Emergency Liquidity Financing by Central Banks: Systemic Protection or Bank Bailout?

Ross S. Delston and Andrew Campbell

I. Introduction

The aim of this paper is to consider the ways in which emergency liquidity funding (“ELF”) may be provided by central banks to individual banks that are experiencing financial difficulties. ELF takes the form of loans from, or guarantees by, the central bank that are designed to assist one or more commercial banks that are either undergoing a run on deposits as a result of concerns about safety and soundness or that are experiencing a systemic financial crisis.

For the purposes of this paper, “ELF” includes, and is largely synonymous with, the term “lender of last resort” (“LOLR”) financing. Although the term LOLR is widely used internationally and much has been written about it, in our view, ELF more accurately

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2 In most countries it will be the central bank that has this responsibility and it is generally thought that this is the most appropriate body to perform this function. In some jurisdictions other bodies may also have power. See, for example, the United States where the Federal Deposit Insurance Corporation is given power to provide assistance as described in detail below.

describes what actually takes place. Sir Edward George, the Governor of the Bank of
England has noted that the term LOLR can be confusing, and he states that the role of the
central bank is not to prevent each and every bank from failing and that it is necessary for the
maintenance of the health of the banking system that there is a possibility of bank failure. 4

This paper will examine the practical realities of the provision of ELF since although much
has been written on this subject, what actually happens in practice is typically not discussed.

By way of background, the fundamental principles of this type of assistance are relevant.
First, ELF should be given by the central bank only to banks which are illiquid and not
insolvent. Second, the loan or other financing should be subject to a penalty rate of interest.
Third, collateral (or security) should be provided. 5 Fourth, its use must be discretionary and
there should be no expectation that such help will be available. 6 It has also been described as
“the discretionary provision of liquidity to a financial institution (or the market as a whole)
by the central bank in reaction to an adverse shock which causes an abnormal increase in
demand for liquidity which cannot be met from an alternative source.” 7

Historically, banks have been the only type of institution that have had access to ELF from
central banks. Other types of financial institution have not been able to turn to the central
bank for this type of assistance in times of crisis. Banks are considered to be a special case
and the reasons why banks are considered to be different are considered below. For the
purposes of this article, the term ‘bank’ has the same definition as that of ‘credit institution’
as found in the EC Consolidated Banking Directive under which a credit institution is “an
undertaking whose business is to receive deposits or other repayable funds from the public
and to grant credits for its own account.” 8 It is normal practice internationally that institutions
that fit within this description will be treated as banks and be potentially in a position to
receive ELF should the need arise.


5 This, in theory, should be on the basis of market rather than book value, which, at least for loan assets
will typically be inflated, but in reality this will often not be possible and book value will have to suffice.

6 For readers who would like to read a detailed historical analysis see W.Bagehot Lombard Street: A

website at www.bankofengland.co.uk/fsr/fsr07/art6.pdf

relating to the taking up and pursuit of the business of credit institutions.
II. Why do banks request ELF?\textsuperscript{9}

Typically, banks request ELF from a central bank in response to a run on deposits. What exactly is a run? On an accounting basis, a run is a symptom of illiquidity, which means in the banking context that the long-term assets of the bank, generally loans, are not able to be liquidated fast enough to pay the bank’s short-term liabilities, mainly deposits. As a result, the bank quickly runs out of cash, and, assuming that other banks will not lend, must turn to the central bank. This goes to the very heart of the need for a provider of ELF. Banks are different from other type of organizations. They operate on the basis of fractional reserves and are therefore susceptible to runs and panics. What this means is that at any time a bank will only keep a relatively small percentage of its assets in the form of cash. The remainder will be in the form of loans and other assets which can’t normally be converted immediately into cash. How much cash will be held at any time will depend on a number of factors, such as the anticipated level of withdrawals and deposits, and also the legal and regulatory requirements in the particular jurisdiction in which the bank is operating. Despite this, in most jurisdictions depositors will normally be legally entitled to withdraw a significant percentage of their savings on demand. This mismatch, sometimes referred to as “maturity transformation,” is always a source of risk which can never be totally eradicated.

In theory then, when a bank is illiquid prior to, or as a result of, a depositor run, the bank is not necessarily insolvent on a book basis,\textsuperscript{10} since it may simply be experiencing a short-term inability to liquidate long-term assets to pay short-term liabilities. This produces an asset-liability mismatch. In practice, however, experience shows that it is rare indeed to find a bank that is experiencing a run that is not subsequently found to be insolvent.

In other words, in practice, illiquidity almost always means insolvency. In almost every case, once a depositor run is in full sway, and banking regulators or external auditors examine the bank on an emergency basis, the bank is found to be insolvent on a book basis, that is, its assets (primarily loans) are less than its liabilities (primarily deposits). In a number of crisis countries in the late 1990’s, external auditors (who are typically not the auditors that were previously associated with the bank) were brought in to examine insolvent banks to determine the extent of the losses. It was typical in those cases not only for the banks to have been found to have been insolvent, but also that the losses exceeded everyone’s expectations, including the regulators.

It should be noted that under many bankruptcy laws around the world, illiquidity, typically defined in bankruptcy law as the ‘inability to pay debts as they become due’ is one of the

\textsuperscript{9} Much of this section and Sec. V is based on a previous paper by R. Delston, \textit{Five Observations About Failed Banks}, International Monetary Fund, Current Developments in Monetary and Financial Law, Vol. 2 (2003 forthcoming).

\textsuperscript{10} Referred to in many jurisdictions as “balance sheet test.”
grounds for the appointment of a bankruptcy receiver.\textsuperscript{11} This test is also one of the grounds for closure of a bank or license revocation under a number of banking laws, including the United States. The adoption by countries of a ground such as this could mitigate or limit the need to provide ELF.

\textbf{III. Representative Statutory Provisions}

It is, in our view, good practice to have the basis of ELF set out explicitly in the law of the country, preferably in statutory form, rather than to have some sort of implicit arrangement in place. Our research of actual practice in a number of countries indicates that the approach taken to the provision of ELF varies considerably from country to country.\textsuperscript{12}

Many of the laws contain a requirement that where a bank is receiving ELF, collateral must be provided, but what constitutes eligible collateral varies between jurisdictions.\textsuperscript{13} Such collateral may take a number of forms, for example, gold, foreign currency, government paper. Some jurisdictions permit unsecured ELF by the central bank\textsuperscript{14} and some jurisdictions have provisions that allow such financial assistance to be either secured or unsecured.\textsuperscript{15} Some laws may contain limitations on the size of the ELF, as well as requirements as to the time period of the funding,\textsuperscript{16} the repayment terms and interest rates.

There may also be a requirement in the law that the borrowing bank be solvent, either as a matter of law, or of policy. Where this requirement is contained in law it may raise concerns based on the fact that in most cases, banks undergoing runs are subsequently discovered also to be insolvent on a book basis. Hence, if such a provision were to be a condition of ELF as a matter of law, since most central banks typically are predisposed to providing ELF, and, at the time of providing ELF are not in a position to know definitively whether the bank is in fact solvent, the central bank typically will proceed with ELF. Once a subsequent finding has been made that the bank is insolvent, the central bank may be stymied. How can it revoke the bank’s license or otherwise close the bank since it has just made a finding of solvency? This

\footnotesize{\textsuperscript{11} See, for example, section 123 (1)(e) of the Insolvency Act 1986 in the United Kingdom.}

\footnotesize{\textsuperscript{12} See Attachment 1 which contains a chart with the statutory ELF provisions from 19 countries and also Attachments 2 and 3 which contain two provisions of US law on ELF; the first governing the Federal Reserve Board and the second governing the Federal Deposit Insurance Corporation.}

\footnotesize{\textsuperscript{13} For example, Argentina, Bulgaria, Lithuania.}

\footnotesize{\textsuperscript{14} For example Japan and the Kyrgyz Republic.}

\footnotesize{\textsuperscript{15} See, for example, Botswana and Romania.}

\footnotesize{\textsuperscript{16} See, for example, Chile, where the loan period is not to exceed 90 days but such loans can be renewed subject to certain conditions. The Kyrgyz Republic has a period of six months but this can be prolonged by a decision of the Board of the Bank of the Kyrgyz Republic.}
is not a theoretical issue, but has been a practical concern in at least one country, with the unwanted result that regulators have kept insolvent banks open for long periods instead of revoking the license and liquidating the bank. Hence, statutory requirements of solvency are best avoided. Having a policy that ELF will not be available to insolvent banks is a far preferable approach.

The legal provisions on ELF do not usually contain a requirement that the borrowing bank be subject to an immediate examination, conservatorship/provisional administration, or remedial measures such as directives, administrative fines or civil money penalties, conditions on license, or license revocation.

United States

Not atypically, the US has a complex and difficult approach to the issue, with two separate and distinct ELF provisions. The first authorizes the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) to prescribe regulations under which Federal Reserve banks such as the New York Fed may provide loans, called ‘advances’ in the legislation, to member banks for up to four months with appropriate security.\(^ {17} \) Note that under US law, the use of the ‘discount window’ as it is often called is the same regardless of whether the liquidity financing is on an emergency basis or not, however there are a number of restrictions that apply to banks that do not have adequate capital: advances to an undercapitalized member bank are restricted in that any advances may not be outstanding for more than 60 days in any 120-day period.\(^ {18} \)

There are two exceptions to this restriction: First, such restriction may be suspended for one or more 60-day periods if, for each 60-day period, the head of the appropriate Federal banking agency\(^ {19} \) certifies in writing to the Federal Reserve bank that the borrowing bank is viable, or the Chairman of the Federal Reserve Board certifies to the Federal Reserve bank that the borrowing bank is viable after the Board has conducted an examination.\(^ {20} \) Second, in the absence of any such certification, with respect to ‘critically undercapitalized’ banks,\(^ {21} \) advances may be made by the Board not subject to the 60-day rule but the Board will then be liable to the Federal Deposit Insurance Corporation (the “FDIC”) in the event of the failure

\(^ {17} \) 12 U.S.C. Sec. 347b(a). See Attachment 2 for the complete text of this law.

\(^ {18} \) 12 U.S.C. Sec. 347b(b).

\(^ {19} \) i.e. the Office of Comptroller of the Currency for national banks, the Office of Thrift Supervision for savings associations, the Federal Reserve Board for state member banks (banks that are members of the Federal Reserve System), and the Federal Deposit Insurance Corporation for state nonmember banks. 12 U.S.C. Sec. 1813(q).

\(^ {20} \) 12 U.S.C. Sec. 347b(b)(2)(A) and (B).

\(^ {21} \) i.e. banks that are insolvent and therefore may be closed at any time by the appropriate Federal banking agency.
of the bank for any losses in excess of what would have occurred without the advances.\textsuperscript{22} Hence, these provisions attempt to limit the central bank’s ability to provide ELF to insolvent banks, with the ultimate penalty for the central bank - that it will become liable for losses to the FDIC if it continues to make ELF available to critically undercapitalized banks.

There is also a second type of ELF in the US that is available from the FDIC as insurer of deposits over $100,000, not just to banks that are members of the Federal Reserve System, but also to a broader array of ‘insured depository institutions’ (‘IDIs’), independent of that described above. The FDIC may provide financial assistance, including loans or other types of financing, in three cases: (i) to an IDI that is insolvent or in danger of becoming insolvent to restore it to normal operation; (ii) “when severe conditions exist which threaten the stability of a significant number” of IDIs or of IDIs “possessing significant financial resources;” or (iii) “to facilitate a merger or consolidation” of an insolvent IDI with another IDI.\textsuperscript{23} In order to provide this assistance, the FDIC must first make a determination that such assistance is necessary to meet its obligations to provide deposit insurance for the bank’s depositors, and that such assistance would be the least costly method of meeting this insurance obligation.\textsuperscript{24}

Because the ‘least cost test’ is so stringent, there is an exemption in cases of systemic risk: In order to avoid “serious adverse effects on economic conditions or financial stability,” the requirement of least cost resolution may be suspended by the Secretary of the Treasury, in consultation with the President of the United States, upon a written recommendation approved by two-thirds of the board members of each of the FDIC and the Federal Reserve Board.\textsuperscript{25} Any losses to the deposit insurance fund are to be repaid by an emergency special assessment on the members of the deposit insurance fund.\textsuperscript{26} Hence, for banks that are ‘too big to fail’ because their failure would result in systemic harm, ELF is available with the signature of the top financial officials in the US.

**United Kingdom**

While in many countries, including the US, ELF is clearly defined by law, this is not always the case. The United Kingdom provides an example where the approach taken is radically different. Traditionally the Bank of England has been the provider of ELF to UK banks but this has never been set out in law. The Financial Services and Markets Act 2000\textsuperscript{27} is the main

\begin{itemize}
\item \textsuperscript{22} 12 U.S.C. Sec. 347b(b)(2)(D) and (3).
\item \textsuperscript{23} 12 U.S.C. Sec. 1823(c)(1). See Attachment 3 for full text of law.
\item \textsuperscript{24} 12 U.S.C. Sec. 1823(c)(4)(A).
\item \textsuperscript{25} 12 U.S.C. Sec. 1823(c)(4)(G).
\item \textsuperscript{26} 12 U.S.C. Sec. 1823(c)(4)(G)(ii).
\item \textsuperscript{27} Available at \url{http://www.legislation.hmso.gov.uk/acts/acts2000/20000008.htm}
\end{itemize}
piece of legislation in the UK in relation to the regulation of banking but it is silent as to the provision of ELF. Under the Bank of England Act 1998, the Bank of England is responsible for UK monetary policy and no longer has responsibility as regulator of the banks in the UK.

Instead the approach taken is to rely on a Memorandum of Understanding between the Financial Services Authority, the Bank of England, and Her Majesty’s Treasury which sets out the framework for co-operation between the three bodies.28 The Memorandum gives the Bank of England responsibility for the overall stability of the banking system. For banks experiencing financial difficulties the Bank is to undertake official financial operations in exceptional circumstances “to limit the risk of problems in or affecting particular institutions spreading to other parts of the financial system.” No legal authority is cited in the memorandum and no guidance is provided as to the operation of ELF.29

Fortunately, the Governor of the Bank of England, Sir Edward George, has provided guidance on the approach to be taken by the Bank with regard to the provision of ELF.30 George emphasizes that the provision of ELF will be discretionary and that the Bank of England should not be predictable in its decisions to approve or refuse support. He notes also that the decision taken is often not to provide support and this is likely to be the case where there is no perceived risk to the financial system generally.31 Although the lack of formal statutory powers may not be an impediment to the effective provision of ELF in the UK, it is not, in our opinion an approach that should be followed in other jurisdictions.

Illegal State Assistance: The case of the European Union

The question of the legality of providing ELF can be quite complicated where it may be in conflict with other legal provisions. For example, within the European Union the granting of State aid in certain circumstances may be illegal as it may distort competition.32 It is important to appreciate that not all State aid is prohibited but the provision of such financial assistance is only legal where strict conditions have been satisfied and where the European Community guidelines are followed. This means that is permissible for central banks in Member States of the EU to provide financial assistance to a financially troubled bank only

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29 The partial text of the memorandum may be found in Emergency Facilities, p. 17, Box 3.


31 There were nine bank failures in the UK between 1987 and 1994 where ELF was not provided by the Bank of England.

32 For a more detailed discussion of this see A. Campbell & P. Cartwright at pages 62 – 66.
where this would not breach these conditions. It appears to be the case that the provision of ELF is not likely to constitute a breach of European Union law provided that the financial assistance is of a strictly temporary nature and is to be fully repaid with an appropriate rate of interest being charged. In fact the European Commission has indicated that it “will take into account the peculiarities of the banking sector as well as the sensitivity of the financial markets” when deciding whether State aid is justified thereby indicating that ELF when properly applied would be legal. European central banks should therefore have to be particularly careful when considering the provision of ELF.

IV. ELF in a systemic crisis

The role played by the central bank is different in a systemic crisis. One of the first problems is attempting to define what will amount to a systemic crisis. Put simply it is the risk that the failure of one financial institution will have a knock-on effect and lead to financial problems spreading throughout the banking system. Exactly when a crisis becomes systemic is not something about which there is any international agreement and it will usually not be something which is set out clearly in the law but more of a value judgment which has to be made in a hurry. Typically, in a systemic banking crisis, all banks that require assistance will receive funding (be “bailed out”), and any usual collateral requirements will be ignored in the interests of saving the banking system. In this situation it would normally be unrealistic to require any collateral.

Coordination between and among central bank, banking supervisor and Ministry of Finance is needed, and although this is not always required by law, it will often take place on an informal basis. This can prove to be potentially problematic and in many countries the central bank will be reluctant to act unless its powers and duties are clearly set out in law and ideally in the form of a carefully drafted statute. It could be argued that as the amount of ELF that needs to be provided in a systemic crisis will be so large, and the macroeconomic implications so significant, this should be a State obligation rather than a central bank obligation. Much will depend on the political situation in the individual country but it is easy to see why a central bank may be wary of committing such a huge amount of public funds without government backing.

33 The Official Journal Information and Notices 96/C 305/92.

34 Some commentators suggest that where more than 20% of the deposits in a banking system are affected the crisis should be considered systemic. See, for example, C. Dziobek and C. Pazarbasioglu Lessons from Systemic Restructuring: A Survey of 24 Countries, IMF Working Paper, WP/97/161, http://www.imf.org/external/pubs/ft/issues/issues14/index.htm. Alan Greenspan has remarked that “...it would be useful to central banks to be able to measure systemic risk accurately, but its very definition is still somewhat unsettled. It is generally agreed that systemic risk represents a propensity for some sort of significant financial system disruption.” Remarks at a Conference on Risk Measurement and Systemic Risk’ Board of Governors of the Federal Reserve System (New York, 1995) at page 7.
Another matter of significance and something which central bank governors should be concerned about is that post-mortem investigations by the executive, legislative or judicial branches of central bank activities during the crisis are becoming more common.

V. Observed responses to ELF requests by central banks: Unforeseen but Foreseeable Consequences

When central banks provide ELF without adequate security, or with the pledge of assets by the illiquid bank that are sufficient based on book value but not on market value, the potential exists for the financing not to be repaid when the bank fails.

This possibility has at least two outcomes, both of which are undesirable: the first is that the central bank becomes the largest creditor of the bank, since it has replaced deposits with ELF. The nonpayment of this financing can result in a charge against the capital of the central bank. Given enough such financing or a large enough bank that receives it, central banks themselves may become insolvent. At the very least, a significant conflict of interest is created when the central bank, as regulator, becomes a major creditor of a regulated entity. The second possible outcome is that the central bank or banking regulator decides not to close the bank since to do so would result in nonpayment of the financing. Hence, banks may be kept open that would (or should) otherwise be closed.

It is an article of faith among central bankers that ELF should not be provided to insolvent banks, but only to those experiencing short-term liquidity shortfalls. However, this policy (sometimes required by law) presumes that banks undergoing depositor runs will not be found to be insolvent later. If, in fact, the presumption were to be reversed so that such banks were presumed to be insolvent, then ELF would only be provided, if at all, to banks that are considered to be ‘too big to fail.’ At the very least, this would eliminate the need to fund the myriad of smaller, non-essential banks that typically receive such financing. While the concept of too big to fail is a controversial one, in every country that has had a systemic bank crisis in recent years there have been banks that were considered too big or too essential to be allowed to close, and therefore the relevant authorities have (central banks, ministers of finance, financial regulators and/or heads of state) acted in some manner to prevent them from failing.

VI. Model Law

A model statutory provision embodying many of the principles discussed in this paper is attached hereto as Attachment 4. The attached model provision has a number of features: First, ELF is limited to “exceptional circumstances involving systemic implications,” along the lines of US law with respect to the systemic risk exception for ELF provided by the FDIC described above. Second, loans are limited to a period of six months. Third, the Minister of Finance and the Central Bank must each determine in writing that the ELF is necessary. This forces financial officials to work cooperatively.

Fourth, and most controversial, the State and not the Central Bank is liable for all such ELF, since it is only provided where there is systemic risk. This is perhaps the most controversial...
aspect of the model provision. Who should pay? While central bankers the world over might support having the government on the hook for ELF, it is not clear that this is always a good idea. After all, profit-sharing clauses in central bank laws are, at best, imperfect. The best evidence of this is the large number of central bank office buildings the world over that verge on the palatial, including fenced compounds that in some cases house other government agencies, museums, and other indicia of stored value. Central banks are, after all, responsible for the health of the banking system, which may lead them to believe that their own financial health is a paramount concern. There is no easy answer to this question, but it is worth debating in the context of designing an ELF law.

VII. Conclusion

The rules for providing ELF should be revisited, and the tilt toward providing financing for every bank experiencing a run addressed. At the same time, there should be sufficient flexibility in the law to allow a central bank to provide ELF on an unsecured basis when needed in a banking crisis. Central banks will do so regardless of the rules, therefore the law should reflect the practical realities. In the case of a banking crisis, as provided in the model law, consideration should be given to having the state liable for ELF, since the health of an essential part of the economy is at stake.
Appendix I

Emergency Liquidity Financing Provisions From 19 Countries

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<th>Country</th>
<th>Text of Central Bank Law</th>
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CHAPTER V-Operations of the bank-
Article 17
The Bank is empowered to:

b) grant rediscounts to financial institutions on account of temporary lack of liquidity, for periods not exceeding thirty (30) running days, up to a maximum amount per institution equivalent to the equity capital thereof;

c) grant overdrafts to financial institutions due to temporary lack of liquidity, for periods not exceeding thirty (30) running days, collateralized by public bonds or other securities, or by a special or general guarantee or allocation over certain assets, provided that the total amount of rediscounts and overdrafts granted to a single institution is not, under any circumstance, over the limit determined in the previous paragraph.(7)

Should it be necessary to provide the financial system with appropriate liquidity, or when general and extraordinary circumstances may so advise in the opinion of the absolute majority of the Board of Directors, terms and maximum amounts granted to each institution under paragraph b) above may be extended and enlarged, without affecting in any case the freely available reserves that guarantee the monetary base. Whenever this extraordinary financing is granted, shareholders shall, in addition to the Institution’s assets being granted as collateral, pledge, as a minimum, the Institution’s controlling interest, and agree with the contingent subsequent implementation of the procedure set forth in Article 35 bis of the Law of Financial Institutions. Official banks may be exempted from this requirement. [L. 24,485, Article 2, 1]

Those resources provided to financial institutions by means of the procedures set forth in paragraphs b) and c) above may under no circumstance be non-collateralized or granted as an overdraft.

Source: Central Bank Legislation Database, Monetary and Exchange Affairs Dept., IMF (5/9/02)
These operations shall be primarily collateralized by publicly traded securities, which shall be assessed according to their market value.

Resources provided to financial institutions by means of the systems set forth in paragraph b) and c) above, may be rolled over after a period of 45 (forty-five) days as of the settlement thereof. [9L. 24,485, Article 2, 3]

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<td>37 Operations with Account Holders</td>
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**TITLE III The Bank’s Powers and Operations**

**Fifth Section The Authority to Safeguard the Stability of the Financial System**

**Article 36.**

For the purpose of safeguarding the stability of the financial system, the Bank shall be empowered to:

1. grant banking and financial institutions loans in case of emergency for a period not to exceed 90 days, when the problems stem from a temporary shortage of liquidity. To renew these loans, a Board decision adopted by a majority of the full membership, with a prior report to the Superintendency of Banks and Financial Institutions shall be required. The Bank may make the granting of loans contingent upon compliance by the borrower with particular rules of financial administration. In the situation foreseen in this numeral, the Bank may, accordingly, acquire instruments from the placement or investment portfolios of the above-mentioned institutions;

2. grant loans to or acquire assets from banking and financial institutions, in conformity with the provisions of Article 120, fourth paragraph and Article 129, second paragraph of the General Banking Law; and

3. assist in the drafting of the agreements referred to in the second paragraph of Title XV of the General Banking Law and have a free hand in drafting the provisions of such agreements, being further empowered to remit or cancel part of the debts involved.


**Chapter II TASKS OF THE NBH**

Extraordinary Credit for Credit Institutions [Amended by Para (3) Art. 27 of the Act CXXIX of 1996] in Emergency Situations

Art. 17

[Amended by Art. 1 of the Act IV of 1994 See also Para (1) of the Art. 88 of the Act LXIX of 1991 on the Financial Institutions and their Activities.]
The NBH may grant an extraordinary credit to a credit institution [Amended by Para (3) Art. 27 of the Act CXXIX of 1996] in case of emergency of the credit institution. The NBH may make the granting of such loan dependent on the emergency measure to be taken by the State Money and Capital Market Supervision, and on the compliance of the given credit institution [Amended by Para (3) Art. 27 of the Act CXXIX of 1996] with the measure initiated by the said authority.

<table>
<thead>
<tr>
<th>Country</th>
<th>Document Details</th>
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<tbody>
<tr>
<td>Iceland</td>
<td>The Central Bank of Iceland Act No. 36 of 5 May 1986, last amendment - August 2000</td>
</tr>
<tr>
<td></td>
<td>CHAPTER III Domestic Activities of the Central Bank Article 7 [The Central Bank may advance loans to parties referred to in Art. 6 and engage in deposit transactions with the Bank by way of the purchase of securities or in another manner against collaterals which the Bank deems valid. These transactions may be in domestic or foreign currency.] [Article 3 of Act No. 88/1998] The Central Bank lays down further rules with respect to its transactions pursuant to this Article.</td>
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<td></td>
<td>Chapter II Policy Board Article 15. Powers 2. In addition to those listed in the preceding Paragraph as being subject to the Board's vote, the following matters shall also be decided by the Board; (1) making loans prescribed by Article 37, Paragraph 1, and executing business prescribed by Article 38, Paragraph 2;</td>
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<td></td>
<td>Chapter IV Business Article 37. Temporary loans to financial institutions The Bank of Japan, irrespective of the provisions of Article 33, Paragraph 1, may provide uncollateralized loans to financial institutions (defined as those engaged in the business of taking bank deposits (deposits prescribed by Article 2, Paragraph 2 of the Deposit Insurance Law, Law No. 34 of 1971) as well as engaging in exchange transactions, the same definition shall apply hereinafter) and other financial business entities prescribed by a Cabinet Order (hereinafter referred to as &quot;financial institutions&quot; together) for a period within that prescribed by a Cabinet Order when they unexpectedly experience a temporary shortage of funds for payment due to accidental causes, including computer</td>
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system problems, whereby the business operations of the financial institutions may be seriously hampered if the shortage is not recovered swiftly, provided that the advance is necessary to secure the smooth settlement of funds among financial institutions.

2. The Bank shall, when providing loans as prescribed by the preceding Paragraph, report the fact to the Prime Minister and the Minister of Finance without delay.

Chapter IV Business
Article 38. Business contributing to the maintenance of an orderly financial system
The Prime Minister and the Minister of Finance may request that the Bank of Japan conduct the business necessary to maintain an orderly financial system, including provision of loans, when it is believed to be especially necessary for the maintenance of an orderly financial system including the case where it is judged, after consultation pursuant to the provisions of Article 57-2 of the Banking Act (Law No. 59 of 1981) and other relevant laws and regulations that a serious problem in an orderly financial system may arise.

2. At the request of the Prime Minister and the Minister of Finance as prescribed by the preceding Paragraph, the Bank may conduct business necessary to maintain an orderly financial system, including provision of loans under special conditions, in addition to the business prescribed by Article 33, Paragraph 1.

Kyrgyz Republic
Law of the Kyrgyz Republic on the National Bank of the Kyrgyz Republic of August 6, 1997

CHAPTER I. GENERAL PROVISIONS
ARTICLE 4. Functions of the Bank of Kyrgyzstan
4) to be a creditor of last resort for banks in conformity with the present Law;

CHAPTER VII. RELATIONS BETWEEN THE BANK OF KYRGYZSTAN AND OTHER BANKS
Article 28. Loans Extended to Other Banks
3. In emergency cases, to maintain the banking system intact, the Bank of Kyrgyzstan may extend an unsecured loan or a loan secured by other types of assets, on terms as specified by the Board of the Bank of Kyrgyzstan.

An emergency loan may be extended for a period of six months. This period may be prolonged by decision of the Board of the Bank of Kyrgyzstan. During the term of such loans, the Bank of Kyrgyzstan shall
apply special borrower treatment as specified in the rules and regulations of the Bank of Kyrgyzstan.

Lithuania


CHAPTER 4. MONETARY POLICY OF THE BANK OF LITHUANIA

Article 27. Loans of the Bank of Lithuania

1. The Bank of Lithuania, pursuant to the procedure, terms and conditions laid down by the Bank, shall have the right to make loans in Litas to credit institutions registered in the Republic of Lithuania that have their accounts at the Bank of Lithuania.

2. The loans made by the Bank of Lithuania shall be secured by the pledge of the following assets of a credit institution which obtains the loan:

1) debt securities issued by the Government or the Bank of Lithuania;

2) foreign currency or precious metals; and

3) bills of exchange, other debt instruments and real estate which satisfy the terms established by the Bank of Lithuania.

3. Loans may also be secured by a state guarantee, or a surety or guarantee of a credit institution.

Madagascar

Charter of the Central Bank of Madagascar, Law No. 94-04 of June 10, 1994

CHAPTER IV CENTRAL BANK ASSISTANCE TO BANKS AND FINANCIAL INSTITUTIONS

Article 34.

In the event of temporarily liquidity problems experienced by a bank or financial institution in connection with the implementation of a recovery plan acceptable to the Bank and Financial Institutions Control Commission and the Central Bank, the latter may grant such institution a special advance on the conditions adopted by the Board.

CHAPTER VI PROVISIONS COMMON TO CHAPTERS II, III, IV, AND V

Article 38.

The Central Bank may make its assistance contingent on the submission of any documentation it deems necessary.

It may, as appropriate, require that any real or personal guarantees be
|-------------|----------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| New Zealand | Reserve Bank of New Zealand Act of 1989, last amendment - Reserve Bank of New Zealand Amendment Act 1999 | PART II. FUNCTIONS AND POWERS OF RESERVE BANK  
Other Functions and Powers  
31. Bank to act as lender of last resort---  
The Bank shall, if the Bank considers it necessary for the purpose of maintaining the soundness of the financial system, act as lender of last resort for the financial system.  
PART V. REGISTRATION OF BANKS AND PRUDENTIAL SUPERVISION OF REGISTERED BANKS  
68. Exercise of powers under this Part---  
[Cf. 1964, No. 134, s. 38J; 1986, No. 131, s. 10]  
The powers conferred on the Governor-General, the Minister, and the Bank by this Part of this Act shall be exercised for the purposes of---  
(a) Promoting the maintenance of a sound and efficient financial system; or  
(b) Avoiding significant damage to the financial system that could result from the failure of a registered bank. |
| Norway      | Act on Norges Bank and the Monetary System of May 24, 1985, last amendment - 18 June 1999 | Chapter IV. Role in the credit market  
Section 19. Extension of credit to banks  
When warranted by special circumstances, the Bank may grant credit on special terms. |
| Portugal    | Banco de Portugal Organic Law, Law No. 5/98 of January 31 | CHAPTER IV Central Bank functions  
SECTION I General Provisions  
Article 12  
Without prejudice to the requirements derived from its participation in the ESCB it shall be particularly incumbent upon the Bank to:  
c) Provide for the stability of the domestic financial system, performing for the purpose the function of lender of last resort;  
CHAPTER IV Central Bank functions  
SECTION VI Operations of the Bank |
<table>
<thead>
<tr>
<th>Country</th>
<th>Law and Revisions</th>
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<tbody>
<tr>
<td>Romania</td>
<td>Law on the Statute of the National Bank of Romania of May 26, 1998, last amendment - Law No. 156 of October 12, 1999</td>
</tr>
<tr>
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<td>Chapter V BANK SUPERVISION</td>
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<td></td>
<td>Article 27. Protection against system risk</td>
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<td>To limit risks in the banking and payments system, the National Bank of Romania may, in exceptional circumstances and on a case-by-case basis, grant loans to banks that are either unsecured, or secured with assets other than those provided for in Article 20.</td>
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<tr>
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<td>Chapter I. Nature and legal status</td>
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<td>Article 4. Economic and budgetary treatment</td>
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<td>The government, upon proposal by the Economy and Finance Minister, shall have the authority to approve the annual balance sheet and accounts of the Bank, which will be sent to Parliament for informational purposes. Without prejudice to the terms of article 27 of the Statutes of the ESCB, the Banco de España shall be subject to external auditing by the Tribunal de Cuenta [National Accounts Office] under the terms of Organic Law 2/1982, of May 12, on the Tribunal de Cuentas. The report accompanying the annual balance sheet and accounts shall give further detail on different operations or items on the balance sheet, according to their characteristics. In particular, the Bank's contributions to the Deposit Guarantee Funds shall be detailed, as will any loans or other operations made for the benefit of any other institution or person on non-market conditions, or which in any other way implied loss of profit or losses for the Bank. In such cases the amount of such loss of profit or losses shall be specified.</td>
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<tr>
<td>Sweden</td>
<td>The Sveriges Riksbank Act (1988:1385) – as amended to apply from 1 January 1999</td>
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<td>Chapter 6 Monetary policy and the payment system</td>
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<tr>
<td></td>
<td>Art. 8.</td>
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<td>In exceptional circumstances, the Riksbank may, with the end of supporting liquidity, grant credits or provide guarantees on special terms</td>
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to banking institutions and Swedish companies that are under the supervision of the Financial Supervisory Authority.

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<tr>
<th>Country</th>
<th>Law/Act</th>
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<tr>
<td>Switzerland</td>
<td>National Bank Law of Switzerland of December 23, 1953, last amendment - June 20, 1997</td>
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</table>
|                                | 1. The Individual Organs  
b) The Bank Council  
Art.43  
(1) In addition to the general supervision of the progress and conduct of the Bank's business the Bank Council shall deal with the following:  
12. establishing the credit limits of customers if the amounts exceed, according to the regulations, the powers of the Bank Committee and the Governing Board; |
| West African Monetary Union    | Statutes of the Central Bank of West African States                      |
|                                | CENTRAL BANK OPERATIONS  
SECTION 5 – RELATIONS OF THE CENTRAL BANK WITH BANKS AND FINANCIAL INSTITUTIONS OF THE WEST AFRICAN MONETARY UNION  
Article 23  
The Central Bank may grant assistance only to the West African Development Bank, other joint financing institutions set up pursuant to Article 23 of the Treaty Establishing the West African Monetary Union, and banks and financial institutions authorized to operate in the States of the Union, subject to the conditions of banking legislation and credit regulations, determined in accordance with Article 22 of said Treaty. |
| Zambia                         | The Bank of Zambia Act, Act No. 43 of 1996 of December 12, 1996          |
|                                | Part VI  Relations with Banks and Financial Institutions  
42. Accounts for Banks and other Financial Institutions  
(3) Where the Bank is of the opinion that an advance is necessary in order to:  
(a) meet liquidity requirements; or  
(b) forestall insolvency to safeguard the financial system; of a holder of any account operated in accordance with subsection 1(l) the Bank may make an unsecured advance or an advance secured by such assets; and on such special terms and conditions as the Board may determine.  
of a holder of any account operated in accordance with subsection (1) the Bank may make an unsecured advance or an advance secured by such assets; and on such special terms and conditions as the Board may determine. |
Appendix II


12 U.S.C. Sec. 347b. Advances To Individual Member Banks On Time Or Demand Notes; Maturities; Time Notes Secured By Mortgage Loans Covering One-To-Four Family Residences

(a) In general

Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank.

Notwithstanding the foregoing, any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time notes having such maturities as the Board may prescribe and which are secured by mortgage loans covering a one-to-four family residence. Such advances shall bear interest at a rate equal to the lowest discount rate in effect at such Federal Reserve bank on the date of such note.

(b) Limitations on advances

(1) Limitation on extended periods

Except as provided in paragraph (2), no advances to any undercapitalized depository institution by any Federal Reserve bank under this section may be outstanding for more than 60 days in any 120-day period.

(2) Viability exception

(A) In general

If --

(i) the head of the appropriate Federal banking agency certifies in advance in writing to the Federal Reserve bank that any depository institution is viable; or

(ii) the Board conducts an examination of any depository institution and the Chairman of the Board certifies in writing to the Federal Reserve bank that the institution is viable,

the limitation contained in paragraph (1) shall not apply during the 60-day period beginning on the date such certification is received.

(B) Extensions of period
The 60-day period may be extended for additional 60-day periods upon receipt by the Federal Reserve bank of additional written certifications under subparagraph (A) with respect to each such additional period.

(C) Authority to issue a certificate of viability may not be delegated

The authority of the head of any agency to issue a written certification of viability under this paragraph may not be delegated to any other person.

(D) Extended advances subject to paragraph (3) Notwithstanding paragraph (1), an undercapitalized depository institution which does not have a certificate of viability in effect under this paragraph may have advances outstanding for more than 60 days in any 120-day period if the Board elects to treat --

(i) such institution as critically undercapitalized under paragraph (3); and

(ii) any such advance as an advance described in subparagraph (A)(i) of paragraph (3).

(3) Advances to critically undercapitalized depository institutions

(A) Liability for increased loss

Notwithstanding any other provision of this section, if --

(i) in the case of any critically undercapitalized depository institution --

(I) any advance under this section to such institution is outstanding without payment having been demanded as of the end of the 5-day period beginning on the date the institution becomes a critically undercapitalized depository institution; or

(II) any new advance is made to such institution under this section after the end of such period; and

(ii) after the end of that 5-day period, any deposit insurance fund in the Federal Deposit Insurance Corporation incurs a loss exceeding the loss that the Corporation would have incurred if it had liquidated that institution as of the end of that period,

the Board shall, subject to the limitations in subparagraph (B), be liable to the Federal Deposit Insurance Corporation for the excess loss, without regard to the terms of the advance or any collateral pledged to secure the advance.

(B) Limitation on excess loss

The liability of the Board under subparagraph (A) shall not exceed the lesser of the following:
(i) The amount of the loss the Board or any Federal Reserve bank would have incurred on the increases in the amount of advances made after the 5-day period referred to in subparagraph (A) if those increased advances had been unsecured.

(ii) The interest received on the increases in the amount of advances made after the 5-day period referred to in subparagraph (A).

(C) Federal Reserve to pay obligation

The Board shall pay the Federal Deposit Insurance Corporation the amount of any liability of the Board under subparagraph (A).

(D) Report

The Board shall report to the Congress on any excess loss liability it incurs under subparagraph (A), as limited by subparagraph (B)(i), and the reasons therefore, not later than 6 months after incurring the liability.

(4) No obligation to make advances A Federal Reserve bank shall have no obligation to make, increase, renew, or extend any advance or discount under this chapter to any depository institution.

(5) Definitions

(A) Appropriate Federal banking agency

The term "appropriate Federal banking agency" has the same meaning as in section 1813 of this title.

(B) Critically undercapitalized

The term "critically undercapitalized" has the same meaning as in section 1831o of this title.

(C) Depository institution

The term "depository institution" has the same meaning as in section 1813 of this title.

(D) Undercapitalized depository institution

The term "undercapitalized depository institution" means any depository institution which

(i) is undercapitalized, as defined in section 1831o of this title; or

(ii) has a composite CAMEL rating of 5 under the Uniform Financial Institutions Rating
System (or an equivalent rating by any such agency under a comparable rating system) as of the most recent examination of such institution.

(E) Viable

A depository institution is "viable" if the Board or the appropriate Federal banking agency determines, giving due regard to the economic conditions and circumstances in the market in which the institution operates, that the institution --

(i) is not critically undercapitalized;
(ii) is not expected to become critically undercapitalized; and
(iii) is not expected to be placed in conservatorship or receivership.

SOURCE

Appendix III

I. US LAW – FDIC PROVISIONS


(c) Assistance to insured depository institutions

(1) The Corporation is authorized, in its sole discretion and upon such terms and conditions as the Board of Directors may prescribe, to make loans to, to make deposits in, to purchase the assets or securities of, to assume the liabilities of, or to make contributions to, any insured depository institution --

(A) if such action is taken to prevent the default of such insured depository institution;

(B) if, with respect to an insured bank in default, such action is taken to restore such insured bank to normal operation; or

(C) if, when severe financial conditions exist which threaten the stability of a significant number of insured depository institutions or of insured depository institutions possessing significant financial resources, such action is taken in order to lessen the risk to the Corporation posed by such insured depository institution under such threat of instability.

(2)(A) In order to facilitate a merger or consolidation of another\(^1\) insured depository institution described in subparagraph (B) with another insured depository institution or the sale of any or all of the assets of such insured depository institution or the assumption of any or all of such insured depository institution's liabilities by another insured depository institution, or the acquisition of the stock of such insured depository institution, the Corporation is authorized, in its sole discretion and upon such terms and conditions as the Board of Directors may prescribe --

\(^1\) So in original. Probably should be "an".

(i) to purchase any such assets or assume any such liabilities;

(ii) to make loans or contributions to, or deposits in, or purchase the securities of, such other insured depository institution or the company which controls or will acquire control of such other insured depository institution;

(iii) to guarantee such other insured depository institution or the company which controls or will acquire control of such other insured depository institution against loss by reason of such insured institution's merging or consolidating with or assuming the liabilities and purchasing the assets of such insured depository institution or by reason of such company acquiring control of such insured depository institution; or
(iv) to take any combination of the actions referred to in subparagraphs (i) through (iii).

(B) For the purpose of subparagraph (A), the insured depository institution must be an insured depository institution --

(i) which is in default;

(ii) which, in the judgment of the Board of Directors, is in danger of default; or

(iii) which, when severe financial conditions exist which threaten the stability of a significant number of insured depository institutions or of insured depository institutions possessing significant financial resources, is determined by the Corporation, in its sole discretion, to require assistance under subparagraph (A) in order to lessen the risk to the Corporation posed by such insured depository institution under such threat of instability.

(C) Any action to which the Corporation is or becomes a party by acquiring any asset or exercising any other authority set forth in this section shall be stayed for a period of 60 days at the request of the Corporation.

(3) The Corporation may provide any person acquiring control of, merging with, consolidating with or acquiring the assets of an insured depository institution under subsection (f) or (k) of this section with such financial assistance as it could provide an insured institution under this subsection.

(4) Least-cost resolution required. --

(A) In general. -- Notwithstanding any other provision of this chapter, the Corporation may not exercise any authority under this subsection or subsection (d), (f), (h), (i), or (k) of this section with respect to any insured depository institution unless --

(i) the Corporation determines that the exercise of such authority is necessary to meet the obligation of the Corporation to provide insurance coverage for the insured deposits in such institution; and

(ii) the total amount of the expenditures by the Corporation and obligations incurred by the Corporation (including any immediate and long-term obligation of the Corporation and any direct or contingent liability for future payment by the Corporation) in connection with the exercise of any such authority with respect to such institution is the least costly to the deposit insurance fund of all possible methods for meeting the Corporation's obligation under this section.

(B) Determining least costly approach. -- In determining how to satisfy the Corporation's obligations to an institution's insured depositors at the least possible cost to the deposit insurance fund, the Corporation shall comply with the following provisions:

(i) Present-value analysis; documentation required. -- The Corporation shall --
(I) evaluate alternatives on a present-value basis, using a realistic discount rate;

(II) document that evaluation and the assumptions on which the evaluation is based, including any assumptions with regard to interest rates, asset recovery rates, asset holding costs, and payment of contingent liabilities; and

(III) retain the documentation for not less than 5 years.

(ii) Foregone tax revenues. -- Federal tax revenues that the Government would forego as the result of a proposed transaction, to the extent reasonably ascertainable, shall be treated as if they were revenues foregone by the deposit insurance fund.

(C) Time of determination. --

(i) General rule. -- For purposes of this subsection, the determination of the costs of providing any assistance under paragraph (1) or (2) or any other provision of this section with respect to any depository institution shall be made as of the date on which the Corporation makes the determination to provide such assistance to the institution under this section.

(ii) Rule for liquidations. -- For purposes of this subsection, the determination of the costs of liquidation of any depository institution shall be made as of the earliest of --

(I) the date on which a conservator is appointed for such institution;

(II) the date on which a receiver is appointed for such institution; or

(III) the date on which the Corporation makes any determination to provide any assistance under this section with respect to such institution.

(D) Liquidation costs. -- In determining the cost of liquidating any depository institution for the purpose of comparing the costs under subparagraph (A) (with respect to such institution), the amount of such cost may not exceed the amount which is equal to the sum of the insured deposits of such institution as of the earliest of the dates described in subparagraph (C), minus the present value of the total net amount the Corporation reasonably expects to receive from the disposition of the assets of such institution in connection with such liquidation.

(E) Deposit insurance funds available for intended purpose only. --

(i) In general. -- After December 31, 1994, or at such earlier time as the Corporation determines to be appropriate, the Corporation may not take any action, directly or indirectly, with respect to any insured depository institution that would have the effect of increasing losses to any insurance fund by protecting --
(I) depositors for more than the insured portion of deposits (determined without regard to whether such institution is liquidated); or

(II) creditors other than depositors.

(ii) Deadline for regulations. -- The Corporation shall prescribe regulations to implement clause (i) not later than January 1, 1994, and the regulations shall take effect not later than January 1, 1995.

(iii) Purchase and assumption transactions. -- No provision of this subparagraph shall be construed as prohibiting the Corporation from allowing any person who acquires any assets or assumes any liabilities of any insured depository institution for which the Corporation has been appointed conservator or receiver to acquire uninsured deposit liabilities of such institution so long as the insurance fund does not incur any loss with respect to such deposit liabilities in an amount greater than the loss which would have been incurred with respect to such liabilities if the institution had been liquidated.

(F) Discretionary determinations. -- Any determination which the Corporation may make under this paragraph shall be made in the sole discretion of the Corporation.

(G) Systemic risk. --

(i) Emergency determination by secretary of the treasury. -- Notwithstanding subparagraphs (A) and (E), if, upon the written recommendation of the Board of Directors (upon a vote of not less than two-thirds of the members of the Board of Directors) and the Board of Governors of the Federal Reserve System (upon a vote of not less than two-thirds of the members of such Board), the Secretary of the Treasury (in consultation with the President) determines that --

(I) the Corporation's compliance with subparagraphs (A) and (E) with respect to an insured depository institution would have serious adverse effects on economic conditions or financial stability; and

(II) any action or assistance under this subparagraph would avoid or mitigate such adverse effects,

the Corporation may take other action or provide assistance under this section as necessary to avoid or mitigate such effects.

(ii) Repayment of loss. -- The Corporation shall recover the loss to the appropriate insurance fund arising from any action taken or assistance provided with respect to an insured depository institution under clause (i) expeditiously from 1 or more emergency special assessments on the members of the insurance fund (of which such institution is a member) equal to the product of --

(I) an assessment rate established by the Corporation; and
(II) the amount of each member's average total assets during the semiannual period, minus
the sum of the amount of the member's average total tangible equity and the amount of the
member's average total subordinated debt.

(iii) Documentation required. -- The Secretary of the Treasury shall --

(I) document any determination under clause (i); and
(II) retain the documentation for review under clause (iv).

(iv) GAO review. -- The Comptroller General of the United States shall review and report
to the Congress on any determination under clause (i), including --

(I) the basis for the determination;
(II) the purpose for which any action was taken pursuant to such clause; and
(III) the likely effect of the determination and such action on the incentives and conduct of
insured depository institutions and uninsured depositors.

(v) Notice. --

(I) In general. -- The Secretary of the Treasury shall provide written notice of any
determination under clause (i) to the Committee on Banking, Housing, and Urban Affairs
of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of
Representatives.

(II) Description of basis of determination. -- The notice under subclause (I) shall include a
description of the basis for any determination under clause (i).

(H) Rule of construction. -- No provision of law shall be construed as permitting the
Corporation to take any action prohibited by paragraph (4) unless such provision
expressly provides, by direct reference to this paragraph, that this paragraph shall not
apply with respect to such action.

(5) The Corporation may not use its authority under this subsection to purchase the voting
or common stock of an insured depository institution. Nothing in the preceding sentence
shall be construed to limit the ability of the Corporation to enter into and enforce
covenants and agreements that it determines to be necessary to protect its financial
interest.

(6)(A) During any period in which an insured depository institution has received
assistance under this subsection and such assistance is still outstanding, such insured
depository institution may defer the payment of any State or local tax which is determined
on the basis of the deposits held by such insured depository institution or of the interest or
dividends paid on such deposits.
(B) When such insured depository institution no longer has any outstanding assistance, such insured depository institution shall pay all taxes which were deferred under subparagraph (A). Such payments shall be made in accordance with a payment plan established by the Corporation, after consultation with the applicable State and local taxing authorities.

(7) The transfer of any assets or liabilities associated with any trust business of an insured depository institution in default under subparagraph (2)(A) shall be effective without any State or Federal approval, assignment, or consent with respect thereto.

(8) Assistance before appointment of conservator or receiver. --

(A) In general. -- Subject to the least-cost provisions of paragraph (4), the Corporation shall consider providing direct financial assistance under this section for depository institutions before the appointment of a conservator or receiver for such institution only under the following circumstances:

(i) Troubled condition criteria. -- The Corporation determines --

(I) grounds for the appointment of a conservator or receiver exist or likely will exist in the future unless the depository institution's capital levels are increased; and

(II) it is unlikely that the institution can meet all currently applicable capital standards without assistance.

(ii) Other criteria. -- The depository institution meets the following criteria:

(I) The appropriate Federal banking agency and the Corporation have determined that, during such period of time preceding the date of such determination as the agency or the Corporation considers to be relevant, the institution's management has been competent and has complied with applicable laws, rules, and supervisory directives and orders.

(II) The institution's management did not engage in any insider dealing, speculative practice, or other abusive activity.

(B) Public disclosure. -- Any determination under this paragraph to provide assistance under this section shall be made in writing and published in the Federal Register.

(9) Any assistance provided under this subsection may be in subordination to the rights of depositors and other creditors.

(10) In its annual report to the Congress, the Corporation shall report the total amount it has saved, or estimates it has saved, by exercising the authority provided in this subsection.

(11) Payments made under this subsection shall be made --
(A) from the Bank Insurance Fund in the case of payments to or on behalf of a member of such Fund; or

(B) from the Savings Association Insurance Fund or from funds made available by the Resolution Trust Corporation in the case of payments to or on behalf of any Savings Association Insurance Fund member.

SOURCE

Appendix IV

Model Statutory Language for Emergency Liquidity Financing (“ELF”) by the Central Bank

Article --. Emergency Lending to Banks\textsuperscript{36}

(a) The Central Bank may,\textsuperscript{37} on such terms and conditions as it may determine, grant emergency loans or contingent commitments for the benefit of one or more banks\textsuperscript{38} for periods not exceeding [six months],\textsuperscript{39} in the event that the Central Bank decides that such loan or commitment would be justified by exceptional circumstances involving systemic implications;\textsuperscript{40} provided, however, that no such loan or commitment shall be made by the Central Bank unless:

(i) in the opinion of the Central Bank, which shall be transmitted in writing to the Minister of Finance and made public within 15 days thereafter,\textsuperscript{41} such loan

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\item \textsuperscript{36}This statutory provision assumes that a separate and distinct liquidity financing provision is in the central bank law for liquidity problems that arise from time to time in the ordinary course of business. While such problems may be symptomatic of more serious concerns, they are different from those contemplated by this provision.
\item \textsuperscript{37}This should be a discretionary rather than mandatory function of the central bank.
\item \textsuperscript{38}These should be commercial banks rather than state banks, since the latter should be financed by their ultimate owner, the state, through direct government expenditures.
\item \textsuperscript{39}The loans should be for a time limited period, with six months to be a rule of thumb. At some point, the question arises whether the bank will be able to survive; exactly when that occurs should be in the discretion of the central bank but should be limited to a reasonable period.
\item \textsuperscript{40}This is a purposefully high threshold designed to ensure that the central bank does not extend loans to all banks with emergency liquidity needs.
\item \textsuperscript{41}To promote transparency and to ensure uniformity of treatment, this determination should be made public.
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or commitment is dictated by the liquidity requirements of the bank\textsuperscript{42} and by the public interest;\textsuperscript{43}
(ii) the Minister of Finance has concurred in writing with any such opinion submitted by the Central Bank;\textsuperscript{44} and
(iii) such loan shall be extended by the Central Bank to the Republic for the benefit of such bank.\textsuperscript{45}

(b) Any such loan by the Central Bank to the Republic shall be collateralized by debt securities that bear interest at market rates, that have maturities corresponding to the maturities of the loans that they secured but in any event not to exceed one year, and that are issued and delivered by the Republic to the Central Bank.\textsuperscript{46} For each such loan there shall be a two written loan agreements:\textsuperscript{47} the first, executed by the Republic, represented by its Minister of Finance, and the Central Bank, and the second, executed by the Republic, represented by the Minister of Finance, the Central Bank, as agent for the Republic, and the bank named in the opinion referred to in paragraph (a)(i) above; each such agreement shall, among other things, clearly state the principal amount of the loan, its maturity and the applicable rates of interest,

\textsuperscript{42} The reference to liquidity is meant to ensure that banks that are insolvent on a book basis are not eligible for such financing. However, it would be preferable that the statutory provision not explicitly state this as a requirement since in many cases the solvency of the bank has not been determined at the time of the ELF.

\textsuperscript{43} In other words, ELF should not be made available to banks simply because they are suffering from a liquidity problem, but rather the public interest, where there are “exceptional circumstances involving systemic implications” as stated in para. (a), should also be a condition to such financing.

\textsuperscript{44} This is to ensure that the central bank and the minister act with one voice, since often differing institutional and other interests result in rivalry rather than cooperation between the two.

\textsuperscript{45} Since the ELF is being made “in the public interest,” the state should be the obligor as well as the bank, ensuring that the Minister’s concurrence would not be lightly given.

\textsuperscript{46} To ensure that the provision of ELF by the central bank does not result in a threat to the solvency of the central bank in the event that the ELF is not repaid in a timely manner.

\textsuperscript{47} The agreements should be in writing to promote transparency, uniformity, and to minimize disputes in the future.
which shall be at a rate of interest based on the inter-bank rate plus [_] percent, and other charges. The period for such loan or commitment may be extended by the Central Bank on the basis of a program acceptable to the Central Bank that specifies the measures to be taken by the bank concerned to satisfy the Central Bank's liquidity requirements. With respect to any such loan, the Central Bank shall act as agent for the Republic, and in such capacity shall, among other things, make disbursements to any bank that is named in the opinion referred to in paragraph (a)(i) above.

(c) Any bank receiving a loan or commitment hereunder shall be examined immediately by the Central Bank [Banking Supervisor].

\[48\] Since in virtually all cases the bank in question is seeking ELF based on the fact that normal inter-bank financing arrangements are not available to it, the provision of ELF should be based on a penalty rate of interest. This would also tend to discourage non-emergency requests for ELF.

\[49\] This requirement, along with that of subparagraph (c), reflects the fact that banks with emergency liquidity needs are almost always insolvent, and therefore should be subject to greater scrutiny by central banks and regulators.