From Bail-Outs to Bail-Ins: Risks and Ramifications

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1 Introduction by Dr Brian Lucey

The era of bondholder bailouts is ending and that of depositor bail-ins is coming.

The changing financial landscape post crisis poses challenges to savers and investors in Ireland and globally. With over €152 billion in deposits in Irish banks and over €80 billion in Irish pension funds, it is important we consider how the national savings pool can be protected.

Bail-ins are a risk in the coming years and yet there is a lack of appreciation of this risk as there was a lack of appreciation of the risks posed by the Irish property bubble and the global debt crisis.

This research note is therefore timely and welcome as there is a lack of research regarding bail-ins and the ramifications thereof.

It will take a number of years for the final configuration of the new financial order to become clear. This means that there are difficulties inherent in selecting appropriate investments when the ultimate outcome is unclear. Apart from that, what we do know at present is that there are straws in the wind that should concern savers.

The era of bondholder bailouts is ending and that of depositor bail-ins is coming

The approach taken with failing banks in Europe, to in one form or another socialise the debts across taxpayers created a so called doom loop. As the banks got weaker more and more of their debts were passed to already strained sovereign treasuries, weakening them and making it more difficult for them to intervene early in stressed banks. The realisation that, with banks which were multiples in size of the sovereign regulating them, this could not go on was slow to emerge but it has now done so.

In an as yet to be determined but medium term future, banks which face losses will have to act in an avowedly capitalistic manner. First reserves and equity, then senior, then junior debt will be used as the risk capital in order to fill these debt holes. What is new is that if losses continue, after burning through this capital, rather than the state, it is depositors who will be in play.

Beyond that we see other threats to the stability and profitability of the banking system. The EU has launched a consultative process on the sustainability of the present financial system and has concluded in early work that a much more hybrid system, merging the bank based continental system and the Anglo Saxon market scheme, is needed. Combined with the inevitability of inflation (even the desirability of same in so far as it entails in its early stages a recovered economy), these suggest that savers will face a complex and perhaps lower return environment in the medium term.

In that context a move to increased allocation of savings to alternative investments, including a prudent allocation of some 5% to 10% to precious metals, is a sensible policy. This research note is very useful in pulling together some of these strands and others and should be required reading for savers internationally and for medium and long term investors.

Dr Brian Lucey is Professor of Finance at the School of Business at Trinity College Dublin. He studied at graduate level in Canada, Ireland and Scotland, and holds a PhD from the University of Stirling. His research interests include international asset market integration and contagion; financial market efficiency, particularly as measured by calendar anomalies and the psychology of economics. His research on gold has established that gold is important as a long term diversification due to gold's "unique properties as simultaneously a hedge instrument and a safe haven."

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2 Executive Summary

'From Bail-Outs to Bail-Ins: Risks and Ramifications' is a research document about one of the most important risks facing investors and savers today - bank and financial institution bail-ins.

The "bail-in" in Cyprus was a financial rubicon and the investment and savings landscape has fundamentally changed

Preparations have been or are being put in place by the international monetary and financial authorities for bail-ins. The majority of the public are unaware of these developments, the risks and the ramifications.

In March 2013, the EU and IMF spearheaded the restructuring of the troubled Cypriot banking sector. Although the terminology of bank 'bail-ins' first entered public consciousness during the Cypriot financial crisis of March 2013, the idea of bail-ins as a central bank rescue mechanism has been openly discussed for a number of years amongst international central bank policymakers.

Cyprus became the defining event since it revealed the preparations and planning of international banking regulators and governments at the highest levels for the coming 'Bail-In Regime'.

The market's expectation was that Cyprus would be similar to previous Eurozone rescue packages applied to economies such as Greece, Ireland and Spain, where banks had their losses 'bailed-out' by governments, with the bail-out cost and risk transferred to the sovereign nation and funded by the taxpayer.

However, the backlash from taxpayers and certain political parties and a vicious circle of sovereign bank-induced debt was leading to recessions and the possibility of an economic depression. This may have contributed to the international monetary authorities, central banks and governments altering the approach to burden sharing, pushing the losses onto bank depositors.

The important shift from bail-out to bail-in had not been signalled in a very public way. The market's expectation was therefore confounded when Eurozone finance ministers imposed a financial package on Cyprus. This forced bondholders to convert into shareholders, and critically, imposed an element of bank deposit confiscation and the forced conversion of these deposits into bank equity.

Never before in the public's perception had bank deposits been countenanced as potential financing sources for the rescue of insolvent banks. The public was shocked by the freezing and confiscation of deposits and the use of them in a desperate attempt to prevent banks from failing.

Almost overnight, the sacrosanctity of bank deposits was shattered

While bail-in generally refers to a bank restructuring where shareholders and various unsecured creditors such as bondholders are forced to share the rescue costs, after Cyprus, the term 'bail-in' became synonymous with possible deposit confiscation, where uninsured depositors were seen as unsecured creditors of the bank and liable to share bank restructuring costs.

The coming bail-ins regimes will pose real challenges and risks to investors and of course depositors - both household and corporate. Return of capital, rather than return on capital will assume far greater importance.

Evaluating counterparty risk and only using the safest banks, investment providers and financial institutions will become essential in order to protect and grow capital and wealth.

Retail investors, retail savers, high net worth individuals, family offices, pension funds, charities, companies, corporations, corporate treasurers, financial advisors, accountants and anyone who manages money on behalf of clients need to consider the risks and ramifications of bail-ins.

Many in the financial services sector have paid lip service to diversification in recent years. This has led to many investors experiencing sub par returns and returns below the market rate of return. Those who have achieved real diversification involving owning international equities, high credit bonds, property, cash and gold have been protected from the recent volatility. They have protected and grown their wealth.

If there is a failure to observe the fundamental tenet of investing in the coming years – real diversification – we may be subject to further financial pain.

Conservative wealth management, asset diversification and wealth preservation will again become important and gold will again have an important role to play in order to protect, preserve and grow wealth in the coming bail-in era.

3 What Are Bail-Ins?

A bail-in is when regulators or governments have statutory powers to restructure the liabilities of a distressed financial institution and impose losses on both bondholders and depositors.

Simply stated, a bank bail-in is an attempt to resolve and restructure a bank as a going concern, by creating additional bank capital (recapitalisation) via forced conversion of the bank's creditors' claims (potentially bonds and deposits) into newly created share capital (common shares of the bank).

The bail-in is undertaken by a regulatory authority that is vested with powers to execute a previously agreed bail-in plan in a very short space of time, possibly over a weekend, so as to keep the bank functioning, and to preserve financial stability as far as possible.

To understand what the bail-in concept of a troubled bank is, it is important to understand what a bank balance sheet is, and what the balance sheet consists of. Simply put, a bank's balance sheet consists of sources of financing and uses of this financing. At a high level, the sources are shareholders' equity (shares) and the bank's liabilities, which consist of lending to the bank by bondholders (bonds) and lending to the bank by depositors (deposits).

The shareholders are the bank's owners, while the bondholders and depositors are the bank's creditors. These components constitute the bank's capital, and in total are known as its capital structure. The bank then lends out and invests its liabilities and refers to them as assets.

A bail-in is when regulators or governments have statutory powers to restructure the liabilities of a distressed financial institution and impose losses on both bondholders and depositors

Previously, during bank bail-outs, when a bank was failing and the government stepped in, the losses were absorbed by the sovereign states and the risk was transferred to the taxpayer. In a bail-in, during the resolution of the problematic bank, the risk is pushed back to the bank's shareholders and creditors.

In a bank's capital structure, the various sources of financing exist in a hierarchy of claims. This is both a hierarchy for repayment when the bank is a going concern, and also in liquidation. Debt resides at the top of the hierarchy for repayment, since bondholders get repaid ahead of equity holders. In a liquidation, the company's assets are sold and proceeds are paid to senior creditors, subordinated creditors, and then shareholders, in that specific order. If senior creditors take a hit, subordinated creditors get nothing, nor do shareholders, who get wiped out. If subordinated creditors take a hit, shareholders are wiped out.

There is normally a stratum of seniority within debt holders, for example, from top to bottom, running from super senior debt, to senior debt, to subordinated debt, then to junior debt. Senior debt can include secured and unsecured bonds, depositors, and in some cases wholesale money market borrowing. Secured bonds are 'backed' by specific assets or collateral and rank higher in the repayment hierarchy than unsecured bonds. Below debt in the hierarchy sits equity, such as preferred equity, and at the bottom, common equity (shares).

In a direct bail-in regime, as proposed by the Financial Stability Board and associated monetary authorities, there is also a hierarchy of first to be bailed-in (converted to bank shares), but it differs from the liquidation creditor hierarchy since in a bail-in, shareholders do not get wiped out, they get diluted. The more the bank's assets are impaired, the more categories of bank liabilities get converted to shares.

This impacts the shareholders since their shareholdings become diluted as entities who were previously creditors become shareholders. So a bail-in differs from a liquidation in that although creditors take a loss, existing shareholders survive but own less of the overall share capital.

In Cyprus, bondholders (including senior bond holders) and depositors over €100,000 were bailed-in. Their money was seized, and in return they were given shares in the problematic banks, thereby becoming shareholders of these struggling banks.

Usually, only bonds with a conversion option, called convertible bonds, ever have the potential for getting converted into equity. However, there is another class of convertible bonds called contingent convertible bonds that can be converted into equity depending on particular outcomes or scenarios.

Given that the bail-in regime can force bondholders and depositors to be converted into shareholders, a new thinking is evolving in which unsecured bonds and bank deposits should now be viewed as contingent capital.

This is really the crux of the Cyprus template as proposed by international monetary authorities , i.e. that depositors internationally now have to think of their uninsured deposits as liable to potentially being confiscated and transformed into bank shares.

Bank depositors have traditionally viewed their bank deposits as 100% secure, with an inalienable right to have their deposits returned in full. However, this has never been the case in legal terms. A bank depositor is just an unsecured creditor of the bank. [1]

In other words, the depositor is a lender who has loaned their deposit to the bank. If the bank became insolvent, depositors would have to line up with the other creditors in the hierarchy of claims and wait to see if their money was returned

In light of the above hierarchy and the essential unsecured creditor nature of bank deposits, it's useful to look at some formal definitions of bail-ins as applied to Systematically Important Financial Institutions (SIFIs).

A 2012 IMF Staff Paper defined a bail-in as:

A statutory power to restructure the liabilities of a distressed SIFI by converting and/or writing down unsecured debt on a "going concern basis." In bail-in, the concerned SIFI remains open and its existence as an on-going legal entity is maintained. The idea is to eliminate insolvency risk by restoring a distressed financial institution to viability through the restructuring of its liabilities and without having to inject public funds....The aim is to have a private-sector solution as an alternative to government-funded rescues of SIFIs [2]

The Systematically Important Financial Institution concept is similar to the Too Big To Fail (TBTF) doctrine which was used to bail-out a number of large international banks during the financial crisis in 2008. The 'TBTF' concept maintains that when a financial institution is so big and interconnected into an economy that if it failed it would be disastrous to that economy, then it has to be supported by the relevant government or authority.

In October 2012, in a speech to the International Association of Depositor Insurers (IADI) annual conference, Paul Tucker, a deputy governor of the Bank of England, explained the central bank view on bail-ins:

> "The central principle running through this whole endeavour is that after equity is exhausted, losses should fall next on uninsured debt holders, in the order they would take losses in a standard bankruptcy or liquidation process. Although all resolution strategies have that effect, it is the particular focus of what has come to be called 'bail-in'. I should perhaps say that bail-in isn't about identifying a special type of bond that can be written down or converted. 'Bail-in' is a verb not a noun. It's about giving the authorities the tools, the powers, to affect a restructuring of the capital and liabilities of a bank that isn't toxic all the way through

For large institutions, there are two main approaches to a bail-in, the first being 'single point of entry resolution' where the bail-in occurs in the holding company at the top of the group, and the second being 'multiple point of entry resolution' where, given that a banking group may be operating across lots of regions and jurisdictions, the national authorities will coordinate parallel bail-ins for parts of the banking group.

1. *In the same way that an unallocated gold account holder at an LBMA bullion bank is just an unsecured creditor of that bank.*
2. *http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf*

4 Cyprus - The First EU Bail-In

In the latter half of the 20th century and early years of the 21st century, Cyprus was one of many countries that had increasingly allowed an oversized banking system to develop relative to the size of its economy.

Before its financial crisis, the country's banking sector loan to GDP ratio had reached over 800%. Today, the UK's total debt to GDP ratio, for household, government, non-financial and largest of all financial, is over 800%.

The balance sheets of banks in Cyprus had grown unchecked, fuelled primarily by large, mostly offshore deposits (the banks' liabilities), which in turn had to be lent and invested (becoming the banks' assets). When Cypriot banks' assets became distressed on souring property loans and deteriorating Greek bond investments, the banking sector found itself in danger of collapsing, or as the Central Bank of Cyprus described it, 'disorderly bankruptcy.'

As a Eurozone common currency member, fellow Eurozone members could not allow Cyprus to collapse as it could have triggered an exit from the single currency.

> This could have potentially led to contagion and the domino effect of other countries reverting to their national currencies and the end of the euro as we know it today

Therefore, Cyprus was forced to officially ask the Eurozone System to rescue its two largest banks, Bank of Cyprus, and Cyprus Popular Bank, also known as Laiki Bank. However, Cypriot banks had relied heavily on depositors to fund their liabilities, and the reach of the restructuring went beyond just bondholders taking a hit.

Shockingly, on the evening of Saturday 16th March 2013, international negotiators comprising the European Commission, European Central Bank and the International Monetary Fund, revealed a €10 billion rescue programme that included a one off tax levy of 9.9% on all Cypriot bank deposits over €100,000, and a 6.7% levy on all deposits under €100,000. This deposit confiscation, disguised as a tax or levy, would have affected all depositors in both institutions.

The terms of the plan had been agreed and endorsed by the 17 Eurozone finance ministers at a meeting that day in Brussels.

Although accepted by the Cypriot President Nicos Anastasiades, the Cypriot Parliament convincingly rejected this first version of the bail-in deal on 19th March due to the severe impact it would have had on smaller depositors and on the Cypriot economy.

On the 25th March, a revised plan was agreed by Eurozone finance ministers, structured in such a way as to circumvent Cypriot parliamentary obstacles. This revised plan called for the closure and conversion of the country's second largest bank, Laiki Bank, into a 'bad bank'. Laiki's insured deposits, under €100,000, would be transferred to the largest bank, the Bank of Cyprus. Laiki's uninsured deposits (over €100,000) would be retained within the 'bad bank' with the loss suffered being dependent on the outcome of the receivership process. Meanwhile, uninsured depositors at Bank of Cyprus would have a haircut imposed on all deposits above €100,000.

Therefore, deposits above €100,000 were essentially frozen at both banks and used to contribute to the rescue. It is thought that of the €5.6 billion that Cyprus was expected to contribute to the rescue, €4.2 billion would come from deposits,[3] and up to 40% of deposits would be converted into bank shares, in other words a form of deposit confiscation.

> In lieu, depositors in both banks would be forced to take low value or near to worthless, very high risk bank shares

This all occurred in an environment where capital controls, which remain in place and are set to continue until late 2014 according to the Central Bank of Cyprus, were imposed on the Cypriot economy to prevent excessive bank withdrawals and capital flight.

3. *http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/136487.pdf*

5 The New Bail-In 'Template' After Cyprus

While the shock of the Cypriot bail-in was still being digested around the world, a further bombshell was released on 25th March 2013. On that day, President of the Eurogroup of Finance Ministers and the Finance Minister of the Netherlands, Jeroen Dijsselbloem, revealed that the Cyprus rescue would in future be used as a template for similar European bank rescues to substantially replace government led bail-outs such as the EU's €500 billion direct bank recapitalisation rescue fund, the European Stability Mechanism.

Dijsselbloem commented and said that: "We should aim at a situation where we will never need to even consider direct recapitalisation….If we have even more instruments in terms of bail-in and how far we can go on bail-in, the need for direct recap will become smaller and smaller….I think the approach needs to be, let's deal with the banks within the banks first, before looking at public money or any other instrument coming from the public side. Banks should basically be able to save themselves, or at least restructure or recapitalise themselves as far as possible. [4]

Now we're going down the bail-in track and I'm pretty confident that the markets will see this as a sensible, very concentrated and direct approach instead of a more general approach."

> It will force all financial institutions, as well as investors, to think about the risks they are taking on because they will now have to realise that it may also hurt them. The risks might come towards them

President of the Eurogroup of Finance Ministers and the Finance Minister of the Netherlands, Jeroen Dijsselbloem

As Dijsselbloem's comments caused further consternation amongst depositors and financial markets when released, he and others tried various attempts to backtrack and contradict the Cyprus 'template'. When these proved unsuccessful, the European Commission released a statement the following day confirming that uninsured depositors, over €100,000 were a valid target for future bail-ins:

"At no point is it possible to bail-in depositors under 100,000 euros, either now nor in the future…..In the Commission's proposal, which is under discussion, it is not excluded that deposits over 100,000 euros could be instruments eligible for bail-in. It is a possibility." [5]

During the first phase of the Cypriot bail-in negotiations, while the EU was attempting to confiscate banks' insured deposits, German Finance Minister Wolfgang Schäuble went on record stating that insured deposits would be bailed-in in Cyprus because the Cypriot government was insolvent and therefore unable to cover their deposit insurance obligations.

> The media falsely created the impression that deposits are not safe in other countries ... They are safe, though only on the proviso that the states are solvent

German Finance Minister Wolfgang Schäuble

Although Schäuble implied that insured deposits in all other European States were safe, this assumption was, he said, "only on the proviso that the (other) States are solvent".[6] So, via this one-off statement, Schäuble effectively undermined the entire concept of European deposit insurance, and revealed that EU Deposit Guarantee Schemes are only as good as a Member State's solvency.

Therefore, where a Member State in question becomes insolvent, or cannot for other reasons obtain external (European) funding for its national Deposit Guarantee Scheme, then its insured deposits would likely be subject to bail-in.

4. *http://uk.reuters.com/article/2013/03/25/uk-eurogroup-cyprus-dijsselbloem-idUKBRE92O0IL20130325*

5. *http://www.reuters.com/article/2013/03/26/eurozone-deposits-idUSB5N0BM02B20130326*

6. *German Finance Minister, Wolfgang Schäuble, Deutschland Radio, 19th March 2013 http://www.bloomberg.com/news/2013-03-19/cyprus-bank-levy-threatens-european-plan-for-deposit-guarantees.html*

6 Who Is Driving The Bail-In Regime?

It is revealing to examine the genesis and evolution of the centrally planned bail-in regime as discussed by central banks and international policymakers, since it highlights that the planning and preparation for a global bank "Bail-In Regime" has been on-going internationally at a high level for a number of years now, primarily under the auspices of the Financial Stability Board (FSB).

The Financial Stability Board emerged from the Financial Stability Forum (FSF), which was a group of finance ministries, central bankers and international financial bodies, founded in 1999 after discussions among Finance Ministers and Central Bank Governors of the G7 countries. The FSF facilitated discussion and co-operation on supervision and surveillance of financial institutions, transactions and events. The FSF was managed by a small secretariat housed at the Bank for International Settlements in Basel, Switzerland.

The FSB was officially founded at a Group of Twenty Finance Ministers and Central Bankers (G20) meeting in London in April 2009. The FSB coordinates national and supra-national regulatory and supervisory bodies on financial sector stability.

> The FSB's first chairman was Mario Draghi, current President of the European Central Bank, while its current chairman is Mark Carney, Governor of the Bank of England [7]

Mario Draghi, President of ECB & Mark Carney, Governor of the BoE

FSB members now include monetary authorities and security market regulators from the US, the UK, Canada, Australia, France, Italy, the Netherlands, Germany, Switzerland, Japan, Hong Kong, Singapore, Brazil, Russia, India, China and South Africa, as well as the European Commission, IMF, OECD, World Bank, and the Bank for International Settlements (BIS).

7. *Not to be confused with the Group of Thirty. Both Draghi and Carney are members of the private central banker's organisation called the Group of Thirty (G30), which was founded in 1978 at the behest of the Rockefeller Foundation.*

The Key Attributes Of A Bail-In Regime

In October 2011, the Financial Stability Board (FSB) published a seminal report on the bail-in regime titled "Key Attributes of Effective Resolution Regimes for Financial Institutions". [8]

This report set out a high-level framework for responding to and resolving failures at banks and other financial institutions, and was officially endorsed by the G20 at a summit in Cannes in November 2011 "as the international standard for resolution regime".

The intent is to "allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of their vital economic functions". Essentially this means addressing the funding of firms in resolution, as well as recovery and resolution planning.

The Key Attributes include a number of noteworthy pronouncements on an effective resolution regime such as:

- *Allocating losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims.*
- *Not relying on public solvency support and not creating an expectation that such support will be available.*
- *Where covered by schemes and arrangements, protecting depositors that are covered by such schemes and arrangements, and ensuring the rapid return of segregated client assets.*

> The inclusion of Financial Market Infrastructures means that large parts of the global financial system is susceptible to bail-in and could potentially be bailed-in

The scope of this planned bail-in regime for participating countries is not just limited to large domestic banks. In addition to these "systemically significant or critical" financial institutions, the scope also applies to two further categories of institutions, a) Global SIFIs, in other words, cross-border banks which happen to be incorporated domestically in a country that is implementing the bail-in regime, and b) "Financial Market Infrastructures (FMIs)", such as clearing houses.

The inclusion of Financial Market Infrastructures in potential bail-ins is in itself a major departure.

The FSB defines these market infrastructures to include multilateral securities and derivatives clearing and settlement systems, and a whole host of exchange and transaction systems, such as payment systems, central securities depositories, and trade depositories. This would mean that an unsecured creditor claim to, for example, a clearing house institution, or to a stock exchange, could in theory be affected if such an institution needed to be bailed-in.

As Paul Tucker phrased it at the IADI conference:
"resolution isn't just about banks, and so we are planning to elaborate on how the Key Attributes should be applied to, for example, central counterparties, insurers, and the client assets held by prime brokers, custodians and others."

The inclusion of Financial Market Infrastructures means that large parts of the global financial system is susceptible to bail-in and could potentially be bailed-in.

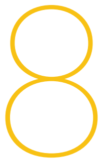
According to the FSB report, the implementation of the bail-ins should be undertaken by a resolution authority in each country with statutory resolution powers to enforce bail-ins.

These powers would include powers to:

- *Override rights of shareholders of the firm in resolution.*
- *Transfer or sell assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares to a solvent third party.*
- *Carry out bail-in within resolution.*
- *Impose a moratorium with a suspension of payments to unsecured creditors.*
- *Effect the closure and orderly wind down (liquidation) of the whole or part of a failing firm with timely payout or transfer of insured deposits.*

Following on from the release of the FSB Key Attributes report in 2011, it became apparent that national monetary authorities and regulators had been actively working for some time on national bail-in preparedness and their own versions of the Key Attributes.

7. *http://www.financialstabilityboard.org/publications/r_111104cc.pdf*



Bail-Ins in the European Union

The European Union is implementing the Financial Stability Board's (FSB) Key Attribute bail-in recommendations through coordinated EU legislation that will be based on a Resolution and Recovery Directive (RRD). [9]

The European RRD was proposed by the European Commission and agreed as a common position by EU finance ministers at a meeting in Luxembourg in June 2013. [10]

At this meeting, various EU member countries had differing views on the extent to which bail-ins should occur before the state should step in and help troubled financial institutions. Some countries such as Germany, the Netherlands and Denmark pushed for strong bail-in rules with less state intervention. For example, Denmark was seen to be less in favour of state support as this would help protect the country's AAA sovereign credit rating. [11]

Other countries such as France and Sweden pushed for more national flexibility for the state to intervene and more extensive use of the EU's European Stability Mechanism.

> Ultimately, a compromise was reached where a bank's shareholders, bondholders, and depositors (in that order) must absorb minimum losses of 8%

In addition, a country's Resolution Fund must pay out 5% of the bank's losses, before the state would be allowed to step in.[12] Resolution Funds must represent at least 0.8% of covered deposits of a country's deposit-taking institutions.

However, the compromise still left each country with flexibility to decide when it might help in a bank rescue. The European Stability Mechanism will still play a role by injecting capital directly into banks, but only after unsecured creditors have taken a hit. The bail-in rules are seen to be primarily for large banks and the EU will still be able to nationalise banks.

The Resolution and Recovery Directive is seen as a precursor to a more advanced European Commission initiative called the European "Single Resolution Mechanism" which is planned to be a standard European approach to implementing bail-ins in the EU. (see Appendix)

9. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0280:FIN:EN:HTML
10. http://www.reuters.com/article/2013/06/27/us-eu-banks-idUSBRE95Q02L20130627
11. http://www.bloomberg.com/news/2013-06-27/denmark-commits-to-toughest-bail-ins-as-eu-deal-readings-vary.html
12. http://www.spiegel.de/international/business/eu-deal-would-require-bail-ins-in-future-bank-rescue-plans-a-908175.html

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9 Bail-Ins In The UK and U.S.

In December 2012 the Bank of England and the U.S. Federal Deposit Insurance Corporation (FDIC) produced a joint paper on "Resolving Globally Active, Systemically Important, Financial Institutions"

This important and little reported upon document explained the need for a single national resolution authority and claimed that the bail-in regime is a reaction to the financial crisis that began in 2007 and the lessons learned from bail-outs. [13]

The U.S. resolution strategy is based on powers stemming from the Dodd-Frank Wall Street Reform Act of 2010 which would "assign losses to shareholders and unsecured creditors", while the UK approach draws its powers from the UK Banking Act of 2009 and would involve "the bail-in (write-down or conversion) of creditors".

Andrew Gracie is Director of the Special Resolution Unit in the Bank of England and is the man who will be in charge of dismantling insolvent British banks and enforcing bail-ins. The Special Resolution Unit was created in February 2009. Reporting to Paul Tucker, it develops and co-ordinates the Bank's response to the resolution of individual institutions, using the powers of the Banking Act 2009, and undertakes analysis to enhance the resolution regime going forward. [14]

Gracie said, "Bail-in, like other resolution tools, involves some interference with property rights. But safeguards will apply which will ensure that no creditor is left worse off than they would have fared in a counterfactual insolvency. In keeping with that, it is important that bail-in follows the creditor hierarchy, secured claims are protected and netting arrangements are respected. And bail-in, like the other resolution tools, can only be used when it is necessary to do so in pursuit of clearly defined public interest objectives.

The Bank of England, alongside other domestic and international authorities, has been working to ensure that bail-in's can be implemented effectively. Applying it will involve overcoming legal, operational and financial challenges. But these challenges are surmountable and are being addressed — through legislation, through cross-border dialogue and resolution planning, and through changes to market practice." [15]

13. *http://www.bankofengland.co.uk/publications/documents/news/2012/nr156.pdf*

14. *http://www.bankofengland.co.uk/about/Pages/structure/default.aspx*

15. *http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech600.pdf*

10 Bail-Ins in Australia

Australia, as a member country of the Financial Stability Board and the G20, has also been actively preparing for the global bail-in regime but has remained relatively low-key in highlighting these preparations.

An early indication was the September 2012 issue of the Reserve Bank of Australia's "Financial Stability Review", which discussed the FSB's Key Attributes report, and noted that the Australian Government (specifically the Treasury) was readying its financial regulator, the Australian Prudential Regulation Authority (APRA) to take on increased bank resolution powers: "The Australian Government released a consultation paper in September(2012) containing proposals to strengthen APRA's crisis management powers and to better align Australia's resolution framework with international standards, such as the Key Attributes. The proposals also seek to harmonise and enhance APRA's regulatory powers across the various Acts it administers". [16]

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This consultation paper was titled "Strengthening APRA's Crisis Management Powers". By January 2013, the Australian Financial Markets Association (AFMA) responded to the Australian Treasury's consultation paper claiming that it was the Australian Prudential Regulation Authority's (APRA's) job, and not the job of a specially appointed manager, to implement Australian bank bail-ins:

"In terms of the role of the special manager, we do not see it as their role to, if appointed, to enact a bail-in of the firm. The FSB's Key Attributes lays out its principles for executing a bail-in with in resolution. We welcome the role of the bail-in tool for a resolution. However, APRA, as the resolution authority, should have the power to enact a bail-in for banks incorporated in Australia during a resolution. It is important to clarify that a bail-in is not a recovery tool, nor should it be enacted by a Special Manager. It is a tool for resolution to be used by the resolution authority". [17]

The IMF even chimed into the Australian bail-in debate. In an IMF Country Report on Australia, dated November 2012, in a discussion of risk management and resolution of systemically important Australian banks, the authors note that "Australia's crisis management framework includes such measures as bridge bank, recapitalization, merger, etc., and they are exploring bail-in options". [18]

The IMF points out that the Australian banking sector is seen as highly concentrated and dominated by four Authorized Deposit-taking Institutions (ADIs) which hold over three-quarters of banking assets, and that for these large ADIs "ordinary liquidation proceedings could prove unmanageable due to their size and interconnectedness", and that failure could lead to possible systemic effects.

Australia has a deposit insurance scheme called the Financial Claims Scheme (FCS), which guarantees deposits up to AU$250,000 per person, per institution, but the banks do not share the cost of this scheme. The IMF believes this lack of cost sharing adds to moral hazard in the Australian banking system (i.e. the banks take on too much risk).

To counter this risk of moral hazard, the IMF recommends that "the authorities should develop credible contingency plans and build into the system features that will ensure that ADIs bear the costs of their own failures."

By April 2013, the Financial Stability Board, in one of its resolution regime progress reports to the G20 Finance Ministers and Central Bank Governors, seemed slightly impatient that some jurisdictions, including Australia, were still working on their bail-in legislation but they noted that "legislation is in train":

"It is critical that authorities have a broad range of powers at their disposal when faced with a crisis. This is not the case in all FSB jurisdictions. In many jurisdictions, resolution authorities still lack the powers set out in the Key Attributes to achieve rapid transfer of assets and liabilities and to write down debt of a failing institution or convert it into equity ("bail-in"), although legislation is in train in some jurisdictions (including Australia, Brazil, the EU, France, Germany, Indonesia, Singapore and South Africa) to align national regimes fully with the Key Attributes". [19]

It is critical that authorities have a broad range of powers at their disposal when faced with a crisis
FSB Resolution Regime Progress Report, Arpil 2013

A second FSB progress report from April 2013, which lists "Planned Reforms to Resolution Regimes in FSB Jurisdictions", notes that in Australia's case, legislative changes are being pushed through not only for banks, but also for the critical moving parts of the Australian financial system, the Financial Market Infrastructures (FMIs):
"Following public consultation, legislative reforms are being developed to strengthen various crisis management powers over banks and insurers, including group resolution powers, statutory or judicial management regimes, direction powers and business transfer powers. Legislative reforms are also being developed to clarify rights relating to early termination, close-out and market netting. In addition, following public consultation, legislative reforms are being developed to introduce a resolution regime for FMIs similar to that for banks". [20]

So it appears that after a slower start than in some other countries, work is now proceeding apace in Australia at readying the financial and legislative systems for its version of the FSB's global bail-in regime

16. *"Financial Stability Review, September 2012, Reserve Bank of Australia, http://www.rba.gov.au/publications/fsr/2012/sep/pdf/dev-fin-sys-arch.pdf*

17. *Response by AFMA to Treasury, January2013, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/2012/APRA/Submissions/PDF/Australian_Financial_Markets_Association.ashx*

18. *"Australia: Financial Safety Net and Crisis Management Framework—Technical Note", IMF Country Report No. 12/310, Nov 2012, http://www.apra.gov.au/AboutAPRA/Publications/Documents/Financial%20Safety%20Net%20and%20Crisis%20Management%20Framework%20%E2%80%93%20Technical%20Note%20%E2%80%93%20November%202012.pdf*

19. *Implementing the FSB Key Attributes of Effective Resolution Regimes –how far have we come", Financial Stability Board, April 2013, http://www.financialstabilityboard.org/publications/r_130419b.pdf*

20. *"Thematic Review on Resolution Regimes: Peer Review Report", Financial Stability Board, April 2013, http://www.financialstabilityboard.org/publications/r_130411a.pdf*

11 Bail-Ins in Canada

In Canada, on 21st March 2013, Minister of Finance, James Flaherty, introduced the Government's "Economic Action Plan 2013". This caused quite a heated debate when it was noticed that the 'Action Plan' revealed plans to introduce a Canadian bail-in regime.

The bail-in regime was referred to in a section of the document for implementing "a comprehensive risk management framework for Canada's systemically important banks", where it was stated that there was a need for "a robust set of options for resolving these institutions without the use of taxpayer funds, in the unlikely event that one becomes non-viable".

The Canadian framework stated that it would follow the "Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions".

In Canada, on 21st March 2013, Minister of Finance, James Flaherty, introduced the Government's "Economic Action Plan 2013". This caused quite a heated debate when it was noticed that the 'Action Plan' revealed plans to introduce a Canadian bail-in regime

BANK OF CANADA
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"The Government proposes to implement a bail-in regime for systemically important banks. This regime will be designed to ensure that, in the unlikely event that a systemically important bank depletes its capital, the bank can be recapitalized and returned to viability through the very rapid conversion of certain bank liabilities into regulatory capital. This will reduce risks for taxpayers. The Government will consult stakeholders on how best to implement a bail-in regime in Canada. Implementation timelines will allow for a smooth transition for affected institutions, investors and other market participants." [21]

Widespread public concern that a Canadian bail-in regime would see a repeat of a Cypriot type deposit confiscation forced the Canadian Department of Finance to issue a statement, [22] claiming that a bail-in would not affect insured deposits. However, there was no mention of uninsured deposits.

"The 'bail-in' scenario described in the budget has nothing to do with consumer deposits and they are not part of the 'bail-in' regime." "Those accounts will continue to remain insured through the Canada Deposit Insurance Corporation, as always." "The (Canadian) bail-in regime is to protect both taxpayers from having to bail out banks and depositors from having to take a financial hit like we've seen in Cyprus." "If a bank is having severe difficulties, the bail-in regime would force certain debt instruments to be converted into equity to recapitalize
the bank."

21. *"Economic Action Plan 2013", Minister of Finance, James Flaherty, 21st March 2013, Report Page 144-145 (PDF page 154-155) http://www.budget.gc.ca/2013/doc/plan/budget2013-eng.pdf*

22. *Kathleen Perchaluk, Canadian Department of Finance spokeswoman, Tuesday 2nd April 2013*

12 Bail-Ins Internationally

There is an important difference between the jurisdictions in which bail-ins can take place versus where they're likely to take place.

Bail-ins can take place when banks and other institutions with significant assets become insolvent internationally.

Given that the bail-in regime is being coordinated by the Financial Stability Board based on their Key Attributes report, then it is feasible that any FSB member could be subject to the FSB recommendations. Although FSB standards are non-binding, central banks internationally generally take note of them, and seek to align their policies with those of the FSB.

Therefore, the bail-in regime will conceivably be on the table as a policy option in any country that has institutional membership of the FSB. And remembering that bail-ins require statutory powers, then most if not all affected jurisdictions and common areas such as the European Union would be expected to be working on legislation to facilitate these statutory powers.

As illustrated above, this has in fact been occurring for some time. Remembering that the FSB Key Attributes were officially endorsed by the G20 in 2011, then it's realistic to assume that they will apply to all twenty G20 members. Given that all of the G20 members are in the FSB, then this point is slightly redundant.

However, a number of FSB members aren't in the G20 such as Hong Kong, Singapore, Switzerland, the Netherlands and Spain. It remains to be seen to what extent these non-G20 members who are FSB members, plan to implement the FSB recommendations.

It is most probable, that Spain and the Netherlands will take their lead from the ECB and European Union. It is not yet known if other nations will implement the Key Attributes in the exact same manner as the G20 members.

So, at the outset, the FSB's bail-in regime recommendations are expected to be taken on board by FSB members in the following locations; all of North America (USA and Canada), some of Central & South America (Mexico, Brazil and Argentina), most of Asia (Japan, China, India, Indonesia, South Korea), all of the European Union, and then in addition, Russia, Saudi Arabia, Turkey & South Africa, & possibly Hong Kong, Switzerland, Singapore

In his October 2012 speech to the IADI, Paul Tucker alluded to the far-reaching jurisdictional scope of the coming bail-in regime: *"A year ago, the G20 Leaders endorsed an international standard – the FSB's Key Attributes – that lays down what resolution regimes need to look like in the different jurisdictions around the world. It's now a matter of countries putting those regimes into place. The US has largely done so through Dodd Frank. Europe is on the verge of doing so. It has a draft directive on recovery and resolution which seeks to implement the FSB standard very faithfully. This will be an enormous step forward. I think Asia will then follow that pattern, to the extent that it hasn't done so already".*

Whether China and Hong Kong, Singapore, India and other Asian nations will adopt the bail-in regime is yet to be seen and there have been little signs, comment or legislation suggesting that Asian nations, or indeed BRIC nations, such as Russia and Brazil, will.

13 How Likely Are Bail-Ins?

There are differing opinions as to the severity of the on-going financial crisis, and whether it has turned a corner. There are two very broad 'schools of thought'.

The first school believes that the U.S. Federal Reserve, along with partner central banks internationally, has successfully stabilised the global financial system through low interest rates and quantitative easing, while the EU has managed to help recapitalise banks and avoid bank insolvencies in the European Union and and the breakup of the European Monetary Union (EMU).

The second school is more skeptical of this view and believes that many banks globally remain vulnerable to insolvency because they are being kept on life-support due to extremely accommodating central bank measures including near zero percent interest rates and quantitative easing. Banks are also being supported through the use of almost fictional, though internationally endorsed, accounting treatment for their asset books, such as mark-to-model valuations for their over-the-counter (OTC) derivatives exposures and by failing to have realistic valuations on problematic property loan portfolios.

Many sovereigns nations remain vulnerable to sovereign debt crises. The Eurozone debt crisis and other sovereign debt crises have been solved for the moment through various forms of ultra loose monetary policies, quantitative easing or debt monetisation.

All short term panaceas have not addressed the root cause of the global debt crisis - too much debt

Indeed, the concern is that the solution of socialising the debt and transferring it to the sovereign and taxpayers, has simply bought some time and may make the crisis much worse in the long term.

We believe the second school will be proved right in the coming months and years; therefore, depositors with deposits in certain banks, or planning to place deposits, must look at the likelihood of and how likely that bank is to get bailed in.

This likelihood would be a function of the strength of the individual bank, which jurisdiction that bank is governed by, which financial systems and economies the bank is exposed to, the extent to which the bank has potentially problematic property or derivatives exposure, and whether deposits are insured by deposit protection schemes, and to what extent are they insured.

In practice, the financial markets would normally do this analysis, but the previous approach of bail-outs and across the board central bank support appears to have clouded the analysis.

The movement by international monetary and financial institutions towards a bail-in regime and the extent of preparation for bail-ins suggest that bail-ins will happen should banks get into trouble again.

Recent statements by Mario Draghi suggest that depositors might be bailed in in the future.

In a letter to Joaquín Almunia, the Vice President of the European Commission, Draghi suggested that bondholders might be spared in future, for fear that once burned bond investors may not return.

This would strongly suggest that sovereign governments would be required to make a decision as to whether they would absorb losses or instead force bail-ins on depositors.

14 Where Are Bail-Ins Likely To Take Place

Bail-ins are likely to happen to banks that are close to failure in countries that have adopted the FSB bail-in conventions and or do not have financial resources to bail-out their banks. Thus, deposits in failing banks in G20 nations may be subject to bail-ins.

> The total debt to GDP ratios, household, corporate, financial and sovereign debt, in Japan, the UK and the U.S. are all at very high levels. All three countries have banks whose outlook is far from positive

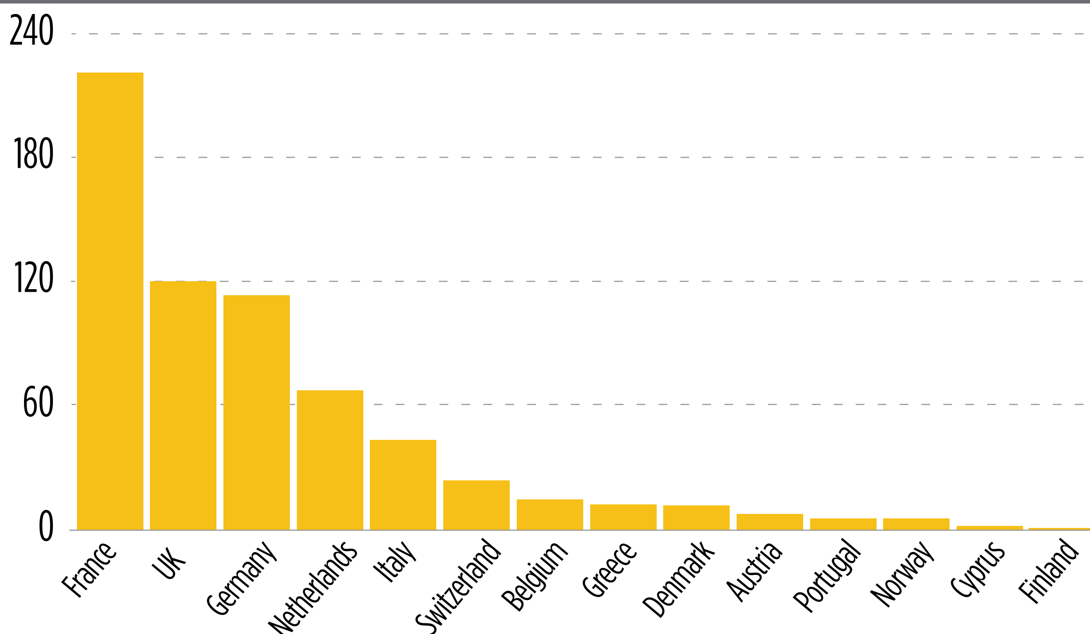
Many analysts warn that many Wall Street and City of London banks are bigger now than they were prior to the collapse of Lehman.

The Eurozone debt crisis has abated in recent months but many analysts and economists are concerned that it is only a matter of time before the debt crisis returns with Greece, Spain, Portugal and Italy all remaining vulnerable.

At present Ireland is less vulnerable than other countries and Irish banks are well capitalised. However, many economists believe Irish banks will require additional capital.

The state of the mortgage book in Ireland is bad and the state of the small to medium enterprise (SME) loan book is very bad. It was reported earlier this year that 50% of the SME loan book was in distress. There is a massive €70 billion in total SME lending, of which a huge €30 billion is exposed to property. It is almost certain that there will be losses in the billions on SME lending and mortgage debt and this will pose challenges for Irish banks.

Banks recapitalization need in case of systemic crisis, bn €, computed on the basis of CRML simulations



Source: The recapitalization needs of European banks if a new financial crisis occurs - Eric Dor, IESEQ

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European banks have been recapitalised but should the sovereign debt crisis return or a new global systemic crisis happen, à la Lehman Brothers, individual banks may again face capital shortages.

> Greece, Cyprus, Spain, Italy, Portugal and Ireland all remain vulnerable. However, other countries in the EU also have risks, including the UK, the Netherlands, Switzerland, Denmark & France

A recent paper by Eric Dor of the IESEG School of Management in France,[23] warned how most European governments remain very exposed to their banks, especially France.

The paper computes the total recapitalisation needs of the banking sector of each European country in case of a new systemic financial crisis. It looks at ratios that would represent the increase of public debt, in percentage of GDP, that would result from a recapitalisation of the big national banks by each country. (see chart below)

Banks recapitalization need in the event of a systemic crisis computed on the basis of CRML simulations

COUNTRY	% GDP	Billions €
France	10,75%	220.880
Cyprus	10,54%	1.732
Netherlands	7,31%	44.168
Greece	6,69%	12.714
United Kingdom	6,56%	121.175
Switzerland	4,81%	24.179
Denmark	4,58%	11.423
Italy	4,29%	67.356
Germany	4,22%	113.594
Belgium	3,93%	15.051
Portugal	3,44%	5.656
Austria	2,67%	8.491
Norway	1,32%	5.385
Finland	0,03%	0.061

Source: 'The recapitalization needs of European banks if a new financial crisis occurs' - Eric Dor, IESEQ

France which would incur the highest cost in percentage of GDP, if the big banks in France had to be recapitalised with public monies. After France, Cyprus, the Netherlands Greece, the United Kingdom and Switzerland are most vulnerable.

The research highlighted the vulnerability of many large European banks and the capital shortages of these banks in the event of a systemic crisis. Particularly vulnerable banks in each country, according to data compiled by the Center for Risk Management of Lausanne (CRML) and the VLAB of Stern Business School at New York University were (in no particular order):

Danske Bank in Denmark
Deutsche Bank in Germany
Erste Group Bank in Austria
ING Groep in Netherlands
Credit Suisse in Switzerland
UBS AG in Switzerland
Bank of Greece in Greece
Bank of Cyprus Plc in Cyprus
Credit Agricole in France
BNP Paribas in France
Societe Generale in France
Banco Comercial Portugues in Portugal
UniCredit in Italy
Nordea Bank in Sweden
DNB in Norway
Dexia in Belgium
KBC Group in Belgium

Source VLAB and CRML (See Appendix)

Stor and his colleagues concluded that:

> The potential capital shortages of the banking sectors of many European countries in the event of a new systemic crisis are very high

23. *http://www.ieseg.fr/wp-content/uploads/2013-ECO-19_Dor.pdf*

15 When Could Bail-Ins Take Place?

The readiness for the bail-in regime depends on how quickly each participating jurisdiction implements supporting legislation. Given the below updates from a number of regulators and central banks, it appears that they are well positioned to have the necessary legal framework in place to support resolution authorities by about 2015, if not before.

The Financial Stability Board released an updated report in November 2012, titled "Recovery and Resolution Planning: Making the Key Attributes Requirements Operational" requesting input from regulators, supervisory authorities and banking institutions, in which it stated that:

"Reforms are now underway in many jurisdictions to align national resolution regimes and institutional frameworks more closely with the Key Attributes". [24]

In March 2013, the Reserve Bank of New Zealand stated that it had "been working closely with registered banks for the last two years to put (bail-in) functionality in place", and intended for the pre-positioning requirements to be in place by 30 June 2013.

The FSB has a Standards Implementation Committee which is currently "reviewing progress on legislating the Key Attributes" and was expected to produce a report by the second quarter of 2013. EU leaders plan to agree on the 'Single Resolution Mechanism' by the end of 2013, for adoption by the European Parliament in 2014, and implementation in January 2015.

The UK and U.S. appear to already have the supporting powers and legislation in place for bail-ins, based on powers granted in the UK Banking Act of 2009 and the Dodd Frank Act of 2010, respectively.

The exact timing of any bank rescue involving a bail-in obviously would then depend on the need for the bank to be rescued.

Emergency resolutions and legislation would be likely in many countries in the event of another Lehman Brothers collapse and another global credit and financial crisis

EUROPEAN CENTRAL BANK

24. https://www.financialstabilityboard.org/publications/r_121102.pdf

16 What a Bail-In Would Look Like

While bank bail-ins have not yet become commonplace, it's worth examining what a bail-in would look like in practice. Some helpful insight comes from the Bank of England, but more importantly, from the evidence witnessed in Cyprus during its bank bail-ins.

The Bank of England recently extended the Financial Stability Board's Key Attributes guidelines and added four practical steps to follow when bailing-in a financial firm.

These four steps are Stabilisation, Valuation and Exchange, Relaunch, and Restructuring:

- *Step 1 - Stabilisation*

> Stabilisation is key, in that it reveals that international regulatory authorities are leaning towards the well-used 'weekend solution' plan, to which they actually refer as a 'Resolution Weekend'

However, if the situation requires dramatic intervention, they can even opt for a mid-week bail-in:

"Ideally a firm would enter resolution at close-of-business on a Friday evening, which would provide the authorities approximately 48 hours in which to stabilise the firm outside market hours. But this cannot be guaranteed. If a firm reached the point of non-viability during the middle of the week, it would be necessary to commence resolution proceedings at that point." [25]

At the time of resolution intervention, the regulatory authorities would suspend stock and bond listing of the bank while making various announcements to the market. These announcements would include details on which securities were being totally wiped out, and which creditors, such as bondholders and depositors, would have their bonds and deposits converted into bank shares. The announcements would also, according to the Bank of England, provide a timeline for the other stages of the bail-in and seek to reassure insured depositors that they were protected while attempting to provide "market counterparties with confidence".

- *Step 2 - Valuation and Exchange*

This step would re-value the firm, calculate its losses and capital needs, and then write down creditors (including deposit confiscation where necessary), while converting these creditors to shareholders before embarking on relaunch.

- *Step 3 - Relaunch*

Relaunch would relist the bank's shares (and possibly some of the bank's bonds) and then allow the bank to re-open while implementing restructuring.

- *Step 4 - Restructuring*

Restructuring would aim to force the bank to appoint new management, change its corporate governance procedures, and force it to operate in a way that prevents subsequent financial market instability.

Although the Bank of England's four step bail-in approach is quite detailed, it does not address the capital controls that would be needed so as to prevent a bank run. This is where the Cyprus example becomes useful.

Capital controls were widely implemented in Cyprus during a theoretical two week long 'Resolution Weekend'. Authorities knew that depositors would act rationally and attempt to close their accounts or transfer their funds abroad, thereby causing capital flight. To prevent this happening, draconian capital controls were imposed and banks were kept shut for two weeks. This was the first time that capital controls had ever been imposed within the Eurozone.

Some of the capital controls included the following: Limits were imposed on bank withdrawals, foreign money transfers, and credit card transactions.

> Customers could only withdraw a maximum of €300 per day from branches and ATMs, and could only carry a maximum of €3,000 while travelling out of the country

In addition bank transfers over €5,000 needed Central Bank of Cyprus approval, and foreign credit card transactions were limited to €5,000 per month. [26]

When capital controls are imposed on economies, they usually remain in place for some time, for example, Icelandic capital controls imposed in 2008 are still in place.[27] Not surprisingly, Cypriot capital controls are still in place and will not likely begin to be lifted (in various stages) until early 2014, according to the Cypriot President, or even longer, according to the finance ministry. Controls on international fund transfers are envisaged as being the final piece of the controls to be lifted.[28]

The lessons from the Bank of England plan and from Cyprus are essentially that depositors will not get any notice that their bank is about to be bailed in. The bail-in would probably happen during a weekend. The bank would probably not re-open on the following Monday. There is also a strong likelihood that capital controls would be imposed on the country's banks during the bail-in and for a lengthy follow-on period.

> Given this lack of warning, depositors need to plan in advance so as not to be caught in a bail-in if at all possible

25. *Andrew Gracie , Bank of England, Speech to the British Bankers Association "A practical process for implementing a bail-in resolution power", pages 4-5, 17th September 2012, http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech600.pdf*
26. *The Financial Times, 27th March 2013, http://www.ft.com/intl/cms/s/0/9901f6ce-96f2-11e2-a77c-00144feabdc0.html?siteedition=intl#axzz2fihWpxh6*
27. *http://euobserver.com/economic/121074*
28. *http://www.telegraph.co.uk/finance/financialcrisis/10319005/Bailed-out-Cyprus-plans-to-lift-capital-controls-next-year.html*

17 What Should Depositors Do?

Depositors in G20 or FSB regulated countries should examine the financial health of their existing bank or banks.

Some issues to watch would include institutions with legacy issues such as a high level of non-performing loans, a possible need for recapitalisation and low credit ratings. These banks should be avoided, as they have a higher chance of needing restructuring and hence a higher chance of a bail-in.

Within Europe, deposits are insured for up to €100,000 per person, per account. Although there is no guarantee that a European government can fund its deposit insurance scheme, it is uninsured deposits which are more at risk of a bail-in. Therefore, it would be prudent for depositors not to hold bank deposits in excess of €100,000 in any one European financial institution since a) they are not insured, and b) deposits in excess of €100,000 are more likely to be bailed in.

There is an assumption that in the event of bail-ins, only bank deposits of over €100,000 would be vulnerable. However, there is no guarantee that this would be the case. Should a government be under severe financial pressure, it may opt to only protect deposits over a lower amount (e.g. €50,000 to €80,000).

> Depositors in G20 or FSB regulated countries should examine the financial health of their existing bank or banks

Since capital controls have already been imposed on one Eurozone country, Cyprus, it seems quite likely that they will be imposed in other Eurozone countries in the event of new banking crises or a new global systemic crisis.

Cypriot authorities imposed restrictions on bank money transfers and withdrawals, including a daily cash withdrawal limit of €300 per day. Many banks had to restrict withdrawals to €100 per customer per day in order to prevent them running out of euros. Electronic wire transfers were suspended for a number of days, prior to being allowed but with a low maximum daily limit.

Therefore, having some of one's savings outside of the banking system makes sense. It should be held in a form that is highly liquid, such as gold, and can be converted back into cash in the event of cash withdrawal restrictions. Cypriots who owned gold were less affected by the deposit confiscation or 'haircut' as they could sell their gold in order to get much needed euros.

In the coming years, the role of gold in an investment portfolio will become more important due to its academically and historically proven safe haven qualities. Now, with the risk of bail-ins, savers and corporate treasurers should consider diversifying their savings portfolio and allocate 5% to 10% of the overall savings portfolio to gold.

However, it will not be enough to simply allocate funds to some form of gold investment. In the same way that certain banks are more risky than others, so too are many forms of gold speculation and investment more risky than others.

> It is vitally important that those tasked with diversifying deposits do not jump out of the frying pan and into the fire

An allocation to actual physical gold owned with the safest counterparties in the world will help depositors hedge the not insignificant risk of keeping money on deposit in many banks today.

 © 2013

It is important that one owns physical gold and not paper gold which could be subject to bail-ins.

Physical gold, held in allocated accounts conferring outright legal ownership through bailment remains the safest way to own gold. Many gold investment vehicles result in the buyers having very significant, unappreciated exposure and very high counterparty risk.

Owning a form of paper gold and derivative gold such as an exchange traded fund (ETF) in which one is an unsecured creditor of a large number of custodians, who are banks which potentially could be bailed in, defeats the purpose of owning gold.

Potentially, many forms of gold investment themselves could be bailed in and the FSB's inclusion of Financial Market Infrastructures in potential bail-ins including "central counterparties, insurers, and the client assets held by prime brokers, custodians and others" underlines the importance of owning unencumbered assets that are owned directly.

Extensive research shows that owning gold in an investment portfolio enhances returns and reduces the entire portfolio's volatility over the long term. In the coming years, a diversified savings portfolio with an allocation to gold, will reduce counterparty risk and compensate for very low yields.

The wise old Wall Street adage to always keep 10% of one's wealth in gold served investors well in recent years. It will serve those attempting to safeguard deposits very well in the coming years.

In general, people should avoid holding euros or other cash outside of their bank accounts, however there is now a case to be made that holding a small amount of cash outside of vulnerable banks would be prudent. Just enough cash to provide for you and your family's needs for a few weeks. However, this should never be done unless the cash is held in a very secure way, such as a well hidden safe or safety deposit box.

Overall, diversification of deposits now has to be considered

This means diversification across financial institutions and across countries or jurisdictions globally.

Financial institutions should be chosen on the basis of the strength of the institution. Jurisdictions should be chosen on the basis of political and economic stability. A culture and tradition of respecting private property and property rights is also pertinent.

While depositors need to do their own due diligence in which banks globally they may wish to open a bank account,
Table 1 (see page 34 and Appendices) illustrates that there are numerous banks globally which are still perceived to be financially strong. The banks in table 1 have been ranked by taking the average long term issuer credit rating applied to the bank by the main global credit rating companies, Moody's, S&P and Fitch.

A credit rating is an assessment of the solvency or creditworthiness of debtors or bond issuers according to established credit review procedures. These ratings and associated research help investors analyse the credit risks associated with fixed income securities by providing detailed information of the ability of issuers to meet their obligations. A rating is continuously monitored. It enables investors and savers to measure their investment risk.

Long term credit ratings of the major agencies take into account factors such as financial fundamentals, operating environment, regulatory environment, corporate governance, franchise value of the business,

and risk management, as well as the potential financial support available to the bank from a parent group, or a local or national government.

While credit ratings express an opinion on a bank's vulnerability of defaulting, they don't quantify the probability of default. However, credit ratings are still widely used and are one of the most commonly used ways of ranking the relative financial strength of banks.

The credit rating reflects the credit risk or general paying ability of the issuer, and so reflects the solvency or creditworthiness of the issuer from the point of view of investors who, along with depositors, are the main creditors of the bank. Certain countries host more financially strong banks than others as can be graphically seen in the table.

> Notice that many of the safest banks in the world are in Switzerland and Germany

Indeed, it is interesting to note that despite the Eurozone debt crisis, many of the safest banks in the world are in the EU or wider Europe. These include banks in the Netherlands, Luxembourg and France.

> Outside of Europe, Singapore has some very strong banks, as does Australia, Canada and Sweden

There are only a few UK and U.S. banks on the list of global top banks that should give pause for thought. There are a number of institutions in jurisdictions such as Hong Kong, Chile, Japan and some Middle Eastern countries. As of yet, banks in the large emerging markets have not made their mark but we would expect banks in China, Russia, Brazil and in India to begin moving up the table in the coming years. The sounder sovereign position and lack of public and private debt in these countries will help in this regard.

There are no banks from problem European economies on the list for good reason. Their banks do not have high enough credit ratings. In fact, banks from Cyprus, Greece, Portugal, Spain, Italy and Ireland consistently had relatively low long term ratings from the ratings agencies. In terms of ratings, they rank nowhere near the top 20 banks in the world and most are ranked between 200 and 400.

Besides considering the relative safety of different banks, with interest rates so low on bank deposits and deposit interest retention tax (DIRT), now at 41%, depositors are not being rewarded with adequate yields to compensate for the risk to which they are exposed.

> Thus, as is often the case, savers need to consider alternatives to protect their wealth

Without a clearly thought out plan, many will be prey for the financial services sales machine and brokers and their array of more risky investment and savings products - including so called "capital guaranteed" products - many of which are high risk due to significant counterparty risk.

It is vitally important that investors have independent custodians and trustees. This greatly reduces counterparty risk should a broker, financial adviser, insurance company or other financial institution become insolvent.

Key Considerations

1	Diversify savings across banks and in different countries.
2	Consider counterparty risk and the health of the deposit-taking bank.
3	Attempt to own assets outright and reduce risk to custodians and trustees.
4	Own physical gold in allocated accounts with outright legal ownership.
5	Avoid investments where there is significant counterparty risk, such as exchange traded funds and many structured products.
6	Avoid banks with large derivative books and large mortgage books.
7	Monitor banks' and institutions' financial stability.
8	Monitor government policy pertaining to banks and bank deposits.
9	Monitor deposit and savings accounts' terms and conditions.

Table 1 - Safer Banks In The World Based On Average Of Credit Ratings Of S&P, Moodys and Fitch

Rank	Name	Country	S&P Rating	S&P Ranking	Fitch Rating	Fitch Ranking	Moodys Rating	Moodys Ranking	COMBINED RANKING
1	Zurcher Kantonalbank	Switzerland	AAA	1	AAA	1	Aaa	1	1
2	NRW.BANK	Germany	AAA	1	AAA	1	Aaa	1	1
3	Caisse des Dépôts et Consignations	France	AAA	1	AAA	1	Aaa	1	1
4	Aargauische Kantonalbank	Switzerland	AAA	1	-	-	-	-	1
5	Basellandschaftliche Kantonalbank	Switzerland	AAA	1	-	-	-	-	1
6	Schwyzer Kantonalbank	Switzerland	AAA	1	-	-	-	-	1
7	Kreditanstalt für Wiederaufbau	Germany	-	-	-	-	Aaa	1	1
8	LfA Förderbank Bayern	Germany	-	-	-	-	Aaa	1	1
9	Amagerbanken Aktieselskab	Denmark	-	-	-	-	Aaa	1	1
10	LBBW Luxembourg	Luxembourg	-	-	-	-	Aaa	1	1
11	Oesterreichische Kontrollbank AG	Austria	AA+	2	-	-	Aaa	1	1
12	NRW.BANK	Germany	AA+	2	AAA	1	Aa1	2	1.66
13	Luzerner Kantonalbank	Switzerland	AA+	2	-	-	-	-	2
14	Graubündner Kantonalbank	Switzerland	AA+	2	-	-	-	-	2
15	St Galler Kantonalbank	Switzerland	-	-			Aa1	2	2
16	Banque et Caisse d'Epargne de l'Etat	Luxembourg	AA+	2	-	-	Aa1	2	2
17	Caisse des Dépôts et Consignations	France	AA+	2	-	-	Aa1	2	2
18	Basler Kantonalbank	Switzerland	AA	3	-	-	-	-	3
19	Rabobank Nederland	Netherlands	AA-	4	AA	2	Aa2	3	3
20	Rabobank Ireland plc	Ireland					Aa2	3	3

Global Top 20 Banks **(See Appendix for Global Top 60 Banks)**

Disclaimer: Credit ratings were compiled from Bloomberg and from each banks company website and are valid as of October 1st. The rating agency reports we have compiled constitute publicly accessible information. We have merely chosen to publish them in order to educate our clients and the investment and savings public. These reports do not necessarily represent the opinion of GoldCore Limited. GoldCore Limited accepts no liability for the completeness, timeliness, accuracy or selection of such information.

18 Economists Warn of Bail-Ins

Dr Constantin Gurdgiev:

"The recent abatement of the euro area crisis and the reduction in overall global financial uncertainty have led to a decline in the demand for gold as a safe haven instrument and speculative asset.

This is the good news. In line with more normalised demand for gold and the precious metals, the risk hedging properties of these assets remain intact and require continued and structured approach to their inclusion when building a diversified, long-term focused investment portfolios.

> In addition, changes in the regulatory and policy responses to the financial crises, established in response to the Cypriot banking crisis, warrant longer-term re-weighting of optimal gold and other precious metals' shares in defensive portfolios

Given that the euro area is moving toward a pro-forma inclusion of the depositors bail-ins in the standard toolbox for dealing with the financially distressed national banking systems, the case for gradual cost-minimising increase in long term share of these instruments in individual investors portfolios is being made not only by the market forces, but also by regulatory changes.

Contrary to the short-term signals in the spot markets, gold and other precious metals role in delivering long-term risk management opportunities and tail risks hedging is becoming more important as the immediate volatility and short-term risks recede."

Dr Constantin Gurdgiev lectures in Finance in Trinity College, Dublin and in the Smurfit School of Business, UCD. He serves as the Chairman of Ireland Russia Business Association. In the past, he served as non-executive member on the Investment Committee of GoldCore

Cormac Lucey:

"In November 2012, it was reported by RTÉ's David Murphy that CRH "was mandated by its board not to leave cash in a bank in the euro zone during any weekend.

The logic of CRH's stance only became fully clear after weekend decisions taken by Eurozone finance ministers had a severe and adverse effect on the financial claims of depositors in Cypriot banks in March 2013. Had ordinary retail and SME depositors in Cyprus's banks known in February of CRH's stance and of the logic behind it, does anyone seriously think that they would have left themselves so vulnerable in March?

> The lesson from Cyprus is that individual and SME depositors need to show at least as much care in making their deposit decisions as large corporations such as CRH

Depositors should seriously consider two questions when putting money into a bank:
(i) is there is a serious possibility of the bank failing?
(ii) if the bank fails, is there then a serious possibility that the government would be unable to honour deposit guarantees in full?

If there is a significant possibility, even small, of capital loss, depositors should ask themselves the same question that corporate treasurers regularly ask themselves: am I being adequately compensated by the deposit rate for the risk I am now exposing my money to?"

Cormac Lucey is a chartered accountant, financial analyst & lecturer at the Irish Management Institute (IMI). He was special advisor to Michael McDowell from 2003 to 2007. He is a commentator on economics and politics.

Jim Power:

"The attempted bail-in of all deposits in the Cypriot banking crisis and the eventual decision to bail-in deposits in excess of €100,000 has drawn a line in the sand and has created a very dangerous and damaging precedent. A banking system has to be based on trust and confidence; the Cypriot decision and subsequent statements from European policy makers suggest that trust and confidence have been seriously, and possibly irredeemably, damaged.

> Any individual or any corporate treasurer would be taking an unacceptable risk in making a decision to leave deposits in excess of €100,000 in any single bank, unless one is convinced that the institution is 100% sound

The events of the past 5 years should have taught us that such a conviction would be dangerous.

> For investors, bank diversification is essential, but more broadly, asset diversification has to be the priority for anybody with any wealth

We still live in very dangerous and uncertain times and investors should do whatever it takes to manage risk and ensure that all of their eggs are not in a single basket that may be badly holed."

Jim Power is a graduate of University College Dublin with a BA in Economics & Politics, and a Master of Economic Science Degree. He is Chief Economist at Friends First Group, a wholly owned subsidiary of Eureko, one of Europe's largest insurance groups. He teaches Finance and Economics on the Local Government MBA at Dublin City University, and Business Economics on the Executive MBA at the Michael Smurfit Graduate School of Business, University College Dublin.

19 Conclusion

> Bail-in is now the rule," admitted the Irish finance minister Michael Noonan. Yet depositors both in the EU and internationally have yet to appreciate the ramifications and risks of this important development and the stealth bail-in regimes developing globally

Michael Noonan TD, Minister for Finance

As Dr Brian Lucey so pointedly put it in his introduction to this research, *"the era of bondholder bailouts is ending and that of depositor bail-ins is coming."*

In the same way that there were a few voices who asked hard questions about the Irish property bubble and helped protect many Irish people from the consequences of the property crash, so today there are a few voices asking questions about the risks and ramifications of bail-ins in Ireland, the EU and internationally.

Cyprus and the real risk of bail-ins in many countries in the coming years shows that even bank deposits are no longer completely safe. We have outlined in this document that there are plans internationally for so called 'bail-ins' or deposit confiscation in banks, should they get into trouble.

Today, the majority of G20 nations have or are adopting legislation that will allow for bail-ins in the event of banks getting into difficulty.

> Depositors internationally now have to think of their uninsured deposits as liable to potentially being confiscated

The fundamental tenet of investment theory is diversification and the importance of owning a broad range of assets, or eggs in different baskets. Today, diversification remains vitally important to investors internationally. Now savers and those with large deposits in banks need to also diversify and not allow themselves to be overly exposed to any one institution.

This diversification should take into account the financial health and standing of the bank and the bank's country. Return of capital, rather than simply return on capital, needs to be considered. This means that the financial stability and long term outlook of deposit taking banks needs to be evaluated once again.

We have long advocated that depositors hold a portion of their assets in precious metals. Our investment rationale for holding gold is as a portfolio diversifier, a store of value and hedge against inflation, a hedge against currency and systemic risk and hence as a safe haven asset.

We can now add bail-ins and deposit confiscation as another reason to have an allocation to gold.

However, the key insight from Cyprus and the coming move from bail-out regimes to bail-in regimes, is that a precedent has now been created in terms of deposit confiscation. Therefore, simply having deposits in a bank is no longer the safest way to save, protect capital and conservatively grow wealth.

We have argued consistently for the last 10 years that investment diversification is vitally important in order to protect and grow wealth. Now savings diversification has to be considered.

APPENDICES

1 European Deposit Insurance & Resolution Funds

Many countries operate deposit insurance systems so as to cover losses on bank deposits up to a limit in situations where troubled banks may not be able to repay depositors. These systems are designed to maintain financial stability and to prevent bank runs by smaller depositors.

In the US, deposit insurance is overseen by the Federal Deposit Insurance Corporation (FDIC). In the European Union, deposit insurance in each member country is undertaken by Deposit Guarantee Schemes. The EU-wide deposit protection limit is €100,000, and generally only applies to retail and small business depositors and not to large wholesale or corporate depositors.

Perhaps surprisingly, under the EU Resolution and Recovery Directive, Deposit Guarantee Scheme funds could also be obliged to participate in bank bail-ins, so as to ensure that depositors have continuous access to 'covered deposits' (deposits up to the insured limit of €100,000).[29]

EU Deposit Guarantee Schemes were originally designed to compensate depositors up to the agreed limit in cases where a bank suffered losses and was liquidated or broken up. Where the insured deposits were lost by the bank, depositors would receive a compensation pay-out from the national deposit guarantee scheme. In a bank resolution scenario, since the bank is being rescued so as to continue as a going entity, the deposit scheme is not being used for its intended purpose, and does pay out to depositors after liquidation, since there is no liquidation. The scheme pays into the bank to keep the covered deposits available to the depositors.

The EU Resolution and Recovery Directive also expects each member country to establish a Resolution Fund which could also be called on to fund bail-ins. These Resolution Funds would be financed by the state or by a levy on the country's banks. Resolution Funds should not be confused with Deposit Guarantee Schemes but the Directive allows the two to be merged. It is envisaged that the money in the Resolution Fund can be lent or guaranteed to a bank in resolution and can also be drawn upon to compensate shareholders or creditors in some bail-in scenarios.[30]

Therefore, given the European Commission's statement that "At no point is it possible to bail-in depositors under 100,000 euros, either now nor in the future", this statement does not appear totally accurate given the ability of both European Deposit Guarantee Schemes and a possibly merged Deposit Guarantee Scheme and Resolution Fund to be forced into providing money for European bank bail-ins.

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29. *See Article 99 of EU Resolution and Recovery Directive*

30. *http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/137627.pdf*

2 Uninsured Deposits and EU Bail-In

It's clear from the myriad bail-in papers written by global regulators that uninsured deposits are totally exposed to being bailed-in, as was seen with the recent Cypriot deposit confiscation.

An IMF Staff Paper from April 2012, which analysed the proposed framework for a bail-in regime, commented on which bank liabilities should be excluded from a bail-in. This only specified insured/guaranteed deposits and did not mention uninsured deposits:

"The legal framework will need to clearly specify which bank liabilities may be restructured under the bail-in power. To improve transparency and avoid uncertainty, only subordinated and senior unsecured debt should be subject to bail-in. Insured/guaranteed deposits, secured debt (including covered bonds), and repurchase agreements should be excluded from restructuring."[31]

The general position of uninsured deposits in the new bail-in regime is quite clear-cut. They are not protected and they are at risk of being confiscated and transformed into low value or worthless bank shares in a restructured bank that needed to be rescued. However there are some legal subtleties that may make uninsured deposits slightly less risky than other unsecured creditors.

In some jurisdictions, such as the US, uninsured deposits already have precedence over other unsecured creditors during insolvency. This is referred to as 'depositor preference'.

On 27th June 2013, the European Council issued a statement that they had agreed a common position on the Recovery and Resolution Directive that would contain an element of depositor preference within bail-ins:

"…eligible deposits from natural persons and micro, small and medium-sized enterprises, as well as liabilities to the European Investment Bank, would have preference over the claims of ordinary unsecured, non-preferred creditors and depositors from large corporations. The deposit guarantee scheme, which would always step in for covered deposits (i.e. deposits below €100,000), would have a higher ranking than eligible deposits."[32]

31. *http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf*

32. *http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/137627.pdf*

3 European Deposit Insurance & Resolution Funds

Many countries operate deposit insurance systems so as to cover losses on bank deposits up to a limit in situations where troubled banks may not be able to repay depositors. These systems are designed to maintain financial stability and to prevent bank runs by smaller depositors.

In the US, deposit insurance is overseen by the Federal Deposit Insurance Corporation (FDIC). In the European Union, deposit insurance in each member country is undertaken by Deposit Guarantee Schemes. The EU-wide deposit protection limit is €100,000, and generally only applies to retail and small business depositors and not to large wholesale or corporate depositors.

Perhaps surprisingly, under the EU Resolution and Recovery Directive, Deposit Guarantee Scheme funds could also be obliged to participate in bank bail-ins, so as to ensure that depositors have continuous access to 'covered deposits' (deposits up to the insured limit of €100,000).[29]

EU Deposit Guarantee Schemes were originally designed to compensate depositors up to the agreed limit in cases where a bank suffered losses and was liquidated or broken up. Where the insured deposits were lost by the bank, depositors would receive a compensation pay-out from the national deposit guarantee scheme. In a bank resolution scenario, since the bank is being rescued so as to continue as a going entity, the deposit scheme is not being used for its intended purpose, and does pay out to depositors after liquidation, since there is no liquidation. The scheme pays into the bank to keep the covered deposits available to the depositors.

The EU Resolution and Recovery Directive also expects each member country to establish a Resolution Fund which could also be called on to fund bail-ins. These Resolution Funds would be financed by the state or by a levy on the country's banks. Resolution Funds should not be confused with Deposit Guarantee Schemes but the Directive allows the two to be merged. It is envisaged that the money in the Resolution Fund can be lent or guaranteed to a bank in resolution and can also be drawn upon to compensate shareholders or creditors in some bail-in scenarios.[30]

4 EU Resolution Funds

To make matters more complex, under the new Resolution and Recovery Directive, each EU member state is expected to establish a Resolution Fund representing 0.8% of covered deposits of the country's institutions. These funds can also be pulled into bail-ins. The Resolution Fund should not be confused with the Deposit Guarantee Scheme. This Resolution Fund can be funded via annual contributions from institutions or else the government can finance it externally. Sovereign nations can keep this new Resolution Fund distinct from their Deposit Guarantee Scheme fund but are allowed to merge them. Lending is also allowed amongst the national funds. The money in the Resolution Fund can be lent or guaranteed to a bank in resolution and also can be "drawn on to compensate shareholders or creditors if and to the extent that their losses under bail-in exceed the losses they would have undergone under normal insolvency proceedings."

31. *http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf*

32. *http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/137627.pdf*

5 Uninsured Deposits, Depositor Preference & Bail-In

It's clear from the myriad papers from global regulators on bail-ins that uninsured deposits are totally exposed to being bailed-in.

An IMF Staff Paper from April 2012 titled "From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions", analysed the proposed framework for a bail-in regime, and commented that some bank liabilities were needed to be excluded from for bail-in. This did not mention uninsured deposits, even in the suggested exclusions:

"The legal framework will need to clearly specify which bank liabilities may be restructured under the bail-in power. To improve transparency and avoid uncertainty, only subordinated and senior unsecured debt should be subject to bail-in. Insured/guaranteed deposits, secured debt (including covered bonds), and repurchase agreements should be excluded from restructuring.

A different but related question is whether it may be appropriate to carve out some types of senior unsecured debt from the restructuring process, including inter-bank deposits, payments, clearing and securities settlement system obligations and, arguably, also some trade-finance obligations. These liabilities may be of systemic or strategic importance and might justify a differential treatment from other senior debt, even if they rank equally in a liquidation context. Any legal concerns might be addressed either by creating different classes for unsecured creditors, or by providing compensation to creditors who are made worse off than they would have been by liquidation."

The general position of uninsured deposits in the new bail-in regime is quite clear-cut. They are not protected and they are at risk of being confiscated and transformed into low value or worthless bank shares in a restructured bank that needed to be rescued. However there are some legal subtleties that may make uninsured deposits slightly less risky than other unsecured creditors.

In some jurisdictions, such as the U.S., uninsured deposits already have precedence over other unsecured creditors during insolvency. This is referred to as 'depositor preference'.

On 27th June 2013, the European Council issued a statement that they had agreed a common position on the Recovery and Resolution Directive that would contain an element of depositor preference within bail-ins:

"…eligible deposits from natural persons and micro, small and medium-sized enterprises, as well as liabilities to the European Investment Bank, would have preference over the claims of ordinary unsecured, non-preferred creditors and depositors from large corporations. The deposit guarantee scheme, which would always step in for covered deposits (i.e. deposits below €100,000), would have a higher ranking than eligible deposits." [33]

33. *The European Directive excludes certain types of bank liabilities from being bailed-in. Exclusions include covered deposits (i.e. insured by deposit insurance), covered bonds, short term inter-bank deposits with a one week maturity, and employee salaries. Again, uninsured deposits are totally exposed to being bailed-in.*

6 European Deposit Guarantee Schemes

The seemingly random €100,000 'red-line' number used in Cyprus is not random at all but is in fact the European Deposit Guarantee Scheme (DGS) limit of €100,000 for insured deposits.

In the European Union, EU Directive 94/19/EC addresses Deposit Guarantee Schemes (DGS) and stipulates an EU-wide deposit protection limit of €100,000 to which EU member States have to adhere. DGS generally only apply to retail and small business depositors and not large wholesale or corporate depositors. In non-Euro States such as the UK, the limit is set in the national currency using an approximate exchange rate; for example, the UK insured deposit limit is £85,000.

Under the new EU Resolution and Recovery Directive, article 99 of the Directive makes it clear that deposit guarantee scheme funds are obliged to participate in bank bail-ins, so as to ensure that depositors have continuous access to 'covered deposits' (deposits up to the insured limit of €100,000).

EU Deposit Guarantee Schemes were originally designed to compensate depositors up to the agreed limit in cases where a bank suffered losses and was liquidated or broken up. Where the insured deposits were lost by the bank, depositors would receive a compensation pay-out from the national deposit guarantee scheme. In a bank resolution scenario, since the bank is being rescued so as to continue as a going entity, the deposit scheme doesn't pay out to depositors after liquidation, since there is no liquidation. The scheme pays into the bank to keep the covered deposits available to the depositors.

But there are a number of concerns in using insured deposits in this way. If the scheme is government funded, and the government runs out of money to cover the insured deposits then who pays? If the government covers the insured deposits and then the bank which continues to operate happens to fail at a later stage then should the insured deposits be covered again? If the scheme is funded by a bank levy, then if one bank needs its insured deposits covered by the scheme, do the remaining banks have to pay progressively larger levies to refund the scheme, which indirectly penalises their depositors?

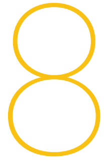
This may require banks to start paying into a scheme in proportion to how risky they are perceived to be.

7 Irish Deposit Guarantee Scheme

The Irish Deposit Guarantee Scheme is administered by the Central bank of Ireland and covers eligible deposits of individuals, partnerships and small businesses up to a limit of €100,000 per person in participating member credit institutions. These which can be institutions operating in Ireland, or Irish institutions operating in other EU Member States. The Scheme is funded by the member credit institutions.

Depositors that suffer eligible losses are compensated by the Central Bank, which aims make reimbursements within 20 days of the appointment of a liquidator to the relevant institution. Medium and large companies, pension schemes and other large entities are excluded from the Scheme. The DGS does not pay compensation in respect of any balances in excess of €100,000.

The Central Bank maintains a Deposit Protection Account (DPA) to fund claims. At the start of 2013, the balance in the DPA was €388 million, but this was before the payments associated with the liquidation of IBRC.



Financial Services Compensation Scheme – UK

The Financial Services Compensation Scheme (FSCS) protects eligible deposits at authorised firms (for example, firms regulated by the Financial Conduct Authority. It covers deposits for private individuals and small businesses up to £85,000. It aims to pay claims within 20 days of the failure of an institution.

9 Derivatives and Bail-ins

The topic of banks' derivatives exposure deserves special mention since it could be the underlying trigger for multiple large future bank bail-ins. °Investment banks and the investing banking arms of large commercial banks globally hold derivatives exposures, mostly over-the-counter (OTC) derivatives, worth a gigantic $1.4 quadrillion.

This combined exposure is supposed to net out to a far smaller number, but since OTC derivatives are opaque and in most cases are valued according to unrealistic assumptions such as non-market prices, there is a widely held fear that any relatively small percentage derivative loss could wipe out seemingly large well-capitalised banks. Furthermore, under US securities regulations (the Bankruptcy Reform Act of 2005), derivatives have super-seniority status in bankruptcy, and rank above other secured creditors.

So it might be prudent for a depositor to avoid a bank that engages in derivatives trading or that has large derivatives exposure. This would include many Wall Street and City of London banks and many well-known global financial institutions.

There is a view that some regional banks in Europe and in Asia are less likely to need rescuing and therefore less likely to be bailed-in. How true this view is remains to be seen.

10 Appendix

Table 1 - Safer Banks In The World Based On Average Of Credit Ratings Of S&P, Moodys and Fitch

Rank	Name	Country	S&P Rating	S&P Ranking	Fitch Rating	Fitch Ranking	Moodys Rating	Moodys Ranking	COMBINED RANKING
1	Zurcher Kantonalbank	Switzerland	AAA	1	AAA	1	Aaa	1	1
2	NRW.BANK	Germany	AAA	1	AAA	1	Aaa	1	1
3	Caisse des Dépôts et Consignations	France	AAA	1	AAA	1	Aaa	1	1
4	Aargauische Kantonalbank	Switzerland	AAA	1	-	-	-	-	1
5	Basellandschaftliche Kantonalbank	Switzerland	AAA	1	-	-	-	-	1
6	Schwyzer Kantonalbank	Switzerland	AAA	1	-	-	-	-	1
7	Kreditanstalt für Wiederaufbau	Germany	-	-	-	-	Aaa	1	1
8	LfA Förderbank Bayern	Germany	-	-	-	-	Aaa	1	1
9	Amagerbanken Aktieselskab	Denmark	-	-	-	-	Aaa	1	1
10	LBBW Luxembourg	Luxembourg	-	-	-	-	Aaa	1	1
11	Oesterreichische Kontrollbank AG	Austria	AA+	2	-	-	Aaa	1	1
12	NRW.BANK	Germany	AA+	2	AAA	1	Aa1	2	1.66
13	Luzerner Kantonalbank	Switzerland	AA+	2	-	-	-	-	2
14	Graubündner Kantonalbank	Switzerland	AA+	2	-	-	-	-	2
15	St Galler Kantonalbank	Switzerland	-	-			Aa1	2	2
16	Banque et Caisse d'Epargne de l'Etat	Luxembourg	AA+	2	-	-	Aa1	2	2
17	Caisse des Dépôts et Consignations	France	AA+	2	-	-	Aa1	2	2
18	Basler Kantonalbank	Switzerland	AA	3	-	-	-	-	3
19	Rabobank Nederland	Netherlands	AA-	4	AA	2	Aa2	3	3
20	Rabobank Ireland plc	Ireland					Aa2	3	3
21	DBS Bank	Singapore	AA-	4	AA-	4	Aa1	2	3.33
22	United Oversea Bank	Singapore	AA-	4	AA-	4	Aa1	2	3.33

Rank	Name	Country	S&P Rating	S&P Ranking	Fitch Rating	Fitch Ranking	Moodys Rating	Moodys Ranking	COMBINED RANKING
23	OCBC Bank	Singapore	AA-	4	AA-	4	Aa1	2	3.33
24	Toronto Dominion (TD) Bank	Canada	AA-	4	AA-	4	Aa1	2	3.33
25	Pictet et Cie	Switzerland			AA-	4	Aa2	3	3.5
26	Westpac Bank	Australia	AA-	4	AA-	4	Aa2	3	3.67
27	Commonwealth Bank of Australia	Australia	AA-	4	AA-	4	Aa2	3	3.67
28	Australia and New Zealand Bank	Australia	AA-	4	AA-	4	Aa2	3	3.67
29	National Australia Bank	Australia	AA-	4	AA-	4	Aa2	3	3.67
30	Banque Cantonale Vaudoise	Switzerland	AA	3	-	-	A1	5	4
31	Royal Bank of Canada	Canada	AA-	4	AA	4	Aa3	4	4.00
32	Nordea	Sweden	AA-	4	AA-	4	Aa3	4	4.00
33	Hang Seng Bank	Hong Kong	AA-	4	A+	5	Aa2	3	4.00
34	Svenska Handelsbanken	Sweden	AA-	4	AA-	4	Aa3	4	4.00
35	Bank of Nova Scotia	Canada	A+	5	AA-	4	Aa2	3	4.00
36	Seven Bank	Japan	AA-	4	-	-	-	-	4.00
37	CA Atlantique Vendée	France	A	6	-	-	Aa1	2	4.00
38	HSBC Holdings Plc	UK	A+	5	AA-	4	Aa3	4	4.33
39	Pohjola Bank	Finland	AA-	4	A+	5	Aa3	4	4.33
40	Canadian Imperial Bank of Commerce	Canada	A+	5	AA-	4	Aa3	4	4.33
40	Bank of Montreal	Canada	A+	5	AA-	4	Aa3	4	4.33
41	Industrial Bank of Korea	South Korea	A+	5	AA-	4	Aa3	4	4.33
42	National Bank of Abu Dhabi	UAE	A+	5	AA-	4	Aa3	4	4.33
43	National Bank of Kuwait	Kuwait	A+	5	AA-	4	Aa3	4	4.33
44	Banco de Chile	Chile	A+	5	-	-	Aa3	4	4.50
45	Shizuoka Bank	Japan	A+	5	-	-	Aa3	4	4.50
46	QNB (Qatar National Bank)	Qatar	A+	5	A+	5	Aa3	4	4.67

Rank	Name	Country	S&P Rating	S&P Ranking	Fitch Rating	Fitch Ranking	Moodys Rating	Moodys Ranking	COMBINED RANKING
47	Samba Financial Group	Saudi Arabia	A+	5	A+	5	Aa3	4	4.67
48	DNB Bank (ASA)	Norway	A+	5	A+	5	Aa3	4	4.67
49	US Bancorp	USA	A+	5	AA-	4	A1	5	4.67
50	Riyad Bank	Saudi Arabia	A+	5	A+	5	A1	5	5.00
51	Al Rajhi Bank	Saudi Arabia	A+	5	A+	5	A1	5	5.00
52	Swedbank	Sweden	A+	5	A+	5	A1	5	5.00
53	SEB	Sweden	A+	5	A+	5	A1	5	5.00
54	Wells Fargo	USA	A+	5	AA-	4	A2	6	5.00
55	Standard Chartered	UK	A+	5	AA-	4	A2	6	5.00
56	National Bank of Canada	Canada	A	6	A+	5	Aa3	4	5.00
57	CIC	France	A	6	A+	5	Aa3	4	5.00
58	Shinkin Central Bank	Japan	A+	5	-	-	A1	5	5.00
59	Banque Cantonale de Genève	Switzerland	A+	5	-	-	0	-	5.00
60	Saudi British Bank (affiliate of HSBC)	Saudi Arabia	A	6	-	-	Aa3	4	5.00

Global Top 60 Banks
Disclaimer: Credit ratings were compiled from Bloomberg and from each banks company website and are valid as of October 1st. The rating agency reports we have compiled constitute publicly accessible information. We have merely chosen to publish them in order to educate our clients and the investment and savings public. These reports do not necessarily represent the opinion of GoldCore Limited. GoldCore Limited accepts no liability for the completeness, timeliness, accuracy or selection of such information.

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About GoldCore

GoldCore are respected international bullion dealers who are experts in the execution and logistics of the highly specialised precious metals market.

GoldCore have been providing precious metal investment solutions for an international client base since 2003. Today, our team of experts service all investor classes from private individuals to companies and institutional investors. Whether you are a small or large investor looking to take delivery or arrange for secure, trusted insured storage, GoldCore has a solution to suit your needs.

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