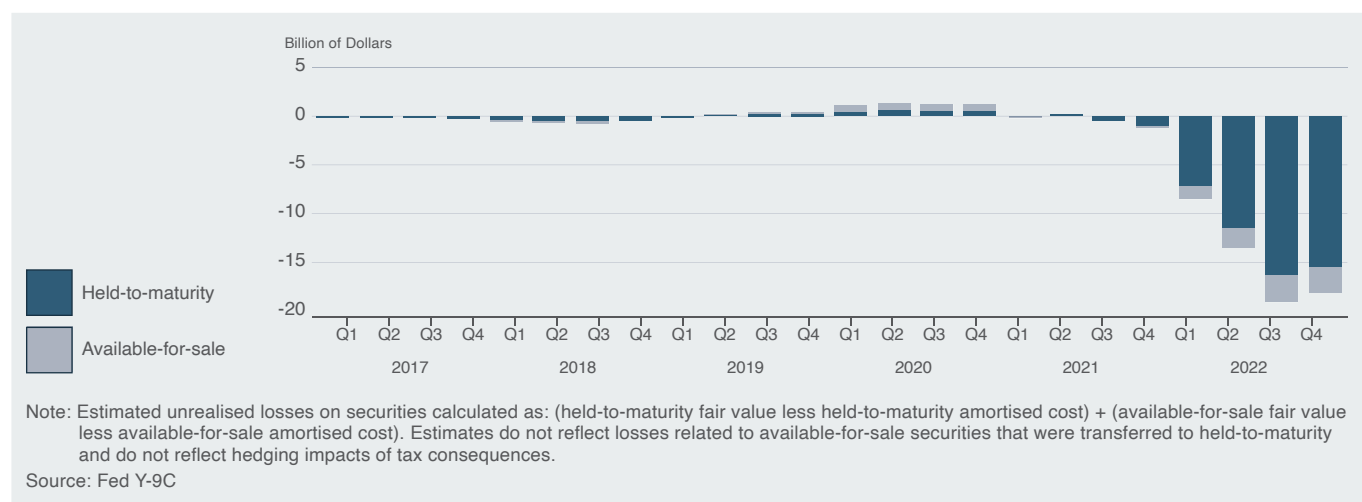


**Table 3:**  
Peer comparison, 2022: Q4 (%)

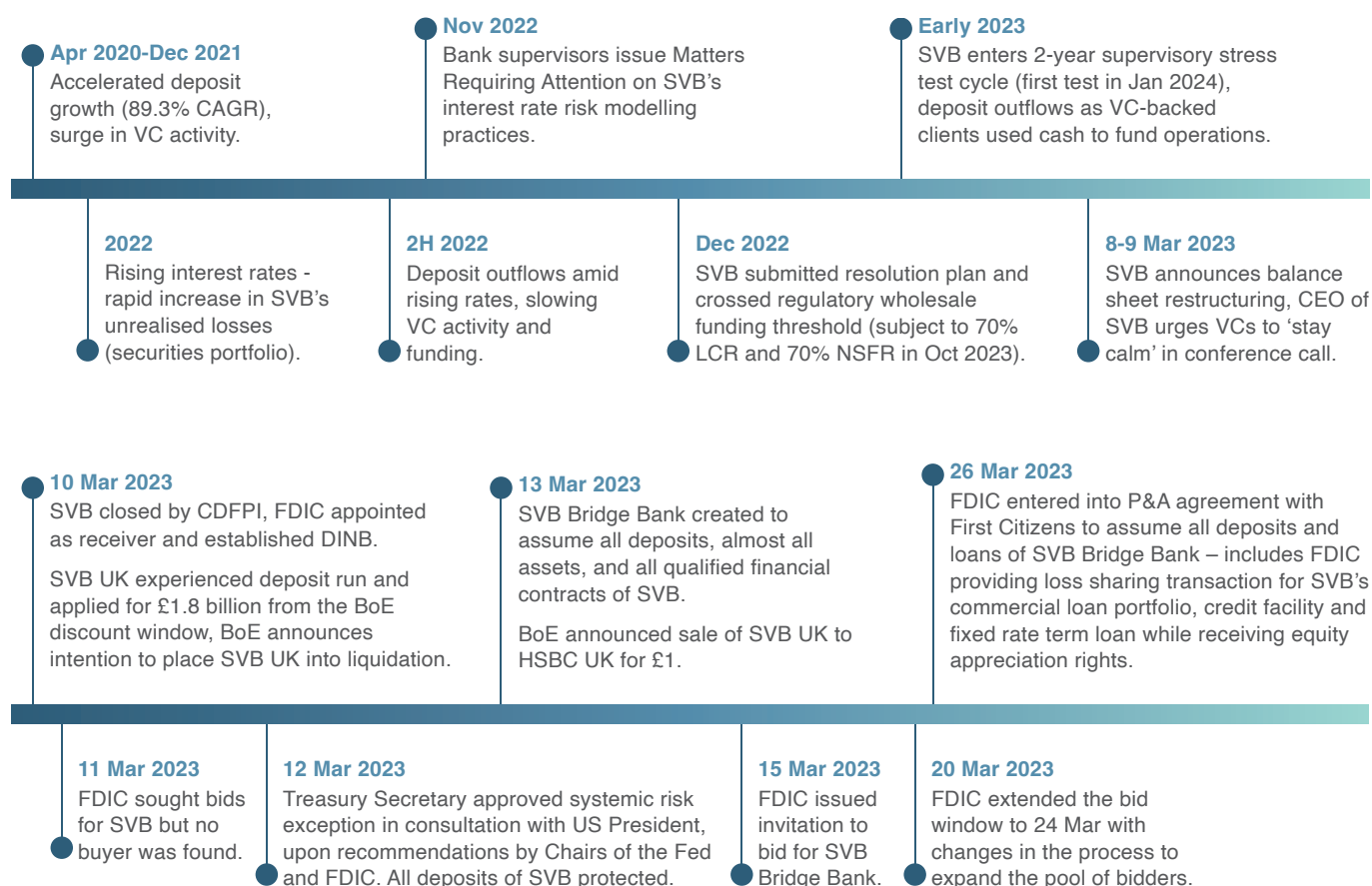
Metric	SVBFG	LBOs
Loans as a percentage of total assets	35	58
Securities as a percentage of total assets	55	25
Held-to-maturity securities as a percentage of total securities	78	42
Total deposits as a percentage of total liabilities	89	82
Uninsured deposits as a percentage of total deposits	94	41
Common equity tier 1 capital as a percentage of total risk-weighted assets	12	10

Note: Values for large banking organisations (LBOs) represent weighted averages of all US bank holding companies and savings & loan holding companies with total assets greater than \$100 billion, with the exception of banking organisations in the Large Institution Supervision Coordinating Committee (LISCC) supervisory portfolio.  
 Source: Fed-Y9C and Call Report.

**Figure 2:**  
Estimated unrealised gains (losses) on SVBFG's investment portfolio securities



### Resolution of SVB – Timeline of Key Events



### Systemic risk exception applied to protect all deposits at SVB

On 10 March, upon the closure of SVB, the FDIC established the Deposit Insurance National Bank<sup>24</sup> of Santa Clara (DINB) and all insured deposits were immediately transferred to DINB. Meanwhile, uninsured depositors would be paid an amount in the following week, with future payments contingent upon the sale of SVB's assets. While the FDIC sought bids from an auction of SVB on 11 March, no buyer was found. Only two bids were received, and the one valid offer would have resulted in recoveries below that of a liquidation scenario.

Hence, on 12 March, the Treasury Secretary, Chair of the Federal Reserve (Fed Chair), and Chairman of the FDIC jointly announced, among others, that a systemic risk exception would be applied to SVB to strengthen public confidence in the US banking system. This action was approved by the Treasury Secretary in consultation with the US President, upon recommendations by the Fed Chair and FDIC Chairman.

This meant that all deposits in SVB, including the uninsured portions, would be fully protected. However, shareholders and certain unsecured debtholders took losses. It was also communicated that senior management of SVB has been removed and as required by law, losses sustained by the Deposit Insurance Fund (DIF) would be recovered by way of special assessment on banks. Taxpayers would not bear any losses relating to SVB's resolution.

In addition, to provide assurance that banks could meet depositor needs, the Fed provided additional funding through a new Bank Term Funding Program (BTFP) for depository institutions.<sup>25</sup>

<sup>24</sup> The Banking Act of 1933 authorised the FDIC to establish a "new" bank called a Deposit Insurance National Bank (DINB) (a national bank chartered with limited life and powers) to assume the insured deposits of a failed bank, and pay depositors. Depositors of a DINB were given up to two years to move their insured accounts to other institutions, allowing a failed bank to be liquidated in an orderly fashion

<sup>25</sup> The BTFP offers loans of up to one year to banks pledging collateral (valued at par) as an additional source of liquidity. This eliminates an institution's need to quickly sell highly liquid securities in times of stress



## Bridge bank established as a stabilisation measure

On 13 March, Silicon Valley Bridge Bank, N.A. (SVB BB) was created as a bridge bank operated on a temporary basis by the FDIC, which appointed a new CEO for the SVB BB. All deposits, almost all of SVB's assets, and all qualified financial contracts, were transferred to SVB BB to protect depositors, preserve asset values and operations of SVB, and potentially improve recoveries for creditors and the DIF.

With the bridge bank structure in place, the FDIC was able to source for better offers. Prospective acquirers also had more time to assess SVB's condition. Invitation for bids were issued on 15 March, with reports suggesting the FDIC's

preference for a sale of the entire bank. Subsequently, the FDIC announced several changes to the bid process for SVB BB, including extension of the bid window to 24 March. Notably, the FDIC would accept separate bids for SVB BB and Silicon Valley Private Bank (for HNWI). Moreover, the pool of bidders was widened – qualified insured banks in alliance with nonbank partners could submit whole-bank bids, while non-bank financial firms could bid on asset portfolios. The FDIC ended up receiving 27 bids from 18 parties (one or more bidders submitted more than one bid), across all three categories: whole-bank, private bank and asset portfolios.

## Purchase and Assumption of SVB Bridge Bank by First Citizens Bank & Trust Company (First Citizens)

On 26 March, 16 days after the SVB auction process was initiated, the FDIC entered into a P&A agreement with First Citizens which assumed all deposits and loans of SVB BB, and also acquired the private bank. As at 10 March, SVB BB held an estimated \$167 billion in assets and about \$119 billion in deposits.

***Let me say that this acquisition is compelling financially, strategically and operationally***

Frank Holding, Chief Executive Officer of  
First Citizens Bank



The deal involved purchase of approximately \$72 billion of SVB BB's assets at a discount of \$16.5 billion. Meanwhile, \$90 billion of securities and other assets remained in receivership with the FDIC. The structure also involved a loss sharing transaction, where the FDIC will cover an estimated \$60 billion of loans and reimburse First Citizens for 50% losses of SVB's commercial loans in excess of a \$5 billion threshold. The FDIC also provided a \$70 billion credit facility for a two-year period for liquidity support to First Citizens, as well as a five-year loan of \$35 billion at a fixed rate of 3.5% (this was structured as a purchase money note issued by First Citizens to the FDIC). Lastly, the FDIC received equity appreciation rights for the common stock of First Citizens with a potential value of up to \$500 million.

## Sale of SVB UK to HSBC UK Bank Plc (HSBC UK)

The BoE, in its earlier statement on 10 March stating the intention to place SVB UK into insolvency (with reimbursements to depositors up to the deposit insurance limit of £85,000 per depositor), explained that the bank had limited presence in the UK and did not perform any critical functions supporting the financial system. The insolvency approach was also the BoE's preferred resolution strategy for SVB UK.

***This decision (to sell SVB UK to HSBC UK) has been taken to stabilise SVB UK, ensuring the continuity of banking services, minimising disruption to the UK technology sector and supporting confidence in the financial system***

Bank of England



However, on 13 March, the BoE announced that – in consultation with the Prudential Regulatory Authority, Her Majesty's Treasury and the Financial Conduct Authority – the decision was made to sell SVB UK to HSBC UK for £1.<sup>26</sup> In explaining its position at the Treasury Select Committee hearing on SVB UK held on 28 March, Andrew Bailey, Governor of the BoE, argued that the resolution strategy of a sale was always the preference for a better outcome. In the case of SVB UK, effecting a sale also preserved continuity of banking for important businesses in the technology and life sciences sector.

Despite interest from prospective suitors which accessed SVB UK's data room from 11 to 12 March, only HSBC UK put in a bid. It was reported that HSBC UK had concluded only 70% of its due diligence on SVB UK's loan books. However, it still went ahead with the decision to acquire SVB UK, which was solvent and seen as a good strategic fit to expand HSBC UK's commercial banking business in high-growth industries. Following the acquisition, HSBC UK disclosed plans to inject £2 billion (\$2.4 billion) into SVB UK to fund its holdings of long-dated assets and sustain operations, pending business integration.

<sup>26</sup> The BoE undertook a provisional valuation of SVB UK and its AT1 and Tier 2 regulatory capital instruments were mandatorily written down with the whole equity transferred to HSBC UK. The interests of SVB US, as the sole holder of SVB UK's regulatory capital instruments, were extinguished following resolution execution.

## Key takeaways

The failure of SVB in March 2023 drew significant interest owing to its unique characteristics, as well as concerns of potential contagion across the US as well as global financial system. It has been argued that SVB's failure – as well as the failures of Silvergate Bank on 8 March and Signature Bank (Signature) on 12 March – led to broader loss of confidence in banks, which then affected Credit Suisse Group AG (acquired by UBS AG on 19 March) and First Republic Bank (acquired by JP Morgan Chase on 1 May). From a policy and resolution lens, six key insights and areas can be distilled from the collapse of SVB.

### Agile resolution execution

First, the importance of agility in resolution execution in terms of timing, assessing systemic risk, and recalibrations in resolution strategies and tactics. In SVB's case, the runway or 'time-to-resolution intervention' was significantly truncated by massive deposit withdrawals, leading to its urgent closure by the CDFPI on Friday morning. FDIC moved in immediately to create the DINB without having the benefit of a 'resolution weekend'.<sup>27</sup>

Dynamic situations also require greater adaptability, supported by comprehensive powers and tools to facilitate changes in the resolution approach. Having decided to only cover insured deposits via the DINB, the FDIC altered the course of its resolution strategy for SVB over the weekend. With the imminent failure of Signature in sight, the FDIC and Fed speedily assessed and sought approvals from the Treasury Secretary on systemic risk determinations for both SVB and Signature. With 2 bank failures within a 48-hour window, there were serious concerns of contagion to other institutions, risk to the overall financial system, and broader economic spillover effects. Losses of uninsured deposits could also adversely impact the ability of SVB and Signature's small and medium-sized business customers to make payroll, pay suppliers and sustain operations. This led to the swift resolution action of protecting all deposits by applying the systemic risk exception, and creating temporary bridge banks while the FDIC worked expeditiously to find suitable acquirers for SVB and Signature.

The FDIC also demonstrated flexibility on the tactical front. For instance, it extended and simplified the bidding processes for SVB. Meanwhile, in the UK, the BoE also changed its resolution strategy from an initial position to place SVB UK into insolvency, to the sale of its business to HSBC UK as a better solution that emerged over the weekend.

### Robust regulation

Second, the importance of robust regulatory action and policies. According to the Fed, a key reason for SVB's collapse was the failure by SVB's Board and senior management to oversee inherent risks in SVB's business model and balance sheet strategies. Beyond the issues at SVB, while supervisors identified vulnerabilities, due to changes in rules applied to US banking institutions in 2018, SVB ended up being subject to less intensified regulatory and supervisory frameworks.<sup>28</sup>

Even after crossing the regulatory threshold in June 2021 of \$100 billion (average total consolidated assets) for enhanced prudential standards, at the time of its failure, SVB had yet to adopt important capital and liquidity requirements due to transition periods in the rules, e.g. SVB would have been subjected to its first stress test only in January 2024. In addition, SVB's tailored resolution plans were only submitted to authorities in December 2022 – had those and other rules been applied earlier, SVB may have been more resilient, for instance having better contingency funding plans. SVB's ability to set up data rooms for faster bidding by potential acquirers (as part of regulatory initiatives to enhance the resolvability of banks) could have also led to more effective resolution.

<sup>27</sup> This departed from FDIC's conventional approach to announce closure of failed banks on a Friday evening to facilitate potential sale over the weekend, and re-opening on Monday morning to ensure minimal disruption to customers of the failed bank

<sup>28</sup> In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) amended the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) by raising the \$50 billion minimum asset threshold for general application of Enhanced Prudential Standards (EPS) to bank holding companies with \$250 billion in total assets. Consistent with the EGRRCPA, in 2019, the Fed raised the threshold for EPS from \$50 billion in assets to \$100 billion in assets, and SVBFG was subject to a less stringent set of EPS when it reached the \$100 billion threshold than would have applied before 2019

## Dynamic policies for bank runs and reform of deposit insurance coverage

Third, the importance of addressing the risks of fast-paced and amplified deposit runs. The withdrawal of \$42 billion from SVB in a single day (25% of total deposits), with another \$100 billion (62%) in waiting on the next day, was unprecedented and led to the swift closure of SVB by the CDFPI. It was fuelled by the mix of a large uninsured depositor base, social media, digital access and herd behaviours among a common network of technology and VC depositors. To put in context, the largest failure in US banking history (Washington Mutual Bank in 2008) recorded a 10% deposit outflow over a period of 16 days.

While SVB's case was unusual (high level of uninsured deposits with concentration among similar tech start-up depositors), it highlights the broader need for more effective policies to tackle liquidity risks as well as strategies to mitigate the spread of panic and potential dis-information through social media channels. In addition, policy discussions are taking place internationally on the possibility of increasing the level of deposit coverage to include certain uninsured deposits. For instance, under the FDIC's reform proposals, the favoured option is to target coverage of large accounts used for business payments. While such policies may increase public confidence in the deposit insurance system, it is equally essential to consider the trade-off of moral hazard in ensuring market discipline is not compromised, as well as costs associated with higher coverage levels. Another point is to consider the complimentary roles of deposit insurance, the prudential framework and the resolution regime.

**Table 4: Selected Deposit Runs from 1984 to 2023**

Bank	Date run started	Deposit insurance coverage (%)	Total outflow (%)	Duration of outflow
Continental Illinois	May 7, 1984	15	30	10 days (7 bus. days)
Washington Mutual	Sep 8, 2008	74	10.1	16 days (12 bus. days)
Wachovia	Sep 15, 2008	61	4.4	19 days (15 bus. days)
Silergate	2022 Q4	11	52	Possibly 7 days or less
Silicon Valley Bank	Mar 9, 2023	6	25 + 62*	1 day + expected next day
Signature Bank	Mar 10, 2023	10	20 + 9*	1 day + expected next day
First Republic	Mar 10, 2023	32	57	About 7-14 days (5-10 bus. days)

\* Expected amounts of outflows that were scheduled to go out the next business days, but did not actually occur because the banks were closed  
Source: Federal Reserve Bank of St. Louis

## Effective crisis communications and interagency coordination

Fourth, the importance of effective crisis communications and interagency coordination.

Spokespersons need to exercise greater conscientiousness amid heightened sensitivities in the heat of a crisis. SVB's communications in the days leading up to its failure may have exacerbated the loss of confidence in the bank. On 8 March, SVB's press release communicated the intention to shore up its capital base, but lacked details explaining the reasons for its action. On the following day, it was reported that Greg Becker, SVB's CEO, claimed in a conference call that SVB had "ample liquidity to support our clients with one exception: If everyone is telling each other SVB is in trouble, that would be a challenge". He also attempted to leverage the goodwill of relationships with SVB customers to stabilise the situation, by urging them to stay calm and not panic. As it turned out, instead of building confidence, those statements proliferated across social media and yielded the opposite effect of intensifying concerns and deposit withdrawals from SVB.

Nevertheless, communications by financial safety net authorities on actions taken to resolve SVB during the height of the crisis were clear and well executed. The US Treasury, Fed, and FDIC released joint statements, and Treasury Secretary Yellen fronted public communications to address concerns.

Besides within the US, regulatory coordination also extended across borders to the UK. The Governor of the BoE recognised close cooperation with the Fed and FDIC during critical times, towards the successful resolution of SVB UK.<sup>29</sup>

<sup>29</sup> The BoE had developed strong working relationships over the years with US authorities in areas covering the development of resolution plans for cross-border banks, high level crisis management scenario-based exercises, and other collaborations

### ***Tackling contagion and its implication***

Fifth, the importance of recognising the impact of crisis contagion instead of underestimating it. Contagion can lead to potential loss of confidence in other healthy banking institutions (of similar profile with the failed banks) as well as the broader financial system. Some market commentators were of the view that SVB's failure aggravated troubles faced by Credit Suisse leading to its 'emergency rescue' by UBS. Meanwhile, even as other observers questioned if SVB was indeed 'too-big-to-fail', contagion risk in the US proved to be a decisive factor supporting the Fed and FDIC's recommendation to trigger the systemic risk exception for SVB and Signature.

While such actions provided stability, the fallout of SVB continued to undermine confidence in other regional banks. At the height of the crisis, the flight-to-safety from regional banks saw large US banks and institutions inundated with significant deposit inflows. The loss of deposits proved too much to bear for First Republic Bank (First Republic) as its overall deposit base shrunk by 40.8% in the first quarter of 2023. First Republic was closed by the CDFPI on 1 May. On the same day, it was resolved by the FDIC by way of a P&A agreement with JP Morgan Chase, which assumed all the deposits and substantially all the assets of First Republic (as of 13 April, First Republic held about \$229 billion of assets and \$103.9 billion of deposits and was the 14<sup>th</sup> largest bank in the US).

### ***Bank failures are costly***

Last but not least, the importance of advanced planning for resolution and crisis preparedness to potentially reduce the cost of failures. One way of assessing the overall cost of recent bank failures in the US is to capture it across three dimensions. First is the cost of \$31.5 billion to the DIF administered by the FDIC. Second is the cost of \$155 billion – which could be generally termed as individual government backstops – for SVB and First Republic (liquidity line and terms loans provided by the FDIC). Third is market-wide support by the Fed of about \$305 billion as at 11 May (including the Fed discount window,<sup>30</sup> BTFP and other credit extensions). In aggregate, this represented about 1.9% of US GDP (as at 2022).

A key aspect to reiterate is that taxpayers did not bear any losses from the recent failures. Instead, losses to the DIF sustained from protecting uninsured depositors would be recouped from the industry. On 11 May, the FDIC proposed rules to apply the special assessments which mainly covered large banks (with higher amount of uninsured deposits) that benefitted the most from the systemic risk determination.<sup>31</sup>

As bank failures can be a costly affair, it is imperative that authorities as well as the industry invest in early planning and preparedness for crisis situations. This can be done through regulatory policies such as robust recovery and resolution planning towards enhancing the resilience and sustainability of the financial systems.

<sup>30</sup> Use of the Fed discount window facility peaked at \$153 billion in the week to 15 March 2023

<sup>31</sup> The FDIC estimated that a total of 113 banking organisations would be subject to the special assessment. Those with total assets over \$50 billion would pay more than 95 percent of the special assessment to be collected at an annual rate of approximately 12.5 basis points over eight quarterly assessment periods





## Purchase and Assumption *Washington Mutual Bank (2008)*



### Background and context

Washington Mutual Bank (WaMu) was founded in Seattle in 1889 and grew to become one of the largest savings and loans institutions in the US. It began operations as Washington National Building Loan and Investment Association and was renamed to Washington Mutual Savings Bank in 1917. Through the years, WaMu had made several acquisitions and had gone public in 1983. The bank's aggressive expansion strategy saw further acquisitions (including Long Beach Financial), propelling WaMu to be a key player in the lucrative market of subprime mortgages. By 2007, it was selling 10 times more mortgage debt to the secondary market than it did in 2001.

WaMu's foray into aggressive lending did not end with its mortgage related acquisitions. The bank also purchased Provident for \$6.45 billion in 2005 and was heavily involved in the business of providing high-risk uncollateralised credit card debt to subprime borrowers.

The bankruptcy of Washington Mutual, Inc (WaMu's holding company) was the second largest ever in the US, after Lehman Brothers, and the failure was the largest bank failure in the history of the US. At the time of its failure, WaMu had \$188 billion in deposits, an asset size of \$307 billion, and over 2,300 branches in 15 states (at the end of 2007, WaMu had more than 43,000 employees). Its largest customers were individuals and small businesses.

***Washington Mutual ... was the largest failure of an insured depository institution in the history of the FDIC***

Federal Deposit Insurance Corporation

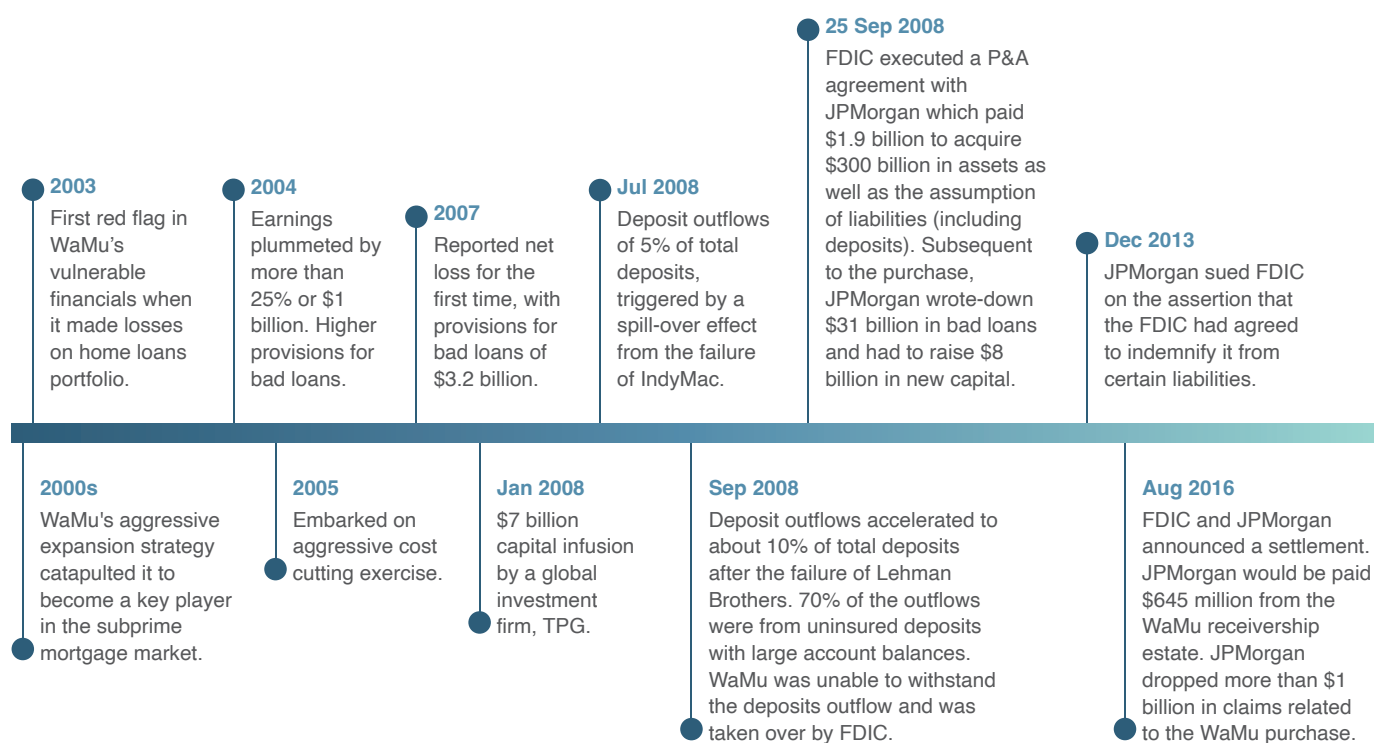


## Significant deterioration in WaMu's performance leading to bank runs

The red flags to WaMu's downfall had been apparent when it began to experience substantial losses on home loans. In 2004, WaMu's earnings plummeted by more than \$1 billion or 25% and provisions for bad loans increased by five times. The bank embarked on an aggressive cost cutting exercise, culling 13,450 jobs as well as closing 100 mortgage offices and 53 commercial banking operations. By 2007, the bank's earnings swung to a loss of \$67 million from a profit of \$3.6 billion in 2006, and provisions for bad loans ballooned to nearly \$3.2 billion. In early 2008, WaMu attempted to shore up confidence with a \$7 billion capital infusion led by a global investment firm, TPG. However, this proved futile as the bank reported losses of \$7.9 billion in 2008.

This series of events preceded WaMu's plummeting deposits over two key periods of significant outflows. The first was triggered by the failure of IndyMac Bank on 11 July 2008. The second episode began on 8 September 2008 and accelerated after the failure of Lehman Brothers. WaMu lost about 5% and 10% of deposits, respectively. On a monthly basis, the bank lost 19% of deposits in September 2008. About 70% of the outflows were from uninsured deposits with large withdrawals from accounts with more than \$500 million (these were far above WaMu's average account size of \$8,700).

### Resolution of WaMu – Timeline of Key Events



## Resolution actions

### Sale of WaMu to JPMorgan

Since early 2008, JPMorgan had eyed WaMu as a key acquisition target with interest in WaMu's network of over 2,000 branches and strong deposit base in regional markets. With such an acquisition, JPMorgan would be able to expand its presence across the west coast of US with a bigger share in key markets (New York, Chicago, Dallas, Houston and Phoenix). A broader regional banking presence would also strengthen its retail business including its commercial and business banking, credit card, and asset management units. However, at the time, WaMu had rejected a potential take-over bid by JPMorgan and chose to accept the \$7 billion investment from TPG.

Prior to WaMu entering into receivership, the FDIC had received (on a confidential basis, contingent upon WaMu's failure) competing bids from Citibank<sup>32</sup> and JPMorgan for the assets and liabilities of WaMu. Citibank had proposed for 80% of losses to be absorbed by the US government and to limit its financial exposure for the remaining 20% losses to \$10 billion. It did not suggest any cash upfront and was unwilling to take on WaMu's uninsured deposits. JPMorgan, on the other hand, was prepared to assume all of WaMu's deposits without any loss sharing arrangement and offered \$1.88 billion for the transaction.

***This deal makes excellent strategic sense for our company and our shareholders***

Jamie Dimon, CEO of JPMorgan Chase

The resolution of WaMu took place at the height of the GFC (only two weeks after the failure of Lehman Brothers). The prevailing environment was one of low public confidence in the financial system, exacerbated by media leaks of WaMu's resolution. As a result, the FDIC acted urgently to instill public confidence following the closure of WaMu on the night of Thursday (25 September 2008). The FDIC Chairman provided assurances to all depositors and for WaMu customers to expect business as usual with no service interruptions on Friday morning. This decision to intervene on Thursday departed from the typical approach of FDIC (as well as other resolution authorities) to close failed banks on Friday night, and work to prepare for smooth transfer of the bank's deposit accounts to an assuming institution over the closing weekend.

On 25 September 2008, FDIC executed a whole bank P&A agreement<sup>33</sup> with JPMorgan for the sale of WaMu. The next day, WaMu's holding company declared bankruptcy. On paper, it appears that JPMorgan had secured a good deal by paying about \$1.9 billion for about \$300 billion in assets and \$40 billion of shareholders' equity. JPMorgan also assumed WaMu's liabilities, including deposits. WaMu's bondholders, shareholders, and bank investors also shouldered the heaviest cumulative losses of about \$30 billion of collective investments in WaMu. In fact, JPMorgan had to write down \$31 billion in bad loans and raise \$8 billion in new capital to support WaMu.

The resolution via P&A resulted in no cost to the FDIC's deposit insurance fund and was made possible due to two key elements. First was the availability of an acquirer (JPMorgan) with the capacity and ability to execute the P&A swiftly, having undertaken prior due diligence on WaMu. Second was WaMu's unsecured debt of \$13.8 billion (4.5% of total assets) to absorb losses in resolution. Without these factors, the bridge bank tool would have been a likely option for the FDIC, which would have adversely impacted the deposit insurance fund as well as uninsured depositors.

Following the acquisition, JPMorgan entered into a protracted legal dispute with the FDIC. The row centred around JPMorgan's assertion that the FDIC had agreed to indemnify it from liabilities not assumed as part of the deal, including claims from decisions that WaMu had made before FDIC struck the deal with JPMorgan. Hence, JPMorgan sought a portion of the remaining \$2.7 billion in the WaMu receivership. It was reported that terms of the final agreement between both parties lacked details on included and excluded liabilities, and this was uncommon when compared with resolution arrangements for other large institutions during the GFC.<sup>34</sup> In December 2013, JPMorgan sued the FDIC. On 19 August 2016, FDIC, JPMorgan and Deutsche Bank (which had a separate claim against the WaMu estate) announced a settlement whereby JPMorgan would be paid \$645 million from the WaMu receivership estate. In consideration of the settlement, JPMorgan dropped more than \$1 billion in claims related to the WaMu purchase.

<sup>32</sup> Citibank submitted a contingent bid for the assets and liabilities of WaMu on 24 September 2008, one day prior to WaMu's failure

<sup>33</sup> As part of its resolution toolkit, the FDIC undertakes P&A transactions according to several variations including Basic P&As, Whole Bank P&As (acquirers of failed institutions purchase maximum amount of the failed FI's assets), P&As with Optional Shared Loss, and Bridge Bank P&As

<sup>34</sup> For instance, JPMorgan agreed "to pay, perform and discharge all the Liabilities of the Failed Bank which are reflected on the Books and Records of the Failed Bank as of Bank Closing". However, the term "Books and Records" was not defined

## Key takeaways

The resolution process is significantly aided by the availability of potential bidders, especially for troubled banks with a strong franchise value and synergies with acquirers. The suitor(s) – JPMorgan in WaMu's case – would likely have sized up the bank or attempted to make bid(s) for the distressed institution prior to its non-viability declaration or commencement of formal resolution action. These elements work in favour of a swift resolution process via P&A, which achieves three aims. First, avoiding disruption and protecting insured depositors. Second, zero exposure for the government. Third, preserving the resources of the resolution authority or deposit insurer so that those can be deployed for other failing FIs in times of crisis.

***For all depositors and other customers of WaMu, this is simply a combination of two banks ... for bank customers, it will be a seamless transition***

Sheila Bair, former Chairman of the Federal Deposit Insurance Corporation



Agreements that are promptly brokered during times of crisis need to unambiguously reflect the negotiated positions of the buyer (acquiring institution) and seller (resolution authority). This case highlights several areas of uncertainty, such as specific liabilities to be transferred to and assumed by JPMorgan, as well as indemnities provided by FDIC (potentially covering lawsuits by institutional investors against WaMu relating to subprime mortgages). In turn, these led to lengthy post-resolution legal disputes that had dragged on for eight years.

During periods of financial crisis, systemic risk and contagion can spread quickly from failed institutions to other problem ones. The failure on IndyMac on 11 July 2008, for example, triggered a loss of confidence and significant deposit outflows from WaMu. In addition, the bankruptcy of Lehman Brothers on 15 September 2008 occurred slightly a week before WaMu's failure.

In the midst of unfolding crises and stress on the financial system, the case of WaMu highlights the criticality of rapid and expedited responses by resolution authorities pressured by compressed time-to-act and unrelenting public scrutiny. Under such circumstances, resolution authorities need to have heightened levels of planning and preparedness to execute interventions at any time. Typical assumptions of time buffers from 'over-the-weekend' resolution procedures may no longer hold true, particularly in times of fragile public sentiment in banks and when adverse news leaks are rapidly propagated by social media.

A similar source of failure for many FIs is the combination of rapid acquisitions and aggressive lending practices. Such strategies may at first generate rapid growth, but it may be just a matter of time before this apparent success transforms into significantly deteriorating asset portfolios. During the GFC, in spite of the many red flags that had been raised, WaMu continued to bet on recovery of the housing market.





## Sale of Business; Insolvency Sberbank d.d. and Sberbank banka d.d.; Sberbank Europe AG (2022)



### Background and context

Sberbank Europe Group (Sberbank Group) operated as a universal banking group across Central and Eastern Europe. The parent entity of the Group, Sberbank Europe AG (Sberbank Europe) located in Austria was fully owned by Sberbank of Russia (Sberbank Russia), the largest bank which is also majority-owned by the Russian Federation (50% plus 1 voting share). Sberbank Europe was founded in 2012 after Sberbank Russia acquired Volksbank International AG (VBI)<sup>35</sup> and rebranded it as Sberbank Europe. Following the acquisition of the VBI, all VBI subsidiaries<sup>36</sup> were transferred accordingly to Sberbank Europe. Sberbank Europe had also a fully online branch in Germany (Sberbank Digital).

Sberbank Group had 185 branches and more than 3,933 staff serving corporates (loans and global market services), SMEs (loans and account services), and the retail segment (mortgage and consumer loans, deposits and account services). As at end-2021, Sberbank Europe's consolidated assets amounted to about €13.64 billion (\$15.51 billion).

Diagram 2: Overview of Sberbank Group



Source: Sberbank Europe Fact Sheet 2020

<sup>35</sup> The acquisition was completed in 2012 for €505 million. Pursuant to its transformation and group restructuring, Vienna was selected as the regional headquarters of Sberbank Europe. In 2013, Sberbank Europe received a full banking license in Austria. VBI subsidiaries were then fully rebranded as Sberbank by 2014

<sup>36</sup> Two subsidiaries were within the banking union (Croatia and Slovenia), two were within EU member states but outside the banking union (Czech Republic and Hungary) and two were in third countries (Serbia and Bosnia and Herzegovina)

## Russian invasion of Ukraine triggered the collapse of Sberbank Group

In 2021, Sberbank Europe had decided to sell its subsidiary banks in Serbia, Croatia, Slovenia, Bosnia and Herzegovina (including the subsidiary in the Republic of Srpska) and Hungary, by way of a package deal. The decision was driven by several factors, including the comparably low market share of Sberbank Group in most of its markets, substantial need for investments into digitalisation, market consolidation, as well as impact from the Covid-19 pandemic.

However, following Russia's commencement of military operations in Ukraine on 24 February 2022, the liquidity situation of Sberbank Europe and its subsidiaries weakened significantly within a short period. From 23 February onwards, Sberbank Group experienced significant deposit outflows.

Sberbank Europe had been under supervision of the ECB since 2014, and was also under the SRB's remit. Hence, recovery and resolution plans had been put in place. In particular, on 3 May 2021, the SRB had adopted Sberbank Europe's 2020 resolution plan (Resolution Plan). Under the Resolution Plan, the preferred resolution strategy was bail-in at the parent / Sberbank Europe level, while recognising the sale of business strategy as another option.

On 25 February, Sberbank Europe activated its group recovery plan and triggered measures such as emergency funding requests from its shareholder (Sberbank Russia), asset transfers of performing loans within Sberbank Group, attracting additional retail deposits, and communications according to escalation procedures. However, events later in the same day saw the Central Bank of the Russian Federation prohibiting Sberbank Russia from providing financial support to Sberbank Europe.<sup>37</sup> Sberbank Europe then requested for Emergency Liquidity Assistance (ELA) from the Austrian National Bank (OeNB) and the European Central Bank (ECB). On the same day, the European Council imposed a second package of sanctions on Russia that included financial sector sanctions intended to cut Russia's access to important capital markets, and which targeted 70% of the Russian banking market.

On 26 February, Sberbank Europe informed the EU Single Resolution Board (SRB). ECB and Austrian Financial Market Authority that it would unlikely be able to pay debts and liabilities that fell due.

On 27 February, the OeNB notified Sberbank Europe that no ELA would be provided. Meanwhile, the authorities (ECB and SRB) continued to assess if Sberbank Europe, Sberbank d.d. in Croatia and Sberbank banka d.d. in Slovenia (Sberbank entities within the banking union) were Failing or Likely To Fail (FOLTF), given rapid deterioration in liquidity conditions. The SRB had conducted an urgent provisional valuation on those entities using available public and supervisory information.<sup>38</sup> Known as 'Valuation 1', this provisional valuation was used by the SRB to support the FOLTF determination.

On 28 February, the ECB announced that the Sberbank entities within the banking union were FOLTF. The ECB had considered the adverse reputational impact of geopolitical tensions on Sberbank Europe that hastened deposit withdrawals, expectations of financial support from Sberbank Europe to its subsidiaries, and the loss of access to both USD correspondent banking and payments. Moreover, external interbank funding was off the table as financial institutions ceased business relations with Sberbank Europe. Following the ECB's press release, the SRB also announced its FOLTF decision on the same entities, including the application of a 2-day moratorium to the three banks (refer section below on Resolution Actions).

**... there are no measures with a realistic chance of restoring Sberbank Europe's liquidity position at group level and in each of its subsidiaries within the banking union**

European Central Bank

This case study focuses on actions taken by the SRB and National Resolution Authorities (NRAs) to resolve Sberbank entities within the banking union, i.e. Sberbank Europe, Sberbank d.d. (Sberbank Croatia)<sup>39</sup> and Sberbank Banka d.d. (Sberbank Slovenia). As for the other 5 subsidiaries of Sberbank Europe, those entities were resolved by their respective authorities in-charge, as depicted in Diagram 3.

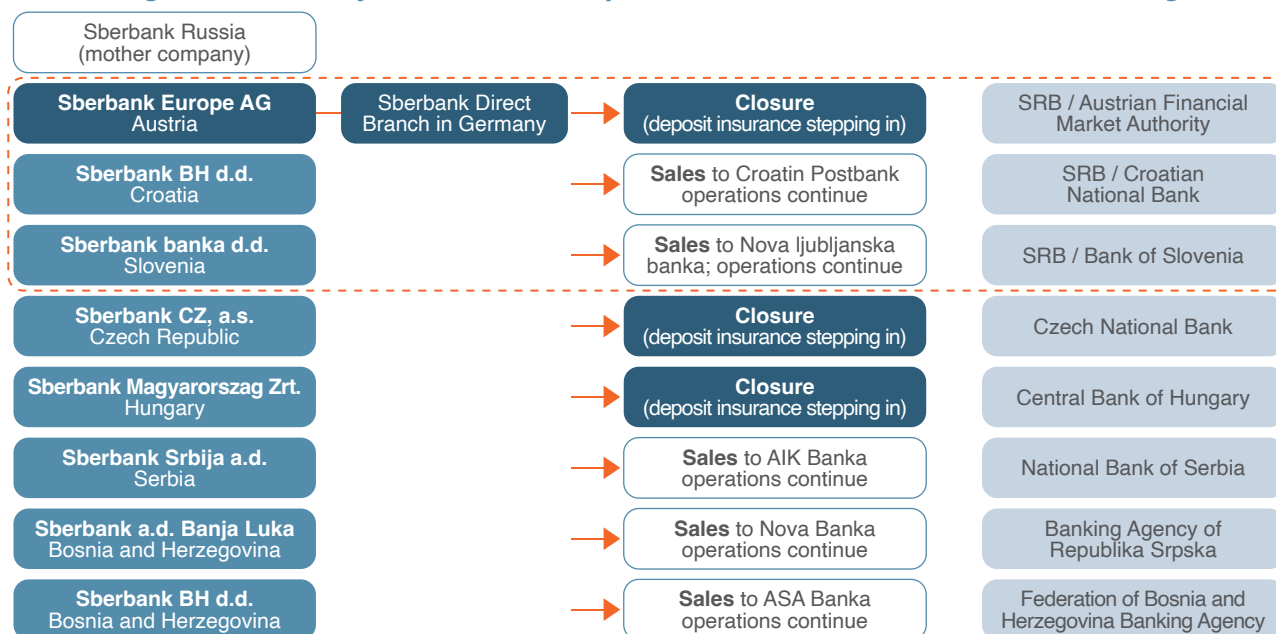
<sup>37</sup> The prohibition prevented Sberbank of Russia from transferring any foreign currency denominated funds in favour of/to any banking subsidiary located in any foreign jurisdiction/unions of jurisdictions, whose state authorities introduced sanctions against Russian legal persons and/or assets and/or officials thereof

<sup>38</sup> The Valuation 1 report is used to assess if there are objective elements to support a determination that, in the near future, the banking institutions will be unable to pay its liabilities as they fall due

<sup>39</sup> Sberbank entities within the banking union held €6.82 billion of Sberbank Group's total assets

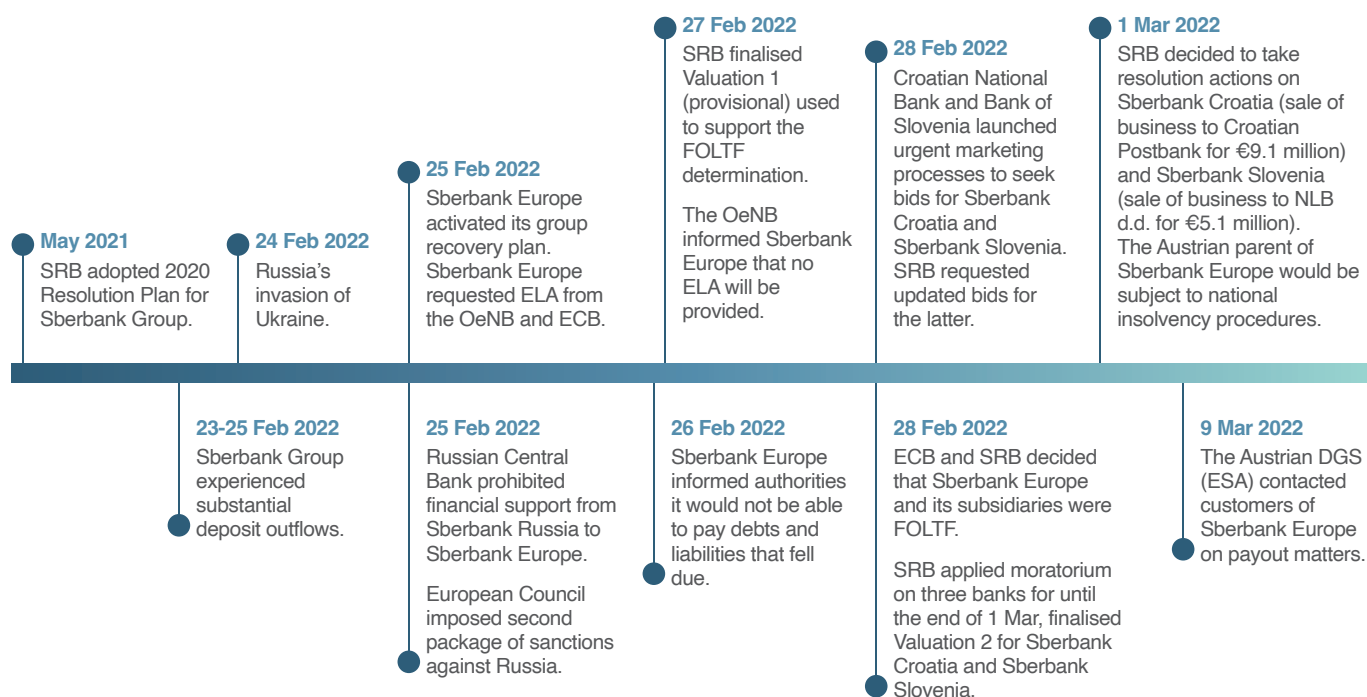


**Diagram 3: Summary of Sberbank Group, resolution actions and authorities in-charge**



Source: EGOV

### Resolution of Sberbank Entities Within The Banking Union – Timeline of Key Events



### Moratorium and SRB's resolution scheme for Sberbank entities within the banking union

Following the declarations of FOLTF, the SRB immediately applied a moratorium on Sberbank entities within the banking union on 28 February for 48 hours until the end of 1 March (Moratorium). In essence, payments, enforcement and termination rights were suspended.<sup>40</sup> Depositor withdrawals were also limited to a daily allowance amount, as determined by NRAs in Austria, Croatia and Slovenia.

During the Moratorium, the SRB was able to consider next steps to resolve the troubled institutions (either to apply resolution actions or for insolvency procedures to be carried

out according to national laws). It was also emphasised that depositors in Sberbank Europe and its subsidiaries were protected up to the limit of €100,000.

On 1 March, the SRB announced that resolution actions were necessary in the public interest for Sberbank Croatia and Sberbank Slovenia, in order to avoid adverse significant effects on financial stability in both countries. As for the Austrian parent, Sberbank Europe, no resolution action was necessary and insolvency procedures would be implemented in line with national laws.

<sup>40</sup> (1) All payment or delivery obligations pursuant to any contract to which Sberbank Europe and its subsidiaries were, including eligible deposits, were suspended, with the exception of payment or delivery obligations to systems and operators of systems, Central Counterparty Clearing Houses (CCPs) in the banking union, and central banks; (2) All secured creditors are restricted from enforcing security interests; (3) All termination rights of any party to a contract with Sberbank Europe and its subsidiaries are suspended

## Sale of business of Sberbank's subsidiaries in Croatia and Slovenia

Sberbank Croatia was the 8<sup>th</sup> largest credit institution in Croatia by asset size, with 31 branches, 478 employees and about 84,000 customers across 22 cities. While the SRB ascertained that it did not provide critical functions,<sup>41</sup> the failure (insolvency and liquidation) of Sberbank Croatia would likely cause significant indirect contagion to the Croatian banking system and severely impact financial stability, as well as create a spill over effect into the real economy of Croatia.

The SRB had hired an independent valuer earlier to perform a provisional valuation informing the application of resolution tools. The value of shares in Sberbank Croatia was estimated to range from HRK -2 million to HRK1 million (-€642,000 to €321,000), including a buffer for additional losses. Given the exigent circumstances, the SRB deemed this to be a fair disposal value that purchasers may be willing to pay. Known as 'Valuation 2', this serves the purpose of informing the SRB on elements constituting commercial terms, i.e. decisions on the assets, rights, liabilities or instruments of ownership of Sberbank Croatia to be transferred to another party.

On 28 February, the Croatian National Bank (CNB) launched a marketing process targeted at a specific number of potential bidders with the capacity to absorb Sberbank Croatia. Urgent invitations were sent out for potential buyers to provide unconditional and binding offers (by 15:00), given impending expiry of the Moratorium the following day. This was further complicated by the fact that no due diligence could be performed, and data on the business of Sberbank Croatia was unavailable.

The SRB explained that deviation from typical marketing processes<sup>42</sup> to complete an expedient sale were necessary, given the risk of aggravating uncertainty and further loss of market and depositor confidence in Sberbank Croatia, in turn constituting a material threat to financial stability in Croatia. In addition, while CNB sought to maximise the transaction price, it also recognised the need for immediate resolution action taking precedence over prolonged price negotiations.

On 1 March, the bid of HRK71 million (€9.4 million / \$10.5 million) from Hrvatska Poštanska Banka d.d. (Croatian Postbank) was accepted and the SRB decided to transfer all the shares from Sberbank Croatia to its acquirer. Beyond considerations on commercial terms of the price (which conformed to Valuation 2), the Croatian Postbank demonstrated capability to plug the liquidity drain of Sberbank Croatia, and preserve financial stability. The Croatian Postbank is 77% owned (directly or indirectly) by the Republic of Croatia, including 9% ownership by the Croatian Deposit Insurance Agency.

***Given the specific circumstances of the case, the sale of business tool in the form of transfer of shares will ensure that Sberbank Croatia and Sberbank Slovenia will continue operating as part of a group, and thus would meet the resolution objectives more effectively than the bail-in or bridge institution tools (even if those were combined with the asset separation tool)***

Single Resolution Board

In the case of Sberbank Slovenia, it was a medium sized bank and the 9<sup>th</sup> largest credit institution in Slovenia by asset size, with 12 branches, 371 employees and about 49,000 customers. Importantly, the SRB deemed Sberbank Slovenia's lending to SMEs as a critical function. Most of its SME clients only had one banking relationship, with a longer timeframe required for substitution. Hence, a sudden disruption could negatively impact third parties and trigger contagion / undermine the confidence of broader market participants.

A 'Valuation 2' exercise was conducted and placed the estimated value of shares in Sberbank Slovenia within the range of €-2 million and €1 million (including buffer for additional losses), which the SRB deemed to be a fair price due to prevailing circumstances.

On 28 February, the Bank of Slovenia (BoS) contacted several potential acquirers with the capability to immediately support Sberbank Slovenia by addressing the deterioration in its liquidity and preserving its critical function. Two bidders submitted offers by the urgent deadline of 15:00, and were subsequently invited by the SRB to adjust the offers. This process was significantly aided by virtual data rooms that facilitated access by potential purchasers to key data supporting the transfer, including supervisory information.

On 1 March, the updated bid from Nova Ljubljanska Banka d.d. (NLB) of €5.1 million (\$5.7 million) proved to be the highest and was accepted. The SRB decided to transfer all the shares from Sberbank Slovenia to NLB, constituting commercial terms that conformed to Valuation 2. The Republic of Slovenia holds a 25% equity stake in NLB.

By implementing the sale of business tool, the SRB emphasised that depositors or clients of Sberbank Croatia and Sberbank Slovenia would not experience any disruption and operations would resume as normal. From the customer perspective, they would now be part of large, well established and robust banking groups.

<sup>41</sup> Across deposit taking, lending and loan services, payment systems, capital market and investment activities, and wholesale funding markets activities (defined as per Article 2(1)(35) of the Directive 2014/59/EU and Article 6 of the Commission Delegated Regulation (EU) 2016/778)

<sup>42</sup> Article 24(3) of Regulation (EU) No 806/2014 and Article 39(3) of Directive 2014/59/EU, provide for the resolution authority's possibility to deviate from the marketing requirements as established in Article 24(1) of Regulation (EU) No 806/2014 and Article 39(1) of Directive 2014/59/EU



## Insolvency of Sberbank Europe in Austria

Since the SRB had decided that resolution action would not be applied to Sberbank Europe, it would only be subject to insolvency procedures carried out according to national laws and depositors would be protected by the Austrian Deposit Guarantee System (DGS).

In the 2020 Resolution Plan for Sberbank Europe (adopted in May 2021), the SRB concluded that the failure of Sberbank Europe would adversely affect financial stability beyond the Austrian market. This was due to the financial and operational inter-connectedness of Sberbank Europe with other entities in Sberbank Group across the EU.

However, the SRB recognised that the situation had changed since 2021 and justifications for resolution action using the bail-in and sale of business tools as set forth in the Resolution Plan was no longer applicable. The SRB had also assessed

that for the Austrian market, Sberbank Europe did not provide any critical functions and its failure (insolvency) would not substantially impact financial stability at the national level.<sup>43</sup>

Hence, the SRB concluded that a deviation from the assessment included in the Resolution Plan<sup>44</sup> for Sberbank Europe was warranted, owing to significant changes in circumstances since it was adopted. Sberbank Europe was unlikely to significantly impact financial stability beyond the Austrian market due to among others, its level of systemic relevance, asset size and market share (below medium-low threshold), low impact of failure on the real economy and the rest of the banking union financial system<sup>45</sup> (no other institution was identified as being at risk of failure in any scenario), low interconnectedness with other market participants, and insignificant indirect contagion effects in Austria.

## Payout to depositors

In Austria, there are 3 schemes for deposit insurance – the Einlagensicherung Austria GmbH (ESA), Sparkassen-Haftungs GmbH and the Austrian Raiffeisen Protection Scheme eGen (ORS). Under relevant provisions of the Deposit Guarantee Schemes and Investor Compensation Act, each Austrian DGS made financial means available (proportionally provided by all Austrian banks)<sup>46</sup> to reimburse depositors of Sberbank Europe up to the limit of €100,000.

Sberbank Europe had about 35,000 customers with guaranteed deposits of €913 million (from the total of €1 billion). According to ESA, it contacted the customers of Sberbank Europe on 9 March, and most have already been compensated.

As for deposits in Sberbank Europe's branch in Frankfurt, Germany, those were also protected by the Austrian DGS. However, on behalf of ESA, those reimbursements were implemented by the Compensation Scheme of the German Private Banks (EdB) within 7 days of ascertaining payable compensation.

***As envisaged for cross-border compensation cases in Europe, we are resorting to the support of the national deposit guarantee scheme in this pay-out process. In coordination with ESA, the Compensation Scheme of German Private Banks (EdB) will ensure that all eligible depositors in Germany will be able to obtain their money quickly and without complications***

Stefan Tacke, Managing Director of ESA



<sup>43</sup> Sberbank Europe did not identify any functions as critical in its 2021 Recovery Plan and Critical Function Report (for FYE 2020)

<sup>44</sup> In accordance with Article 23 (third subparagraph) of Regulation (EU) No 806/2014

<sup>45</sup> Based on the SRB's internal multilayer network contagion model

<sup>46</sup> According to the ratio of the total amount of covered deposits of their members as a proportion of the total covered deposits of the members of all Austrian DGS as of 31 December 2021

## Key takeaways

The resolution of Sberbank Europe holds out several useful lessons and five are highlighted in this section.

### *Failure can happen for many reasons, and not all of them can be simulated*

First is the speed of failure emanating from geopolitical risks and how essential it is for banks and authorities to be prepared for crisis and a potential resolution scenario. Within a matter of days (prior to and after the Russian invasion of Ukraine), Sberbank Europe and its subsidiaries were confronted with deposit withdrawals and severe liquidity gaps that ultimately led to its failures. Those institutions ended up being resolved by the SRB and NRAs within the short span of 6 days or less than a week of the risk event being triggered. The case of Sberbank Europe also demonstrates how unexpected sources and nature of crises - this time from geopolitics - can lead to the idiosyncratic failure of otherwise healthy financial institutions. It is worth noting that the nature and severity of this geopolitical crisis scuppered Sberbank Europe's recovery plans, which depended substantially on financial lifelines from Sberbank Russia.

### *Planning helps, even if not fully*

Secondly, resolution authorities were fast and agile in execution owing to advanced preparations and having in place a robust resolution framework. The Resolution Plan for Sberbank Group provided important groundwork to facilitate swift and informed decision making by authorities during the time of resolution. While the bail-in tool had been identified as the preferred resolution strategy for Sberbank Europe, the SRB re-assessed and adapted its approach to fit new and pressing circumstances from the Russia-Ukraine war. As a result, Sberbank Europe entered into insolvency in Austria (with depositor payout by the Austrian DGS), while the sale of business tool was effectively deployed for Sberbank Croatia and Sberbank Slovenia. Deviations from the Resolution Plan and other rules such as marketing processes enabled efficient resolution implementation. This included trade-offs concerning immediacy of closing the sale (bids received within the same day of marketing by 15:00) versus more time to negotiate for higher prices.

### *Clear communications helped smoother execution*

In terms of communications, clear messages were transmitted to key stakeholders. In particular, timely assurances were provided to depositors and customers of Sberbank in Croatia and Slovenia (to expect resumption of normal day-to-day operations under strong national banking groups) as well as in Austria (to expect deposit protection and payout by the DGS). Collectively, these and other effective actions taken by the SRB and NRAs achieved the ultimate aim of preserving financial stability across the EU.

***The resolution of Sberbank showed again that the system works: Financial stability was maintained, there was no need for a public bailout, and the taxpayer was protected. That is the definition of a successful outcome for resolution cases***

Elke König, former Chair of the Single Resolution Board



### ***Different approaches for different cases, even though in the same group***

Fourth is a related point in recognising that resolution actions can be highly contextual and market or institution-specific, against the backdrop of applying the broad resolution framework and tools. A case in point is the different treatment of resolving the parent entity in Austria compared to its subsidiaries in Croatia and Slovenia. Even when the sale of business tool was activated for both Sberbank Croatia and Sberbank Slovenia, it was not a cookie-cutter approach and specific circumstances guided the implementation of resolution strategies and tactics. For example, a critical function (lending to SMEs) was identified for the Slovenian market, with none in Croatia. Potential acquirers of Sberbank Slovenia also had access to a virtual data room and were requested to provide updated bids to the SRB, while prospective buyers of Sberbank Croatia were not able to access any specific data.

### ***Institutional arrangements and strong co-ordination matters***

Lastly, the effectiveness of resolution decisions and actions were underpinned by strong institutional structures and interagency co-ordination arrangements. For instance, the close coordination between the ECB and SRB saw both institutions attend multiple joint-meetings (of the ECB's Supervisory Board meetings and specific crisis management team meetings, as well as SRB's Extended Executive Sessions) during the crucial period of tackling troubles at Sberbank Europe and its subsidiaries.<sup>47</sup> These important practices for cooperation and information exchange had been formalised in an SRB-ECB MoU, which was subsequently revised in December 2022.

Besides this, cross-border coordination also contributed to the successful resolution of Sberbank Europe and its subsidiaries. This was exemplified by close cooperation between the SRB and relevant NRAs, regular engagements by the SRB with relevant members of the European resolution college, as well as cooperation between the DGS in Austria (ESA) and Germany (EdB) to ensure efficient payouts to affected customers from the German branch of Sberbank Europe.

<sup>47</sup> The SRB attended the ECB's Supervisory Board meetings on 17, 23 and 27 February 2022, and specific Crisis Management Team meetings for Sberbank Europe on 25 and 26 February 2022. The ECB attended the SRB Extended Executive Sessions on Sberbank Europe on 26, 27, 28 February and 1 March 2022



## Sale of Business

### *Banco Popular Español (2017)*



#### Background and context

The resolution of Banco Popular Español, S.A. (Banco Popular) represents a key milestone in relation to the bank resolution framework within the European Banking Union (Single Resolution Mechanism).<sup>48</sup> This case was the first time the SRB had used its powers to write down the liabilities of a bank. Banco Popular was resolved through the write-down and conversion of its capital instruments, and subsequent transfer to Banco Santander S.A. (Santander).

Banco Popular was formed in 1926 as a local bank servicing Spanish customer. Historically, Banco Popular's core business consisted of a strong Spanish retail franchise, with a focus on lending to SMEs. Its lending included mortgages and other home loans to retail customers. As at December 2016, Banco Popular was Spain's sixth largest bank, with a market share of 17.7%. It had total assets of approximately €148 billion (\$156 billion), 1,739 branches worldwide, and

was supported by a workforce of 10,671 employees. Banco Popular was listed on the Spanish Stock Exchange, and formed part of the IBEX35 (consisting of the 35 companies with the highest market capitalisation in Spain). It was an active participant in both Spanish and European capital markets.

Beginning in 2007, Spain suffered one of the most severe financial crises amongst the EU member states, with unemployment peaking at 26.1% in 2013. In 2014, public debt stood at a record high of 100.4% of GDP. The crisis heavily impacted the financial industry, which had over-invested in the real estate sector during the years leading up to 2008. By November 2012, bad debts in the banking sector had reached a record high of €197 billion (\$255.8 billion) – more than 10 times higher than the €17 billion (\$25 billion) recorded in December 2007. During this period, numerous

<sup>48</sup> The Single Resolution Mechanism is second of three pillars of the European Banking Union. The first pillar is the Single Supervisory Mechanism which has been setup under the ECB, and the third pillar is the European Deposit Insurance Scheme which is still being discussed



Spanish banks experienced solvency and liquidity problems, aggravated by increasing difficulties in accessing wholesale funding and the drying up of short-term interbank liquidity. In contrast to most other Spanish banks, Banco Popular emerged from the 2008 financial crisis independently without requesting or receiving any state aid in the form of capital injections or asset transfers.

Like many other European banks, Banco Popular was saddled with NPLs. From 2008, it implemented a number of significant asset write-downs. In 2016, Banco Popular reported losses of €3.5 billion (\$3.69 billion), followed by a first-quarter 2017 loss of €137 million (\$146.5 million) with NPLs representing 15% of the loan book. In the first

week of June 2017, Banco Popular experienced a bank run of approximately €6 billion (\$6.7 billion) of deposits being withdrawn. It was noted that many state-owned entities were quick to withdraw deposits. On 5 and 6 June 2017, Banco Popular requested and received consecutive Emergency Liquidity Assistance (ELA) of €1.9 billion and €1.6 billion (\$2.17 billion and \$1.82 billion) from Banco de Espana (the Spanish Central Bank). It was reported that discussions on Banco Popular's eligible collaterals had already taken place since March 2017.<sup>49</sup> However, the ELA proved to be inadequate and the severity of this liquidity crisis led the ECB to decide that Banco Popular was Failing Or Likely To Fail (FOLTF)<sup>50</sup> on 7 June 2017.

***We believe it (the Banco Popular resolution) was a successful example of the first use of the single resolution mechanism***

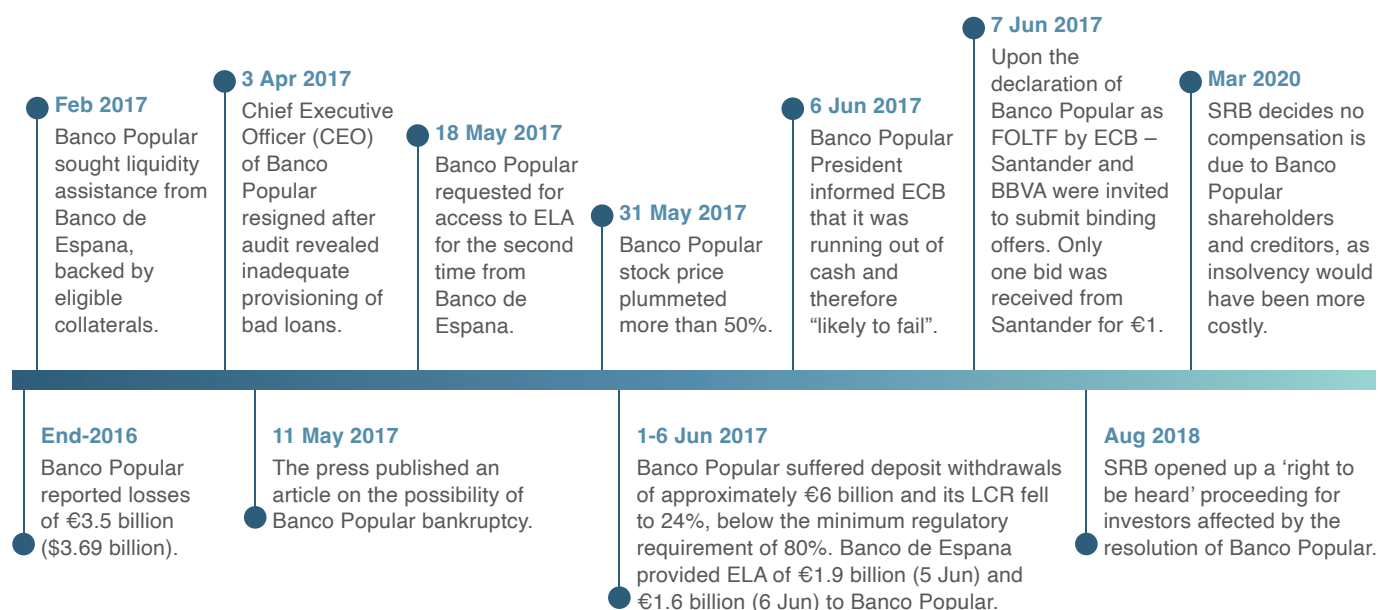
Valdis Dombrovskis, former European Commissioner for Financial Stability, Financial Services and the Capital Markets Union

## Resolution actions

### **Bank run preceding resolution<sup>51</sup>**

Investor confidence in Banco Popular began to wane due to concerns of the bank's inability to clean up its balance sheet and to strengthen its capital position.

### Resolution of Banco Popular – Timeline of Key Events



<sup>49</sup> In mid-May 2017, Banco Popular had presented a collateral portfolio of at least €22 billion (\$24.7 billion) to Banco de Espana and were informed of possible ELA provision of €700 million (\$787 million) (about 3% of total value of collaterals). The significant haircuts of 97% were unprecedented given that a maximum rate of 65% would be applied under normal circumstances

<sup>50</sup> FOLTF is a classification used by supervisors from the ECB. It covers aspects of troubled institutions relating to the withdrawal of authorisation, liabilities of the institution exceeding its assets, inability to pay debts as they fall due, or the need for extraordinary financial public support. FOLTF is determined by the ECB after consultation with the SRB. The SRB may also determine that a bank is considered FOLTF, if it has informed the ECB of its intention to do so and the ECB has not reacted within three days

***The decision taken today safeguards the depositors and critical functions of Banco Popular. This shows that the tools given to resolution authorities after the crisis are effective to protect taxpayers' money from bailing out banks.***

Elke König, former Chair of the SRB

The purchase of Banco Popular was a strategic move that would propel Santander ahead of rivals BBVA and La Caixa in the domestic banking market, giving it an additional 18% market share, adding important SME clients and boosting its presence in important regions. In the weeks prior to Banco Popular's collapse, Santander had considered acquiring it for up to €1.6 billion (\$1.8 billion)<sup>52</sup> but had held off making an offer because of concerns that shareholders would reject the proposal.

The new Banco Popular CEO had set up formal sales processes, with Santander, BBVA, Bankia and Sabadell taking part. However, none of the four banks were willing to make a bid by the closing date of 16 May 2017.

However, a week later, Santander decided to submit a bid to purchase Banco Popular through a resolution process under two conditions: (1) the offer price was to be €0, with a negotiation margin of up to €200 million (\$225 million); and (2) a write down of Additional Tier 1 (AT1) and Tier 2 bonds (Tier 2) worth €2 billion (\$2.25 billion). In addition, Santander would undertake a €7 billion (\$7.9 billion) rights issue after the resolution.

On 3 June 2017, while Banco Popular and Banco de Espana were doing final checks on the ELA process, the resolution authorities<sup>53</sup> contacted Santander and BBVA, piggybacking on a failed sales process that Banco Popular had run earlier.

After signing non-disclosure agreements, the two bidders spent the next few days going over Banco Popular's books. On 7 June 2017 – upon the declaration of Banco Popular as FOLTF by the ECB – Santander and BBVA were invited to submit binding offers. Only one bid was received from Santander for €1 with the condition that shareholders, AT1 holders and Tier 2 holders were to be written down. The SRB accepted the offer, having concluded that a winding up of the bank under normal insolvency proceedings would pose risks to financial stability.

On 6 August 2018, the SRB opened up a 'right to be heard' proceeding for investors affected by the resolution of Banco Popular.<sup>54</sup> The SRB assessed 2,856 submissions from affected parties, including comments on the SRB's approach to the valuation of Banco Popular. On 18 March 2020, the SRB concluded that the resolution of Banco Popular by winding up would have been costlier than the approach taken, based on a post-resolution valuation undertaken by an independent valuer. Therefore, no compensation was due to the shareholders and creditors of Banco Popular.



<sup>51</sup> Summarised from the notice of arbitration between claimants and Kingdom of Spain for Banco Popular's resolution

<sup>52</sup> On 3 May 2017, the Santander bid team had proposed to its Board of Directors to make a €1.6 billion (\$1.8 billion) offer for Banco Popular. They concluded that, even after a €6 billion (\$6.4 billion) rights issue to clean up the bank, as well as litigation and restructuring costs, such an offer could still deliver an 11% return within three years

<sup>53</sup> Spain's Fund For Orderly Bank Restructuring (FROB) and the SRB

<sup>54</sup> The right to be heard process allows affected shareholders and creditors to explain why they consider that alternative approaches or assumptions for the normal insolvency proceedings should have been adopted and, if they had been, how in their view these would have affected the final outcome

## Key takeaways

In the case of Banco Popular, the SRB and FROB (Spanish National Resolution Authority) were fortunate that efforts to identify a buyer and the sales process had already taken off prior to the actual resolution. The Chair of the SRB also noted that the structure of Banco Popular was relatively simple. While these factors facilitated swift resolution via immediate sale of Banco Popular to Santander, this case demonstrates that the volume of groundwork needed (identifying potential buyers, due diligence, negotiations, and others) for acquisitions of distressed banking institutions should not be underestimated.

The outcome of solvency stress test results may not guarantee the viability of a bank in the medium term. In similar vein, a run on deposits can quickly erode a high level of Liquidity Coverage Ratio (LCR). Striking a balance between solvency-based and liquidity-centric scenarios as part of the recovery and resolution planning process is critical to ensure that banks and regulators have more capacity and are more ready to face possible crisis situations.

Where banking institutions are faced with a liquidity crisis, clarity about conditions under which it may receive ELA from central banks become crucial. The provision of liquidity through ELA can also be affected by substantial haircuts on collateral posted, as the case of Banco Popular demonstrates.

The valuation process is another essential component supporting the execution of resolution actions. This can be highly challenging, given that the valuation of assets nose-dives once a bank is deemed non-viable. Additionally, in a situation of stress, the losses borne by Tier 2 bondholders may not be very different from those borne by holders of AT1 instruments. Experience has shown that losses imposed on investors have been considerably larger than market expectations (besides Banco Popular, another example is from the case of Portugal's Novo Banco).

Post-resolution, authorities need to be prepared to contend with legal challenges from aggrieved parties. These could cover claims around the issues of transparency and reliance on disputed information that guided key decisions taken by authorities to resolve distressed institutions.

***When deciding upon resolution or insolvency for a failing bank, the SRB takes into account the idiosyncratic and systemic circumstances at the point of failure of a bank, which gives us the flexibility to properly account for the economic circumstances at that point in time***

Elke König, former Chair of the SRB







## Bridge Bank *Incubator Bank of Japan (2010)*



### Background and context

**Table 4: Profile of IBJ at point of failure on 10 September 2010**

Total employees	Total branches	Total depositors	Total deposits	Total loans
782	114	126,779 Uninsured: 3,405	¥581.8 billion (\$5.1 billion) Insured: ¥570.9 billion, Uninsured: ¥10.9 billion	¥434.6 billion (\$3.8 billion)

Established in April 2004, the business model of the Incubator Bank of Japan (IBJ) involved lending to small and medium sized firms, and buying of large amounts of loan assets from non-banks. IBJ held only time deposits and did not provide any payment and settlement services.

Before its failure, the former Chairman of IBJ had embarked on an overly ambitious expansion of business and a series of allegedly illegal transactions. IBJ also had a controversial business model that purchased loan claims from money lending businesses. The bank had rapidly expanded its business with major borrowers and failed to perform adequate credit checks. Consequently, IBJ had to set aside a large amount of additional reserves. In July 2010, the former Chairman of IBJ, Takeshi Kimura – who had also been an ex- advisor to the Japan Financial Services Agency (JFSA) –

was arrested for allegedly obstructing JFSA inspections. The IBJ was placed under the control of the Deposit Insurance Corporation of Japan (DICJ) and filed for civil rehabilitation in September 2010. The JFSA recognised that causes of the failure of IBJ were unique to the bank. IBJ did not have a settlement function and had a small size of depositors relative to other commercial banks. As such, IBJ's failure would not affect the stability of the Japanese financial system and IBJ was deemed a non-systemic institution.

To resolve IBJ, financial assistance (through P&A) was expected to be more cost efficient and less disruptive to markets and the local economy. In this case, DICJ estimated that the cost of financial assistance would be less than a pay out to depositors. IBJ was resolved over the weekend and resumed business on Monday DICJ had publicly solicited



candidates to take over IBJ but required more time and decided to temporarily transfer IBJ to the Second Bridge Bank of Japan (Bridge Bank) on 25 April 2011.

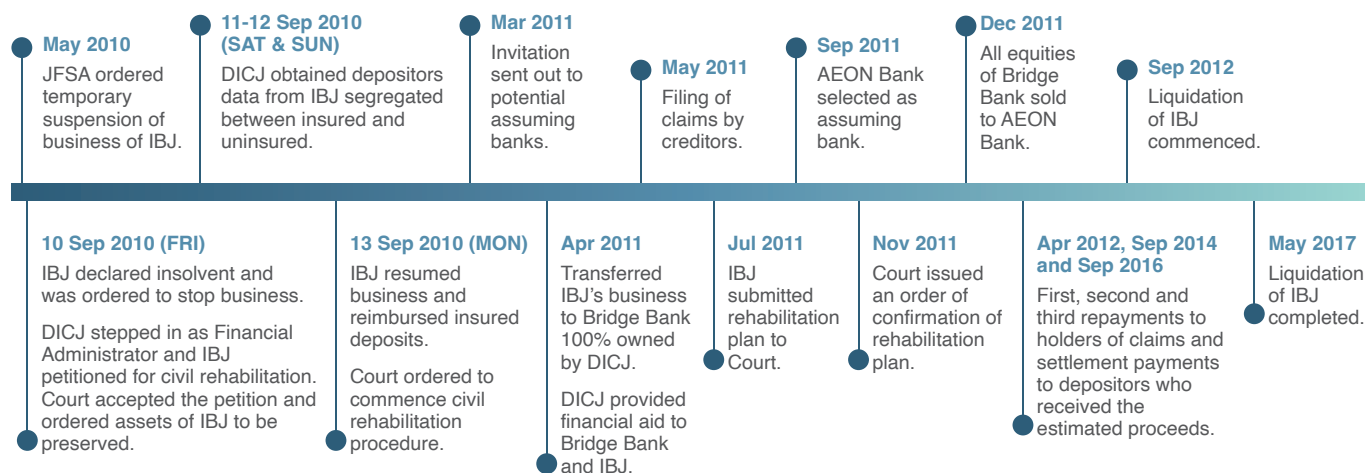
Japan's limited deposit guarantee programme had been established in 1971. However, IBJ's failure was the first time the Japanese government had limited 'payoffs' or deposit guarantees, with the cap of ¥10 million (\$123,000) per account, including interest earned. Between 1996 and 2005, this cap had been suspended to prevent runs on banks, but was subsequently reinstated as part of the financial sector

reforms. IBJ's customers with more than ¥10 million in their accounts had to rely on pro-rata distribution to creditors for amounts of non-insured deposits exceeding ¥10 million.

*Since the decisions on the final assuming financial institution and the business transfer were expected to take some time, the DICJ decided to transfer IBJ to a bridge bank*

Deposit Insurance Corporation of Japan

### Resolution of IBJ – Timeline of Key Events



### Resolution actions

The DICJ is organised under the Deposit Insurance Act and is supervised by the Ministry of Finance and the JFSA. While the JFSA is responsible for supervision and resolution of banks, the DICJ is responsible for deposit protection and the execution of the resolution of failed banks. Upon a deposit-taking FI's failure, the JFSA would appoint the DICJ as financial administrator.<sup>55</sup> The Civil Rehabilitation Act 23 – rather than the Corporate Reorganization Act 24 – applies to failures of deposit-taking institutions.<sup>56</sup> In a civil rehabilitation proceeding, only amounts in excess of the deposit insurance scheme (¥10 million) would be treated as depositor claims. The resolution methods available to the DICJ depend on whether the failed bank is systemically insignificant (ordinary resolution) or significant (exception applied). For systemically significant resolutions, there are additional resolution options (nationalisation, blanket guarantee, and capital injection). The Financial Crisis Response Council, which is chaired by the Prime Minister, is responsible for high-level crisis coordination.

In September 2010, IBJ filed for commencement of the civil rehabilitation procedure with the Tokyo District Court and made preparations for a business transfer while continuing operations. In terms of resolution procedures, IBJ faced specific challenges relating to data. There was insufficient data on borrowers, complicated fund transfers among affiliated companies within

IBJ, purchased assets that were twice transferred to other parties, and borrowers that became creditors by virtue of 'overpayments' to the bank (due to IBJ charging higher interest rates above that permitted by law). As a result, DICJ needed a longer time to reassess IBJ's assets.

In April 2011, part of IBJ's business (sound assets and deposits within the insured amount)<sup>57</sup> was transferred to the Bridge Bank. The DICJ then provided the Bridge Bank with grants to cover the necessary costs for the transfer. The Bridge Bank was a 100% subsidiary of the DICJ, with the objective of temporarily assuming the business of IBJ and later, to transfer the business to a final assuming FI (Assuming FI). The management of the Bridge Bank by DICJ was to be concluded by two years from the failure of IBJ or up to a maximum of three years. As shown in illustration 2, DICJ also provided financial assistance to facilitate the resolution scheme.

On 26 December 2011, all outstanding shares of the Bridge Bank were transferred to AEON Bank, as the Assuming FI. As for the uninsured deposits and general claims, these remained with IBJ, and were reimbursed through civil rehabilitation procedures after about six years. On 2 May 2017, the liquidated IBJ completed all repayments and terminated operations.

<sup>55</sup> The JFSA may, alternatively or additionally, appoint attorneys-at-law, certified public accountants and / or other financial specialists as financial administrators

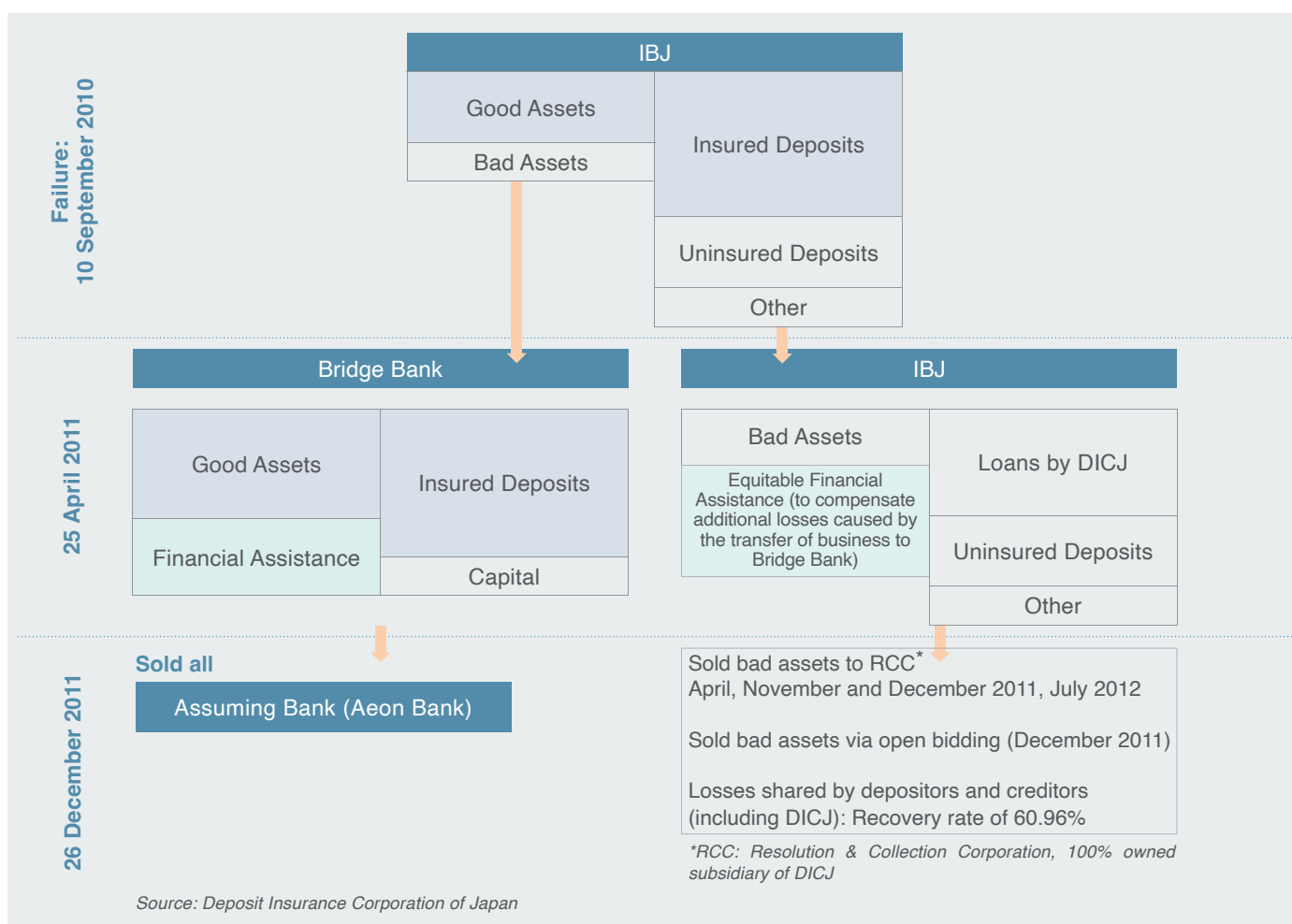
<sup>56</sup> An insolvent FI that commences civil rehabilitation proceedings would not automatically lose its licence. It is generally perceived that the Civil Rehabilitation Act (rather than the Corporate Reorganization Act) is better for the failure of a deposit-taking institution because, in a civil rehabilitation, the appointment of a trustee by the court is not mandatory

<sup>57</sup> Reimbursements were made to IBJ's depositors within the insured amount from 13 September 2010 onwards. The remaining insured deposits were transferred from IBJ to the Bridge Bank in April 2011

**Illustration 1:**  
Procedures for resolving IBJ over the weekend

Friday Bank Failure and Closure	
JFSA:	Orders for IBJ to stop business, Appoints DICJ as Financial Administrator.
DICJ:	Steps in as Financial Administrator, Seeks data on depositors from IBJ.
IBJ:	Files for the commencement of civil rehabilitation proceedings.
↓	
Saturday and Sunday	
DICJ:	Receives depositor data from IBJ, Conducts name based aggregation of depositors, Returns results to IBJ.
IBJ:	Divides the accounts of depositors to insured and uninsured deposits, Prepares for resuming business on Monday.
↓	
Monday Resume Business	
IBJ:	Reimburses Insured Deposits for Depositors. Resumes business as needed including loans at 16 major branches.
Court:	Orders to commence civil rehabilitation.

**Illustration 2:**  
Procedures for Bridge Bank, transfer of assets to AEON Bank and dealing with bad assets



## Key takeaways

This case is an example of the use of the bridge bank tool to resolve a non-systemic bank by Japanese authorities. The bridge bank temporarily assumed insured deposits and good assets, thus providing the resolution authority with additional time to look for a suitable buyer. Notwithstanding the additional time, it was also important to have a timeframe for the eventual sale of assets from the bridge bank to a purchasing institution. In IBJ's case, the transfer of assets from the Bridge Bank to AEON Bank was completed in approximately 15 months, well within the maximum timeline of three years from the date of IBJ's failure. This case also demonstrates how the resolution authority dealt with non-performing assets through a separate structure, and applied effective strategies to maximise recovery of the bad assets. Claims were also reimbursed in stages within a timeframe of about six years.

Sound governance and communications were key success factors for the resolution. Other key factors included having clear and transparent processes, clear demarcation of roles among financial safety net players and legal certainty. Having over the weekend procedures to resume business on Monday for prompt resolution of IBJ was also critical. This enabled the resolution authority to announce the immediate measures that would apply on the re-opening of IBJ on Monday morning, provide assurance to depositors of IBJ, and maintain overall public confidence in the financial system. In IBJ's case, since the media had also begun reporting on IBJ's failure, the authorities (JFSA and DICJ) had to commence resolution activities on the morning of Friday instead of the evening as originally planned. Having earlier established clear plans, they were able to quickly effect the necessary communications and manage media.

The experience of IBJ highlights another essential facet of bank resolution, namely the need for data integrity, given its impact on the time needed for asset valuations. Efforts to maintain robust data during good times are essential for the effective execution of bank resolution procedures and actions during time-critical periods.

***On 26 December 2011, all outstanding shares of the Bridge Bank were transferred to AEON Bank; the business management of the Bridge Bank was thus completed***

Deposit Insurance Corporation of Japan







## Moratorium and Restructuring *YES Bank (2020)*



### Background and context

YES Bank, an Indian public bank, was founded by Rana Kapoor and Ashok Kapur in 2004. It was listed on the Bombay Stock Exchange in 2005. Over the next decade, it became India's fourth largest private lender by assets. It offered a wide range of banking and financial products for corporate, SME and retail customers. YES Bank operated its investment banking, merchant banking and brokerage businesses through YES Securities, and its mutual fund business through YES Asset Management (India) Ltd, both wholly owned subsidiaries of YES Bank. Headquartered in Mumbai, it had a pan-India presence across all 28 states and nine Union Territories in India, with a network of 1,130 branches. The period from mid-2018 to 2019 saw a significant shift in YES Bank's ownership from institutional to retail investors. As at 2019, retail investors collectively held 48% (June 2018: 9%) in YES Bank, while mutual funds and foreign institutional investors held 5.1% and 15.2% respectively (June 2018: 11.6% and 42.5%).

Several events led to the failure of YES Bank, including aggressive growth, a depositor run, lack of fresh capital and default of a bond coupon payment. YES Bank had experienced a crisis of management and governance, including allegations of money laundering against its founder, Rana Kapoor. In late 2018, the Reserve Bank of India (RBI) refused YES Bank's requests to renew the term of Rana Kapoor, who was replaced in March 2019 by Ravneet Gill, a banker with 30 years of experience from Deutsche Bank tasked with reviving YES Bank.

Over a five-year period, the loan book of YES Bank grew rapidly from INR550 billion (\$8.7 billion) in 2014 to INR1.3 trillion (\$20.3 billion) in 2017, and then accelerated substantially by more than 80% to INR2.4 trillion (\$33.6 billion) in 2019. 62% of YES Bank's loan portfolio was to corporates (industry average: 40%). Such financing was extended to financially stressed borrowers such as

Reliance Communications, Essel Group, Vodafone Idea and Jet Airways in the engineering, steel, construction and power sectors. In addition, more than INR400 billion (\$5.6 billion) had been provided to India's troubled shadow banks, property developers and power generators. All these loans

were made against collaterals such as personal guarantees by tycoons, that were tough to value or seize. In the process, YES Bank had collected high one-time fees on top of interest rates for granting loans to riskier borrowers. It also offered generous interest rates of up to 7% on its savings account.

## Resolution actions

### Moratorium

On 5 March 2020, the RBI placed YES Bank under moratorium for a period of 30 days pursuant to sections 45 and 35A of the Banking Regulation Act 1949,<sup>58</sup> owing to the steady decline of its financial position. Despite rounds of discussions with investors, YES Bank was unable to raise capital and failed to address potential loan losses and resultant downgrades. This triggered investors to invoke bond covenants and the withdrawal of deposits. In recent years, YES Bank also suffered serious governance issues and practices. There had been regular outflows of liquidity from YES Bank. The RBI had undertaken efforts to facilitate a market led revival of YES Bank as a preferred option over regulatory restructuring. Despite being provided with adequate opportunities, YES Bank's management had failed to draw up a credible restructuring plan.

The moratorium involved two areas. Firstly, capping depositor withdrawals and payment to creditors to a maximum of INR50,000 (\$680) except for medical treatment, costs of higher education, obligatory expenses for marriage or other ceremonies, and expenses for any other unavoidable emergency. Even in these cases, payments were not to exceed INR500,000 (\$6,800) or actual depositor balances, whichever was less. Secondly, prohibitions on the granting or renewing of any loan or advance, making investments, incurring any liability or agreement to disburse payment (whether in discharge of its liabilities and obligations, or for the transfer / disposal of any properties or assets). However, exceptions were provided for expenditures necessary to carry on the bank's day-to-day administration and the payment of premiums payable to India's Deposit Insurance and Credit Guarantee Corporation (DICGC).

***The resolution (of YES Bank) will be done very swiftly, it will be done very fast. 30 days which we have given is our outer limit. You will see a very swift action from RBI***

Shaktikanta Das, Governor of the Reserve Bank of India

Expenditures were not to exceed the average monthly expenditure on account of the item, for the six months preceding 5 March 2020.

Shri Prashant Kumar – ex-Deputy Managing Director (MD) and Chief Financial Officer (CFO) of State Bank of India (SBI) – was appointed as YES Bank's administrator and subsequently, as MD and CEO on 26 March 2020.

The RBI continuously assured YES Bank depositors that their interests would be fully protected and there was no need to panic. The central bank also committed to a reconstruction scheme before the end of the 30-day moratorium to ease the hardship of depositors. Prior to lifting of the moratorium on 18 March 2020, the Governor of the RBI reiterated to stakeholders that the restructuring plan for YES Bank was credible and sustainable.

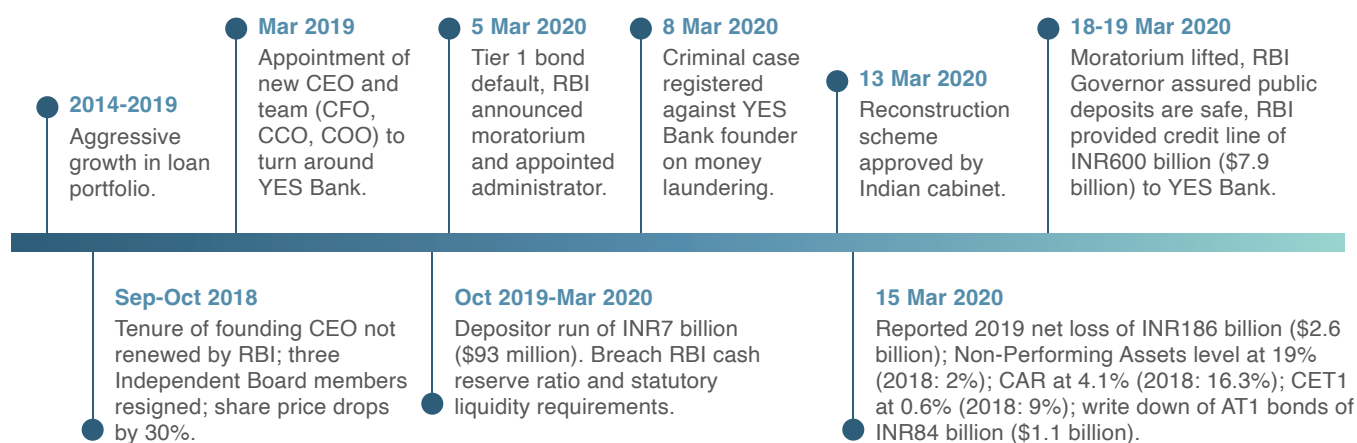
***I'm in continuous interaction with the RBI which has assured they will give a quick resolution. I want to assure every depositor that their money shall be safe. Their monies are safe***

Nirmala Sitharaman, Minister of Finance

<sup>58</sup> On 26 June 2020, this Act was amended to enable RBI to reconstruct a weak bank without the prior requirement of imposing a moratorium on its depositors and creditors



## Resolution of YES Bank – Timeline of Key Events



### Reconstruction Scheme

On 13 March 2020, the Indian cabinet approved the Reconstruction Scheme (Scheme), which covered five main segments. First, SBI was to acquire a 48.2% equity stake in YES Bank for INR60.5 billion (\$817 million) and could not reduce its shareholding to below 26% for the next three years. SBI is India's largest commercial bank (58% government-owned). Second, a consortium of seven new private FIs would take up 31% equity stake for INR39.5 billion (\$533 million), with a lock-down period of three years on 75% of their investments. The FIs were ICICI Bank, Housing Development Finance Corporation, Axis Bank, Kotak Mahindra Bank, Federal Bank, Bandhan Bank, and IDFC First Bank. Besides the new investors, existing shareholders holding more than 100 shares were subjected to the three-year lock-in period. The Scheme resulted in dilution of ownership by existing shareholders, e.g. shares held by retail investors fell to 12.8% as at 31 March 2020 (end-2019: 48%). Third, YES Bank's authorised share capital was increased to cater for the new equity injection. Fourth was the appointment of new Board of Directors (BOD). Lastly, there would be no changes in YES Bank's offices or branches, and employees were to continue in their jobs with the same remuneration and terms and conditions of service.

In addition, INR84.15 billion (\$1.1 billion) of YES Bank's AT1 bonds were written down fully to provide additional loss absorbing capital against its losses. This was the first time in India's banking sector that AT1 bonds were written down which negatively impacted capital markets. As investors turned risk averse, smaller and weaker lenders found it

challenging to raise funds. The total outstanding AT1 debt in the Indian banking system was INR930 billion (\$8.4 billion).<sup>59</sup> Of this amount, INR390 billion (\$5.5 billion) was issued by private banks.

Nevertheless, the write down of AT1 bonds and new capital injection from the identified FIs raised YES Bank's proforma CET1 ratio and CAR to 7.6% and 13.6% (2019: 0.6% and 4.1%). The Scheme also resulted in credit rating upgrades (Moody's long-term issuer rating from Caa3 to Caa1) due to bailout of the bank's depositors and senior creditors, and lifting of the moratorium on its depositors and creditors.

YES Bank also received support from the RBI and raised funds. On 19 March 2020, a day after the moratorium was lifted, RBI extended a credit line of INR600 billion (\$7.9 billion) to YES Bank. However, before accessing the credit line, YES Bank would have to use its immediate liquid assets. The provision of the credit line by the RBI was permitted as YES Bank was deemed to be illiquid but solvent after implementation of the Scheme and write down of the AT1 bonds. To further assure depositors, the Governor stated that RBI was ready to offer liquidity, if required. YES Bank also planned a certificate of deposits programme, to raise up to INR200 billion (\$2.7 billion) from institutional investors. This was assigned an A2 rating by CRISIL Limited (the local arm of S&P Global) premised on continued extraordinary systemic support from key stakeholders, along with the sizeable ownership of YES Bank by SBI.

<sup>59</sup> Source: ICRA Ltd (the local arm of Moody's Investors Service)

## Key takeaways

YES Bank was rescued by strong and early interventions from the RBI, as well as direct support of equity injections from another state-owned bank and a consortium of seven privately owned FIs. Nevertheless, YES Bank's AT1 bonds were fully written down. For the first time in the history of India's banking sector, investors had to bear losses as part of YES Bank's restructuring scheme. Even though this jolted capital markets and a case was filed by an investor against the RBI in the Madras High Court, the RBI stood firm that the decision to write off YES Bank's AT1 bonds were in keeping with the regulations and disclosures in the information memorandum issued to govern such securities.

***It is clear that the AT1 bonds carry higher risk for which the interest rate is also on the higher side. Investors in such financial instruments are by nature savvy, with risk appetite and cognizant of the high reward-high risk principle***

Reserve Bank of India

On 4 February 2020, the deposit insurance limit provided by DICGC was raised from INR1 lakh (\$1,300) to INR5 lakh (\$6,600). Once the order of moratorium is made by the Central Government under section 45(2) of Banking Regulation Act in respect of an insured bank and the said order of moratorium provides for restrictions on depositors of such bank from accessing their deposits, DICGC becomes liable under Section 18A of DICGC Act to pay deposit insurance to the depositors of that insured bank from the date of effect of such order. This was enabled by a bill<sup>60</sup> passed by the Indian parliament on 9 August 2021. In 2018, a proposal for a Financial Resolution and Deposit Insurance Bill fell through, owing to concerns about a bail-in clause.

***Going forward, we need the legislative backing to have some kind of a resolution corporation, which has to deal with resolution and revival of stressed financial firms***

Shaktikanta Das,  
Governor of the Reserve Bank of India

As with the case of YES Bank, the growing complexities of resolving troubled or failed banks demonstrate the importance of instituting a resolution mechanism for FIs. This mechanism could prevent the failure of some FIs from affecting the entire system, and serves as a strong complementarity to adequate deposit insurance coverage. Both act in concert to promote public confidence in the financial system. In addition, resolution regimes and

approaches need to be considered within the strategic context of policies on financial sector development and concomitant systemic risks. For instance, in October 2020, RBI issued a working paper which mooted possible ownership of banks by Indian conglomerates as well as licenses issued to well-run large Non-Bank Financial Companies (NBFCs), which could have implications on the resolution of FIs in India.

Prompt actions and decisions were taken to minimise disruptions in times of crisis. The RBI swiftly imposed a 30-day moratorium to stem the outflow of funds from YES Bank. Within the next 14 days, a reconstruction scheme was put together and approved by the Indian Cabinet, followed by lifting of the moratorium and further assurances by the RBI to support YES Bank. This was crucial to prevent further deterioration of the bank from the prevailing uncertainties of COVID-19, as well as the recent failures of Punjab & Maharashtra Cooperative Bank (PMC) and Dewan Housing Finance Corporation Ltd (DHFL) towards the end of 2019, which had impacted public confidence in the Indian financial system.

Different situations require different resolution responses. The moratorium and restructuring scheme were designed to ensure that YES Bank continued to be run professionally and independently without imposing burdens on its new shareholders. This differed from previous resolutions in India, when failed financial institutions were directly merged with state-owned FIs (e.g. Life Insurance Corporation of India took over 51% of IDBI Bank in 2019) or where the RBI initiated insolvency proceedings against DHFL.

In November 2020, the RBI also intervened to rescue a regional lender, Lakshmi Vilas Bank (LVB). The RBI imposed a withdrawal limit of INR25,000 (\$336) and replaced the BOD of LVB. On 27 November 2020, LVB merged with the Indian unit of Singapore's DBS Bank (DBS India) (in 2018, DBS India had attempted to acquire a 50% stake in LVB). DBS India would inject INR25 billion (\$336 million) into LVB and prior to the merger, LVB's Tier 2 bonds worth INR318 crore (\$43 million) were completely written off.

As the crisis unfolded, there was also continuous public communications from the failed bank (YES Bank), the regulator (RBI) as well as main investor (SBI). The Governor of the RBI directly addressed YES Bank depositors to provide assurance that their deposits were safe and this message was echoed by the Finance Minister. Despite the long queues outside YES Bank branches for withdrawals, such assurances served to mitigate panic and were backed by timely actions to restore public confidence.

<sup>60</sup> Deposit Insurance and Credit Guarantee Corporation (Amendment) Bill, 2021





## Temporary Capital Placement *PT Bank Century (2008)*

## Indonesia

### Background and context

PT Bank Century (Bank Century) was established on 28 December 2004 following the merger of PT Bank CIC International, PT Bank Pikko and PT Bank Danpac. In 2008, Bank Century held total assets of IDR15.02 trillion (\$1.28 billion) and a network of 56 offices focusing on retail, consumer and SME banking. In comparison, during the same period, the total assets of Indonesia's largest bank, PT Bank Mandiri, stood at IDR318.7 trillion (\$25 billion).

The resolution of Bank Century happened in the midst of the GFC, with policy measures in place to maintain public confidence in Indonesian banks. This included raising of the deposit insurance limit substantially from IDR100 million to

IDR2 billion (about \$180,000) in October 2008. Subsequently, on 21 November 2008, the central bank – Bank Indonesia (BI) – deemed Bank Century to be a failed systemic bank, paving the way for its takeover by the Indonesia Deposit Insurance Corporation (IDIC). IDIC is directly accountable to the President of Indonesia.

IDIC then restructured and rebranded Bank Century as PT Bank Mutiara (Bank Mutiara) and sold it to a Japanese finance company, J Trust Co. Ltd (J Trust) in November 2014 for IDR4.4 trillion (\$360 million) at 3.5 times price-to-book value. As at October 2014, Bank Mutiara had registered losses of IDR163.1 billion (\$13.4 billion).

## Resolution actions

### Temporary Capital Placement (TCP)

On 21 November 2008, an FSSC meeting – led by the Minister of Finance and attended by members of the FSSC, namely the Governor of BI, the Chairman of IDIC, and several other related parties – discussed Bank Century's problems and measures that needed to be taken.

There were three key considerations. Firstly, the threat of contagion to, as well as runs in other banks, if Bank Century were to be declared insolvent. According to BI (then Indonesia's banking supervisor), 23 other mid-sized banks were at risk with liquidity problems having experienced bank runs. The concern was then a broader spread of vulnerabilities from the financial sector to other industries and the impact on jobs. Moreover, there were financial and economic uncertainties from the GFC during that period.

***In an emergency situation - market psychology wise - any failing bank would trigger a bank run ... the contagion would travel from bank to bank, from the financial sector to industries, which eventually would hurt jobs***

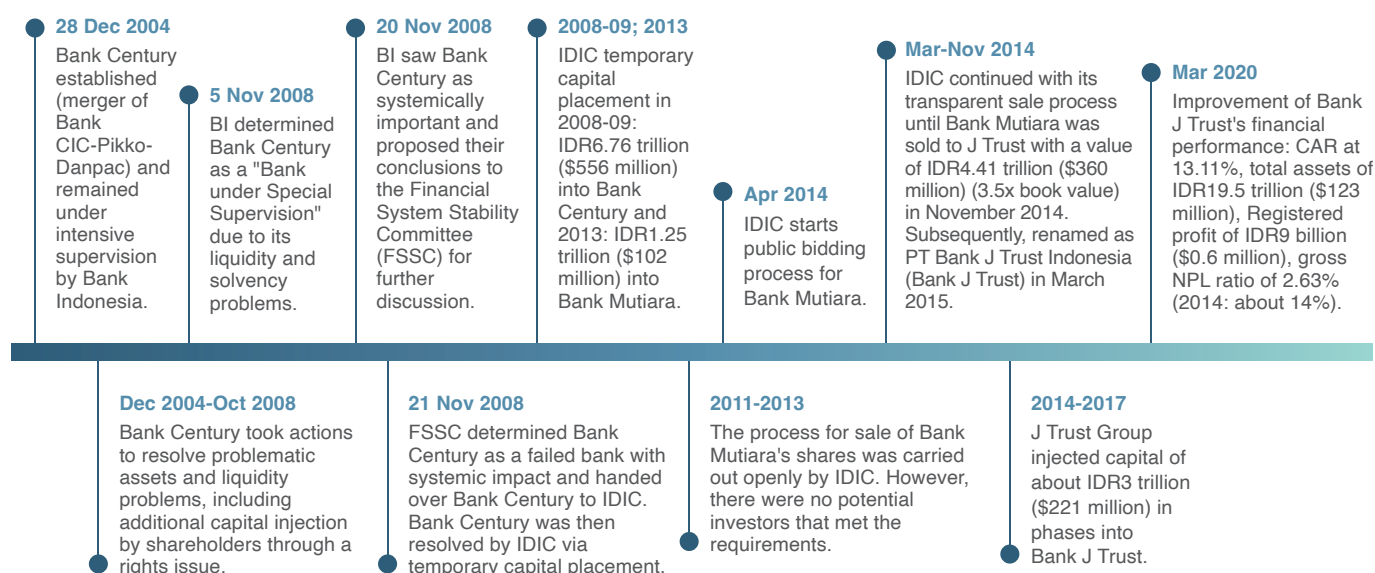
Boediono, former Governor of Bank Indonesia

Second was the financial condition of Bank Century and the costs of saving it. At the time of the decision, Bank Century's CAR was -3.53%, equivalent to additional capital requirements of IDR632 billion (\$51 million). However, three days later, Bank Century's actual CAR was discovered to be -35.92%, after accounting for non-performing securities and fictitious assets.

Third was the strain that the bailout costs would put on the deposit insurance fund (Fund). Decision makers deemed the first estimate of capital requirements to be reasonable in terms of impact to the Fund. The critical factor was whether the deposit insurance scheme could support depositors, and prevent the loss of confidence and severe bank runs such as those that had taken place during the AFC in 1997 to 1998. In 2008, the Fund size was IDR14 trillion (\$1.1 billion) compared with total covered public deposits of up to 1,000 trillion (\$78.4 billion).

During the resolution process performed by IDIC (from November 2008 to November 2014), IDIC made five TCPs in Bank Century / Bank Mutiara amounting to IDR8.011 trillion (\$658 billion).

### Resolution of Bank Century – Timeline of Key Events



***The sale of Bank Mutiara's shares to a Japanese investor, J Trust, was done openly and transparently ... IDIC has handled the failed bank according to the law***

Indonesia Deposit Insurance Corporation



In April 2014, pursuant to IDIC's auction of Bank Mutiara, 11 potential buyers from China, Indonesia, Japan, Malaysia and Singapore submitted letters of interest. Those short-listed then submitted preliminary bids and were given access to IDIC's data room to facilitate the due diligence processes. Buyers were attracted to Bank Mutiara due to exemption from the 40% cap on foreign ownership of local banks in Indonesia, and the prospect of tapping into a profitable market with strong growth potential. In November 2014, after approval from the Financial Services Authority or Otoritas Jasa Keuangan (OJK), J Trust was announced as the successful bidder. On 30 March 2015, Bank Mutiara was rebranded as Bank J Trust.

From a legal perspective, the IDIC was required to complete the sale of Bank Mutiara within a five-year period. This was required to be conducted at a minimum amount equal to the total of IDIC's TCP (known as the Optimum Return). However, where the Optimum Return could not be realised within five years, the law permits a sale, in the sixth year, at the most optimal market price.<sup>61</sup>

Bank Mutiara was sold to J Trust for IDR4.4 trillion (\$360 million) at 3.5 times price-to-book value. Most analysts saw the sale price as being a premium, given the weak financial condition of Bank Mutiara. Pursuant to the acquisition, from 2014 to 2017, the capital position of Bank J Trust was strengthened through phased injections amounting to a total of IDR3 trillion (\$221 million). According to results in the first quarter of 2020, Bank J Trust's financial performance has improved: CAR stood at 13.11% with gross NPL ratio of 2.63%.

### **Key takeaways**

Arriving at a decision on the idiosyncratic or systemic nature and impact of a FI is highly challenging. In Bank Century's case, this was made more complex by four inter-related factors. First, the prevailing GFC environment with low level of public confidence in the financial sector and economic uncertainties. Second, the speed and urgency of decisions as contagion risked sparking more bank runs. Third, the mid-sized characteristic of Bank Century made it harder to establish adverse impact on the overall financial system and economy. Fourth, the structure of the Indonesian financial system with a large number of banks and the developmental stage of market-based finance.

A decision on the optimal resolution method is heavily reliant on accurate data concerning the financial condition of the institution. This is critical to enable decision makers to ascertain the costs of resolution and the amount of resources required to tackle the root problem.

Resolution via nationalisation provides immediate stability to the financial system, but can take up considerable amount of resources and time. Bank Mutiara required two large capital injections and was divested to J Trust after six years of being managed by the IDIC.

Coordination and cooperation amongst financial safety net players is a crucial and key success factor in resolving problem banks to safeguard financial system stability. Sound governance – including clear and transparent processes and strong legal foundations – are important pillars for effective bank resolution. These are important to support decision making by policy makers, and in light of scrutiny by lawmakers and other stakeholders of the selected resolution scheme and actions such as capital injections and sale of the distressed bank to interested parties.

<sup>61</sup> In 2014, the Constitutional Court issued a decision stating that IDIC may sell the shares of the rescued failed banks with the price below the TCP value, provided that it does not cause the state loss as long as it is carried out openly and transparently





## Nationalisation and Restructuring *Baoshang Bank (2019-2020)*



**Table 5: Summary of Chinese banks supported by the authorities from 2019 to 2020<sup>62</sup>**

No	Bank (established)	Date of intervention	Region	Branches	Employees (estimated)	Total Assets (CNY billion) (estimated % of banking industry)
1	Baoshang Bank <sup>63, 64</sup> (Dec 1998)	May 2019	Inner Mongolia	18 (291 sub- branches)	8,000	431.6 / \$62.2 billion (2016) (0.2%)
2	Hengfeng Bank <sup>63, 64</sup> (Oct 1987)	Dec 2019	Yantai city, Shangdong	18 (306 sub- branches)	10,700	1,028.8 / \$147.7 billion (2019) (0.3%)
3	Harbin Bank <sup>64, 65</sup> (Jul 1997)	Nov 2019	Harbin, Heilongjiang Province	17 (282 sub- branches)	7,000	623.4 / \$94 billion (June 2018) (0.3%)
4	Bank of Jinzhou <sup>65</sup> (22 Jan 1997)	Mar 2020, Jul 2019	Liaoning province	15	6,000	748.4 / \$113 billion (June 2018) (0.3%)
5	Bank of Gansu <sup>65</sup> (19 Nov 2011)	Apr 2020	Lanzhou city, Gansu	12 (190 sub- branches)	4,200	335.1 / \$48 billion (2019) (0.1%)
						3,167.3 / \$464.9 billion (1.2%)

<sup>62</sup> Non-exhaustive list of banks

<sup>63</sup> Baoshang and Hengfeng are part of 12 national joint-stock commercial banks in China

<sup>64</sup> Linked to Tomorrow Group, a conglomerate involved in banking, insurance, real estate, and other businesses

<sup>65</sup> Harbin, Jinzhou and Gansu were listed on the Hong Kong Stock Exchange (HKEX) in March 2014, December 2015 and January 2018 respectively

## Background and context

On 24 May 2019, China's financial regulators, the People's Bank of China (PBOC) and the China Banking and Insurance Regulatory Commission (CBIRC), jointly announced that they would take over the management of Baoshang Bank (Baoshang) for a period of one year citing the severity of its credit risk.

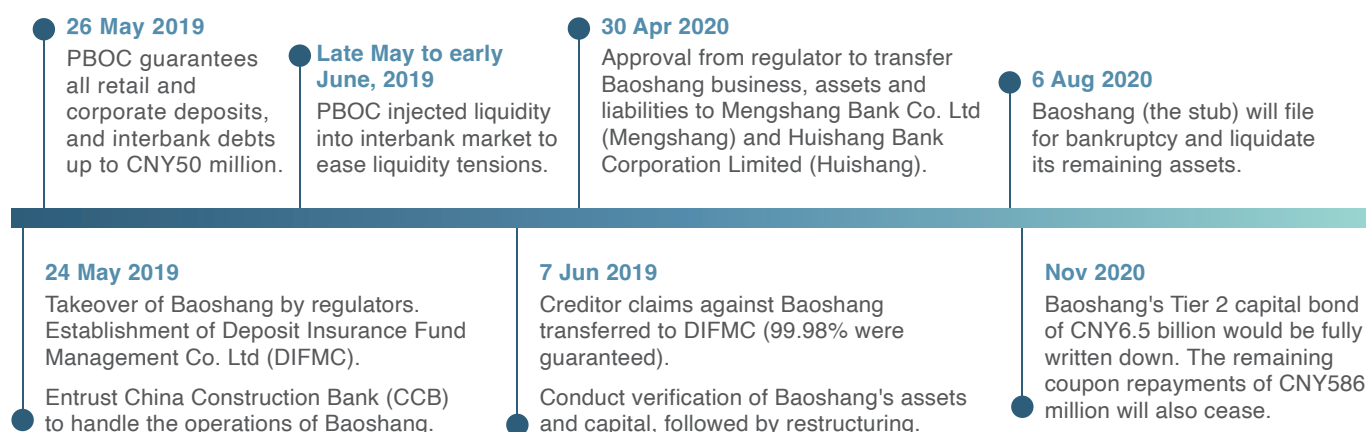
This was China's first government takeover of a bank since 1998 and it took place against the backdrop of rising defaults, growing debt burdens and a slowing economy. As at end 2016, Baoshang had an asset size of CNY432 billion (\$62.2 billion). At the time of the takeover, it had about 4.73 million customers, including 4.67 million individuals and 63,600 corporate clients. Baoshang had not published any annual reports since 2016. It was also reported that 18 small Chinese banks had yet to release financial results in 2018, signalling a potential build-up of non-performing loans (NPL) in the Chinese banking system.

Financial markets were concerned that Baoshang's troubles reflected wider problems among the smaller

regional banks across China, which had expanded aggressively and were highly dependent on interbank funding. Shortly after Baoshang's takeover by the Chinese authorities, these small banks faced issues securing borrowing, as fears permeated the interbank market. The interbank borrowing rate for smaller banks spiked from its normal level of about 3.5% to as high as 15% in June 2019, triggering severe liquidity tensions in the Chinese interbank market.

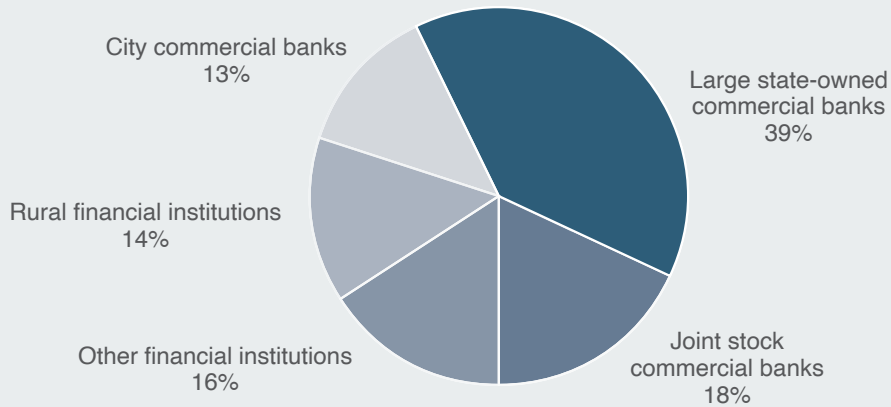
Matters were further complicated by virtue of the 89% owner of Baoshang, Tomorrow Holdings. In early 2017, Xiao Jianhua – the billionaire founder of Tomorrow Holdings – was taken into police custody in mainland China from Hong Kong. His involvement in Baoshang inevitably raised the question as to whether the regulators would seek to break up his sprawling business empire. It was reported that the Tomorrow Group had illegally borrowed CNY156 billion (\$22.3 billion) from Baoshang in the form of 347 loans through 209 shell companies from 2005 to 2019 and these had subsequently become delinquent.

### Resolution of Baoshang – Timeline of Key Events

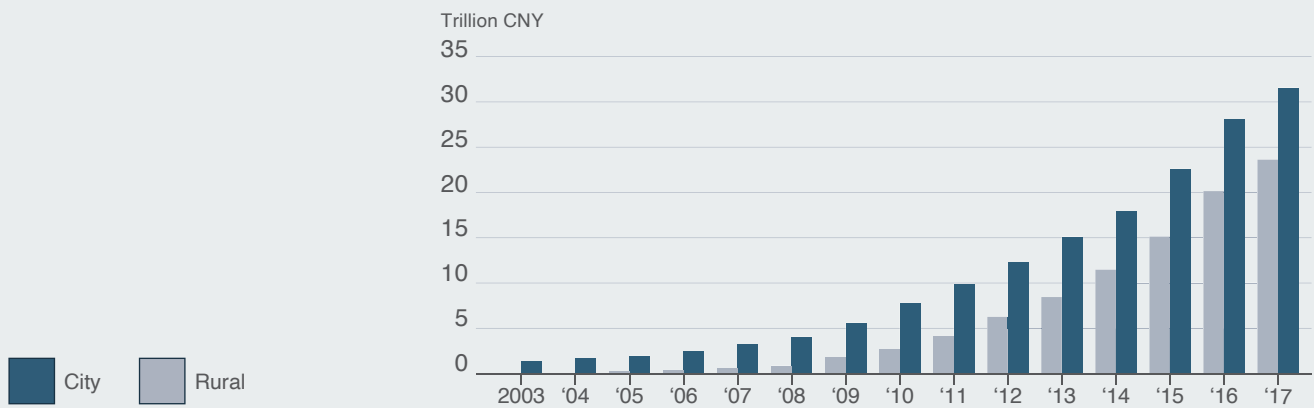


**Diagram 4: Overview and salient features of the Chinese banking system**

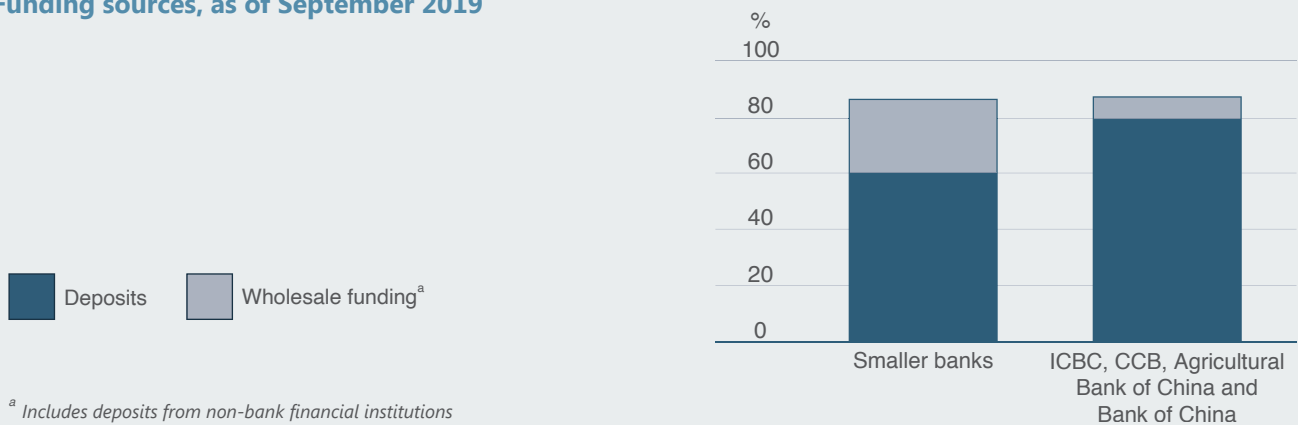
**China: Share of banking sector assets as at 31 December 2021**



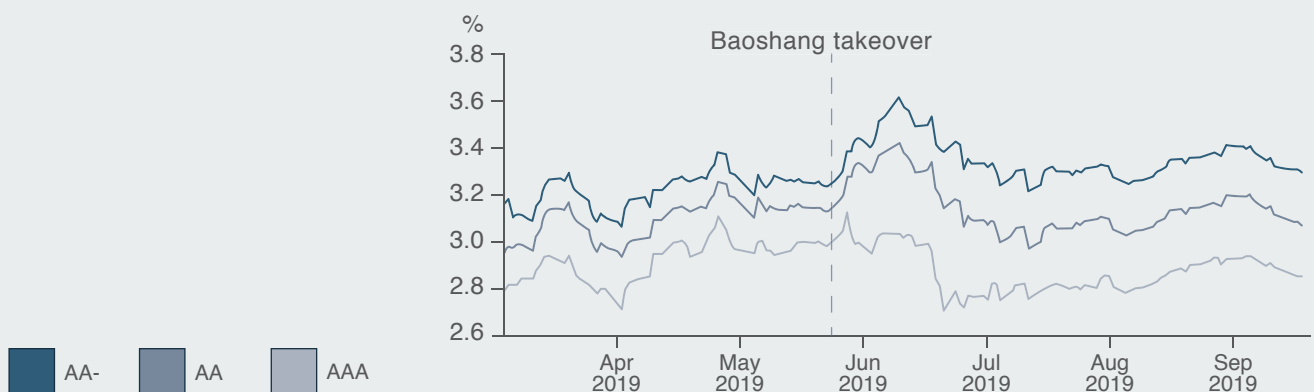
**Total assets of smaller Chinese commercial banks by category**



**Funding sources, as of September 2019**



**Yields on Chinese bank debt by credit rating**



Sources: PBOC, CBIRC, Wind, The Wall Street Journal

## Resolution actions

### *Stabilisation measures taken to alleviate market fears of a sudden takeover*

On the same day of the Baoshang takeover, in order to protect depositors' savings, PBOC set up the DIFMC<sup>66</sup> to manage a CNY100 billion (\$14.5 billion) fund.

On 26 May 2019, PBOC issued an official statement that it would guarantee all retail deposits, corporate deposits and interbank debts of up to CNY50 million (\$7.2 million) in Baoshang. For debts above that threshold, there would be guarantees to corporate creditors at least 80% of their deposits, and to other financial institutional creditors at least 70%.

CCB was appointed to assume the daily operations of Baoshang to protect the interests of customers and depositors. PBOC also announced that it would offer timely and sufficient funds to ensure that the payment services of Baoshang operated smoothly.

In response to the liquidity tensions, PBOC took steps to support small banks by injecting more money into the system, and extended its medium-term lending facility to institutions at a rate of 3.30%. To further reassure investors, the PBOC

stated that it was not planning to undertake any other bank takeovers. In addition, it would use various monetary policy tools to stabilise the money market and boost liquidity of the banking system. Financial markets reacted positively to the steps taken by the PBOC, and interbank market interest rates then stabilised, indicating that the concerns around the takeover had abated.

By 7 June 2019, Baoshang's creditors had transferred all their claims to the DIFMC fund. The transfer marked the end of the first phase of the takeover. 99.98% of Baoshang's corporate creditors had their claims fully guaranteed. The remainder – as well as some large interbank creditors – had an average of 90% of their claims guaranteed. The regulators disclosed that not all creditors were fully guaranteed, to avoid the perception that they were encouraging FIs to invest in illegal high-interest products without conducting robust risk assessments. This moral hazard could lead to a systemic crisis. In November 2019, PBOC proceeded to restructure Baoshang after being close to completing asset and capital verification work.

### *Business Transfer and Sale of Baoshang*

On 30 April 2020, Baoshang received regulatory approval for the transfer of its business, assets and liabilities to Mengshang (a new province-level FI) and Huishang.

Mengshang assumed the business, assets and liabilities of the head office and various branches of Baoshang in North China's Inner Mongolia autonomous region, while Huishang took over branches outside Inner Mongolia.

Mengshang – with a registered capital of about CNY20 billion (\$2.8 billion) – would serve as the 'New Baoshang'. Its shareholding structure comprises Inner Mongolia's finance

department and state-owned enterprises (50.16%), DIFMC (29.84%), Huishang (15%), and CCB's subsidiary, Jianxin Finance Asset Investment Co. Ltd (5%).

Anhui-province's Huishang<sup>67</sup> was one of Baoshang's biggest creditors prior to the latter's takeover by the government, and is reported to have sustained CNY3 billion (\$425 million) in losses via interbank loans. The DIFMC provided CNY34.4 billion (\$5.0 billion) to Huishang to cover losses from buying part of Baoshang's good assets. In August 2020, it was reported that DIFMC had injected another CNY8.9 billion (\$1.3 billion) into Huishang and became its second largest shareholder.

### *Liquidation of Baoshang's Stub*

Subsequently, in August 2020, it was reported that Baoshang would file for bankruptcy and liquidate its remaining assets in a final step to clean up the mess. The equity of Baoshang's original shareholders and unprotected creditors would be liquidated in accordance with the law. Authorities had stated that they would also hold relevant persons to account for Baoshang's troubles.

According to the official disclosure by PBOC, the government-led restructuring of Baoshang covered repayment of 90% of debts to large creditors. Since the takeover of Baoshang, PBOC has provided CNY23.5 billion (\$3.38 billion) of

liquidity support through a standing lending facility. Without the injection of public funds, the average repayment rate for creditors would be less than 60%.

In November 2020, Baoshang stated that it would write-down the full principal amount of a CNY6.5 billion (\$984 million) Tier 2 capital bond (Bond) and not make remaining coupon payments of CNY585.6 million (\$89 million). This was in accordance with clauses in the Bond's prospectus, and followed a notice by the PBOC and CBIRC confirming that Baoshang had experienced a "non-viability trigger event".

<sup>66</sup> PBOC established the deposit insurance fund in 2015 and has since collected insurance premiums from depository FIs. Depositors could receive up to CNY500,000 (\$70,800) each in compensation if a bank were to fail

<sup>67</sup> Huishang Bank's asset size was CNY1.13 trillion (\$162 billion) in 2019, equivalent to market share of 0.4% of China's banking system



## Key takeaways

Resolution strategies need to fit within the broader context and state of play of financial systems in specific jurisdictions. In China's case, these considerations include the market structure (e.g. size, concentration, type of players, geographical dispersion), stage of development, sectoral interconnectedness between banks and insurers, role of government in the financial sector, political economy and other regulatory as well as institutional factors.

The resolution of Baoshang relied on funding and operational support from central and provincial governments, as well as the Deposit Insurance Fund Management Corporation. A large state-owned bank was also drafted into the overall restructuring scheme.

The authorities in China also sought to avoid moral hazard in executing the resolution strategy for Baoshang. The PBOC chose a measured response to impose haircuts on corporate and interbank depositors while retail and small deposits were fully protected. Baoshang's Tier 2 bond worth a principal sum of CNY6.5 billion (\$984 million), would also be fully written down together with the ceasing of related coupon payments. This loss-sharing mechanism was an attempt to break the long-existing implicit government guarantee of full repayment, which had fuelled risk-taking by FIs. Such actions were also in line with regulators' heightened scrutiny of the risk management of regional banks.

***Commercial banks and deposit-taking institutions in China will begin to use deposit insurance labels starting from November 28 (2020) ... this is a break from past practice, where it was widely assumed the authorities would step in to save collapsing financial firms***

Central Banking Publications



While the group of recent bank failures and restructurings in China including Baoshang Bank, involved small, regional banks (collectively holding just 1.2% of total assets of the banking industry), authorities nonetheless acted decisively to preserve financial stability and market confidence. Swift and close collaboration between regulatory bodies were imperative in crisis management. Clear communications on the progress of resolution, including successive press conferences on areas such as reasons for takeover, status of follow up actions, and the liquidity position of troubled banks – all served to alleviate market anxiety. These actions were crucial to address prospective contagion risk, amid growing investor concerns on the collective indebtedness of small banks.

China's experience also highlights issues relating to corporate governance. In July 2020, the CBIRC published a list of 38 shareholders required to divest from banks and insurance companies. These shareholders had used banks to finance companies they own leading to concentration risk for the lenders, including the case of Baoshang Bank linked to Tomorrow Group.

Another separate development in China was a spate of bank runs in rural banks. These were triggered by social media rumours in end-2019 and from July to August 2020.







## Nationalisation and Restructuring *Royal Bank of Scotland (2008)*

### Background and context

The founding of the Royal Bank of Scotland (RBS) dates back to 1727. RBS's business portfolio included investment, corporate and retail banking in the UK and across the world. From 2000 to around 2007, it had embarked on a series of acquisitions, including NatWest, Churchill, Charter One, and ABN AMRO. In particular, the ABN AMRO acquisition was then the biggest deal in financial services history. At its peak, RBS was the largest bank in the world, as measured by assets of £1.9 trillion (\$3.8 trillion) which was more than the then UK GDP. RBS was named Global Bank of the Year in 2007. It employed 226,400 staff, and had the widest network of 2,278 branches across the UK. It also owned Citizens Financial Group in the US and prior to the GFC, was the second largest shareholder in the Bank of China.

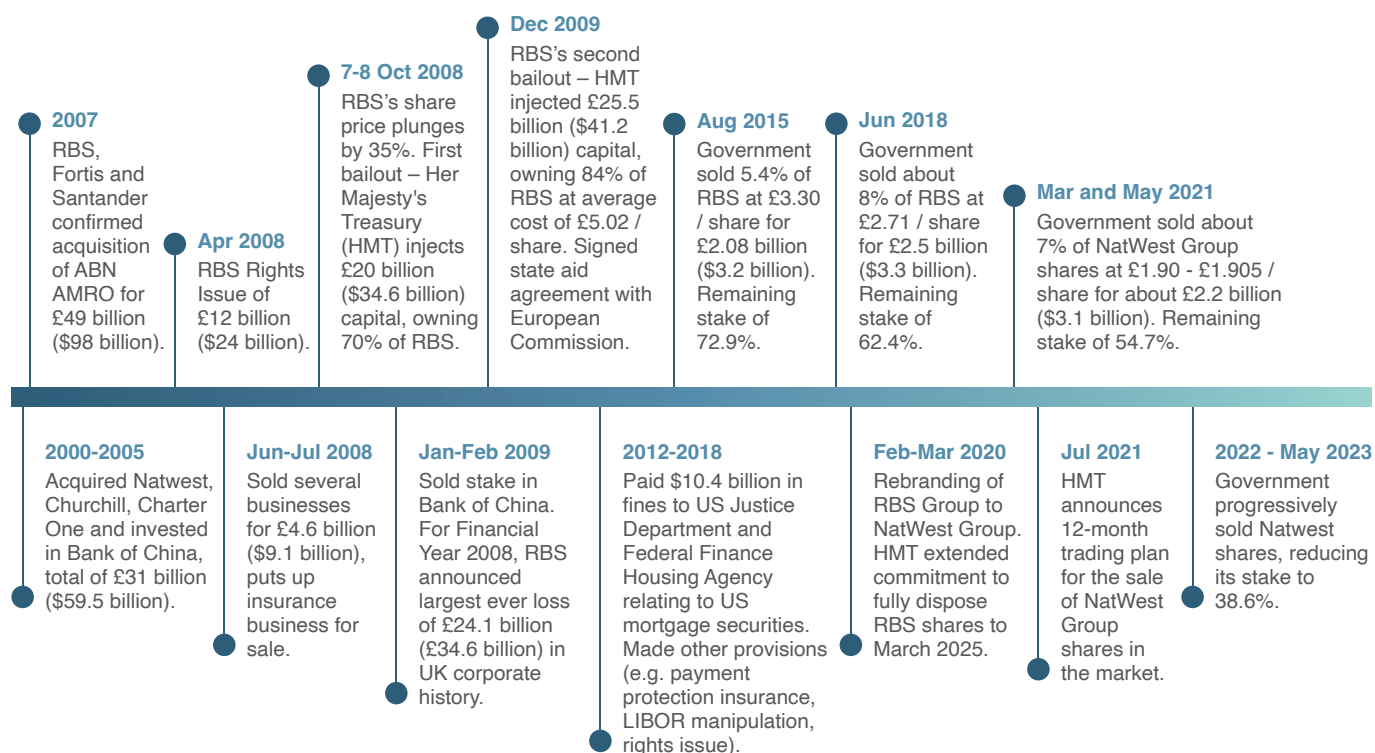
There were seven inter-related factors that contributed to the collapse of RBS, namely, weaknesses in its capital position, over-reliance on risky short-term wholesale funding, uncertainties about its underlying asset quality and lack of scrutiny by the UK Financial Services Authority (UK FSA), losses in credit trading activities (under-estimated by RBS and UK FSA), the poor due diligence in the acquisition of

ABN AMRO, the overall systemic crisis that exacerbated RBS's vulnerability to failure, and lastly, deficiencies in the management, governance and culture of RBS.

Relative to peers, RBS had chosen to be lightly capitalised (using lower quality forms of capital), and had been more reliant on wholesale and overnight funding. According to the UK FSA's estimates, under Basel III, RBS's common equity Tier 1 ratio was only 2.5% as at end-2007, and the LCR stood at only 18% to 32% as at end-August 2008.

The acquisition of ABN AMRO in 2007 proved a step too far. This eroded RBS's capital adequacy, increased its reliance on short-term wholesale funding (the acquisition was funded primarily via short term debt) and resulted in significantly higher exposures to structured credit and other asset classes, which was to lead to large losses. Additionally, the due diligence was visibly inadequate relative to the risks being assumed—RBS was reported to have received only “two lever arch folders and a CD's” worth of information from ABN AMRO for an acquisition to the tune of £49 billion (\$98 billion).

## Resolution of RBS – Timeline of Key Events



### Resolution actions

In the first three quarters of 2008, RBS took recovery actions such as recapitalisation via a rights issue of £12 billion (\$24 billion). It also carried out the sale of businesses, including Angel Trains and Tesco Personal Finance, for a total of £4.6 billion (\$9.1 billion). However, in August 2008, RBS reported its first loss in 40 years. Subsequently, on 7 October 2008, RBS's share price plunged 35% and it fell in critical danger of running out of money. On the same day, the Bank of England (BoE) provided ELA to RBS in US dollars, and subsequently in sterling. Use of the BoE's dollar facility peaked at \$25 billion on 10 October 2008, and the sterling facility at £29.4 billion (\$47.9 billion) on 27 October 2008. RBS made final repayment of the ELA on 16 December 2008.

On 8 October 2008, the UK government announced a package of support measures for the financial system, comprising provision of capital to banks and a credit guarantee scheme (CGS) (government guarantees for new short and medium-term unsecured debt issuances). RBS received 80% or £20 billion (\$34.6 billion) out of the £25 billion (\$43.2 billion) of the capital made available to banks. It also proceeded to issue debt under the CGS. Besides RBS, the UK financial system was also reeling from capital injections required to save HBOS and for Northern Rock's nationalisation in early 2008.

In October 2008 and January 2009, the CEO and Chairman of RBS were replaced. This was followed by significant changes to the board. In June 2009, the former CEO, Sir Fred Goodwin, agreed to give up £200,000 a year of his

pension of £703,000, in order to appease public anger. He was later stripped of his knighthood.

***The internal bad bank by RBS will quickly and efficiently dispose of risky legacy assets that remain on its balance sheet, without the use of fresh taxpayer funds***

Her Majesty's Treasury

In 2009, a key component in restructuring RBS was the establishment of an internal non-core division to take on bad assets worth £258 billion (\$426 billion) or £171 billion (\$282 billion) of risk-weighted assets. By 2013, the non-core division had reduced unwanted assets by 89% to £29 billion (\$48 billion), representing about 4% of RBS's funded balance sheet (2009: 21%). In 2014, RBS stepped up its programme to deal with troubled assets by setting up an internal bad bank – RBS Capital Resolution (RCR) – with a renewed focus on eliminating RBS's highest-risk assets, stronger oversight (from non-executive directors) and improved disclosures. In November 2013, Her Majesty's Treasury (HMT) published a detailed review supporting RBS's approach for an internal bad bank. The review concluded, among others, that an external bad bank (requiring 12-18 months to establish) would not facilitate a faster return to the private sector than an internal one. It took RBS close to nine years to deal with bad assets from 2009 until closure of the RCR division in November 2017.

## The long, winding and costly path of RBS's protracted return to the private sector

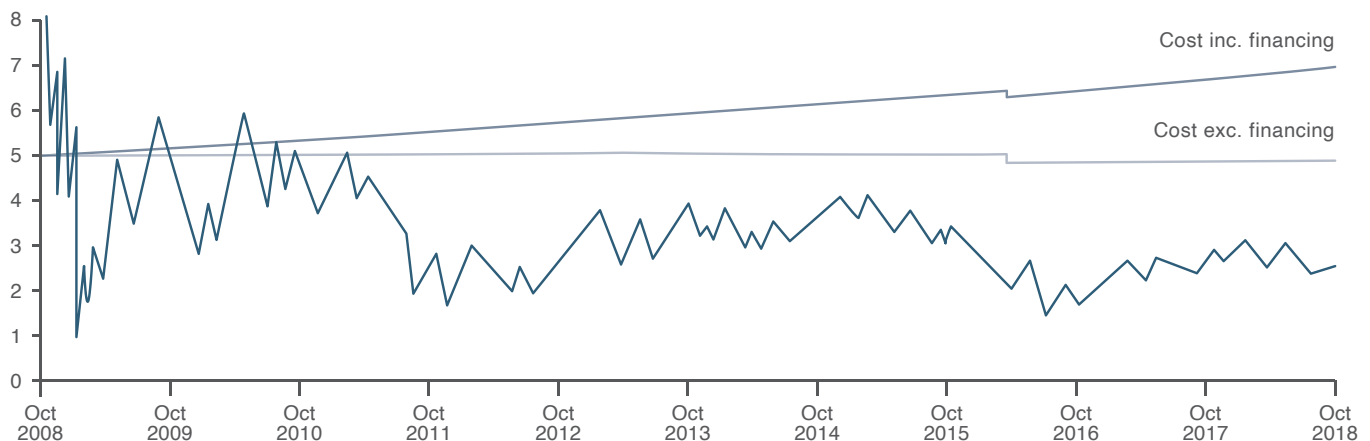
Post-nationalisation, RBS underwent several strategic transformations under three different CEOs – Stephen Hester (October 2008 to 2013), Ross McEwan (October 2013 to 2019) and Alison Rose (November 2019 to current) – and only paid out its first dividend to ordinary shareholders in 2018. For almost a decade, it had been confronted with the multiple challenges of internal restructuring, a difficult operating environment and recurring legacy issues of misconduct. The latter saw RBS pay out total settlements of about £20 billion (\$27 billion) from 2012 to 2018, including those related to US mortgage-backed securities, LIBOR manipulation, the 2008 rights issue, payment protection insurance, and with the EU for RBS' state aid.

As part of the government bailout in 2009, RBS had agreed with the EU to divest 316 branches of its operations (under Williams & Glyn) to resolve competition concerns in the concentrated UK SME banking sector. In place of that commitment, in 2018, RBS agreed to set up a fund of about £835 million (\$1.1 billion) to help UK's 'challenger banks'<sup>68</sup> compete with and obtain a 3% market share from RBS in the area of business banking.

The strategic objective of the HMT was to return RBS to the hands of the private sector, while realising the best possible value for its stake, so that funds could be released to reduce national debt and provide more resources to support economic recovery. This precarious trade-off saw the UK government taking a phased approach to twice reduce its equity stake in 2015 and 2018, booking total losses of £3.2 billion (\$4.5 billion). Imputing the cost of financing, as estimated by the UK National Audit Office (NAO) in 2015, this cost has risen to £5.2 billion (\$7.3 billion). As at March 2020, the UK Office for Budget Responsibility (OBR) estimates that saving RBS cost the public a sum of £32.1 billion (\$39.8 billion). Despite its efforts, the UK government still holds 62.4% in RBS. In March 2020, owing to market conditions, HMT extended its timeframe to fully dispose of the RBS shares to March 2025.

Following share sales in 2021 to May 2023, the UK government held a remaining stake of 38.6% in RBS (rebranded as NatWest Group). In 2021, HMT announced a 12-month trading plan - beginning in August 2021 - for further share sales in the market. In June 2022, the plan was extended by another 12 months to August 2023.

**Figure 3: RBS share price vs cost to public purse**  
£ per share



Source: UK House of Commons Library

<sup>68</sup> Relatively small retail banks setup with the intention of competing for business with large, long-established national banks



## Key takeaways

Nationalisation directly achieves stability for institutions and restores public confidence, particularly when the entire financial system is under severe stress. However, efforts to turn around the bank and secure good valuations comparable to historical returns for the government when exiting the institution, are typically long-drawn and costly affairs. As the case of RBS demonstrates and assuming HMT's full divestment plan comes to pass, it would take 18 years. The government is also straddled with the prospect of further significant losses. This scenario is likely to be further complicated by the interplay of various factors, including the broader, evolving fiscal and economic conditions, and political and public backlash from crystallised losses to the public purse.

*The government should not be in the business of owning banks*

Philip Hammond, former Chancellor of the Exchequer

...

The complexity of restructuring large institutions with cross-border operations should not be underestimated. The case of RBS offers insights into the different models for executing internal bad banks (and considerations for an external bad bank). It demonstrates the challenges of dealing with multiple legacy issues that repeatedly impede the path to profitability, implementing strategic transformation programmes as envisioned by different CEOs, maintaining investor confidence, and dealing with the political economy, including the pressures of scrutiny by government bodies such as the NAO and OBR as well as post-state aid EU competition concerns.

Regulatory regimes also need to be in step with periods of accelerated growth in the financial sector. In the case of RBS, during its failure, the UK FSA had adopted 'light-touch' regulation, which had focused on market conduct, rather than on prudential requirements and supervision commensurate with RBS's size and aggressive expansion in the 2000s.







## Nationalisation and Restructuring *Woori Financial Group (1998)*



### Background and context

Woori Bank, formerly known as Hanvit Bank (Hanvit), was a commercial bank established in 1899. During the AFC, the financial condition of Hanvit had been affected by large NPLs, which led to higher reserve requirements. Ultimately, Hanvit was unable to meet regulatory capital requirements. In April 2001, Woori Financial Group (Woori) became the first Korean financial holding company formed out of a merger of five failed banks (Hanvit, Kyongnam Bank, Kwangju Bank, Peace Bank and Hanaro Merchant Bank). These banks were all impacted by the NPLs of large corporates in Korea in the late 1990s, which resulted in capital erosion.

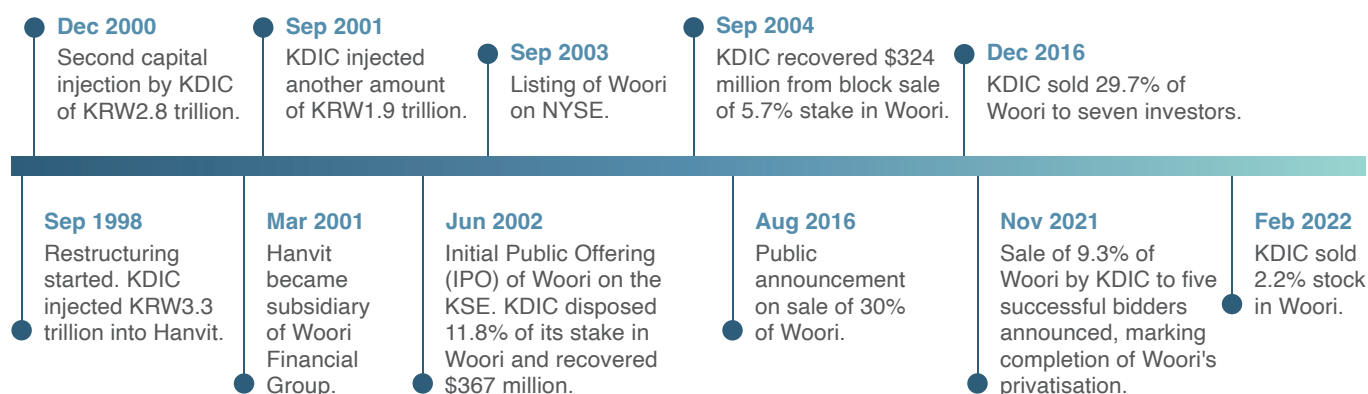
In 1999 and 2000, the Korea Deposit Insurance Corporation (KDIC) provided open bank assistance (OBA)<sup>69</sup> by injecting a total of \$12.8 billion to recapitalise these failed banks and to stabilise the Korean financial system. Hanvit was a major beneficiary of this exercise and received \$7.9 billion. To improve the transparency and efficiency of public fund management, and to expedite recovery of funds from institutions which received support from the government, a

Public Fund Oversight Committee (PFOC) was established in February 2001. In evaluating the suitability of this resolution approach, a least-cost assessment concluded that financial assistance would be a costlier option compared with the liquidation of Hanvit. However, a liquidation option could have had adverse implications on the Korean economy. This includes financial market stress, possible freezing of the capital market, insolvencies of domestic companies and an increase in unemployment as a result of large corporate failures. Having considered these factors, the PFOC decided to proceed with OBA.

During the first restructuring exercise on the Korean banking sector in 1998, KDIC had provided KRW3.26 trillion (\$2.69 billion) to raise Hanvit's CAR to 10%. This was followed by a capital injection of KRW2.76 trillion (\$2.18 billion) in 2000, and the provision of KRW1.88 trillion (\$1.44 billion) to settle Hanvit's outstanding payment obligations. To stabilise Hanvit, KDIC had to close the gap between its assets and liabilities, followed by equity investments for continued operations.

<sup>69</sup> The OBA was preceded by capital reductions

## Resolution of Woori – Timeline of Key Events



## Resolution actions

### Open Bank Assistance

In 1999, the first injection of funds totalling \$3.5 billion was to recapitalise failed Korean banks. In 2000, the second injection of \$9.3 billion into these failed banks took place after a restructuring roadmap was released by the Korea Financial Services Commission. Woori Bank (formerly known as Hanvit) received \$7.9 billion out of the total funds of \$12.8 billion provided to five failed banks.

### Restructuring and privatisation, including IPO and block sale of sales in Woori<sup>70</sup>

The financial group structure was established to strengthen Woori's internal organisation to become a leading financial services institution. A Memorandum of Understanding (MoU) between KDIC and Woori provided for transparent and rigorous oversight. Through clear targets and close monitoring by a representative appointed by KDIC, Woori was able to record an early turn around.

The indicators managed under the MoU were broadly divided into financial and non-financial metrics. Generally, the holding company and bank were required to meet semi-annual and quarterly targets respectively for two years. However, after the GFC, future targets were set for a one-year period and incorporated weighted average performance parameters over the past five years relative to competitors. Non-financial metrics included the streamlining of management, rebuilding of the credit system and the improvement of risk management as well as internal controls.

In 2002, KDIC restructured and listed Woori on the Korea Stock Exchange (KSE) and in 2003 on the New York Stock Exchange (NYSE). The listings served as a self-supervising system through market discipline. The listing on NYSE also countered negative perceptions of Woori. Through an IPO on the KSE in June 2002, KDIC recovered \$367 million by disposing 11.8% of its stake in Woori. KDIC received another \$324 million in September 2004 through a block disposal of its 5.7% stake at a discounted rate of 3%.

KDIC adopted a three-step privatisation plan for Woori. First, through the sale of regional bank units to domestic strategic investors, followed secondly by the direct sale of Woori's various non-bank subsidiaries such as the investment and securities, life insurance and asset management units. Third, through the merger of Woori Bank and Woori Financial Group, and subsequent sale of KDIC's remaining stake in the merged entity.

Another major initiative was to structure and manage the sale of a major stake (29.7%) in Woori to multiple buyers. KDIC chose to pursue this new strategy after several attempts to find a single investor to take on a large stake in Woori. A key challenge was to consider investor needs under a multi-ownership structure, which included the easing of KDIC's control over Woori. For instance, once investors named outside directors to Woori's board and upon approval by the PFOC, the MoU between KDIC and Woori would cease. However, KDIC would continue to provide support to Woori for a period of time, as it transitioned into full autonomy by the management of Woori. The model of multi-ownership shareholding with a controlling stake was also expected to enhance firm value and promote governance as well as healthy competition in the banking industry.

<sup>70</sup> KDIC's stake in Woori Bank was converted to shares in Woori Financial Group in early 2020



***The revised MoU with Woori (in 2015) is expected to help assure market participants of the government's commitment to privatize Woori and improve its corporate value to facilitate the sale***

Korea Financial Services Commission



On 1 December 2016, KDIC agreed to sell its 29.7% stake to seven investors with collective ownership of Woori (IMM Private Equity: 6%; Hanwha Life, Tongyang Life Insurance Co. (owned by China's Anbang Insurance), Eugene Asset Management Co., Korea Investment & Securities Co., Kiwoom Securities Co.: Each 4%; and Mirae Asset Global Investments Co.: 3.7%). This deal marked significant progress in KDIC's commendable efforts over many years to privatise Woori.

The proceeds of KRW2.4 trillion (\$2.05 billion) from the sale substantially increased the recovery of public funds injected into Woori. It was reported in June 2019 that KDIC had recouped 87.3% of its initial investment through proceeds from the sale of shares, sale of subsidiaries and dividends. In November 2021, the sale of 9.3% of shares in Woori by KDIC to five bidders was announced. This marked completion of Woori's privatisation after 23 years, as KDIC ceased to be its largest shareholder. The proceeds from this sale would result in a collective recovery of about KRW12.3 trillion (\$10.4 billion) or 96.6% of the total funds injected to bailout Woori.

In February 2022, KDIC sold a 2.2% stake in Woori for about KRW239 billion (\$199 million), and holds a remaining stake of 3.6%.

## Key takeaways

The case of Woori highlights challenges faced in resolving the failure of a systemic institution. These challenges cover the dimensions of assessing systemic risks, the legal basis for resolution and type of financial assistance provided, and subsequently to return the ownership of a large, nationalised financial group to the private sector. Frameworks established during good times to provide safeguards against moral hazard and to manage bank failures may be superseded by extenuating circumstances in a financial crisis. In this case, the systemic nature of the AFC and the contagion effects on the Korean financial sector, economy, corporate insolvencies and unemployment, drove the decision by policymakers to provide the OBA and override the results of the least-cost assessment for Woori.

***With successful result of the auction (in November 2021) ... the government's goal of privatisation of Woori has been accomplished some 23 years after the injection of public funds for bailout in 1998.***

Korea Financial Services Commission



In situations with a high level of systemic risk, the nationalisation of FIs could offer immediate stability to the financial system. Nevertheless, post-nationalisation, the restructuring of a large, distressed bank and the return of ownership to the private sector can be a long drawn and costly affair. The divestment of KDIC's shares and privatisation of Woori has taken more than two decades.

Another takeaway is that OBA or financial assistance raises the issue of moral hazard and increases the risk exposure of deposit insurers to higher levels of uncertainty about policy outcomes.

In addition, the need for an effective strategy and the implementation of robust processes to effectively turn around a large, distressed banking institution should not be underestimated. KDIC's successful approach required close and laborious oversight. To ensure progress, KDIC designed and set specific goals and measures to be achieved over an extended timeline and agreed these in an MoU with Woori. One restructuring objective was for Woori to acquire competitive market leadership through scale via the creation of a megabank with an asset size of \$93 billion. Finally, imposing market discipline on Woori through listings on the KSE and NYSE proved to be a sound tactic as part of the restructuring scheme. This helped to sustain improvements in Woori's performance as well as raise its domestic and international standing.



## **Precautionary Recapitalisation** *National Bank of Greece, Piraeus Bank and Banca Monti dei Paschi di Siena (2015-2017)*



### **Precautionary recapitalisation framework under the EU Bank Recovery and Resolution Directive (BRRD)**

To reduce the cost of bank failures falling on taxpayers, in 2014, the EU issued the BRRD. Under this regime, resolution costs must first be borne by the shareholders and creditors of banks through a “bail-in” mechanism. Only once this happens, can there be an injection of state aid for banks, for example from national resolution funds. However, to promote financial stability, EU lawmakers also allowed for extraordinary public support measures under certain conditions. These measures include a state guarantee in respect of new liabilities incurred by the bank or access to central bank refinancing, or the recapitalisation of a solvent bank, subject to strict conditions (Article 32.4 of the BRRD). In essence, the policy caters for situations such as systemic liquidity shortages, when solvent banks might not be able to raise sufficient private capital to make good shortfalls required by authorities arising from stress tests or other assessments.

The primary justification for state aid is ‘to remedy the serious disturbance in the economy of a Member State’. Second, precautionary recapitalisations are ‘confined to solvent institutions’. According to the European Banking Authority (EBA), these are banks that do not and are not likely to, in the near future: (i) infringe the conditions for continuing

authorisation; (ii) hold less assets than liabilities; and (iii) fail to pay debts as they fall due. In other words, these institutions must not be deemed to be failing or be likely to fail under the BRRD rules.

Third, capital injection into the beneficiary bank would require the approval of the European Commission (Commission). A submission for approval would need to include a restructuring plan, which details the measures for a bank to return to long-term viability, burden sharing plans and details about how distortion of competition could be limited, as well as assumptions about how the business would evolve in the future. Fourth, the precautionary recapitalisation should be ‘proportionate’ to the capital shortfall estimated by the banking supervisor. Fifth, the measures taken are ‘temporary and precautionary’, signifying the forward looking nature of the recapitalisation, which would not cover retrospective losses. The new capital ‘should not be applied to offset losses that the institution has incurred or is likely to incur in the near future’. Essentially, this means that losses originating from the baseline scenario of stress tests or asset quality reviews must be absorbed by private funds.



## Application of precautionary recapitalisations in Greece (2015) and Italy (2017)

In August 2015, Greece agreed to a third economic adjustment programme of €86 billion (\$96.4 billion) with creditors, amid a severe economic downturn. These proceeds were deployed, among others, to recapitalise four major Greek banks impacted by high NPLs and deposit outflows. However, the European Central Bank's (ECB) asset quality review and stress test for these banks revealed significant capital shortfalls of between €4.4 billion (\$4.9 billion) under the baseline scenario and €14.4 billion (\$16.1 billion) for the adverse scenario.

While the banks proceeded to raise private capital, it proved inadequate in the cases of National Bank of Greece (NBG) and Piraeus Bank (Piraeus). Hence, in December 2015, the Commission approved precautionary recapitalisations of €2.7 billion (\$3.0 billion) each for NBG and Piraeus. This capital was injected by the Hellenic Financial Stability Fund (HFSF) – in the form of contingent convertibles and ordinary shares – to bridge the capital shortfall required to meet the stress test threshold under ECB's adverse scenario.

**Table 6: Summary breakdown of capital injection into four major Greek banks (2015)**

Details / € Million	NBG	Piraeus	Eurobank	Alpha	Total	%
Conversion of creditors into equity	759	582	418	1,011	2,769	19%
Capital raised from private investors	757	1,340	1,621	1,552	5,271	37%
<b>Capital injected by HFSF</b>	<b>2,706</b>	<b>2,720</b>	-	-	<b>5,426</b>	<b>38%</b>
<i>of which ordinary shares</i>	<i>676</i>	<i>680</i>			<i>1,356</i>	<i>9%</i>
<i>of which convertible instruments</i>	<i>2,029</i>	<i>2,040</i>			<i>4,069</i>	<i>28%</i>
Other capital actions	380	291	83	180	935	6%
Total capital shortfall*	4,602	4,933	2,122	2,743	14,400	100%

\* As determined by the ECB's stress test under the adverse scenario  
Source: European Commission

Subsequent to the Greek experience, Italy carried out precautionary recapitalisation in relation to Banca Monte dei Paschi di Siena (MPS) pursuant to an unsuccessful private capital raise. In the EU-wide stress test results disclosed in July 2016, MPS fared the worst and recorded a negative Common Equity Tier 1 (CET1) ratio of 2.44% under the adverse scenario. However, the ECB recognised that MPS remained solvent, also taking into account the stress test results under the baseline scenario. Precautionary recapitalisation was aimed at covering the unexpected and unrealised losses (the gap between the adverse results and 11.5% CET1), which was considered as a reference by the ECB. Hence, losses of the Additional Tier 1 (AT1) and Tier 2 (T2) buffers resulted in a maximum precautionary recapitalisation amount of €8.8 billion (\$9.9 billion). MPS was further supported by the approval of State guarantees to senior bonds, of which €11 billion (\$12.3 billion) was issued by MPS. Owing to protracted negotiations between the Italian authorities and the Commission, the precautionary recapitalisation in MPS was only approved in July 2017.

The total recapitalisation (taking into account registered losses and the proceeds of certain disposals by MPS) finally amounted to approximately €8.2 billion (\$9.3 billion). These losses were met by the conversion of junior bondholders

(AT1 and T2 bonds) amounting to €4.3 billion (\$4.9 billion), and a government capital injection of €3.9 billion (\$4.4 billion). The Italian government also provided compensation for MPS' mis-selling of subordinated bonds to retail investors to the tune of €1.5 billion (\$1.7 billion). Therefore, total state aid amounted to €5.4 billion (\$6.1 billion), which was approved by the Commission together with a comprehensive restructuring plan. This included plans for MPS to enhance risk management, divest €26.1 billion (\$29.5 billion) in NPLs to a private securitisation vehicle (Atlante II), and re-focus its business model towards national retail customers and Small and Medium Enterprises (SMEs).

Compared to the case of MPS, another two Italian banks – Banca Popolare di Vicenza and Veneto Banca (Venetian banks) – had applied to the Commission for precautionary recapitalisation in April 2017, but their requests were not approved. Based on the EU stress test in 2016, both banks registered a total capital shortfall of €6.4 billion (\$7.2 billion) and failed to raise private capital in an initial phase. The Venetian banks then received funds from a private-sector fund (Atlante) mainly provided by Italian banks, which planned to merge both banks. However, the conditions for precautionary recapitalisation were not met since the ECB declared both banks to be “failing or likely to fail” on 23 June

2017. Subsequently, after the Single Resolution Board (SRB) concluded that resolution was not in the public interest, the two banks went into liquidation under Italian insolvency law. As part of this procedure, the performing businesses of both banks were transferred to Intesa Sanpaolo (Intesa) for €1,

subject to the provision of aid by the Italian government. This liquidation aid took the form of a direct cash injection into Intesa of €4.78 billion (\$5.5 billion), and the provision of state guarantees of up to €12 billion (\$13.7 billion).<sup>71</sup> The liquidation aid was approved by the Commission.

### Key takeaways

Precautionary recapitalisation accords some flexibility to the authorities to provide State aid to a solvent institution facing unexpected losses and to avert its potential failure. Various safeguards have been established to ensure that government funds – in the form of capital or liquidity support to the banks – are deployed in an appropriate, necessary and proportionate manner. Over and above fulfilling specific conditions, the cases in EU demonstrate that, in practice, applying precautionary capitalisation would involve complex negotiations. Among others, extensive negotiations are needed to determine if the conditions for this aid are met (mostly, that State aid should not cover any registered or expected losses), the extent of burden sharing with other parties, or the raising of private capital from investors. Nevertheless, these rules and negotiations mean greater levels of accountability for the early provision of government capital support to institutions.

<sup>71</sup> The cash injection of €4.78 billion comprised €3.5 billion for Intesa to maintain its capital ratios and €1.28 billion for restructuring costs related to staff layoffs and branch closures. The state guarantees covered financing of the liquidation (€5.3 – €6.3 billion), future NPLs from high-risk performing exposures, and legal risks (€4 billion)







## Insolvency *Wirecard AG (2020)*



### Background and context

Wirecard AG (Wirecard) is a German provider of e-payment and risk management (fraud prevention) services, as well as the issuing and processing of physical cards. It is Europe's largest Fintech and operates in 26 locations globally with 5,800 staff. The Wirecard Group includes Wirecard Bank AG – a banking entity, and Wirecard Card Solutions Ltd. (Wirecard UK) – a licensed e-money provider in the UK which allowed Wirecard to issue cards on behalf of UK Fintech firms. In 2018, Wirecard was valued at €24 billion (\$27.9 billion) and replaced Commerzbank in the prestigious Dax 30 Index, making it an automatic investment for global pension funds.

*The company (Wirecard) was led in an extremely casual way ... like a start-up rather than a listed company*

Tina Kleingarn, former member of Wirecard's supervisory board

The failure of Wirecard via filing for insolvency on 25 June 2020, is attributed to multiyear accounting fraud. Irregularities were traced back to 2008 as raised by the Head of the German shareholder's association, followed by the Financial Times (FT) from 2015 to 2020, a criminal investigation by Singaporean authorities in February 2019, and a special audit by KPMG which concluded in April 2020.

Wirecard was deemed as a technology company, and not a financial services provider. As such, the Wirecard Group was not supervised by Germany's Federal Financial Supervisory Authority (BaFin), which only had jurisdiction over Wirecard Bank. Moreover, BaFin, Deutsche Bundesbank (Germany's central bank) and the ECB had jointly agreed that Wirecard should not be categorised as a financial holding company.

*The codename was 'Project Panther'... for Wirecard CEO's most audacious idea yet, a plan to take over Deutsche Bank ... a new entity to be dubbed 'Wirebank' would be thinking and acting like a Fintech, at the scale of a global bank*

Financial Times

In early 2019, Wirecard's share price plummeted by 40% upon investigations of accounting fraud or 'round-tripping' at its Singapore office. However, BaFin's announcement of a two-month ban on the short selling of Wirecard shares immediately restored its value by 16%. BaFin's actions were based on the 'serious threat to market confidence' from the precipitous fall in Wirecard's share price and its 'importance for the economy' (Wirecard processes payments for Germany's two largest retailers and 250,000 merchants, and more than 100 airlines globally).

## Resolution of Wirecard – Timeline of Key Events





## Resolution actions

On 25 June 2020, Wirecard filed for insolvency with debts of €3.5 billion (\$4.26 billion). An administrator was promptly appointed by the Munich court with the priority to stabilise Wirecard's operations, keep its subsidiaries in business and concomitantly, to seek for buyers. As a Fintech company without physical assets, the challenge was to ensure expeditious sale of Wirecard's subsidiaries before its customer base shifted to competitors. As of June 2020, Wirecard's loans were reportedly sold to distressed-debt investors at less than 20 cents to the Euro.

Immediately after the insolvency, BaFin ringfenced and appointed a special representative to Wirecard Bank. The imposition of a partial payments ban prevented monies from being moved out from Wirecard Bank to cover losses in other parts of the group. Reports indicate that BaFin decided against freezing the assets of Wirecard Bank given its solvent status (Tier 1 capital ratio of 21% in 2019). Additionally, messages and clarifications on deposit insurance coverage were continually emphasised to provide assurance to customers of Wirecard Bank.<sup>72</sup>

As at September 2019, Wirecard Bank was reported to have held total deposits of €1.72 billion (\$1.94 billion). In early July 2020, Deutsche Bank disclosed discussions with BaFin on providing potential financial support to Wirecard Bank. Creditors of failed Wirecard AG include Deutsche Bank – within a consortium of 15 banks – which are collectively owed €1.6 billion (\$1.95 billion). In August 2021, it was reported that creditors, shareholders and other aggrieved parties have filed more than €14 billion (\$16.6 billion) of claims with the administrator of Wirecard.

The UK's Financial Conduct Authority (FCA) was also concerned that assets of Wirecard UK would be transferred to Germany after Wirecard AG's insolvency. On 26 June 2020, the FCA suspended Wirecard UK's e-money licence to protect the interests of financial consumers. UK Fintech firms (e.g. Pockit, Anna Money, Curve) used Wirecard UK to issue cards and process payments for individuals and businesses. As a result, millions of consumers were not able to access their 'frozen' monies or make payments for three days until the FCA lifted the suspension on 29 June 2020. On 10 July 2020, the FCA issued additional guidance to payment and e-money firms on proper segregation, records, and holding of customer funds in 'safeguarding accounts'.<sup>73</sup>

### Key takeaways

While the failure of Wirecard is attributed to prolonged sophisticated accounting fraud, it sheds light on contemporary challenges in the oversight of Fintech firms. This includes the regulatory treatment of Fintechs as technology or financial service providers, the level of supervision at holding company (Wirecard Group) or subsidiary level of specific regulated activities (e.g. Wirecard Bank) and inter-connectedness within the group, as well as assessing the systemic nature and impact of Fintech operators within an evolving landscape.

***It is becoming ever more clear that the (Wirecard) Bank ... was part of Wirecard's system of opaque money flows which was used to organise the fraud***

Florian Toncar, German Member of Parliament

Wirecard's case also highlights the potential concern of internal governance lapses when it comes to regulating a banking subsidiary within a broader financial group. In

December 2020, it was reported that the former COO of Wirecard Group had directly influenced credit decisions at Wirecard Bank (although both entities had separate and independent Boards).

A contemporary theme is how COVID-19 potentially fast tracks public adoption of e-payments and continuing digitalisation of financial services. This warrants attention to the growing role of firms such as Wirecard not just in supporting the domestic economy, but also cross-border dynamics of providing critical services to Fintech players in other countries. In parallel is the imperative to ensure adequate protection for consumers of digital payments, e-money, virtual banking and other technological propositions to come.

In Germany's case, statutory and voluntary deposit insurance served as crucial foundations to maintain the confidence of depositors (individuals and business) in times when banks undergo stress. This is particularly true in the case of Wirecard Bank, which remained solvent but faced an existential crisis of confidence from failure of another key entity in the group.

<sup>72</sup> Deposits at Wirecard Bank were protected by two deposit insurance schemes. Firstly, up to €100,000 for private individuals, partnerships and limited companies by the legally prescribed Compensation Scheme of German Private Banks or *Entschädigungseinrichtung deutscher Banken GmbH* (EdB). Second, by the Deposit Protection Fund of the Association of German Banks (BdB) (of which Wirecard Bank is a voluntary member) up to 15% of Wirecard Bank's own funds per customer (€19.7 million). As a rule, creditors who are natural persons (even if they are acting in the course of their commercial business) as well as commercial partnerships and legal persons are included in the scope of protection

<sup>73</sup> These rules were part of planned issuance in response to COVID-19 which was fast tracked as temporary guidance to payment and e-money firms to strengthen prudential risk management and arrangements for safeguarding customers' funds



## Bankruptcy Amsterdam Trade Bank N.V. (2022)



Table 7: Profile of ATB at point of failure on 22 April 2022

Total employees	Total depositors	Total assets	Total liabilities	Total equity
93	20,000 active accounts 23,000 dormant accounts <sup>74</sup>	€953.8 million (\$1,028.8 million)	€737.7 million (\$795.7million)	€216.1 million (\$233.1 million)

### Background and context

Amsterdam Trade Bank (ATB) has been operating in the Netherlands since 1994 with over 23,000 private account holders. During the early years, ATB was mainly involved in international commodity finance, including grain, metals and energy, as well as in shipping. ATB is a subsidiary Alfa-Bank JSC (Alfa-Bank), the largest private bank and fourth largest financial institution in Russia.

Alfa-Bank was sanctioned by the Council of the EU, UK and US Treasury on 25 February, 24 March and 6 April 2022 respectively. At the point of bankruptcy, Alfa-Bank held 78.3% shares in ATB, and some of the ultimate beneficial owners of ATB are sanctioned natural persons. The remaining shares in ATB were held by ATB Holdings S.A. (10.3%), ABH Holdings S.A. (5.8%) and ATB ESPP B.V. (5.6%).

<sup>74</sup> Dormant accounts are terminated accounts by ATB before the bankruptcy due to long-term inactivity, but on which (often small) claimable amounts are still held

## Criminal investigation under the Money Laundering and Terrorist Financing (Prevention) Act

Between 2016 – 2017, ATB faced challenges from non-compliance with obligations under the Money Laundering and Terrorist Financing (Prevention) Act, and was subject to a criminal investigation.<sup>75</sup> Consequently, ATB parted ways with a majority (70%) of its then corporate clients which led to significant losses.

ATB then adjusted its business model. It transitioned from commodities and shipping finance, to focus on delivering digital banking services to SMEs across the EU and UK. While ATB continued to record losses from 2019 to 2021, its bankruptcy was not caused by financial insolvency, but was triggered by geopolitical turmoil / sanctions packages from Russia's invasion of Ukraine.

### Impact from sanctions on Russia

Owing to connections with its Russian parent bank, ATB was heavily impacted by sanctions. In addition to sanctions imposed on Alfa-Bank, ATB itself was officially sanctioned by the US Treasury. Certain companies and individuals from the UK and US were also not permitted to do business with ATB. Moreover, ATB could not rely on financial aid and / or operational assistance from its Russian shareholders and management.

Crucially, near its failure, major ICT and software licence providers terminated or threatened to cut-off their services to ATB. These areas related to internal systems used for financial, loan and customer administration. ATB's digital records were also barred from being accessed by its staff.

## Resolution actions

### Bankruptcy order

In the period leading up to its bankruptcy, ATB had sought other alternatives, including its sale to a potential acquirer. On 14 April 2022, ATB also requested for a prospective bankruptcy trustee. Two main reasons were behind this early request – first, ATB was not convinced that negotiations with the potential purchaser could go through or be completed in the short term. Secondly, the presence of the bankruptcy trustee could smoothen the process of ATB's possible liquidation.

On 21 April 2022, ATB decided to file for bankruptcy, after the deal to acquire ATB fell through. On 22 April 2022, the Amsterdam District Court declared ATB bankrupt and appointed A. van Hees & J.E.P.A. Van Hooff as Bankruptcy

Table 8: Snapshot of ATB's financial record, 2019-2021

Year	Sales	Profit & Loss	Balance Sheet Total
2019	€24.5 M (\$27.4 M)	-€21.1 M (-\$23.6 M)	€1,400.2 M (\$1,568.1 M)
2020	€25.2 M (\$27.4 M)	€37.3 M (\$42.5 M)	€1,216.5 M (\$1,386.8 M)
2021	€19.1 M (\$22.6 M)	-€21.6 M (-\$25.6 M)	€1,242.6 M (\$1,470.0 M)

ATB was later disengaged from all payment systems including its accounts with fellow banks and the Single Euro Payments Area (SEPA) system. Payment orders were not executed, and payments orders to ATB were blocked. Without these ICT services, ATB was not able to carry on its core daily banking business and operations.

**ATB's bankruptcy... is a direct consequence of the sanction packages announced by various jurisdictions in response to Russian invasion of Ukraine**

Stibbe N.V, The Netherlands

Trustees (Trustees).<sup>76</sup> At the point of its failure, ATB had outstanding liabilities of around €737.7 million (\$795.7 million) and total assets of €953.8 million (\$1,028.8 million). Prior to the outbreak of the Ukraine war, ATB's assets stood at €1.4 billion (\$1.6 billion) and nosedived by almost one third in the following two months until its bankruptcy.

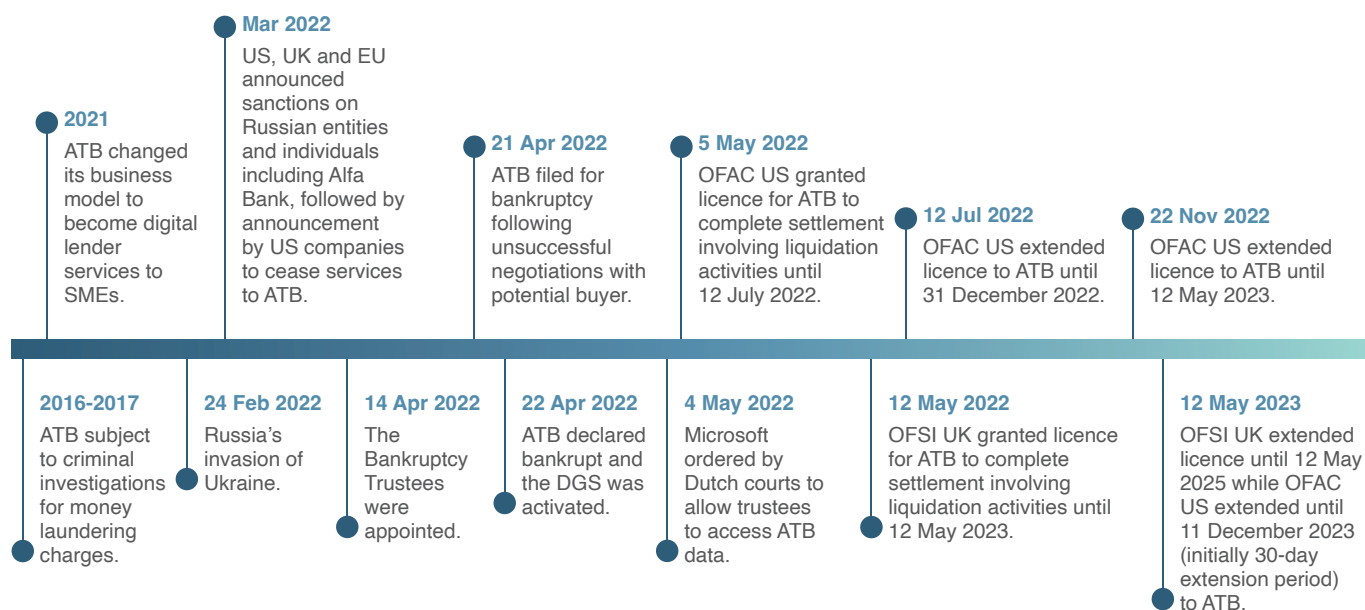
At the same time, the Dutch central bank – De Nederlandsche Bank N.V. (DNB) – activated the Deposit Guarantee Scheme (DGS) for account holders of ATB. DNB administers the DGS on behalf of the Dutch government, and the total amount of guaranteed deposits in ATB was approximately €700 million (\$755 million).

<sup>75</sup> On 12 December 2022, The Public Prosecution Service (OM) decided to drop the criminal case against ATB (which has ceased to exist)

<sup>76</sup> A. van Hees was replaced by D.D. Nijkamp after his retirement end-2022



## Resolution of ATB – Timeline of Key Events



### Deposit Guarantee Scheme

In the case of ATB, the DGS automatically protects retail depositors and almost all firms and other organisations up to €100,000 per person / entity.<sup>77</sup> The scheme also offered additional protection for accounts with temporarily high balance related to the purchase or sale of real estate.<sup>78</sup>

Dutch-based banks had been contributing to the DGS Scheme since 2016 and as at 22 April, the DGS fund had a balance of over €3 billion (\$3.2 billion).

The reimbursement of the DGS was conducted based on the customer's data provided by ATB to DNB one working day after the bankruptcy was declared. As a result, about

€624 million (\$675 million) was reimbursed to 18,000 account holders within the first week. As of 17 May 2023, the DGS had distributed a sum of €669.6 million (\$725.8 million) to a total of 24,070 eligible account holders of ATB. Meanwhile, for account holders with balances above the protection limit of €100,000, the Trustees have made distributions of approximately €20.6 million (\$22.3 million) to 1,356 account holders as of 23 February 2023.

In addition, ATB provided cross-border financial services to almost 6,000 customers from Germany. Since ATB had no branch in Germany, those depositors were repaid directly by DNB.

### Liquidation

The Trustees encountered many challenges from legal complexities surrounding the sanctions regulations of the US, UK and EU. While waivers from the sanctions were provided in order to perform the settlement of the estate, the timeframe provided was often inadequate.

The Trustees sought to sell as many assets as possible within the term of the waivers granted by the sanction administrators – Office of Foreign Assets Control (OFAC) for the US, Office of Financial Sanctions Implementation (OFSI) for the UK and the EU. Eventually, most of ATB's

loan portfolio were sold or early repayment agreements with borrowers were negotiated. In doing so, the Trustees granted discounts in the range of 2-15%. This depended on liquidity of the loans involved, the currency, agreed interest rate, quality of the debtor, security provided, and other factors. As at May 2023, ATB had limited amount of loans to be served. In terms of other assets, ATB had balances of about €17 million (\$18 million) in accounts with three different banks (which have been blocked in connection with the sanctions). In total, the Trustees have realised proceeds from the sale of assets of approximately €575 million (\$623.3 million).

<sup>77</sup> As for joint account holders, the combined protection amounts for two would be up to €200,000. Dormant/ closed accounts with balances more than €5 are also eligible for reimbursement under the DGS

<sup>78</sup> For those who have more than €100,000 in their account(s) related to the purchase or sale of residential property, they are eligible to additional protection of up to €500,000 per person, for a total of €600,000. The additional protection applies for three months and is linked to the amount of the purchase agreement



## Key takeaways

The case of ATB offers us several unique and contemporary learnings, including geopolitical and technological risks relating to bank failures.

### *Failures can happen unexpectedly*

First, bank failures can originate from highly unexpected sources. The bankruptcy of ATB was unique, in that it was triggered by geopolitical events in Europe instead of typical solvency or liquidity issues that precipitated the failure of other banking institutions.

ATB had attempted to distance itself from the Russia-Ukraine conflict. It held out the position of being ‘a Dutch bank acting independently and separately governed from its shareholders’. In addition, it was solvent at the time of bankruptcy. However, sanctions imposed on its parent Russian bank as well as directly on ATB (by the US Treasury on 6 April 2022) led to a loss of confidence in the bank. In turn, a majority of its counterparties expressed doubts and unwillingness to continue doing business with ATB.

***ATB's demise was the first instance of a Dutch bank being bankrupted by sanctions rather than financial insolvency***

Sebastiaan Bennink, Sanctions Specialist and Legal Practitioner



### *Dependency on technology*

A second vital point is the criticality for banks to ensure operational resilience and crisis preparedness, as it relates to technological risks. In ATB's case, such risks were intertwined with, and crystallised upon the imposition of sanctions. Before its bankruptcy, it was reported that Microsoft prevented ATB from accessing systems such as e-mail and cloud services, and Amazon had intended to follow suit. Such untenable circumstances ultimately led ATB to petition for bankruptcy.

Challenges relating to technology and operations not only contributed to ATB's failure, but also hampered its liquidation process. On 4 May 2022, Microsoft was ordered by a Dutch court to provide Trustees with access to ATB's data or risked being fined €10 million per day, or up to a maximum of €100 million. Additionally, the Trustees ended up terminating almost all existing IT contracts and creating a simplified IT system to facilitate liquidation processes (the new system was built with the assistance of employees of ATB with continued employment for this purpose). In summary, the Trustees acknowledged how sanctions complicated these and other operational issues for ATB's liquidation.

### *Planning matters*

Thirdly, ATB's case showed the importance of planning for multiple scenarios in a rapidly worsening situation. While ATB was working out a sale of business to an acquirer, it also prospectively requested the court to provide a bankruptcy trustee. As a result, pre-bankrupt preparations were made, including safeguarding available data and navigating the complexities of sanctions-related issues with US and UK experts, e.g. exemptions from sanctions for liquidation, if necessary. These efforts culminated in more effective execution of actions by the Trustee upon declaration of the bankruptcy.

### *The Deposit Guarantee Scheme was effective in achieving its objective*

Last but not least, the DGS scheme worked well in resolving the failure of ATB and protecting the interests of its depositors. DNB took swift action with clear communications to guide affected ATB customers. It also executed timely reimbursement of monies to most of ATB's depositors, including directly to those living in Germany.



## Voluntary Market Exit

### Australia: Xinja Bank (2020-2021)



#### Background and context

Xinja Bank Limited (Xinja) was founded in 2017 as a digital or neo-bank in Australia. Xinja received a restricted Authorised Deposit-taking Institution (ADI) license from the Australian Prudential Regulation Authority (APRA) in December 2018, followed by an ADI license without restrictions from APRA (under the Banking Act 1959) in September 2019.

*Xinja is creating new digital banking experiences that combine data, technology and fun ... its event-driven architecture enables a 'Netflix'-like experience for customers*

Xinja Bank

Xinja targeted retail consumers with product offerings that included a high interest savings account called *Stash*, deposit accounts, debit cards, payments and transfers, as well as share trading. Its leadership team comprised bankers, experience

designers, technologists and former regulators, aiming to build a bank designed in the interest of customers and delivered through a 'brilliant mobile experience'.

Without legacy systems and branch networks, Xinja's value proposition was for customers to benefit from its low overhead and operating costs, in the form of competitive rates and lower fees. For instance, its *Stash* account offered an interest rate of 2.25% on balances up to AUD245,000 (\$167,000) with no conditions (no minimum deposit balances, transactions or fees).<sup>79</sup> Xinja was reported to have received AUD200 million (\$137 million) of deposit inflows within one month after launching *Stash* in mid-January 2020, and its total deposits then grew to AUD457 million (\$315 million) in June 2020.

More broadly, Xinja argued that its entry facilitated banking competition and innovation in a market dominated by several large banks in Australia.

<sup>79</sup> In comparison, other high interest savings accounts in the market offered interest rates at just over 1% p.a. Other digital banks, Up Bank and 86400, also offered rates of 2.25% p.a. at that time, but with conditions such as minimum transactions with a linked account, smaller balance limits or minimum monthly deposits. However, by November 2020, Xinja had reduced its maximum interest-earning balance limit to \$50,000. Protection applies for three months and is linked to the amount of the purchase agreement.

## Concerns on funding and business model

There are two broad reasons leading to Xinja's decision to leave the banking market. First, its capital raising strategy which fell through. Second, Xinja's business model proved to be unsustainable with the absence of revenue generating loan products to match costs from interest payments to depositors and operations.

In total, Xinja secured funding of about AUD100 million (\$71 million). This began through equity crowdfunding campaigns in 2018 and 2019 where Xinja raised more than AUD5 million (\$3.5 million). Subsequently, Xinja received additional investments from Australian and international institutional investors.

On 24 March 2020, Xinja announced a substantial deal with World Investments P.S.C. (WI), an investment company from the United Arab Emirates. Under this arrangement, WI planned to invest AUD433 million (\$259 million) over the next two years in exchange for a 40% stake in Xinja. An immediate injection of AUD160 million (\$96 million) was on the cards. However, it was reported that the funds were held up owing to COVID-19-related issues and this arrangement was in the form of a non-binding memorandum of understanding. In the end, the deal with WI failed to materialise and this greatly impacted Xinja's ability to sustain its business model.

As described earlier, Xinja began by offering high-interest deposit accounts (*Stash*) in January 2020. However, upon surrendering its license in December 2020, Xinja had yet to launch any loan products (home and personal loans were under development). This meant that without a revenue stream, Xinja was 'burning cash' as it absorbed continuing losses from payments of interest on deposits. Moreover, reports indicated that Xinja's operating costs were on the rise.

Over the course of 2020, interest rates on Xinja's *Stash* account was progressively lowered from 2.25% to 1.50% (several reductions were consistent with monetary policy decisions by the Reserve Bank of Australia). Despite these lower rates, Xinja's losses widened from AUD22 million (\$15.4 million) in 2019 to AUD36 million (\$24.8 million) by June 2020.

In addition, it was reported that concerns on the sustainability of Xinja's business model – in terms of dependency on capital raising from third parties - were flagged out by its auditors. Xinja's former auditor had resigned in April 2020.

In the end, Xinja exited the banking business in mid-December 2020, attributing the decision to the adverse impact from COVID-19 and difficulty of the capital-raising environment in seeking investors for a new bank.

## Voluntary market exit

### *Xinja decides to return deposits to customers and surrender its banking license*

***Xinja's decision to exit the banking industry ... is a commercial decision. As Australia's financial safety regulator, APRA will closely monitor the return of deposits to ensure all funds are returned to Xinja depositors in an orderly and timely manner. In addition to the return of deposit process, Xinja's depositors remain protected by the Financial Claims Scheme***

Australian Prudential Regulation Authority

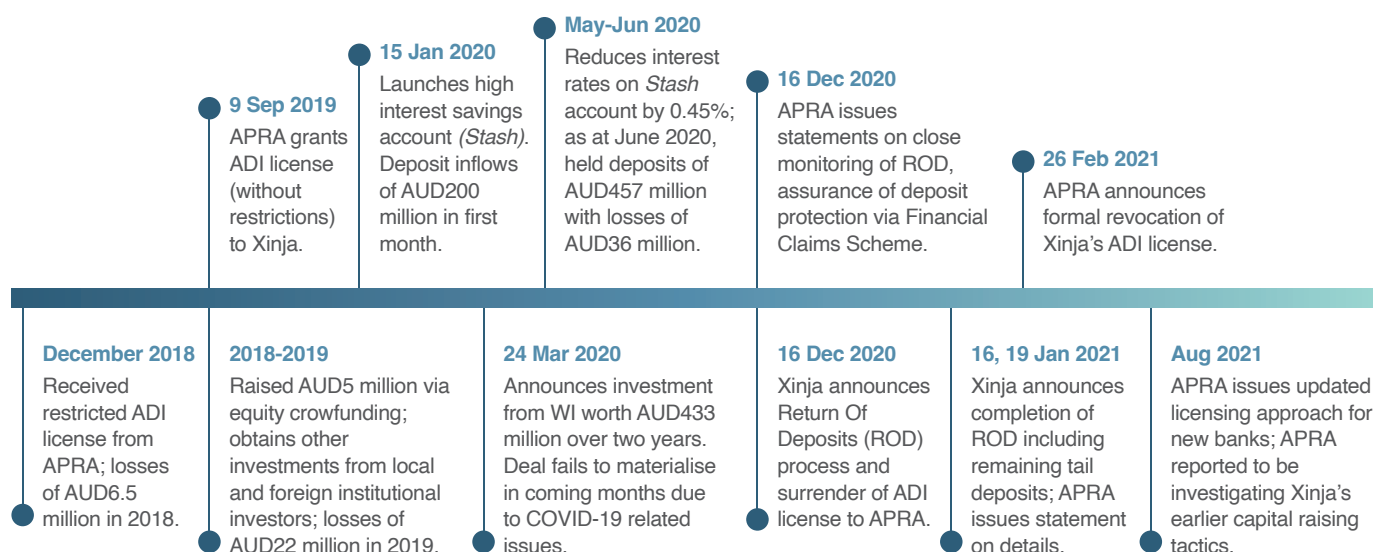
On 16 December 2020, Xinja announced its intention to return all funds to depositors and relinquish its ADI license. It had 37,884 customers with 54,357 individual deposits, collectively worth more than AUD252 million (\$191 million). Customer deposits in Xinja were reported to have progressively declined from AUD\$457 million (\$315 million) as at end-June 2020, to AUD413 million (\$290 million) as at end-October 2020, and subsequently to the lower amount as at 16 December 2020 due for reimbursement to depositors.

According to reports, Xinja provided customers with a seven-day notice prior to closure of their *Stash* savings accounts, with automatic return of any remaining funds thereafter. Additionally, Xinja's customers were advised to transfer funds out of transaction accounts which, once empty of cash balances, would be automatically closed after 29 December 2020.

By 16 January 2021, Xinja announced that it had successfully reimbursed all deposits to its customers. A point of interest was that the remaining tail of a small portion of deposits (4,176 accounts worth AUD65,809) were effected through a voluntary transfer from Xinja to new accounts or customer's existing accounts with another bank, the National Australia Bank (NAB). The specific customers were advised of the transfer and follow up actions with NAB. In that regard, NAB facilitated arrangements such as enabling fee-free accounts for customers, and continually engaged APRA. Another noteworthy point was the exercise to transfer the remaining deposits to NAB was formally approved by APRA via its powers under the Financial Sector (Transfer and Restructure) Act 1999 and Banking Act 1959.



## Voluntary Market Exit of Xinja Bank - Timeline of Key Events



### Actions taken by APRA

APRA provided timely and relevant information flows to stakeholders via media releases on 16 December 2020, 19 January 2021 and finally on 26 February 2021 to announce the formal revocation of Xinja's ADI license. The authority noted that this was the first time a return of deposits to customers had been undertaken by an Australian ADI. APRA provided assurance of its close oversight of the return of deposits process, as well as reiterated the safety net protection for depositors under the Financial Claims Scheme (for deposits up to AUD250,000 per account holder).

In August 2020, APRA had announced a review of its ADI licensing regime, taking into account lessons since the launch of its restricted ADI licensing pathway in 2018. A consultation paper was issued in March 2021, culminating in final revised requirements in August 2021 which placed greater emphasis on the on-going viability and business sustainability of potential entrants. Among others, restricted ADIs were required to have a limited product launch (for assets and deposits), coupled with expectations for improved contingency planning towards an orderly and solvent exit from the banking business.

***This revised approach effectively targets key risks for new entrants, setting a higher bar for gaining a bank license, while enhancing competition by making it more likely new entrants can find their feet and gain a firm foothold in the market***

John Lonsdale, Chair of the  
Australian Prudential Regulation Authority



## Key takeaways

The experience of Xinja raises two key issues when it comes to the introduction and mainstreaming of digital banks into the financial sector. First is the complex policy trade-off to balance development and regulation, all while digital evolution is taking shape. Assessing the prospects and sustainability of new banking entrants in a technologically driven and fast-paced operating environment can be highly challenging. Secondly, the business models of digital banks itself – ownership and funding structures, path to scale and profitability, product value propositions for specific market segments, resilience in the face of financial and operational stress – are being differentiated and subject to changing market conditions as medium to long term projections remain uncertain.

In Xinja's case, the strategic intent to drive innovation and competition was clear and it succeeded in attracting depositors. But failure to launch any loan products left the business model exposed and dependent on future funding flows, which proved too much to bear. Similar to several other new entrants, Xinja initially operated under the terms of a restricted license granted by APRA in 2018. Here, it is important to recognise that during the same period as Xinja and within the Australian market itself, other digital banks have continued to make progress with targeted strategies such as Judo Bank's focus on SMEs,<sup>80</sup> and Volt Bank's adoption of the 'banking-as-a-service' model.

**Nearly all jurisdictions in our sample require sponsors to develop an exit plan ... this requirement is novel as a bank just starting out is not necessarily expected to fail, and this requirement is an explicit recognition by prudential authorities that tech-driven business models are unproven, particularly during an economic downturn**

Financial Stability Institute

Another key lesson from Xinja's case is the value and importance of contingency and exit planning, to safeguard the interests of depositors and avoid disruptions to the broader financial system. These involve policy requirements by regulators, as early as the licensing process, for prospective digital banks to develop strategies for an orderly exit from the system (in addition to deposit insurance coverage). These forward looking plans cover, among others, elements of governance, triggers, exit options, financial resources, and communication strategies. They are crafted by the digital banks and monitored by regulators to ensure fitness for purpose upon required activation to facilitate effective

market exits. As demonstrated by Xinja's return of deposits within a short period (for the first time in the Australian banking sector), the execution of such plans are vital to maintain public confidence, more so for jurisdictions that have not experienced any bank failures for a long time.

With the return of deposits, Xinja's case was perceived to be a 'successful failure'. Besides Xinja, the experience of other digital banks indicate the novelty of new business models, particularly when viewed from the lens of market exits and closures. Such actions can be voluntary or implemented as part of other business strategies. Take the case of 86 400 – another Australian digital bank licensed by APRA in July 2019 – which was fully acquired by UBank (part of NAB) in 2021, mainly for 86 400's technology platform.<sup>81</sup> In other parts of the world, N26 (a German digital bank) voluntarily exited the UK and US markets. Other examples include the closures of stand-alone digital banks that were established by banking groups, such as Finn by JPMorgan Chase and Bo' by the Royal Bank of Scotland. These cases demonstrate the importance of having robust exit policies as part of continued regulatory oversight of new digital banks.

This dovetails into another lesson to be drawn from Xinja's case. Financial sector authorities play a crucial role, even in the situation of a voluntary market exit by digital banks. APRA was clear in its public communications and provided details at key stages of Xinja's process of returning deposits to customers. The authority also stepped in to facilitate the transfer of remaining tail deposits from Xinja to NAB, thus bringing closure to the exercise. In parallel with Xinja's announcement of its market exit and return of customer funds, APRA emphasised the protection of deposits via its Financial Claims Scheme. This was important to provide depositors with assurance during times of uncertainty.

Relatedly, prior to Xinja's exit announcement, reports indicated that its deposit holdings were already on the downtrend. This observation highlights the need for market players and regulators to better understand any distinctive risk behaviours of depositors in digital banks.

A final point is the imperative of close interagency coordination for jurisdictions with different authorities responsible for various aspects of overseeing digital banks, such as roles in licensing, regulation and supervision, as well as deposit insurance and resolution. Additionally, the prominence of technological and other emerging risks from new business models of these entities call for greater agility and differentiation from previous regulatory approaches taken by the authorities.

<sup>80</sup> Judo received its ADI license in April 2019. As at June 2021, its loan book stood at AUD3.5 billion with deposits of AUD2.5 billion. In September 2021, Judo was awarded an investment-grade credit rating (BBB-) by S&P

<sup>81</sup> 86 400 was acquired by NAB for AUD220 million (\$169 million). As at 15 January 2021, 86 400 had more than 85,000 customers, AUD375 million (\$288 million) of deposits, AUD270 million (\$2017 million) in approved residential mortgages and 2,500 accredited brokers

# Insurers Resolution

Case Studies

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## Transfer of Business and Run-Off *Mannheimer Life (2003)*

## Germany

### Background and context

The insurance market in Germany offers an extensive range of products in various lines. In 2003, the life insurance sector had the largest number of insurers (324), followed by general insurance (251) and others in health insurance and reinsurance. Life insurers mainly focused on traditional products with high savings elements such as annuities and pension. The participating cash-value policy was predominant, whereby the investment component was designed with a guaranteed yearly minimum return and a variable non-guaranteed surplus.

In the mid-1990s to 2000s, German life insurers found it increasingly challenging to meet promised investment returns. As the yield on 10-year bonds fell (from 8% in 1995 to around 4% in 1998 until the mid-2000s), life insurers switched to equity investments and were hit by the experience of a slump in capital markets. Life insurers with significant exposure were hardest hit when the Deutsche Boerse AG German Stock Index (DAX) nosedived by 20% and 44% in 2001 and 2002 respectively.

One of those life insurers was Mannheimer Lebensversicherungs-AG (Mannheimer Life), a medium sized German insurer founded in 1922. It mostly sold participating products and expanded rapidly from 1990 to 2000 with premium income and investments registering average annual growth rates of 9.5% and 11.4% respectively. In 2000, it recorded premium income of €413 million (\$491 million) with investments totalling €3.2 billion (\$3.8 billion). While it continued to turn in a profit of €5.2 million (\$6.2 million) in 2000, of substantial concern was Mannheimer Life's investment in equities which had grown from less than 10% to 21.2% of the total portfolio in 2000.

Mannheimer Life's portfolio of participating products required distribution of promised returns of 7.5%, of which between 3% to 4% was guaranteed, which then translated to achieving returns from equity investments of at least 19%. By the time the DAX crashed in 2002, Mannheimer Life's participating interest returns fell sharply.

## Resolution actions

### Serious solvency concerns led to transfer to Protektor Lebensversicherungs-AG

In 2002, Germany's life insurers launched a private initiative to form Protektor Lebensversicherungs-AG (Protektor) as a safety net scheme. Life insurers agreed to contribute funds to Protektor for the rescue of any distressed member to preserve the confidence of policy owners in the life insurance industry. From this fund, about €240 million (\$285 million) was allocated to meet the solvency requirement of the Mannheimer Life's insurance portfolio.

As Mannheimer Life's share price tumbled from €60 (\$71) in 2001 to less than €10 (\$12) in 2003, it faced heightened risk of failure. Mannheimer Life had attempted to manage losses through a profit-and-loss transfer agreement with its parent, Mannheimer Life Holdings. However, this arrangement fell through. The German regulator BaFin then ordered

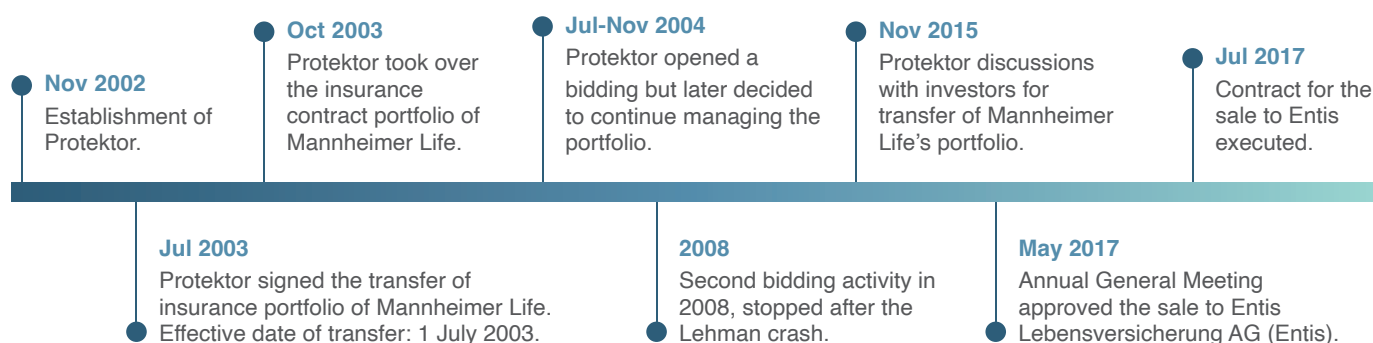
Mannheimer Life to cease the sale of new policies and on 26 June 2003, announced that its assets and liabilities would be transferred to Protektor.

*For the first time ever a life insurer [Mannheimer Life] went into a financial tailspin. In mid-2003 its insurance portfolio was acquired by Protektor, a newly created bailout solution that was funded by the industry*

Federal Financial Supervisory Authority  
(BaFin)

...

### Resolution of Mannheimer Life's portfolio – Timeline of Key Events



### Portfolio run-off

Protektor decided to implement a run-off scheme given the role of life insurance in Germany and adverse implications on policy owners and society if policies were to be terminated. Life insurance served to compensate for declining pension payments (owing to inflation) under the government's statutory pension insurance system. Other than providing disability insurance coverage, the maturity benefit and accumulated investment returns of life insurance policies were also used to repay housing loans. In addition, in a liquidation process there would be no "fair" way to calculate compensation and it would be impossible for policy owners to obtain similar coverage at the original level of premiums given changes in their age and health over the years.

After assuming Mannheimer Life's assets and liabilities, BaFin confirmed that Protektor would meet all legal obligations against policy owners under run-off. The transfer of Mannheimer Life's assets of €3 billion (\$3.6 billion),<sup>82</sup> 344,000 policies and 140 staff to Protektor, was completed in

October 2003. This came with a guarantee that Mannheimer Life would cover future losses arising from any misstatements of its financial statements.

From 2003 to 2015, Protektor had run-off about 70% of Mannheimer Life's policies. The remaining 100,000 policies were managed by 70 employees. Since there was no new business, and as the number of policies in-force steadily declined, cost optimisation in managing the portfolio became more of a challenge.

During the run-off period, Protektor had also continued to source for a solvent life insurer to take over Mannheimer Life's portfolio. After 15 years, on 1 August 2017, Mannheimer Life's portfolio with assets of €1.8 billion (\$2.1 billion) was finally transferred to a new insurance company, Entis. All 92,000 remaining policies were guaranteed continuity of coverage based on unchanged conditions. Entis was sold to Viridium Group (Viridium) which specialises in the efficient

<sup>82</sup> Based on Mannheimer Life's audited balance sheet as at 30 June 2003



management of life insurance portfolios in Germany. As at 30 June 2020, Viridium manages a total of more than 4 million administered insurance policies with €60 billion (\$67.4 billion) assets under management. The integration of Mannheimer Life's policies into a significantly larger portfolio secured long-term stability and translated into lower administrative costs for Mannheimer Life's remaining policy owners.

Following the failure of Mannheimer Life, in 15 December 2004, Germany's Insurance Supervision Law was amended to prescribe the setup of an insurance guarantee fund to protect the claims of policy owners, the people insured, beneficiaries and other persons benefiting from the life insurance policy. Protektor was entrusted to manage the insurance guarantee fund.

***... above all, I want all policy owners to be rest assured that their interests will be protected in the long term, and that they can rely on continuity as part of Viridium***

Dr. Heinz-Peter Ross, Chairman of the Supervisory Board of Viridium Group



### Key takeaways

The failure of insurance companies can adversely impact government policies to strengthen social and financial safety nets. For instance, without effective interventions to resolve Mannheimer Life (through transfer of business and run-off), the negative implications of liquidation and termination of its life insurance policies would shatter confidence in the life insurance industry. In turn, this undermines the government's policy of encouraging the German public to invest in life insurance products (besides relying on government pensions) for sustainable retirement.

During times of failure, decisive actions by authorities – in the case of Mannheimer Life, directing its transfer of business to Protektor – are crucial since insurers in deep distress could be less interested in sourcing for any private transfers. It is also essential that regulators have powers to ensure that the transfer of business protects policy owners through interventions such as limiting the cancellation of insurance policies.

In terms of run-offs for life insurance policies, the approach of leveraging key staff and the existing IT platform of failed insurers could contribute to greater operational efficacy. With the resolution strategy of run-offs, immediate liquidity issues would be generally less of a concern as policy owners continue to pay premiums. However, the shrinking run-off portfolio brings with it challenges of cost optimisation and the risk of inadequate investment returns. As demonstrated by the case of Mannheimer Life's resolution, insurance guarantee schemes such as Protektor should proactively source for other life insurers or specialist companies to take over the portfolio and secure long-term continuity of the life insurance policies.



## Supervised Run-Off, Liquidation and Payment of Claims *Lumbermens Mutual Casualty (2003)*



### Background and context

**Table 9: Lumbermen's Key Financial Indicator, 2001-2003**

Key Financial Indicators (\$ million)	2001	2002	2003
Net premiums	1,880	697	240
Net profit / (loss)	71	(205)	(517)
Total assets	7,091	6,071	5,229
Total liabilities	5,825	5,374	5,027
Surplus (net assets)	1,266	696	202

Lumbermens Mutual Casualty Company (Lumbermens) was founded in 1912 to manage the risk exposures of the lumberyard industry under the then newly enacted workers' compensation laws in Illinois. By 2000, Lumbermens became one of the top 20 general or Property and Casualty (P&C) insurers and was also one of the largest workers' compensation insurers in the US. It also offered the widest range of personal and commercial P&C insurance in all 50 states in US and foreign markets including Canada, Mexico, Australia and Europe.

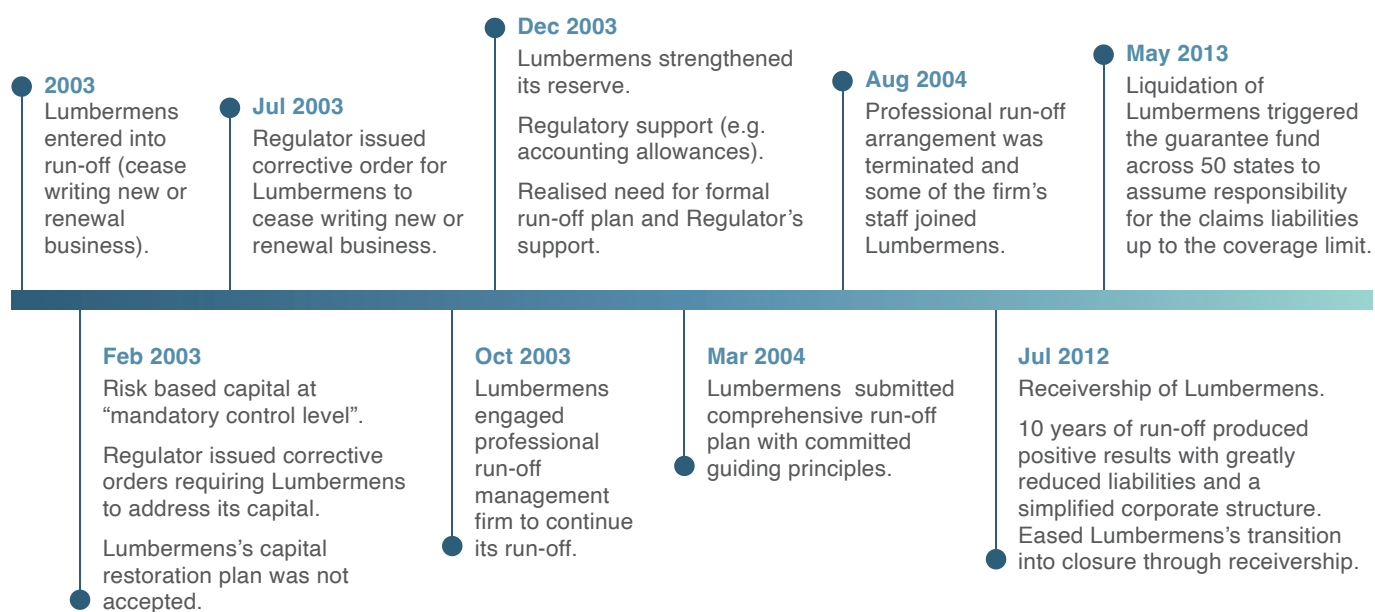
From 2000 to 2003, a number of P&C insurers in the US became financially troubled and were placed under liquidation proceedings, triggering the obligation of insurance guarantee funds to pay protected claims. Lumbermens, however, was an exception. It was placed into supervised run-off<sup>83</sup> in 2003, and was liquidated in 2013. The resolution of Lumbermens (including its insurance subsidiaries and affiliates) was one of the largest P&C run-offs in the US. It lasted almost a decade under the close supervision of the Illinois Department of Insurance (Regulator) and culminated in the successful orderly wind-down of Lumbermens.

In 1996 and 1997, Lumbermens was hit hard from asbestos claims relating to its workmen compensation policies. This resulted in limited capital, inadequate operating profitability and pressures from downgrades by rating agencies. However, Lumbermens was able to address its immediate capital needs through the issuance of subordinated debt. It also pursued the strategy of rapid growth through acquisitions and product

expansion, and maintained a strong rating. From 1997 to 2000, there was further growth in underwriting and premiums as Lumbermens added 20 insurance subsidiaries and various non-insurance entities through more acquisitions and new company formations. This created a large and complex corporate structure that posed significant challenges to the Regulator during implementation of Lumbermens' wind-down.

In 2001 and 2002, the capital position of Lumbermens significantly deteriorated. Its surplus (excess of asset over liabilities) narrowed due to reserve strengthening, realised capital loss and weak operating results. As a mutual insurer (owned by policy owners), Lumbermens also found it hard to raise capital while efforts to find a sponsor for demutualisation proved unsuccessful. By December 2002, Lumbermens' risk-based capital dropped to an 'authorised control level',<sup>84</sup> and three rating agencies downgraded its rating to 'B'. By 2003, Lumbermens had run out of options and entered into run-off.

### Resolution of Lumbermens – Timeline of Key Events



<sup>83</sup> A state where the insurer could not issue new policies and could only collect premiums and pay claims under existing policies

<sup>84</sup> A state where the regulator may place the company under regulatory control

## Resolution actions

### *Corrective actions and run-off*

In early 2003, the Regulator imposed several corrective orders on Lumbermens, including the requirement to submit a capital restoration plan. However, the Regulator rejected a proposal by Lumbermens, and subsequently issued an order for it to cease writing any new or renewal business effective 1 July 2003.

The decision by Lumbermens to adopt run-off as a resolution strategy was premised on four key considerations. First, the external environment was not conducive for either a private market solution or receivership. The latter would adversely disrupt the market, since Lumbermens was the sixth largest insurer for workmen compensation in the US with over 200,000 open multi-state claims. During that time, almost 30 workmen compensation insurers failed, including large providers such as Reliance, Legion, Superior National and Fremont. Consequently, guarantee funds in the US faced significant pressures from strained resources. Secondly, the run-off solution would protect the interest of policy owners from premature cancellation of policies, as well as avoid delays and costs from placing Lumbermens under receivership. Third was Lumbermens' arrangements with reputable reinsurers to support the run-off. Lastly, run-off was seen as an orderly approach to "shrink" Lumbermens as a means of orderly transition into liquidation.

From the start, in March 2004, Lumbermens adopted a comprehensive run-off plan with sound guiding principles. It committed to the Regulator that all valid claims under the policy contract would be paid in a timely manner without reduction, or be settled at an amount mutually agreed with the policy owner or claimant. A key aim was to maximise the value of assets, among others, through recovery of premiums and reinsurance receivables. Management would also provide the Regulator with full information required for effective supervision and oversight, including monthly results of actual performance against projections. In addition, Lumbermens would adopt high standards of transparency and accountability to policy owners and creditors through disclosures in publicly available filings (quarterly and annual financial statements) and regular meetings with various regulators and guarantee funds to provide status updates. However, implementing the run-off strategy was

not straightforward. Lumbermens engaged a professional run-off management firm but terminated the agreement in less than a year, having realised that run-off activities were best performed by Lumbermens' own staff and management.

During the run-off, Lumbermens undertook three key measures to implement an orderly wind-down. Firstly, surplus enhancing transactions created balance sheet surplus via settlement of Lumbermens' obligations at payments considerably below book value (e.g. commutation of Lumbermens' participation in reinsurance pools, policy disengagement with large commercial insureds, and commutation of inward reinsurance). Second, liquidity enhancing transactions that supported claims payment (e.g. timely collection of reinsurance recoveries on paid claims, collection of outstanding premiums, ceasing of policy owner dividends, mergers of subsidiaries to release liquidity, and restructuring of the investment portfolio to maximise yield and meet its cash flow needs). Third was staff retention arrangements, to avoid the flight of institutional memory that proved to be essential for the wind-down. The measures taken by Lumbermens ended up producing positive results, as direct claims were reduced by almost 90% (from \$11 billion to \$1.3 billion) through settlement. Inward reinsurance claims were also lowered by almost 90% (from \$1.3 billion to \$100 million) through settlement at discounts that exceeded those granted to direct insureds. Besides that, the number of claims files were brought down by 95% (from 213,000 to 11,000 cases), and non-US operations were wound-up through closure or disposal of operations of subsidiaries in Canada, Europe and Australia.

A key success factor of Lumbermens' resolution was close regulatory support and oversight throughout the run-off process. The Illinois Department of Insurance ended up issuing over 500 corrective order to Lumbermens and prescribed allowances for accounting practices that had a positive effect on its statutory surplus of \$1 billion (e.g. through discounting rate for loss reserves). Under this "supervised" run-off, the Regulator permitted Lumbermens to use an "economic" basis accounting practice for financial statements, compared to statutory accounting principles.



*Liquidation was the next step in the process ... our staff has worked diligently during this transition with interest to Lumbermens' creditors and customers*

Illinois Department of Insurance



The successful run-off resulted in a group with greatly reduced liabilities and a simplified corporate structure that served to ease Lumbermens' transition into receivership (July 2012) and liquidation (May 2013). The latter triggered provisions of insurance guarantee funds across 50 states in the US to assume responsibility for claim liabilities of policy owners up to coverage limits.

### Key takeaways

The strategy of run-off for resolution of troubled insurance companies can yield significant advantages. These include minimising disruption to the market and crucially, to protect the interest of policy owners through claims settlement and continuity of coverage (compared to direct liquidation which results in termination of policies). The run-off period also opened up a window for policy owners to find replacement cover. In addition, run-off by management eases the strain on insurance guarantee schemes in terms of administrative costs, as well as payout obligations.

The case of Lumbermens demonstrated three key factors for successfully implementing a run-off strategy. First was leveraging the expertise and knowledge of existing employees for the settlement of claims, marshalling of assets, or other activities purposed to "shrink" Lumbermens. Second was the "supervised run-off", which entailed combining a formal run-off plan with close supervisory oversight by the Regulator. This led to the positive outcome of an orderly wind-down, and the eventual transition of Lumbermens into liquidation with a simplified structure and reduced liabilities. Last but not least, early and decisive action by the Management of Lumbermens to enter into a run-off arrangement and to work closely with the Regulator, proved to be highly beneficial to policy owners and claimants. This decision was challenging on many fronts, particularly when the capital position of a troubled insurer was rapidly deteriorating in market conditions that were not conducive for capital raising.







## Bridge Institution and Transfer of Business *Nissan Mutual Life (2007)*



### Background and context

In the mid-1990s, Japanese insurers experienced problems of negative spread<sup>85</sup> from severe business conditions arising from the collapse of the economy in 1992, prolonged challenges in the investment environment (low interest rates and poorly performing stock market), and a market dominated by high guaranteed return insurance products that were issued during good times of the preceding “bubble economy”<sup>86</sup>. While most of Japan’s life insurers survived this crisis, seven life insurers turned insolvent including Nissan Mutual Life Insurance Co. (Nissan Life). Nissan Life was then Japan’s 19<sup>th</sup> largest life insurer with 88 years of experience and ¥2.2 trillion (\$20 billion) worth of assets. It was also the first life insurer to fail in Japan since World War II.

During the recession, asset deflation and low interest rates created a large gap between investment yields (about 3.1%) and guaranteed returns (average of 4.7%) that Nissan Life paid to its policy owners.<sup>87</sup> Nissan Life also suffered losses in its foreign investments and could not rely on huge unrealised capital gains from the stock market as domestic stock and property markets nosedived by 60% and 80% respectively. Nissan Life ended up meeting the annuity payments by selling more high yielding policies. To improve its financial standing, Nissan Life reduced its workforce, consolidated branches and streamlined operations. Despite these efforts, it failed to recover. Nissan Life’s solvency also worsened as loans to real estate developers in the late 1980s turned bad (debts of ¥25.1 billion or \$230 million). By 1997, Nissan Life’s liabilities exceeded its assets by ¥300 billion (\$2.7 billion),<sup>88</sup> leading to suspension of its operations by the Ministry of Finance (MoF).

<sup>85</sup> The insurers suffered from “gyaku-zaya”, or negative spreads, in which actual investment returns were below promised yields

<sup>86</sup> The Japanese asset price bubble or “bubble economy”, was an economic bubble in Japan from 1986 to 1991 in which real estate and stock market prices were greatly inflated. In early 1992, this price bubble burst and Japan’s economy stagnated

<sup>87</sup> Nearly half of Nissan Life’s assets consisted of individual pension fund contracts that guaranteed a high return of about 5.5%. These contracts normally account for 7% to 8% of Japanese insurers’ portfolios. Such an exceptionally high proportion made Nissan vulnerable to any sudden drop in investment yields

<sup>88</sup> In the fiscal year ended 31 March 1997, Nissan Life registered substantial losses relating to the valuation of marketable securities

## Resolution actions

The first action was Nissan Life's transfer to a bridge insurer. In the absence of an institution to rescue Nissan Life, the MoF appointed the LIAJ<sup>89</sup> as the trustee to handle the assets and liabilities of Nissan Life. In the process, Aoba was established as a subsidiary of LIAJ to take over Nissan Life's assets and existing policies in October 1997. Aoba only managed Nissan Life's existing policies and did not handle new contracts. Aoba was set up to ensure continuity of Nissan Life's policies, as termination would adversely impact public confidence in the insurance industry, more so as half of Nissan Life's contracts were individual pension plans. In addition, the Japanese insurance guarantee fund or IPPF was a voluntary scheme that could only provide support to a saviour company up to ¥200 billion (\$1.8 billion). The IPPF was a voluntary scheme and in the case of Nissan Life, there were no interested acquirers and its deficit exceeded the IPPF's maximum amount by ¥100 billion (\$0.9 billion).

Other actions include reducing Nissan Life's policy reserves, modification of policy owners' contract terms and the suspension of surrenders of insurance contracts. While the IPPF ended up providing financial support of ¥200 billion (\$1.8 billion), the remaining amount to cover Nissan Life's asset-liability gap was borne by policy owners. The surrenders of insurance contracts were also suspended to protect the interests of policy owners (avoid loss of insurance coverage), as well as to manage Nissan Life's liquidity position.

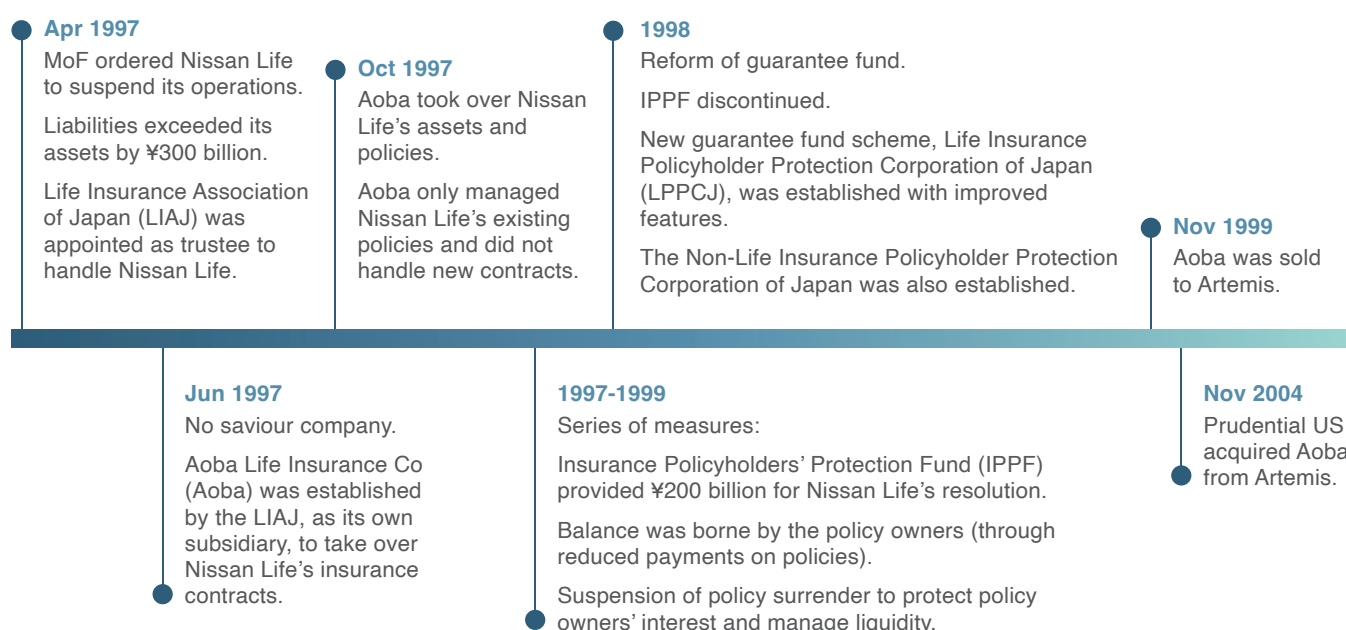
In November 1999, Aoba was acquired by Artemis (a French retailer group) for ¥25 billion (\$230 million). In March 1999, Aoba's asset size stood at ¥1.19 trillion (\$11 billion). This deal was a milestone as it marked the first instance that a failed Japanese FI was sold to a foreign company and could pave the way for the resolution of other failed insurers such as Toho Mutual Life. During that period, foreign firms were eyeing stakes in distressed or failed Japanese FIs. Five years later in November 2004, Artemis sold Aoba to US-based Prudential Life Insurance for ¥20 billion (\$180 million).

*The acquisition of insolvent Japanese companies by foreign insurers ... helped make the Japanese market more global*

Geneva Association

The failure of Nissan Life also resulted in institutional reforms. After the resolution of Nissan Life, the IPPF was replaced with a new and strengthened guarantee fund scheme in 1998 – the LPPCJ. Membership of life insurers in the LPPCJ was made mandatory. The LPPCJ's financial capacity expanded to ¥400 billion (\$3.6 billion) with broader resolution powers of providing direct financial assistance to and taking over the policies of troubled insurers.

### Resolution of Nissan Life – Timeline of Key Events



<sup>89</sup> An industry association of life insurance companies, to which all insurance companies operating in Japan (42 companies) are members (as of 21 December 2020)

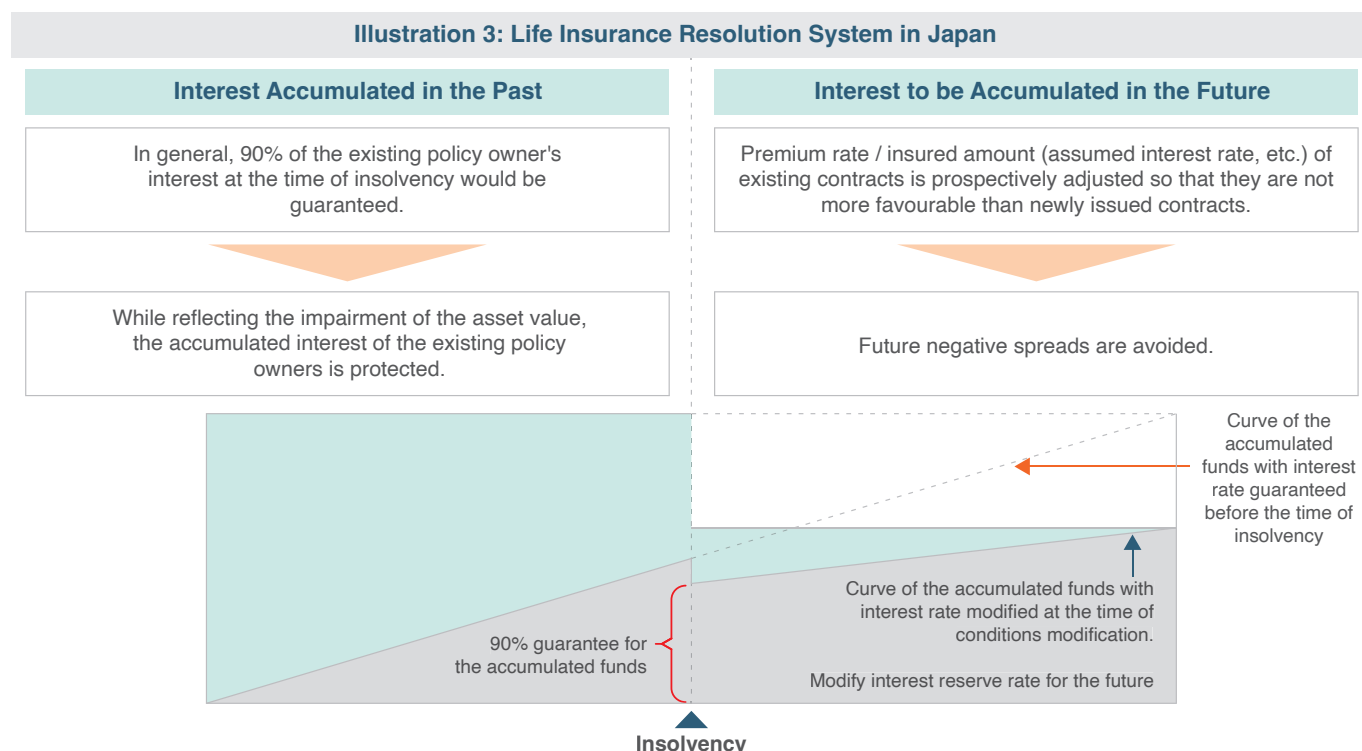


## Broader resolution actions taken for Japan's life insurance insolvencies

In addition to Nissan Life, the period from 1999 to 2008 saw the failure of other Japanese life insurers. In those cases, the LPPCJ adopted several resolution measures including the reduction of policy reserves and modification of contract terms at insolvency. While coverage depended on the type of policy, generally, only about 90% of policy reserves were protected. This was intended to reduce the moral hazard of consumers selecting cheaper insurance products without due consideration of an insurer's financial soundness. Besides that, several contract terms were modified going

forward, including policy owners' accumulated interest and reduction of assumed interest rates. This ensured that the grandfathered right of policy owners to receive benefits higher than the market rate would cease at insolvency. Lastly, similar to Nissan Life, insolvency involved the suspension of surrenders of insurance contracts. In summary, resolution by way of insolvency led to financial stability by avoiding a liquidity crisis / substantially improving the position of troubled life insurers, and preserving both the assets of insurers, as well as the interests of policy owners.

### Modification of contract terms at time of insolvency



Source: Geneva Association / Nippon Life Insurance Company

### Key takeaways

The resolution of Nissan Life was unique as it involved a combination of interventions by the life insurance industry and insurance guarantee fund, with a clear primary objective to provide continuity of coverage and protect the interest of policy owners. The establishment of a bridge institution (Aoba) and provision of financial assistance by the guarantee fund, ensured continuity of coverage for policy owners through transfer of policies to Aoba, and Artemis. Nissan Life's case demonstrates how the selection and collective use of several resolution tools effectively facilitates the well-organised resolution of a failed financial institution.

Nissan Life's failure also triggered the reform of Japan's insurance guarantee scheme and resolution arrangements. Substantial improvements in the financial capacity, governance and resolution powers of the new guarantee scheme were important foundations for sustainability and resilience of the Japanese life insurance industry to tackle future crises.





## Nationalisation, Bridge Institution and Restructuring *Anbang Insurance Group (2018)*



### Background and context

Anbang Insurance Group (Anbang or the Group) was a large conglomerate with more than CNY1.97 trillion (\$278.1 billion) assets in February 2017, servicing 35 million policy owners and employing over 30,000 staff worldwide. The Group provided extensive financial services covering life insurance, general or property and casualty insurance, health insurance, pension insurance, insurance brokerage and agency sales, banking, asset management as well as leasing. Its key subsidiaries were:

- Anbang Property & Casualty Insurance Company Limited (APCIC);
- Anbang Life Insurance Company Limited (ALIC);
- Hexie Health Insurance Company Limited (HHIC);
- Anbang Pension Insurance Company Limited; and
- Anbang Asset Management Company Limited (AAMC).

In 2017, Anbang was 139th in the Fortune Global 500 rankings, while ALIC was ranked third among the life insurers in China with 9% market share.

In 2004, Wu Xiaohui (Anbang's Chairman and CEO / Chairman Wu) founded Anbang as a regional car insurance company. APCIC launched its first branch in Beijing and opened another 22 branches including Liaoning and Fujian in 2005 to lay its business network nationwide. In 2008, APCIC was the first general insurer in China allowed to conduct telemarketing in all provinces of the country via 37 branches. Anbang continued to expand aggressively by establishing ALIC, acquiring Ruifu Health Insurance Company Limited (later renamed to HHIC) in 2010, and establishing AAMC together with Hexie Insurance Sales Company Limited and Beijing Ruihe Insurance Broker Company. The Group also acquired a 35% stake in Chengdu Rural Commercial Bank. By 2013, Anbang was able to offer the entire spectrum of insurance services after obtaining the licence to underwrite pension insurance in China.

From 2014 to 2017, Anbang increased its paid-up capital and grew rapidly overseas through a series of acquisitions. This included acquiring Belgian insurer Fidea Verzekeringen

and a 57.5% stake in Tongyang Life Insurance from Korea. This period also saw Anbang purchasing or investing in other entities, such as Belgian Delta Lloyd Bank, Dutch insurer VIVAT, Allianz Insurance Korea, the Waldorf Astoria Hotel in New York, Bentall Centre office complex and Retirement Concepts (largest retirement homes business in Canada), Strategic Hotels & Resorts Incorporated which owned luxury hotels in US (e.g. Loews Santa Monica Beach Hotel, JW Marriott Essex House in New York and Four Seasons in Washington) as well as residential properties in Japan's major cities. Meanwhile, the Group also held substantial stakes in 20 major listed companies in China.

Anbang was considered as one of China's most politically connected companies by virtue of Chairman Wu's third

marriage to Deng Xiaoping's granddaughter. He also had the backing of Chen Xiaolu, the son of Marshal Chen Yi.<sup>90</sup> However, there were also those who opposed Chairman Wu such as Wang Qishan – the former, head of China's anti-corruption body and a close associate of President Xi Jinping – who was appointed as Vice President in 2018.

***Rarely in corporate history has a giant (Anbang) come and gone so quickly ... China's government takes control of its would-be financial colossus***

The Economist

### Unsound business model and gross mismanagement led to Anbang's downfall

Anbang's fundamental business model was flawed and unsustainable. It relied on wealth management products for funds by selling risky, high yielding short term saving products that promised returns in excess of bank deposits. Most of these products were widely sold to retail customers under the guise of insurance products by including some basic life protection elements. To meet high guaranteed yields, the Group took huge risks by allocating close to one fifth of its long-term investments in equities and exposing Anbang to significant market risk from the volatility of the stock market. By comparison, the industry average for investments in equities was less than 5%. The Group's aggressive investment strategy also saw it placing another 19% of investments in redeemable short-term loans provided through trusts (an opaque area of shadow banking in China), as well as overpaying for illiquid real estate investments, including luxury hotels in the US.

Anbang also ventured into unfamiliar territory through acquisitions of loss-making entities in new markets. For instance, the purchase of VIVAT (a troubled state-owned insurance company) from the Dutch government required Anbang to recapitalise VIVAT with between €770 million – €1 billion (\$863.4 million – \$1.23 billion) in fresh capital, as well as to assume debts amounting to €550 million (\$678.4 million).

These concerns were underpinned by weak governance and risk management control functions, which led to gross mismanagement and fraud at the highest level of the Group. In June 2017, Chairman Wu was arrested and charged with fraud for falsifying documents and deceiving regulators in 2011 during the process of obtaining the licence to sell insurance products. This included overselling insurance products worth CNY724 billion (\$102.2 billion) and diverting CNY65 billion (\$9.2 billion) of premiums to companies controlled by Chairman Wu for overseas investments, debt repayments and personal use. In addition, it was alleged that premiums from the sale of insurance policies had been used to inject capital into Anbang to maintain an appearance of the Group's stable financial position.

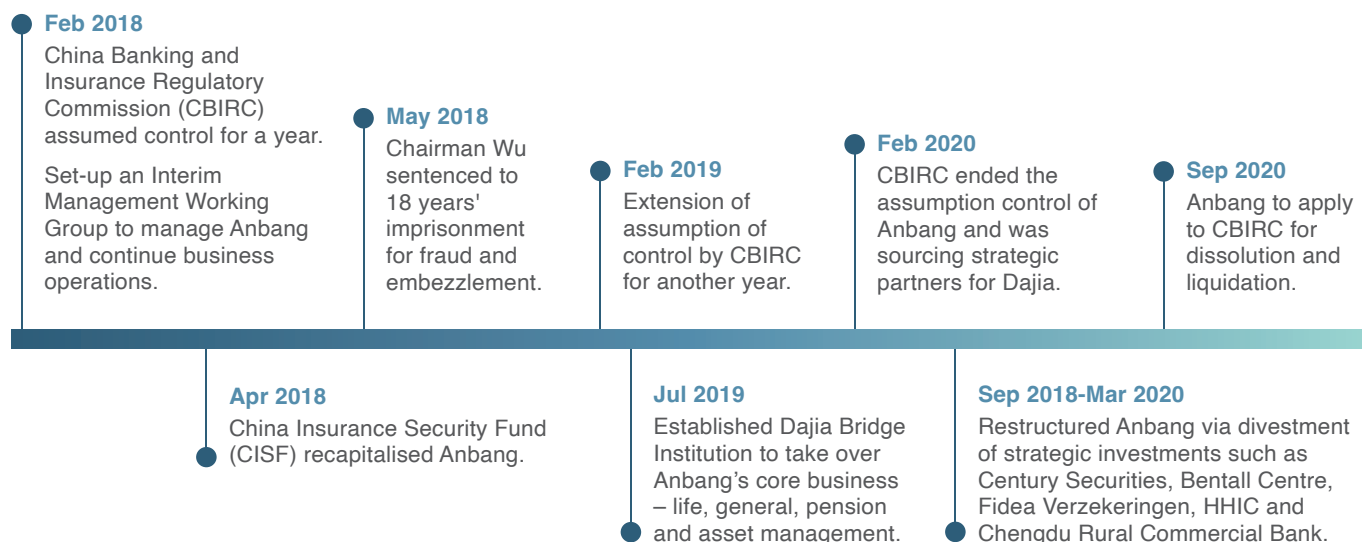
***In the next 10 years (from 2015), Anbang will have subsidiaries on every continent and it will be a global holding company ... by then, Anbang's asset scale will exceed your imagination***

Wu Xiaohui, former Anbang Chairman and CEO

<sup>90</sup> A communist hero in the civil war and early member of Anbang's Board of Directors



### Resolution of Anbang – Timeline of Key Events



On 23 February 2018, CBIRC assumed control of Anbang for a one year period pursuant to Article 144 of the Insurance Law due to violation of regulations that seriously threatened Anbang's solvency.<sup>91</sup> To provide more time for the resolution, the CBIRC extended the assumption of control over Anbang for another year to February 2020. An Interim Management Working Group (IMWG) was established to manage Anbang's assets, liabilities and affairs while business operations continued. The IMWG – comprising key officials from CBIRC, the People's Bank of China (PBOC) and other financial regulators and government bodies – was responsible to restructure Anbang, improve its corporate governance, contain further deterioration in its financial position, and perform a comprehensive review of its assets and business lines.

As an immediate measure to safeguard financial stability, protect the interests of Anbang's policy owners, strengthen its solvency position, and maintain smooth business operations, on 4 April 2018, CBIRC granted approval for the IGS – CISF to inject fresh capital amounting to CNY60.8 billion (\$8.6 billion) into Anbang. As a result, Anbang was nationalised with CISF owning 98.2%. The other two shareholders were state-owned entities, namely Shanghai Automotive Industry Corporation and China Petrochemical Corporation, which held interests of 1.2% and 0.6%, respectively.

The decision to recapitalise Anbang was crucial to avoid it from collapsing and spreading contagion across the financial system, given Anbang's interconnectedness with the banking

system and large corporates such as property developers. For instance, it held substantial stakes in China Minsheng Banking Corporation Limited and China Merchants Bank Company Limited, as well as China Vanke Company Limited and Gemdale Corporation. Without the government rescue, policy owners would face the prospect of losing insurance coverage (life, annuity and medical), and bearing losses from insurance claims that had yet to be honoured. Moreover, business and economic activities would be disrupted by the sudden discontinuance of Anbang's general insurance coverage for areas such as motor, fire, engineering, workers' compensation, professional indemnity and liabilities.

In May 2018, Chairman Wu was sentenced to 18 years' imprisonment for financial fraud and embezzlement of CNY75.2 billion (\$10.6 billion). Meanwhile, Xiang Junbo, the previous Head of the China Insurance Regulatory Commission (CIRC), pleaded guilty to abuse of power by issuing operating licences to favoured insurers and soliciting bribes of CNY19.4 billion (\$2.8 billion). In April 2018, the CIRC was absorbed into the China Banking Regulatory Commission to form a new entity, the CBIRC.

In July 2019, Anbang's business operations were taken over by a newly established company, Dajia Insurance Group (Dajia meaning "everyone" in Chinese) with a paid-up capital of CNY20.4 billion (\$2.9 billion). Utilising a bridge institution (BI), four new entities were set up to acquire different parts of Anbang's core businesses comprising life insurance, general insurance, pension insurance and asset management.

<sup>91</sup> China's Insurance Law stipulates that an insurer could be taken over by regulators if it was insolvent or undertaking illegal activities that threatened its solvency and harmed public interests

Dajia's shareholding structure mirrored Anbang, as existing shareholders injected fresh capital (in the form of cash) to match their respective stakes. By 22 February 2020, the IMWG had successfully restructured and stabilised Anbang by way of recapitalisation, transferring its core businesses to the BI, and divesting domestic and overseas investment assets (as summarised below). Going forward, the CBIRC would also source strategic investors for Dajia. In July 2021, it was reported that sale of the 98.78% stake in Anbang had attracted interest from six consortiums.

*The CBIRC has ended its two-year takeover of Anbang. As of January 2020, the financial insurance issued by Anbang (before being taken over) of CNY1.5 trillion (\$211.8 billion) has been fully paid. This has helped the Group to protect the lawful rights and interests of insurance consumers*

China Banking and Insurance Regulatory Commission

**Table 10: Summary of transactions relating to the sale of Anbang's assets**

Date	Description of Transactions	Amount (\$)
September 2018	Sold domestic securities brokerage firm Century Securities (91.65%) to Shenzhen Qianhai Financial Holdings Company and Xiamen International Trade Group Corporation.	519 million
March 2019	Sold Bentall Centre office complex in Vancouver, Canada to the Blackstone Group (purchased by Anbang for \$1 billion).	Not available
April 2019	Sold Belgian insurer Fidea Verzekeringen via a formal auction process to Swiss insurer Baloise.	543 million
July 2019	Sold HHIC to five companies, including Fujia Group Company Limited (a Liaoning province based petrochemicals and finance conglomerate) which acquired 51% stake.	Not available
September 2019	Sold Strategic Hotels & Resorts Incorporated to Mirae Asset Management (MAM). <sup>92</sup>	5.8 billion
February 2020	Sold residential buildings in Japan's major cities such as Tokyo, Osaka and Nagoya to the Blackstone Group.	2.7 billion
March 2020	Sold 35% owned Chengdu Rural Commercial Bank to Chengdu Xingcheng Investment Group (government-backed investment vehicle in Sichuan).	2.3 billion

### Key takeaways

The case of Anbang reinforces the importance of an IGS – in this case the CISF – as a safety net to protect the interest of policy owners and to promote financial system stability. The CISF secured continuity of insurance coverage for policy owners by providing substantial financial support of \$8.6 billion to Anbang. This ensured it remained in business to meet claim obligations, service existing policy owners and underwrite new business. The CISF also contributed to Anbang's key resolution initiatives including recapitalisation, establishment of a BI (Dajia) which acquired Anbang's insurance businesses, and sourcing for new strategic investors in Dajia.

The decision to resolve Anbang via nationalisation reflected its systemic importance and the risk of contagion from its failure to other parts of the Chinese financial system. This includes the level of interconnectedness between Anbang with the banking system and large corporates. Anbang was also sizeable, ranked third among Chinese insurers in the first half of 2017 with assets of close to \$300 billion. Some effects of Anbang's failure include the strong signal sent on corporate governance, as part of the anti-graft campaign initiated by President Xi, as well as strengthening regulatory oversight of the financial system.

Anbang's resolution should be seen in the light of the Chinese political economy, as well as continuing actions by regulators to tackle financial risks in China (preceding the failure of Baoshang Bank and troubles in other Chinese banks in 2019 and 2020). In July 2020, it was reported that the CBIRC took over another four troubled insurers, including Huaxia Life which has an asset size of about \$85 billion and 500,000 employees. During that time, regulators also seized control of another five entities (two securities brokers, one futures company and two trust companies).

<sup>92</sup> In May 2020, MAM aborted the deal due to Anbang's failure to disclose about a lawsuit for one of the target hotel's ownership, questions regarding titles to certain hotels and the value of properties which have been eroded by the Covid-19 pandemic. A legal suit was initiated by Anbang against Mirae. In December 2020, the Delaware Court of Chancery ruled in favour of Mirae on the ground that Anbang made extensive changes to its hotel business because of COVID-19 and failed to meet the condition that business be "conducted in the ordinary course of business"





## Liquidation and Payment of Claims *HIH Insurance Limited (2001)*



### Background and context

HIH Insurance Limited (HIH) was a complex corporate group with more than 200 subsidiaries and extensive overseas operations, including seven authorised insurers conducting general or property and casualty insurance business in Australia. The Group's main entities were HIH Casualty & General Insurance Limited, CIC Insurance Limited (CIC) and FAI General Insurance Company Limited (FAI). Collectively, HIH ranked as the second largest general insurer in Australia with 13% market share by premiums and 15% by assets.

*The collapse of HIH increased awareness of the significance of insurance to the wider economy. Insurance is socially valuable. It promotes financial security and personal responsibility. The insurance market generates price signals, helping to allocate resources to productive uses ... without insurance, a range of essential activities in commerce, trade and community life can simply grind to a halt*

Treasury of the Australian Government



### Rapid expansion amid challenging operating environment in the late 1990s

HIH was established in 1968 by Ray Williams and Michael Payne as a workers' compensation underwriter. It was then acquired by a UK insurer in 1971 and expanded into property, commercial and professional liability insurance across Australia, New Zealand, Hong Kong and the US. From mid to the late 1990s, HIH grew rapidly through a series of acquisitions. This includes the purchase of CIC from Swiss owned CIC Insurance Group, Heath Cal in the US (now known as CareAmerica Compensation and Liability Insurance Company), Colonial Mutual General Insurance's operations in Australia and New Zealand, Cotesworth Group Limited in the UK, and FAI. Notably, 1998 saw the exit of HIH's majority shareholder (Winterthur International Holdings Limited) due to concerns over HIH's international expansions. This was conducted through a divestment of Winterthur's 51% stake through a public share offer to investors in Australia, which was over-subscribed.

### Significant losses and unsuccessful recovery efforts led to HIH being wound-up

In 1999 and 2000, HIH's financial position was dragged down by poor results from its subsidiaries in the UK and US (due to mispricing and deteriorating market conditions).

As part of its recovery efforts, in September 2000, HIH entered into a JV with Allianz Australia Insurance Limited (Allianz). The JV entity – 51% held by Allianz and 49% by HIH - assumed HIH's profitable business lines (majority of personal lines and compulsory third-party insurance business) in exchange for AUD200 million (\$127 million) received by HIH. The JV was ceased nine months later when HIH sold off all its 49% stake to Allianz. However, the JV had a negative impact on HIH's cash flows, resulting in delayed payment of claims to policy owners. Subsequently, HIH also sold its workers' compensation business to NRMA Insurance (Australia's biggest general insurer). HIH had also pursued a managing general agency agreement with Gerling Australia Insurance Company (Gerling), which fell through. HIH's strategic intent was to leverage Gerling's strong credit rating, following HIH's rating downgrade, which had constrained its conduct of business with insurance brokers.

In early 2001, the APRA issued a 14-day show cause notice to HIH concerning the appointment of an inspector under the Insurance Act 1973. Markets reacted negatively to speculation about HIH's financial sustainability and viability, and the trading of HIH's shares was twice suspended. On 6 March 2001, HIH's Board of Directors (Board) commissioned KPMG to undertake an independent financial review. After receiving the KPMG review, the Board of HIH took the decision on 15 March 2001 to place the company into provisional liquidation. Pending formal appointment of a liquidator by the Court, the interim caretaker took control of, reviewed and assessed HIH's operations, assets, records, financials as well as the

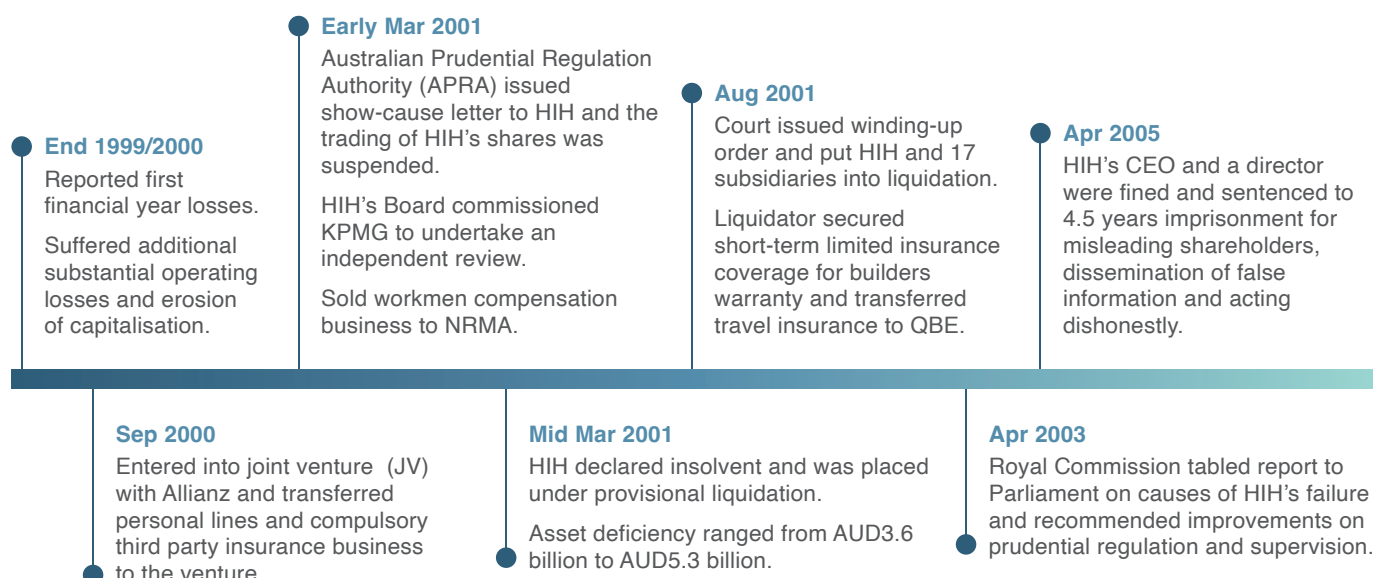
The performance of Australia's general insurance industry began to deteriorate in the mid-1990s, marked by a period of worsening claims experience, poor investment returns, soft premium rates and declining profits. The tough business environment resulted in intense competition, market consolidation, the failure of two small reinsurers and the rescue of a larger company (GIO Australia Holdings Limited) by another insurer (AMP General Insurance) in 1999. During that period, the general insurance industry was both fragmented with close to 160 insurance and reinsurance companies. It was also concentrated with the top five insurers, contributing to about 50% of the industry's business, while the top 20 players accounted for 88% of total gross premiums.

magnitude of losses. HIH was found to be in grave condition with deficient assets ranging from AUD3.6 billion to AUD5.3 billion (\$2.3 billion to \$3.4 billion). This reflected significant under provisioning of outstanding claims liabilities for HIH as well as for overseas business operations in the UK and US. On 27 August 2001, the Court issued formal winding-up orders to put HIH and 17 subsidiaries into liquidation and appointed KPMG as the liquidator.





### Resolution of HIH – Timeline of Key Events



### Impact of failure and setup of HIH Scheme

HIH was the largest corporate failure in Australian history. Its liquidation in 2001 was profound and caused major disruptions to the economy and businesses, as well as livelihoods. HIH's two million policy owners faced significant hardships following the termination of various classes of insurance policies comprising motor, fire, home warranty, workers' compensation, professional indemnity, public liability, personal accident and travel insurance. Apart from the thousands of HIH employees who had lost their jobs, thousands of professionals – including doctors and surgeons – were unable to perform their work without insurance protection. The lack of substitutability for certain insurance coverage and HIH's under-pricing of risk, also triggered significant increases in premiums and caused, among others, rail and tram societies, sports centres and amusement parks, to cease operations. In addition, HIH was one of the largest home-building market underwriters and its failure affected many homeowners and builders, left without home warranty insurance and defective building work coverage.

To close these protection gaps, HIH's liquidator (KPMG) worked with Royal & Sun Alliance Australia Ltd to offer limited, short term insurance for builders' warranty insurance while Dexta Corporation agreed to provide insurance coverage for building works.<sup>93</sup> However, HIH's policy owners bore higher

premium rates and were subjected to specific underwriting requirements. KPMG also completed the transfer of HIH's travel insurance, and insurance coverage of the Rugby Union and Rugby League competitions to QBE Insurance Australia (QBE). This included an agreement by QBE to renew HIH's corporate business.

The failure of HIH severely dented consumer confidence in the insurance industry, as well as the ability of regulators to protect and safeguard the interests of policy owners. The protection of financial consumers became a policy imperative. Since there was no IGS or financial claims scheme when HIH failed, the Australian Government implemented a claims support scheme to assist affected policy owners of HIH (HIH Scheme), valued at more than AUD500 million (\$318 million).

***Ultimately, the success of the HIH Scheme demonstrates that industry and the government can work together to deliver mutually beneficial outcomes***

Treasury of the Australian Government

<sup>93</sup> For works-in-progress and works pending commencement, of which contracts have been signed

## Establishment of a Royal Commission (RC) and findings

The RC was set-up to investigate the causes of HIH's failure as well as to recommend improvements on prudential regulation and supervision of general insurance companies. It was headed by Justice Neville Owen and aided by 70 accountants, information technology specialists, lawyers as well as external actuarial and accounting support from Deloitte and Trowbridge Consulting. This endeavour required AUD50 million (\$32 million) and 18 months, culminating in a report tabled to the Australian Parliament in April 2003.

The RC's conclusions could be summarised in three points. First, how the combination of improper reserving practice (where future claim costs / liabilities were substantially underestimated), aggressive pricing (low premiums), and rapid business expansion led to HIH's downfall. The latter saw HIH's international ventures in the UK and US generating massive losses of AUD2.4 billion (\$1.5 billion). Domestically, HIH overpaid for the purchase of a troubled insurer (FAI), borrowed heavily to fund the acquisition worth AUD300 million (\$191 million), and wrote-off its entire investment.

Other related factors contributing to HIH's failure included the abuse of reinsurance, conglomerate complexity, inappropriate asset valuations as well as lack of integrity in the information submitted by management to the Board, auditors and the regulator.

Second was poor corporate governance. HIH's Board was found to be unduly influenced by the senior management team led by Ray Williams (the CEO and Deputy Chairman). The Board did not pay enough attention to strategic matters, failed to implement robust risk management controls, ignored conflict of interests, and did not reign in excessive expenditures in the form of executive remuneration and benefits.

Thirdly, in terms of regulation, the RC identified areas of improvement. This includes early warning signals of financial difficulties, as well as the implementation of preventive and corrective measures. Since then, APRA has significantly strengthened supervisory practices.

### Key takeaways

An IGS is an essential element of the financial safety net to safeguard the interest of policy owners. In the case of HIH, policy owners were left unprotected and the Australian Government had to step in and establish a specific financial support scheme (HIH Scheme). With this intervention, policy owners were compensated for financial losses (payments of 90 or 100 cents on the AUD) compared to lower and prolonged recoveries from being pooled with unsecured creditors under the winding-up process. During that time, the government also lacked the capability and infrastructure for claims management and collaborated with the industry to promptly implement the HIH Scheme.

***I recommend that the Government introduce a systematic scheme to support policy owners of insurance companies in the event of a failure of any such company***

Royal Commissioner the Honourable  
Justice Owen

In the aftermath of HIH's insolvency, an industry funded IGS was proposed by industry. This led to a technical study considering the merits of introducing an explicit guarantee for parts of the financial system, as well as a comprehensive review of Australia's failure and crisis management arrangements by the Council of Financial Regulators. An IGS, known as the Financial Claims Scheme (FCS), was subsequently adopted by the government for general insurers in 2008 at the same as a deposit insurance scheme

was introduced. The FCS is funded by a government appropriation and APRA is responsible for administering the FCS, if invoked.

Besides a new financial claims scheme administered by APRA, the failure of HIH also led to the strengthening of the oversight of general insurance companies. A new regime for the prudential regulation of general insurance companies was put in place, including increasing minimum capital requirements, introducing a risk-weighted capital solvency framework, strengthening corporate governance policies as well as imposing tighter controls for auditors and actuaries.

The corporate governance failures of HIH were met by a strong response by the authorities. This included civil actions against two of HIH's ex-Board members, Ray Williams and Rodney Adler. Both persons were jointly ordered to pay AUD8 million (\$5.1 million) to HIH, and were individually imprisoned for 4.5 years after pleading guilty to misleading shareholders about HIH's financial position, stock market manipulation, disseminating false information, acting dishonestly, and failing to discharge duties as a director in good faith and the best interests of HIH.

The case of HIH also demonstrates the importance of having in place strong internal capabilities and a robust framework, including comprehensive due diligence before launching a strategy of aggressive business expansion via mergers and acquisitions, proper claims reserving practices and pricing mechanisms, as well as strong internal control, governance and risk management.





## Bankruptcy Conservatrix N.V. (2020)



### Background and context

Table 11: Financial profile of Conservatrix N.V.

Key Figures	2018	2017	2016	2015	2014
Gross premium (€' million)	26.3	29.4	32.4	47.6	115.6
Result after tax (€' million)	(9.5)	95.2	(14.9)	30.6	(71.0)
Solvency I ratio				13%	(74%)
Solvency II ratio	148%	188%	(16%)		
Number of policy contracts	83,301	86,258	88,881	N/A	N/A

The Dutch insurance market is the fifth-largest in Europe (as of 2018) with €77 billion (\$93 billion) of gross written premiums. It is concentrated in health insurance, which is mandatory for every person living and working in the Netherlands. Hence, health insurance accounts for more than 66% of the total gross written premiums of the insurance industry, followed by life (17%) and non-life (17%). The insurance industry in Netherlands is regulated by De Nederlandsche Bank (DNB) – the Dutch central bank, supervisor and resolution authority.

Conservatrix N.V. (Conservatrix) has been operating in the Dutch market since 1872 specializing in life insurance, pension and mortgages. In particular, the pension policies represent a significant proportion of the total value of policies. Conservatrix is a relatively small insurer with about 80,000 policy owners, and the first life insurer to be declared bankrupt in Netherlands since 1993.

## **Events leading to the failure of Conservatrix**

Conservatrix was owned and managed by the Henny family. As a family-owned business, insufficient checks and balances led to suboptimal management decisions. As a result, Conservatrix sold high guaranteed return and profit-sharing policies without being able to generate sufficient returns to support the promised returns.

When Conservatrix ran into trouble in 2014, several measures were explored to revive the company. A trustee was appointed and to safeguard the interests of its existing and prospective policy owners, Conservatrix stopped selling new policies in 2015 (the restriction on sale of new policies continued until the bankruptcy of Conservatrix in 2020). Additionally,

the search for a new owner turned out to be unsuccessful. Conservatrix also considered exercising an “en bloc” clause to adjust its profit-sharing arrangements with policy owners. However, this exercise was unfavourable to the DNB because it meant that policy owners would have to bear the burden of loss, instead of the shareholders of Conservatrix who were unwilling to inject capital.

In the following years, the financial situation of Conservatrix further deteriorated. Its solvency ratio dropped to 13% in 2015 – far below the mandatory limit of 100% – and worsened to a negative position with the introduction of Solvency II in 2016.

## **Forced share transfer, recapitalisation and dividend restriction**

In 2017, Conservatrix did not have sufficient funds to meet its future obligations to policy owners. To protect the interest of policy owners, the DNB exercised its powers to expropriate the shares of Conservatrix from existing owners and effect a transfer of the same to Trier Holdings, a Dutch company owned by US investment group Global Growth (formerly Eli Global). The transfer was approved by the Amsterdam District Court in May 2017.

Subsequently, the solvency ratio of Conservatrix was restored through capital injection by the new owners and a reinsurance arrangement with Colorado Bankers Life Insurance Company (Colorado Bankers, which was part of the Global Growth group in the US).<sup>94</sup> The capital injection was reported to be €88 million (\$106 million), comprising a cash deposit of €18 million (\$22 million) and reinsurance of €70 million (\$84 million). The financial performance of Conservatrix in 2017 then improved substantially due to an increase in the

reinsurers’ share of technical provisions and release of risk margin. As part of the transfer agreement, Conservatrix also agreed to refrain from paying dividends for ten years. Even though the trustee’s appointment was revoked following the recapitalisation, Conservatrix continued to remain under DNB’s intensified supervision.

Conservatrix then underwent further restructuring. This included, among others, strengthening of the leadership team, improving governance, stabilisation of its operations, reserve strengthening and changes in asset composition, as well as the strategy to turn around the company for growth through acquisitions or incremental sales. According to claims by Global Growth (the ultimate owner of Conservatrix), it intended to increase the profitability of Conservatrix via provision of loans with high returns to other subsidiaries of Global Growth, an approach which was not acceptable to the DNB.

## **Challenges faced by Global Growth impacting Conservatrix**

In 2019, the solvency ratio of Conservatrix fell below the mandatory requirement of 100%, owing to weak operating results and losses from reduced valuation of the reinsurance agreement signed with Colorado Bankers (which was placed under rehabilitation in the US in June 2019). Meanwhile, there were also adverse reports in the US of alleged misappropriations relating to the founder of Global Growth. In March 2020, the founder was convicted of bribery. Following intervention by regulators in the US, Conservatrix was left to seek for additional capital without support from its owner.

In May and July 2020, Conservatrix made announcements that it had insufficient buffers to meet future obligations to its policy owners, and was unable to restore its capital to the mandatory level within the required timeframe. Conservatrix then requested support from the Ministry of Finance in August 2020, which was rejected by the Minister of Finance. The DNB proceeded to appoint a trustee<sup>95</sup> in September 2020. At the request of DNB, Conservatrix was declared bankrupt in December 2020.

<sup>94</sup> As part of the agreement with DNB, the new shareholders recapitalised the company and restored the Solvency II ratio at 188% (above the minimum internal target level of 135%) through capital injection of €18.4 million and a reinsurance arrangement of €72.1 million

<sup>95</sup> This is not a bankruptcy trustee, but a person that DNB can appoint to an insurer that fails to meet statutory capital requirements

## Resolution actions

### Bankruptcy with possibility of transfer to another insurer or pay-out to policy owners

Conservatrix was declared bankrupt for failing to meet the regulatory capital requirements, having insufficient cash to pay for the benefits of €800 million (\$964 million) promised to its policy owners, and without any prospect of improvement in its financial position.

***A bankruptcy was unfortunately inevitable because Conservatrix was unable to meet the capital requirements ... and an alternative solution proved impossible within the foreseeable future***

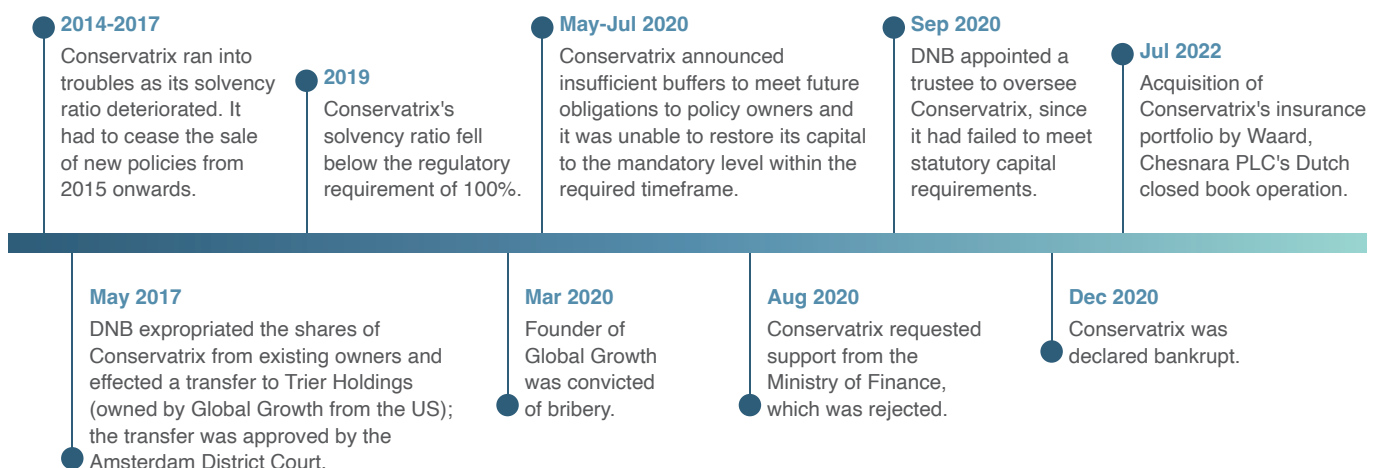
De Nederlandsche Bank

Bankruptcy trustees have been appointed by the court to wind up the bankruptcy. The trustees were looking into options, including the takeover of Conservatrix's policies by a healthy insurer. However, this may require changes to the policy conditions, which are subject to approval by the court. There were also reports of the possibility of industry peers stepping in to save Conservatrix, but contingent upon having the leeway to make changes to the policies.

In the event of an unsuccessful transfer, the insured policy owners will be paid from the assets of Conservatrix. Concomitantly, policy owners could end up receiving less than their entitlements. In January 2021, it was reported that the bankruptcy trustees disclosed the maximum discount rate to be 30% on future payments to the policy owners of Conservatrix. A bail-in of policy owners could support the continuation of insurance policies (particularly for life insurance) with portfolio transfer. This is generally recognised to be the preferred option compared to the termination of policies in insolvency proceedings. In 2018, an earlier analysis of termination performed on Conservatrix foresaw significant losses. In essence, policy owners could still prefer to have continuation of policies even with bail-in, rather than termination of the same in insolvency.

In July 2022, Chesnara PLC finally announced the acquisition of Conservatrix, of which saw the latter's insurance portfolio being acquired by Waard, Chesnara's Dutch closed book operation. The acquisition was effected through the transfer of the insurance portfolio (together with certain other assets and liabilities) to Waard. However, in order to support the solvency position of the Conservatrix insurance portfolio, Waard injected capital of €35 million (\$36.5 million). Conservatrix customers became part of a Waard and continued to enjoy their policy benefits under the new institution.

### Resolution of Conservatrix – Timeline of Key Events





## Key takeaways

Early intervention and decisive actions by regulators are crucial. In this case, among others, the regulator forcibly transferred the shares of Conservatrix to a new owner in 2017. The transfer was accompanied by conditions such as recapitalisation and the imposition of dividend restrictions. These actions were commendable to safeguard the interests of policy owners and to avert further deterioration of the insurer during that period.

This case demonstrates the challenges of providing continuity of coverage at failure for policies with high guaranteed returns. Resolution outcomes will depend on the severity of policy conditions and the level of returns promised to policy owners. Willing buyers may be absent. Even with the possible transfer of policies to another entity, this may warrant modification to the policy terms, leaving policy owners exposed to potential losses. To begin with, pursuing the risky business strategy of high guaranteed return products which are not backed by sufficient investment returns, opens up a path to potential failure of the insurer with detrimental impact on policy owners.

The resolution approach of continuity of coverage is well suited to the nature of life policies that serve as long term contracts / pension provisions for policy owners. In this case, the regulator pursued this approach via the transfer of Conservatrix's shares to a new owner in 2017. Even at the bankruptcy of Conservatrix in 2020, the regulator continued to focus on arranging for continuity of coverage by advising the bankruptcy trustee to look for an acquirer to take over the policies which were eventually assumed by Waard, Chesnara's Dutch closed book operation.

***I considered the request (for financial support) very carefully, but ultimately rejected it ... it is up to DNB to determine which consequences should be attached to this (dealing with a troubled insurer). The system does not provide for use of public funds and is even partly intended to prevent the use of such public funds. In view of this, I could not accept the request of Conservatrix***

Wopke Hoekstra, former Minister of Finance of the Netherlands



An IGS, with sufficient funding and tools, can be a valuable safety net to protect policy owners during the failure of an insurer. The IGS could effectively facilitate the transfer of policies (through funding, guarantees or other means) to a third-party or a bridge institution; or administer a run-off, which will provide continuity of coverage for policy owners. If termination of policy is pursued as the last resort, the IGS would be able to pay the policy owners up to the protection limit.



## Insolvency

### *Merced Property & Casualty Company (2018)*



### Background and context

Headquartered in Altwater, Merced Property & Casualty Company (Merced) has been a prominent provider of property and casualty (P&C) insurance services across California, including Central Valley, since 1906. Operating as Merced Mutual Insurance Company in the past, it provided various insurance for homeowners and property including dwellings, automobiles, marine and farm cover. Merced's comprehensive coverage includes protection against a wide range of direct and accidental losses such as fire, water damage, vandalism, and others.

Amid challenging economic conditions in California's Central Valley, since 2006, Merced experienced a consistent decline in its direct written premiums (DWP) for eight consecutive years. In 2013, Merced opted for demutualisation as a strategy to preserve its viability. The United Heritage Financial Group, Inc (UHFG),<sup>96</sup> based in Meridian, Idaho, acquired all of Merced's shares via its subsidiary, United Heritage Insurance.

The acquisition helped to improve Merced's financial position (Table 12). In 2017, the 23.8% growth in DWP marked its fastest growth in 14 years, mainly due to its homeowners' business segment. Approximately 60.5% of Merced's year-end policies in force and 81.4% of its full-year DWP came from the homeowners' line, all from within California.

***Our expectations for positive sustainable growth are now a reality...  
We are in business for the long haul***

**Merced Property & Casualty Company**



As at end-2017, Merced had assets of \$23.8 million, with liabilities of \$7 million and a policyholder surplus of \$16.8 million. While classified as a small insurance provider, Merced was highly solvent at that time and the financial ratios<sup>97</sup> used by state insurance regulators (from the National Association of Insurance Commissioners' Insurance Regulatory Information System) did not seem to flag out any major concerns.

<sup>96</sup> UHFG had ownership of three additional insurance firms – United Heritage Life Insurance Company, United Heritage Property & Casualty Company, and Sublimity Insurance Company

<sup>97</sup> Include 13 measures of profitability, growth, liquidity and reserve adequacy

**Table 12: Key financial ratios – Merced Property and Casualty Company 2012-2017 (%)**

Key ratio	2017	2016	2015	2014	2013	2012
Expense ratio (*SAP)	53.25	58.68	59.19	58.62	58.10	52.09
Loss & Loss Adjustment Expense Ratio	61.19	46.46	66.42	55.65	45.60	53.09
Combined Ratio (*SAP)	114.44	105.14	125.62	114.27	103.70	105.19
Operating Ratio	100.83	87.02	106.16	91.55	86.66	99.18
Retention Ratio (NPW/GPW)	85.89	85.17	85.86	86.86	85.12	85.13
Return on Equity (ROE)	-1.07	3.24	1.18	4.97	18.42	0.90

Notes: SAP indicates that a ratio is calculated using the Statutory Accounting Principles (SAP); Expense Ratio (SAP) = Other Underwriting Losses / Net Premium Written; Loss & Loss Adjustment Expense Ratio = (Loss Incurred + Loss Adjustment Expenses Incurred) / Net Premium Earned; Combined Ratio (SAP) = Loss & Loss Adjustment Expense Ratio + Expense Ratio (SAP)

Source(s): SNL Insurance, PACICC

### **Impact of the Camp Fire on Merced**

In the early hours of 8 November 2018, a powerline owned by Pacific Gas & Electric Co. caused a massive wildfire known as the “Camp Fire” in Butte County, California. Fuelled by strong winds, dry conditions, and flammable vegetation, the fire within the first six hours engulfed the towns of Concow, Magalia, and Paradise, resulting in extensive damage. Authorities took 17 days to extinguish the Camp Fire. This natural disaster became one of the worst wildfires in history, scorching over 150,000 acres, claiming 86 lives, and destroying 18,793 structures including the entire town of Paradise. Estimated insured losses amounted to \$17 billion.

The devastating impact of Camp Fire resulted in significant financial problems for P&C insurers. Merced was hit hard given the geographical concentration of its insurance portfolio in areas designated by the California Department of Forestry and Fire Protection as “high severity zones”. It is worth noting that the lack of diversity in business and geography was common among smaller regional insurers in California.

In 2016, details of Merced’s homeowners’ insurance composition showed that about 51.9% of its premiums came from properties with low to moderate wildfire risk. However, a substantial portion of 44.3% and 3.8% of their premiums came from properties categorised as having high and extreme risk.

In the aftermath of the Camp Fire, Merced faced substantial losses. Damages in the town of Paradise alone amounted to \$64 million, as Merced was saddled with estimated overall liabilities of \$87 million.

While reinsurance programs softened the blow (potential recovery of \$17 million), available funds were insufficient to cover Merced’s claim obligations. A state examination revealed Merced’s reinsurance coverage required them to cover the initial \$150,000 of any claim, before coverage took effect. This meant that Merced’s assets of \$23 million could have been depleted by only 153 claims. Therefore, the California Department of Insurance determined that Merced lacked the necessary funds to cover its liabilities and attempts to rehabilitate the company were not viable.

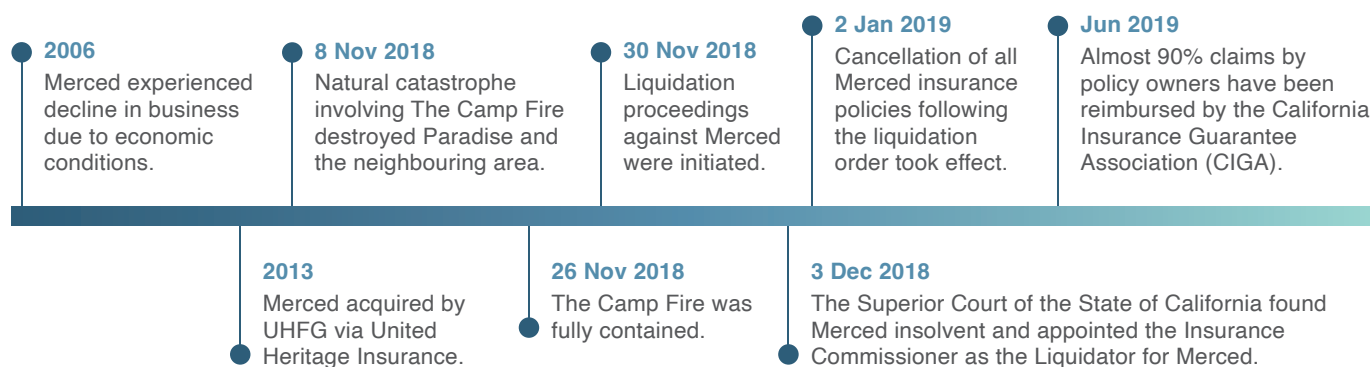
***Small companies tend to have more of their business concentrated in specific areas. That makes it more likely that such a company could be bankrupted by a single catastrophe***

Rex Frazier, President of the Personal Insurance Federation of California

• • •



### Resolution of Merced – Timeline of Key Events



### Insolvency and placement into liquidation

Overwhelmed by claims from policy owners, Merced went from being financially stable to the edge of insolvency within just eight weeks. It was later revealed that Merced had underestimated its exposure to wildfire risks and the potential losses from such events owing to their business concentration in a particular area and arrangements of the reinsurance programme. This was despite having in place risk exposure rules, which were not effectively monitored by the management of Merced.

On 30 November 2018, the California State Insurance Commissioner initiated liquidation proceedings against Merced. Subsequently, on 3 December, the Superior Court of the State of California (the Court) found Merced insolvent and appointed the Insurance Commissioner as the Liquidator<sup>98</sup> as per the Insurance Code. This facilitated liquidation of Merced's assets and recovery for its claimants, creditors, and shareholders.

As a result of the liquidation order, all of Merced's insurance policies were required by law to be cancelled within 30 days from the liquidation date or by 2 January 2019 unless terminated prior to that date by the policy owner. A total of 7,436 cancellation notices were mailed to all known in-force policyholders. The insurance policy claims were covered by the California Insurance Guarantee Association (CIGA) and transferred immediately to CIGA upon the entry of the order of liquidation and finding of insolvency. CIGA was also responsible for reimbursing unearned premiums to insured individuals for coverage extending beyond the cancellation date.

According to CIGA's statute, reimbursements would be provided up to a maximum of \$500,000 per claim. In Merced's case, CIGA formulated the option of treating four different coverages. This enabled policy owners to file four different

claims instead of just a single claim. The four coverage segments included dwelling, structures, contents and additional living expenses. This novel solution led to CIGA covering almost all policy owner's claims, except those which exceeded the \$500,000 cap.

Based on the Statement of Operations by CIGA on 31 March 2019, a total of \$83 million in claims and expenses was estimated to be paid on behalf of the Merced estate. CIGA paid a total of \$3 million in unearned premiums to policy owners and \$66 million in losses, loss adjustment expenses, return premiums and incurred administrative expenses for Merced fire-related claims, as well as other policy claims. Within 7 months after the catastrophic event, CIGA successfully reimbursed 88.5% of total losses sustained by policy owners.



<sup>98</sup> Include (1) David E. Wilson to serve as the Special Deputy Insurance Commissioner in charge of the Merced liquidation and (2) Scott Pearce to serve as Liquidation Manager for Special Deputy Insurance Commissioner Wilson. Liquidation was performed by the Conservation and Liquidation Office, serving the California Insurance Commissioner

## Key takeaways

### The safety net works

The first key lesson offered by Merced's failure is the critical need for safety nets or last resort protection for consumers to preserve the financial security and resilience of affected insurance policy owners. In this case, CIGA stepped in immediately to assume covered policies and proceeded to reimburse almost 90% of total losses suffered by the owners of Merced's insurance policies. Since its establishment in 1969, CIGA has paid out more than \$9 billion in covered claims.<sup>99</sup>

*Losing your insurance should be the last thing on someone's mind after surviving a devastating fire ... This law gives millions of Californians breathing room and hits the pause button on insurance non-renewals while people recover*

Ricardo Lara, California State Insurance Commissioner



### New underestimated risks

The second poignant lesson is the heightened impact of climate change on the solvency risks of insurers, as well as the speed and cost of its failures. It was recognised that Merced was a small player with over-concentration of geographical risks in areas susceptible to natural disasters.<sup>100</sup> Combined with under-reserving, these factors reflect typical root causes of insurer failures.

Nonetheless, the failure of Merced epitomised strategic shifts taking place in the operating environment of insurers. Even with reinsurance coverage, risk modelling and other controls in place, financially stable insurers can be exposed to unexpected extreme scenarios from unmodeled risks, and face a collapse. Other examples include the rehabilitation order for Real Legacy Assurance Co. Inc., which succumbed to losses from Hurricane Irma and Maria in 2017. According to Aon, 2022 saw total economic losses from natural disasters of \$313 billion, with about \$132 billion or 42% covered by insurance. In Asia, flooding events were prominent, accounting for more than 61% of total economic loss.

From the perspective of Insurance Guarantee Schemes or IGS, climate risks lessen the time for intervention preparedness and actions. IGS' are also confronted with higher exposures and funding requirements.

### New undesirable risks

Lastly, during the post-failure phase, effects on market dynamics can continue to reverberate. Following Merced's collapse and the unabating threat of prospective wildfires, property insurance rates went up as coverage in high-risk areas declined and existing policies were not renewed. Subsequently, the public policy response saw California introducing consumer protection legislation to prevent abrupt cancellations of homeowner insurance policies or non-renewals, providing a one-year moratorium. The new law has since been implemented and recently protected the insurance coverage of over 236,000 homeowners, following wildfire emergencies in Northern and Southern California in September 2022. Nevertheless, the introduction of such policies come with balancing trade-offs, given downside risks on the sustainability of insurers that are prevented from repricing risks in evolving market conditions.

<sup>99</sup> CIGA is a not-for-profit organisation funded by assessments of Member Insurers, distributions from the estates of insolvent Member Insurers, and investment income

<sup>100</sup> Besides Merced, it is worth noting other homeowners' insurance companies in California experienced substantial losses from the Camp Fire and relied on reinsurance, e.g. gross losses of Farmers Insurance Group (\$2.1 billion), Allstate Insurance Group (\$1.2 billion) and Mercury General (\$253 million) (YE 2018 financial reports)

## GLOSSARY

<b>Asset Separation</b>	The asset separation tool is used to transfer assets and liabilities of an institution under resolution to a separate asset management vehicle.
<b>Asset Management Vehicle (AMV)</b>	The AMV is wholly or partially owned by one or more public authorities including the resolution authority. It is temporarily created to receive the assets, rights and liabilities of one or more institutions under resolution or from a bridge institution. These are managed by the AMV with a view to maximising their value for an eventual sale, or an orderly gradual wind down if immediate liquidation would be disadvantageous at that point in time.
<b>Bank Run</b>	A rapid and significant withdrawal of deposits from a bank by depositors following a loss of confidence, precipitated by the fear that the bank may fail and that depositors may therefore suffer losses or lose access to funds.
<b>Bankruptcy Trustee</b>	A person licensed to administer bankruptcy estate.
<b>Bail-in</b>	Restructuring mechanisms that enable loss absorption and the recapitalisation of an insurer in resolution or the effective capitalisation of a bridge institution through the cancellation, write-down or termination of equity, debt instruments and other senior or subordinated unsecured liabilities of the insurer in resolution, and the conversion or exchange of all or part of such instruments or liabilities (or claims on the insurer) into or for equity in or other ownership instruments issued by that insurer, a successor (including a bridge institution) or a parent company of that insurer.
<b>Bail-in within Resolution</b>	A mechanism to recapitalise a bank in resolution or effectively capitalise a bridge bank, under specified conditions, through the write-down, conversion or exchange of debt instruments and other senior or subordinated unsecured liabilities of the bank in resolution into / for, equity or other instruments in that bank, the parent company of that bank or a newly formed bridge bank, as appropriate to legal frameworks and market capacity.
<b>Bridge Institution</b>	<p>An entity that is established to temporarily take over and maintain certain assets, liabilities and operations of a failed FI as part of the resolution process.</p> <p>A bridge institution is a temporary institution aimed at receiving a transfer of assets and insurance liabilities from an insurer in resolution, with the intention to transfer the received assets and liabilities to a private sector purchaser at a later stage.</p>
<b>Bail Out</b>	Any transfer of funds from public sources to a failing or failed FI, or a commitment by a public authority to provide funds with a view to sustaining the institution (e.g. by way of guarantees), which results in benefit to the shareholders or uninsured creditors of that FI, or the assumption of risks by the public authority that would otherwise be borne by the FI and its shareholders, where the funds transferred are not recouped from the institution, its unsecured creditors or, if necessary, the financial system more widely, or the national authority is not reimbursed, whether partially or wholly, for the risks assumed.
<b>Capital Adequacy Requirements (CAR)</b>	The adequacy of capital resources relative to regulatory capital requirements.
<b>Challenger Banks</b>	Relatively small retail banks setup with the intention of competing for business with large, long-established national banks.
<b>Claims Provision</b>	Amount set aside on the balance sheet of an insurer to meet the total estimated ultimate cost to settle all claims arising from events which have occurred up to the end of the reporting period, whether reported or not, less amounts already paid in respect of such claims.
<b>Credit Rating</b>	A category or classification that is assigned to an issuer of debt or a debt instrument based on an evaluation of its creditworthiness.
<b>Cross-border Cooperation Arrangements</b>	Specific cooperation agreements, which enable Resolution Authorities or Deposit Insurers to share information and act collectively, to resolve banks located in multiple jurisdictions in a more orderly and less costly manner.
<b>Demutualisation</b>	A process by which a private, member-owned company, such as a co-op, or a mutual life insurance company, legally changes its structure, in order to become a public-traded company owned by shareholders.
<b>Depositor Reimbursement</b>	A Resolution method that involves the reimbursement of Deposits to Insured Depositors.
<b>Digital Banks</b>	Alternative terms for digital banks used by market participants and regulators are virtual banks, internet-only banks, neo banks, challenger banks and fintech banks.
<b>Direct Written Premium</b>	Total amount of an insurer's written premiums without any allowance for premiums ceded to reinsurers.
<b>Due Diligence</b>	An on-site Inspection of the books and records of a failing / failed FI by a potential purchaser, a supervisor, a Resolution Authority, a Deposit Insurer or their agents for a valuation / estimation of assets and liabilities.
<b>Early Intervention</b>	Any actions, including formal corrective action, taken by supervisors, Resolution Authorities or Deposit Insurers in response to weaknesses in a FI prior to entry into Resolution.
<b>Early Warning System</b>	A model that attempts to predict the likelihood of failure or financial distress of FIs over a fixed time horizon, based on a FI's current risk profile.

<b>E-money</b>	An electronic store of monetary value on a technical device that may be widely used for making payments to entities other than the E-money issuer. The device acts as a prepaid bearer instrument which does not necessarily involve bank accounts in transactions.
<b>Ex ante Funding</b>	The regular collection of Premiums, with the aim of accumulating a fund to meet future obligations (e.g. reimbursing depositors) and cover the operational and related costs of the Deposit Insurer.
<b>Ex post Funding</b>	A system in which funds to cover deposit insurance obligations are only collected from surviving FI after failure.
<b>Failing Or Likely To Fail (FOLTF)</b>	FOLTF is a classification used by supervisors from the ECB. It covers aspects of troubled institutions relating to the withdrawal of authorisation, liabilities of the institution exceeding its assets, inability to pay debts as they fall due, or the need for extraordinary financial public support. FOLTF is determined by the ECB after consultation with the SRB. The SRB may also determine that a bank is considered FOLTF, if it has informed the ECB of its intention to do so and the ECB has not reacted within three days.
<b>Financial Assistance</b>	Assistance provided to a Troubled FI by third parties, such as government agencies, Resolution Authorities or Deposit Insurers. This may take various forms, including deposits, loans, guarantees, subsidies, tax allowances, contributions, purchase of assets, subscription of debts, capital injections, or cost-sharing arrangements.
<b>Financial Conglomerate</b>	Two or more legal entities, at least one of which is a banking / insurance legal entity and one a regulated legal entity in the securities or insurance / banking sectors, where one has control over one or more insurance / banking legal entities or one or more regulated legal entities in the securities or insurance or banking sectors and possibly other non-regulated legal entities, whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors (banking, securities, insurance).
<b>Financial Safety Net</b>	A framework that includes the functions of prudential regulation, supervision, Resolution, lender of last resort and Deposit Insurance. In many jurisdictions, a department of government (generally a Ministry of Finance or Treasury responsible for financial sector policy) is included in the financial safety-net.
<b>Going Concern</b>	An approach for considering an institution's financial situation assuming it will continue to operate and that future business will be written.
<b>Initial Public Offering (IPO)</b>	An IPO is the first time a private company issues corporate stock to the public.
<b>Insolvency (Bankruptcy)</b>	A situation in which a FI can no longer meet its financial obligations when due, and / or the value of its assets is less than the total of its liabilities.
<b>Intervention</b>	Any actions, including formal corrective action, taken by supervisors, Resolution Authorities or Deposit Insurers to address concerns that may arise with a FI.
<b>Investment Risk</b>	The risk directly or indirectly associated with or arising from an institution's investment activities.
<b>Least-cost Assessment</b>	A procedure that requires the Resolution Authority to implement the Resolution option, including Liquidation of the failed FI, that is least costly to the Resolution Authority, the financial system or the Deposit Insurance System.
<b>Lender of Last Resort</b>	Banks typically turn to their lender of last resort when they cannot get the funding they need for their daily business. This can happen in periods of financial turmoil, when banks may have doubts about lending to each other and lots of people may suddenly want to withdraw their money from their bank account. In situations like that, central banks act as the lender of last resort. Central banks have traditionally held this role because they are primarily the ones responsible for ensuring that financial markets function smoothly and the financial system is stable.
<b>Liquidation</b>	<p>The Winding-Down (or Winding-Up, as used in some jurisdictions) of the business affairs and operations of a failed FI through the orderly disposition of its assets after its licence has been revoked and it has been placed in Receivership. In most jurisdictions, it is synonymous with "Receivership".</p> <p>A process to terminate operations and corporate existence of the entity through which the remaining assets of the insurer will be distributed to its creditors and shareholders according to the liquidation claims hierarchy. Branches can also be put into liquidation, separately from the insurance legal entity they belong to.</p>
<b>Liquidity Assistance</b>	Additional funding arrangements to supplement the deposit insurance funds in situations where the cumulated funds are insufficient to meet the needs of intervention and failure resolution, including depositor reimbursement.
<b>Loss-sharing Agreement</b>	An agreement in a financial transaction, in which the Resolution Authority or the Liquidator agrees to share with the acquirer losses on certain types of loans. Loss-sharing may be offered in connection with the sale of classified or non-performing loans that otherwise might not be sold to an acquirer at the time of Resolution.
<b>Market Risk</b>	The risk of adverse change in the value of capital resources due to unexpected changes in the level or volatility of market prices of assets and liabilities.



<b>Memorandum of Understanding</b>	A memorandum of understanding (MoU) is an agreement between two parties that is not legally binding, but which outlines the responsibilities of each of the parties to the agreement.
<b>Minimum CAR</b>	In the context of a legal entity's capital adequacy assessment, the level of solvency at which, if breached, the supervisor would invoke its strongest actions, in the absence of appropriate corrective action by the FI.
<b>Moral Hazard</b>	Arises when parties have incentives to accept more risk because the costs that arise from such risk are borne, in whole or in part, by others.
<b>Nationalisation</b>	Transferring the ownership or control of one or more banks from the shareholders to the government.
<b>Neo-Banks</b>	Banks that make extensive use of technology (eg API, big data, artificial intelligence, blockchain) in order to offer retail banking services predominantly through smartphone apps and internet-based platforms.
<b>No Creditor Worse Off than in Liquidation</b>	Principle that requires that, in a resolution action other than a liquidation, creditors should be entitled to compensation if they receive less than they would have received if the insurer was liquidated.
<b>Open Bank Assistance</b>	A Resolution method taken by the Resolution Authority, in which a Bank in danger of failing receives assistance in the form of a direct loan, an assisted merger, a purchase of assets, or other means.
<b>Portfolio Transfer</b>	Transfer of one or more policies together with, when relevant, the assets backing those liabilities.
<b>Private Placement</b>	A private placement is a sale of stock shares or bonds to pre-selected investors and institutions rather than on the open market.
<b>Public Awareness</b>	A comprehensive programme designed to disseminate information to the public regarding the benefits and limitations of a Deposit Insurance System, including how and when depositors can gain access to their funds in the event of a Bank failure.
<b>Public Interest Assessment</b>	A policy used by the SRB to examine whether the resolution of a particular bank that is failing or likely to fail (FOLTF) would be necessary, for example to ensure one or more of the following objectives: maintaining financial stability, protecting covered depositors, and safeguarding public funds by minimising reliance on extraordinary public financial support.
<b>Purchase and Assumption Transaction (P&amp;A)</b>	A Resolution method in which a healthy Bank or a group of investors assume some or all of the obligations, and purchase some or all of the assets of the failed Bank.
<b>Recovery Plan</b>	A plan to guide the recovery of a distressed FI. In the recovery phase, the FI has not yet met the conditions for resolution or entered the resolution regime. There should be a reasonable prospect of recovery if appropriate recovery measures are taken. The recovery plan should include measures to reduce the risk profile of an entity and conserve capital, as well as strategic options such as the divestiture of business lines and restructuring of liabilities.
	A plan developed by an insurer that identifies in advance options to restore its financial condition and viability under severe stress.
<b>Regulatory Capital</b>	Surplus of assets over liabilities, evaluated in accordance with regulation in a particular jurisdiction.
<b>Regulatory Capital Requirements</b>	Financial requirements that are set as part of the solvency regime and relates to the determination of amounts of capital that an insurer must have in addition to its technical provisions and other liabilities.
<b>Reinsurer</b>	An insurer that assumes the risks of a ceding insurer in exchange for a premium.
<b>Resolution</b>	A disposition plan and process for a non-viable FI. Resolution may include: Liquidation and depositor reimbursement; transfer and / or sale of assets and liabilities; establishment of a temporary bridge institution; and write-down or conversion of debt to equity. Resolution may also include the application of procedures under Insolvency law to parts of an entity in Resolution, in conjunction with the exercise of Resolution Powers.
	Actions taken by a resolution authority towards an insurer that is no longer viable, or is likely to be no longer viable, and has no reasonable prospect of returning to viability.
<b>Resolution Authority</b>	A public authority that, either alone or together with other authorities, is responsible for the Resolution of FIs established in its jurisdiction (including resolution planning functions).
	A person that is authorised by law to exercise resolution powers over insurers. This term is used when it involves resolution powers and / or processes after resolution has been instituted. Depending on the jurisdiction, this term may include supervisors, other governmental entities or private persons (including administrators, receivers, trustees, conservators, liquidators, or other officers) or courts authorised by law to exercise resolution powers.
<b>Resolution Funding</b>	Financing that can be used to support the use of resolution powers and achieve the resolution objectives.

<b>Resolution Plan</b>	<p>A plan intended to facilitate the effective use of Resolution Powers by the Resolution Authority, with the aim of making feasible the resolution of any FI without severe systemic disruption and exposure of taxpayers to loss while protecting systemically important functions. It serves as a guide to the authorities for achieving an orderly Resolution, in the event that recovery measures are not feasible or have proven ineffective.</p> <p>A plan that identifies in advance options for resolving all or part(s) of an insurer to maximise the likelihood of an orderly resolution, the development of which is led by the supervisor and / or resolution authority in consultation with the insurer in advance of any circumstances warranting resolution.</p>
<b>Resolution Powers</b>	Powers available to Resolution Authorities under legal frameworks for the purposes of Resolution, and exercisable without the consent of shareholders, creditors, debtors or the entity in resolution.
<b>Resolution Regime</b>	The elements of the legal framework and the policies for planning, preparing for, carrying out and coordinating a Resolution, including the application of Resolution Powers.
<b>Risk Management</b>	The process through which risks are managed allowing all risks of an institution to be identified, assessed, monitored, mitigated (as needed) and reported on a timely and comprehensive basis.
<b>Risk Profile</b>	Point in time assessment of an institution's gross and, as appropriate, net risk exposures aggregated within and across each relevant risk category based on forward looking assumptions.
<b>Run-off</b>	A process under which an insurer ceases to write new business and administers existing contractual obligations. A 'solvent run-off' is the process initiated for an insurer who is still able to pay debts to its creditors when the debts fall due. An 'insolvent run-off' is the process initiated for an insurer who is no longer able to pay debts to its creditors when the debts fall due.
<b>Sale of Business Tool</b>	The sale of business tool enables the Resolution Authority to transfer the institution (or part of its business activities) to a third party without the consent of shareholders.
<b>Solvency</b>	Financial soundness of an institution including the ability to meet its obligations to depositors when they fall due. Solvency includes capital adequacy, liquidity, technical provisions, and other aspects addressed in an enterprise risk management framework.
<b>Solvency Margin</b>	Surplus of assets over liabilities. (Because these terms are frequently used in an imprecise manner, the glossary refers to available solvency (margin) or available surplus capital and required solvency margin or required surplus.)
<b>State Aid</b>	An advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities.
<b>Stress Testing</b>	<p>A range of simulation techniques used to assess the vulnerability of a FI's financial position under different scenarios, such as major changes to the macroeconomic environment, or exceptional but plausible events.</p> <p>A method of assessment that measures the financial impact of stressing one or more factors which could severely affect the insurer.</p>
<b>Systemic Risk</b>	A risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy.
<b>Technical Provisions</b>	The amount that an insurer sets aside to fulfil its insurance obligations and settle all commitments to policyholders and other beneficiaries arising over the lifetime of the portfolio, including the expenses of administering the policies, reinsurance and of the capital required to cover the remaining risks.
<b>Temporary Capital Placement (TCP)</b>	An option for the resolution method of handling banks that are experiencing solvency problems, namely through capital injections in the bank until the bank fulfills the provisions on solvability and liquidity levels.
<b>Troubled FI</b>	An FI that has, or will have, impaired liquidity or solvency unless there is a major improvement in its financial resources, risk profile, strategic business direction, risk management capabilities and / or quality of management.
<b>Underwriting Risk</b>	The risk that is part of insurance risk other than claim reserve risk.
<b>Virtual Data Room</b>	A secure online repository for document storage and distribution typically used during the due diligence process preceding a merger or acquisition to review, share, and disclose company documentation.
<b>Wind Down</b>	A process to cease a firm's regulated activities and achieve cancellation of permission with minimal impact on its clients, counterparties or the wider markets.
<b>Winding Up</b>	The final phase in the dissolution of a failed FI, in which assets are liquidated and creditors' claims are settled.

Sources: Bank for International Settlements, European Central Bank, European Commission, Financial Stability Board, Financial Stability Institute, Indonesia Deposit Insurance Corporation, International Association of Deposit Insurers, International Association of Insurance Supervisors, International Monetary Fund, UK Financial Conduct Authority, World Bank.

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