Bank transfers in resolution – practices and lessons[1]

Executive summary

Transfer transactions can be a useful tool in the resolution of failed banks. Under such strategies, a healthy third party, typically itself a bank, takes over the entirety or parts of a failing bank's portfolio, or the entire legal entity of the failing bank. The adoption of bank transfers as a resolution tool can offer a number of advantages in comparison with other strategies. For instance, in contrast to a bank liquidation and depositor payout, transfer transactions can preserve important economic functions of a failed bank, including the provision of credit; they can limit the role of public authorities in managing the assets of failed banks; and they can avoid a lengthy and costly liquidation process for transferred assets. In addition, if uninsured deposits are included in the transfer, a transfer may reduce the risk of bank runs and contagion, as well as preserving access to those deposits. Separately, a transfer may require a lower level of loss-absorbing capacity at the failing bank compared with that required for a resolution based on an open bank bail-in. This aspect may make transfers a particularly relevant tool for resolving mid-sized banks, which may not be able to issue the larger amounts of loss-absorbing liabilities needed to support a bail-in strategy. Finally, a transfer may be combined with other resolution tools, such as a bail-in of selected bank creditors and, on a temporary basis, a bridge bank.

The use of transfer strategies in resolution is not widespread, but there is increasing interest in it. While a majority of jurisdictions' resolution frameworks include transfer tools, transfer strategies are not, at a global level, the most common way of resolving failing banks, although there are some jurisdictions in which transfers are routinely employed. Bank transfers were employed in the recent episodes of bank failures and distress in March 2023, in the United States and Switzerland for resolution of mid-sized banks and the state-sponsored acquisition of a global systemically important bank, respectively. There may therefore be interest in making this tool better understood and more easily accessible for resolution authorities.

This paper discusses the practical aspects of failed-bank transfers and highlights the key trade-offs. It draws on considerations identified by selected authorities whose resolution frameworks include bank transfers, and their practical experiences with these transactions. By breaking down this resolution strategy into its main components, the paper highlights key decision points that resolution authorities need to consider when adopting this strategy and aims to improve understanding of existing trade-offs and how authorities may address them.

Transfer strategies require authorities to consider a number of factors at the same time. Authorities need to select potential acquirers by considering the readiness and suitability of a third party to take over the failing bank's business. This presupposes the availability of sufficient funding to support the transaction given the asset-liability mismatch that is typical of a failing bank. Funding needs, in turn, are largely influenced by the extent to which the gap between assets and liabilities can be reduced by the failing bank's internal resources, such as its equity or junior debt. Key to the successful implementation of a transfer strategy is the ability of authorities to reconcile each of these elements.

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The authors thank colleagues in the surveyed countries for providing valuable information on their countries' frameworks and their authorities' practices, Ruth Walters and Danilo Palermo for their comments, and Marie-Christine Drexel for administrative support.

As funding is one of the major constraints on the feasibility of a bank transfer, authorities have levers available to reduce "funding gaps" between the value of assets and liabilities transferred. Authorities can minimise needs for additional funding by exhausting the failing bank's internal resources to absorb losses. Liabilities that are not included in the transfer can absorb losses as they tend to remain at the failing bank, which is subject to liquidation. Concerning deposits, a main decision point is whether to include both insured and uninsured deposits in the transfer. Authorities need to consider how best to treat "sensitive liabilities", ie those that, while in theory are capable of being loss absorbing, may be difficult in practice to writedown for social or political reasons, or because a writedown would risk contagion. The inclusion of a material amount of liabilities in the transfer, however, is only possible given either a comparably large level of assets or some flexibility around the level of funding support to the transfer. Accordingly, authorities need to carefully balance tailoring the assets and liabilities included in a transfer – in order to match the preferences of potential acquirers – with meeting the resolution authority's goals of financial stability. In that regard, funding support by resolution or deposit insurance funds will often be necessary.

Various measures could facilitate transfers by increasing the amount of external funding available, but the impact of such measures needs to be considered carefully. A common source of additional funding is the deposit insurance fund, where permitted by the mandate of the deposit insurer. Within the creditor hierarchy, a general depositor preference increases the likelihood of a bank transfer, relative to a preference for insured depositors only, by making funding from the deposit insurance fund more likely to be available. However, unless the asset recoveries are sufficient to repay all depositors, this may imply higher costs to the deposit insurance fund. Shared-loss agreements can reduce the risks to the acquirer, thus increasing the bid price it may be willing to submit, but not without cost to the resolution authority. In rare circumstances, the resolution authority may proceed with a bank transfer under a "systemic risk exception" – which permits the use of deposit insurance funds to complete a transfer even when this transaction is more costly than other resolution measures. Such exceptions are otherwise justified on the grounds of financial instability. However, safeguards are needed to ensure that the resolution authority's resources are not excessively exposed to the costs of the transaction.