

Blurred Border: Bail out or Bail in

Takatoshi Ito

Professor, School of International and Public Affairs (SIPA),
Columbia University

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Banking Crisis taxonomy

	Bail out	Bail in
Liquidity Shortage	Lender of Last Resort operation	Forced rollover (on lenders) *1 Reprofiling (maturity; interest rate) *2 "Pesofication" (currency conversion) *3
Insolvency	Capital Injection (by Government) *4 Rescue merger (with "sweetener") *5 Purchase of bad asset by a public bad bank *6	Resolution mechanism: Temporary Nationalization (*7) or Legal liquidation procedure (*8) Shareholders (Total/Partial loss) Bondholders (default) Straight bonds Coco Deposit holders (haircut) *9
Issues and Concerns	Moral hazard Government budgetary room Valuation of assets Valuation of collaterals	Bank run (on other banks) Capital flight Political will/political backlash Time inconsistency

*1 G7banks to Korean banks, Dec 24, 1997

*2 Many cases (voluntary)

*3 Argentinean banks, January 2002

*4 Indonesia 1999

*5 Bear Stearns, 2008 (Maiden Lane LLC)

*6 Sweden (1992). Thailand AMC and Indonesian IBRA (1998)

*7 LTCB (1998), NCB (1998), Ashikaga Bank (2003);

*8 Lehman Brothers

*9 Indonesian 16 Banks (Oct 1997); Nihon Shinko Bank (2010);

Source: Author's creation

Grey zone (Blurred border)

	Bail out		Bail in
Liquidity Shortage	Lender of Last Resort operation		Forced rollover (on lenders) *1 Reprofiling (maturity; interest rate) *2 "Pesofication" (currency conversion) *3
Undercapitalized	Capital Injection to solvent but weak banks *10		Debt-equity swap TLAC
Insolvency	Capital Injection (by Government) *4 Rescue merger (with "sweetener") *5 Purchase of bad asset by a public bad bank *6	Capital injection that would be paid back later to the gov't Bad bank would make money and return them to tax payers	Resolution mechanism: Temporary Nationalization (*7) or Legal liquidation procedure (*8) Shareholders (Total/Partial loss) Bondholders (default) Straight bonds Coco Deposit holders (haircut) *9

Source: Author's creation

No bail out ever?

Or better to have a plan?

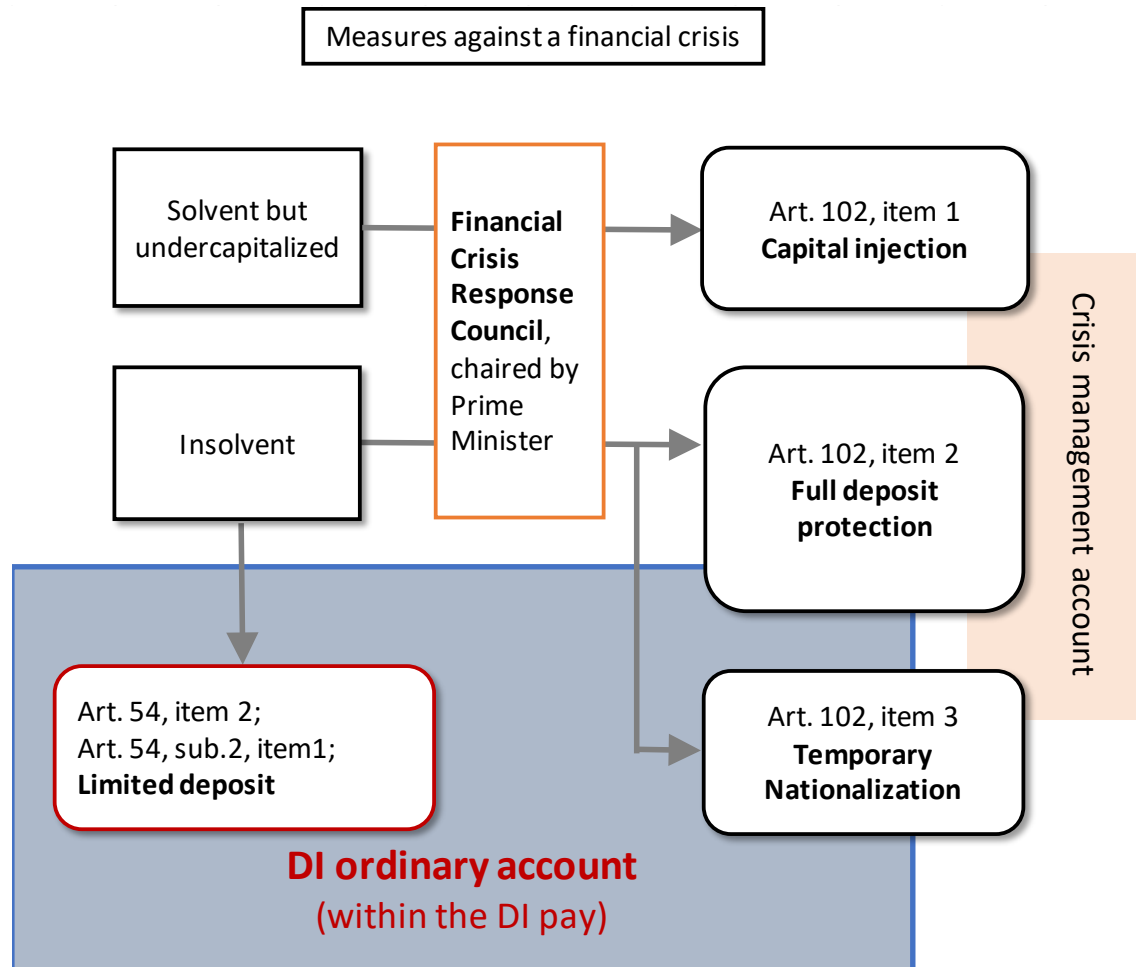
- No bail out (Basel III)
 - How. More capital. Capital of higher quality
 - Other instruments: Cocos, TLAC, debt-equity swap
- Enough?
 - What if a systemically important bank fails, despite ...
 - Wouldn't it be better to have a plan for a bailout with ...
 - Political commitment
 - Punish executives
 - Minimize losses

Japanese Resolution Mechanism

Deposit Insurance Act, Article 102

- Ordinary Deposit Insurance
 - Protection: (a) deposit for settlement (zero interest rate) in full; and (b) other types of deposits, up to 10 million yen per person
- Special resolution mechanism
 - [Systemic risk] A financial institution is considered to be important systemic stability in Japan or in a region
 - [Financial Crisis Response Council] Chaired by Prime Minister decides
 - When the financial institution is solvent but undercapitalized, capital injection is done (Item 1). Applied to Resona Bank in June 2003
 - When the financial institution is insolvent, it can be temporarily nationalized (item 3). Applied to Ashikaga Bank in November 2003.

Japanese Resolution Mechanism: Deposit Insurance Law art. 102



Source: FSA