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POLAR APPROACHES TO REGULATING CROSS-BORDER BANKING: NORDIC AND ANTIPODEAN ROUTES TO FINANCIAL STABILITY*

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Abstract
The growth of banks operating across national borders through branches poses problems for the regulatory and supervisory authorities, who are historically organised on a national basis, particularly in their responsibility for financial stability, crisis resolution, deposit insurance and other aspects of the safety net. This article contrasts two solutions to the problems that are being developed: the first by the Nordic-Baltic countries for handling Nordea, that wishes to take advantage of the European Company Statute in the legal framework of the EU/EEA and the second New Zealand, most of whose banks are Australian owned. The first reflects an attempt at a joint approach and a universalist solution that seeks greater harmonisation while the second reflects a territorial approach and the recognition of differences. Both show that there is already a much wider problem that needs to be addressed even when banks operate across borders through subsidiaries. Halfway houses between internationalisation and renationalisation of responsibility seem rather less plausible routes to success even if couched in terms of careful memoranda of understanding.

Keywords: financial stability, banking regulation, New Zealand, cross-border banks, insolvency.

As the process of economic integration has progressed small countries have increasingly found that their banks are foreign-owned. This poses a potential problem for both prudential financial supervision and the maintenance of financial stability in those countries. The underlying framework for regulating the financial sector was devised when most activity was domestic. Then a country could control the activities of its banks and when anything went wrong, mobilise domestic resources to put it right in the way it thought most appropriate. Now it may find that it not only

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cannot control what banks do in its territory but that it does not have the power to put things right in the least costly manner.

Regulatory authorities round the world have been addressing these issues primarily through the Basel Committee on Banking Supervision that is organised under the auspices of the Bank for International Settlements (BIS) (which is in Basel). Through this body, national regulators from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States agree minimum prudential standards under which banks should operate and draw up codes of best practice for bank regulators and supervisors both for domestic and cross-border activities.[1] The latest agreement (Basel 2) is aimed at 'internationally active banks' and seeks to provide a means of international co-ordination and co-operation such that these banks can be treated on a consolidated basis for all their operations across the world.[2] These standards are not binding and need to be transposed into national legislation if they are to have effect within a jurisdiction.[3] Recommendations that relate to cross-border arrangements require some form of agreement among countries for them to operate. On the whole these agreements have taken the form of soft law, such as 'Memoranda of Understanding' (MoU) which set out what each country undertakes to do. Such Memoranda are not normally enforceable and contain no sanctions for non-performance.[4]

In most countries round the world the host country retains responsibility for supervising banks operating within its territory, even though they are foreign owned. However, responsibility for the parent bank and indeed the financial group or holding company will lie with the lead or consolidating supervisor in the home country, with whom the host will need to co-operate and share information. Under Basel 2, particularly Pillar 2, this co-operation is enhanced and the

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[1] A description is available on the BIS website <http://www.bis.org/bcbs/>. Prudential regulation was initially addressed through what is known as the Basel Accord of 1988 but this was updated in 2004 (with some amendments in 2005 and 2006) after protracted negotiations and the new accord, labelled Basel 2, is due to come into force at the end of 2007 – *International Convergence of Capital Measurement and Capital Standards*, BIS, June 2006. Principles for good banking supervision are enshrined in *Core Principles for Effective Banking Supervision*, BIS, 1997. Parallel groups exist for securities markets – the International Organization of Securities Commissions (IOSCO) – and insurance – the International Association of Insurance Supervisors (IAIS).

[2] See *International Convergence of Capital Measurement and Capital Standards*, BIS, June 2006, p. 7.

[3] The EU has chosen to implement Basel 2 through the Capital Requirements Directive (CRD) (2006/48/EC and 2006/49/EC). The original Basel accord was implemented in the Solvency Ratio Directive (89/647/EEC).

[4] Unfortunately the full text of Memoranda of Understanding are not always published but the agreement between Australian Prudential regulatory Authority and the Reserve Bank of New Zealand signed in June 2003 (<http://www.rbnz.govt.nz/finstab/banking/supervision/0137035.html>) illustrates the form they take.

consolidating supervisor will be responsible for agreeing group-wide risk management procedures.[5] In the EU/EEA, however, prudential host country responsibility only applies if the foreign owned bank runs its operations through a subsidiary (see box 1).[6] If it chooses to operate directly or as a branch then the home country is responsible for prudential supervision (and deposit insurance, subject to a topping up provision) in the host country.[7] This ability to operate across borders under home country regulation (the Passport principle)[8] is fundamental to the implementation of the single European market in financial services and inhibits the member states from imposing barriers to keep out foreign banks.[9] However, there is no matching migration of responsibility for financial stability; that remains firmly with the host country. This is prima facie a recipe for a serious difficulty should the system come under strain.[10]

[5] Basel 2 applies prudential standards through three main 'pillars'. Pillar 1 relates to 'Capital Adequacy'. This forms the bulk of the 350 page document and sets out detailed rules for how banks should hold capital against the various risks they face and how the capital and the risks should be measured. Pillar 2 provides for a 'Supervisory Review' under which the supervisors in the different countries involved with each bank are required to agreement common standards and then assess the risk management measures being applied, requiring changes or more capital provision as appropriate. The third pillar 'Market Discipline' requires banks to disclose publicly a range of information on their activities, risks and balance sheet so that investors and customers can evaluate the risks for themselves. The disclosures made to the authorities under the first two pillars remain otherwise confidential. The original 1988 Accord related just to (a simplified version of) Pillar 1.

[6] EU legislation also applies in the wider European Economic Area (EEA).

[7] If the host country offers better conditions for deposit insurance the foreign bank can apply to top up its provisions for depositors in that country to that level.

[8] Implemented in the 1989 Second Banking Coordination Directive and the 1993 Investment Services Directive.

[9] This 'Passport' only applies to prudential regulation. A bank must comply with the local conduct of business legislation that is in force in each member state.

[10] M. Schüler, 'Incentive Problems in Banking Supervision – the European Case', ZEW Discussion Paper 03-62 (2003), points out this adds a horizontal, cross-border dimension to the traditional vertical principal-agent problem that can exist between the taxpayers and the regulatory authority in a single country, thereby creating an even more intractable incentive problem.

Box 1

The EU supervisory framework

*The EU approach to regulation and supervision of financial markets is sectoral, distinguishing between banking, securities and insurance markets according to the so-called Lamfalussy-process. Within each sector the process operates four 'levels'. On the highest, level one, the EU Commission and the Council of Ministers assisted by various committees (such as the Economic and Financial Committee, EFC), decide on principal regulatory matters in collaboration with the European Parliament, leaving regulatory specification to be carried out on level two. The level two (regulatory) committee for the banking sector is the European Banking Committee (EBC), the other sectors having their own regulatory committees. On level three, national supervisory authorities cooperate. The level three supervisory committee for the banking sector is the London-based Committee of European Banking Supervisors (CEBS). Furthermore, the European Central Bank and its banking Supervision Committee (BSC), with representatives for the national central banks and supervisors, are involved in the supervisory work regarding the stability of European financial markets. (Level four is enforcement.)**

According to Article 40 of the EU banking directive (2006/48/EC), supervision of banks with cross-border activities within the EU is based on the principle of home country control, indicating that the authorities in the country where the bank has its home (head) office, are responsible for the bank's prudential supervision. The directive focuses on the home office of the judicial entities irrespective of ownership. Article 41 states that host country authorities shall retain responsibility in cooperation with home country authorities for the supervision of the liquidity of bank branches. In cases where entities constitute parts of a cross-border group, directives on capital requirements establish an (limited albeit specified) obligation for the authorities of the countries involved to cooperate. In addition, Article 42 of the banking directive introduces a general (and unspecified) liability for authorities to cooperate, and the conduct of business is the responsibility of host country authorities.

Also EU cross-border crisis resolution is based on similar principles, the starting point being the home of the judicial entity. According to Articles 3, 9 and 10 of the insolvency directive (2001/24/EC), the reorganisation and winding up of cross-border banks (i.e., banks with branches) shall be decided on by the authorities of the home country according to the rules of this country. The deposit insurance directive (94/19/EC) states that the deposit insurance scheme of the bank's home country shall cover deposits of bank branches in host countries, whilst the local host country deposit insurance scheme only may be used for topping up, i.e., increasing the coverage in order to secure a level playing field for the marketing of deposits.

Lately, EU regulatory activity in financial markets has mostly corresponded to the EU Financial Services Action Plan (FSAP) and the EU supervisory framework continues to be the subject of debate, in which especially the need for an EU-level supervisor is discussed.

*See M.J. Nieto and J.M. Peñalosa, 'The European architecture of regulation, supervision and financial stability: a central bank perspective', *Journal of International Banking Regulation*, 5(3), pp. 228-242.

While the scale of branch operation remains small this may appear to be a limited problem, as the failure of the branch would not lead to a systemic event and the exposures of different foreign owned banks operating through branches may not be particularly correlated. However, the Nordic-Baltic countries and Finland in particular, face the prospect that much of their banking system may be operated as branches of foreign banks. Nordea, the most cross-border of the large European banks has announced that it intends to take advantage of the European Company Statute and operate as a single entity, headquartered in Sweden with branches in Denmark, Estonia, Finland and Norway.[11] Nordea is a systemic bank in all of these countries, in some cases more so in the host than the home country.[12] This raises two immediate questions:

- will the host country authorities have enough information about their banking system that they feel they can convincingly maintain systemic stability?
- will the host country authorities be able to do enough to maintain stability should a problem occur?

However, the problem is symmetric. The home country, although well informed, is responsible for a bank, most of whose operations are in other countries. Could it handle an event that is systemic both at home and abroad? Switzerland, for example, has already recognised that its deposit insurance fund might be exposed to unsustainable pressure in the event of a serious problem with UBS or CSFB and has placed a cap on the payout.[13] Normally a systemic bank is regarded as

[11] Finland's second largest bank, Sampo, is also foreign-owned, by Danske Bank, and this too would be able to decide that it wished to operate as a branch. This would leave the Finnish authorities only supervising about a quarter of the banking activities in Finland.

[12] The word 'systemic' in this context means that if the bank were to stop operating, the spillover effects onto the rest of the financial system and the economy at large would be sufficiently large and damaging that the authorities would feel obliged to step in. In other words action would be necessary if financial stability is to be maintained. This is not simply a matter of size but of whether the institution is crucial to the smooth operation of the financial system or to the maintenance of confidence in it. There are other events short of failure that could also be systemic in their impact but the point here is that the bank whether in the form of a branch or a subsidiary is thought too crucial to the smooth functioning of the financial system to be allowed to stop operating.

[13] See Hupkes, 'Bank insolvency resolution in Switzerland', in D. Mayes and A. Liuksila, *Who Pays for Bank Insolvency* (Basingstoke, Palgrave 2003) pp. 242-271. Although each account is mandatorily insured up to 30,000CHF in an industry-run scheme, there is a cap on the scheme of a payout of 4bn CHF. The legislation is silent on what will happen at this point but clearly if there were to be any recourse to further funding the taxpayer is the likely source. The Swiss scheme also has depositor preference, with the deposit insurance fund being subrogated to the claims of the insured depositors in a failure. Thus the chances of the fund not be able to collect in full, eventually, from the liquidation are small.

one which is in some sense 'too big to fail'[14] but in these cross-border cases we may have banks that are in some sense 'too big to save'. Considerable thought has gone into the handling of cross-border banks, both in normal times and in a crisis, not least through the two Brouwer Reports in the European context,[15] but the proposals, while identifying the issues clearly, fall well short of what will be required in the more extreme examples of interdependence. There is a danger that problems with such banks might be too difficult to sort out in time and in that sense too big to fail.[16] Indeed one of the recommendations in Brouwer et al. (2003)[17] is that the authorities should 'buy time' by offering some form of support to the institution but how they should agree to do that and what form that should take beyond the emergency liquidity assistance that central banks can offer is not spelt out. This is a recipe for a systemic problem unless it is sorted out in advance.[18] The limits to the conclusions from the Brouwer Reports reflect their terms of reference and it is for the receiving committees, the EFC (Economic and Financial Committee) and ECOFIN (Economic and Financial Affairs Council – of Ministers), to decide on further action, assisted by proposals from the Commission.

Clearly in the Nordic-Baltic case the authorities need to co-operate and are well on the way to sorting out a solution.[19] Because of the structure of their economies and their financial regulatory

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[14] Various definitions of 'too big to fail' have been offered, see, for example, G. Stern and R. Feldman, *Too Big to Fail: the Hazards of Big Bank Bailouts* (Washington, DC, Brookings Institution 2003), but the key concern is that can be no material interruption in the main business operations otherwise there will be a systemic event. This is set out in the excerpt from the New Zealand arrangements in Section 2.

[15] 'Report on Financial Stability', *Economic* Paper, No. 143, European Commission, Economic and Financial Committee, May 2000, 'Report on Financial Crisis Management', *Economic* Paper, No. 156, European Commission, Economic and Financial Committee, July 2001.

[16] The International Monetary Fund in its 2007 Article 4 consultation with the euro area concluded that '

[17] H. Brouwer, G. Hebbink and S. Wesseling, 'A European approach to banking crises', in Mayes and Liuksila (2003) *op.cit*., at pp. 205-221

[18] Traditionally a major concern in the literature has been that if a bank thinks it is too big for the authorities to let it fail there will be a moral hazard that the bank will therefore be tempted to take bigger risks as its downside exposure is limited (e.g., Stern and Feldman, op cit.). Normally this is tackled by making sure that even though the business of the bank may continue, the shareholders can expect to be in the front line of loses and the directors and managers can expect to lose their jobs in the event of actual or near failure and hence have every incentive to avoid this outcome. In any case there is little evidence of such risk-taking among the largest US and EU banks. However, if the outcome for a cross-border bank does appear that it is too big to save the moral hazard will be reduced.

[19] Of the five main countries involved with Nordea as a systemic institution, only four are members of the EU, Norway is member of the EEA and not the EU. Of the EU members, only Finland is a member of the euro area. Indeed each country has a different currency, although Estonia has a currency board backed by the euro and the Danish krone is

systems, it is likely that their interests will be reasonably well aligned in a systemic event and unlikely that the home country will not face a systemic problem at the same time as the hosts even if the intensity is different. However, we are discussing just one bank and there is no reason why this symmetry should apply to all cross-border banks. Home and host could easily have differing interests under imminent or actual default. Handling the problem is assisted in the EU/EEA case because of the requirement for equal treatment of all depositors and other creditors and the common pool approach to the distribution of the assets under the principle of universality. If the home country could apply territoriality or otherwise discriminate against the creditors and depositors in the host country, then such an arrangement would not work. This is clearly the case in New Zealand, where the majority of banks are Australian owned and Australia operates domestic depositor preference.[20] [21]

In this case, the authorities have to work out how to apply territoriality in a satisfactory manner so that they can handle systemic events separately. Indeed New Zealand has gone rather further in recognising the need to have an entity that can be self-sustaining in the host country. Although New Zealand is now insisting that systemic banks be locally incorporated (something the EU/EEA countries cannot do) it has gone much further with what is described as an Outsourcing

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closely pegged to the euro through ERM2 (Exchange Rate Mechanism). The other three Nordic-Baltic countries, Iceland, Latvia and Lithuania, while not facing Nordea as a systemic concern do have strong cross-border linkages in the region through branches or other banks.

[20] T.C. Baxter, J. Hansen and J.H. Sommer, 'Two cheers for territoriality: an essay on international bank insolvency law', 58 *American Bankruptcy Law Journal* (2004) pp. 57-91, provides a helpful assessment of the two approaches. However, within the universal and territorial approaches to insolvency procedures there is still quite a wide range of more detailed differences; see C. Hadjiemmanuil, 'Bank resolution policy and the organization of bank insolvency proceedings: critical dilemmas', pp. 272-330 in Mayes and Liuksila (2003) op.cit.

[21] Depositors normally come low in the ranking of creditors in a bank insolvency. In the US, however, insured depositors are ranked ahead of other unsecured creditors, although the FDIC (Federal Deposit Insurance Corporation) succeeds to their claims on assuming the obligation to pay out under the insurance. In the EU all depositors normally rank equally irrespective of their residence or the branch in which they deposited their funds. In Australia, however, Australian depositors are ranked ahead of other depositors – domestic depositor preference (see 'Greater international links in banking — challenges for banking regulation', by C. Doan, V. Glanville, A. Russell and D. White, Economic Round Up Spring 2006, Australian Treasury <http://www.treasury.gov.au/documents/1190/HTML/docshell.asp?URL=09_banking.asp>). This means that not only are New Zealand depositors in Australian banks uninsured but they are ranked after Australian depositors and hence may receive very little in an insolvency of an Australian bank. Issues of fairness aside, such an arrangement could have a large impact on the New Zealand economy and would in effect result in a subsidy from New Zealanders to Australians, something the New Zealand authorities do not favour.

Policy (RBNZ, 2005).[22] This requires that all systemic banks must be structured so that they can continue in operation without a break even if a major external service provider fails. To a large extent this means that they have to be able to operate on their own (or with other providers) even if other parts of the banking group were to fail. This limits the degree to which banks can integrate but apparently in the Australasian environment the ability to consolidate Australian and New Zealand functions has been quite limited – rather less than the banks originally hoped. However, in Europe banks are increasingly integrating the operations across borders and concentrating key functions in particular locations. Thus while there are important legal differences between branches an subsidiaries, in practice both tend describe a complex transborder entity that cannot neatly be broken up or dealt with on a national basis.

More importantly in the present context, the 'outsourcing' requirements mean that were the bank to fail, the authorities could also step in and keep the bank running as an entity in New Zealand without a break in business. This ability reflects not just the outsourcing policy but the powers of the Reserve Bank in the event of failure, whereby it can step in and appoint a statutory manager who can make a summary valuation, write down the claims so the bank returns to solvency and stay open with a guarantee against further loss under administration. These powers are also different from those that prevail in most of the EU/EEA countries and are an important contribution to having a credible means of handling problems of potentially systemic proportions without threatening financial stability.

These moves in New Zealand towards ensuring a workable solution for ensuring financial stability in the face of a problem in a foreign owned systemic bank have generated some opposition among the banks, which has been reflected in concerns at the political level.[23] As a result, Australia and New Zealand are engaged in discussions which could move them more towards an EU/EEA solution whereby both countries' interests both for individual creditors and depositors and for systemic stability are jointly and equitably taken into account both in avoiding problems and in solving them. In the Nordic-Baltic case the move is in a sense in the opposite direction as in the current EU/EEA framework the joint arrangements for avoiding and correcting these problems are not sufficiently workable to provide adequate comfort that systemic level events will be handled adequately and that the national authorities can deliver their obligations to financial stability. While the two approaches may not meet in the middle this article explores the lessons they have to offer

[22] Reserve Bank of New Zealand, Financial Stability Department Document BS11, October 2005, available at: <www.rbnz.govt.nz>, p. 2.

[23] These concerns and the resulting consultations and reflections are given in a series of papers available on the RBNZ website at: <http://www.rbnz.govt.nz/finstab/banking/supervision/>.

each other in resolving the difficulty. What does seem clear from the two approaches is that many current arrangements and suggested solutions whereby the interested parties get together in some international committee style of approach are likely to be unworkable in practice. The pressure of a crisis requires that the rules of engagement be clearly sorted out beforehand and the powers to take action that will affect stakeholders, particularly taxpayers, in other countries, firmly established in form even sovereign governments will find it difficult to over-ride.

The structure of the paper is therefore as follows. Section 1 sets out the nature of the problem faced by the authorities in the Nordic-Baltic region by the case of Nordea and extends this more widely to the handling other cross-border banks across the whole of the EU/EEA. In particular, it sets out an approach which argues that the only way to have satisfactory procedures in place in advance to handle bank distress in a way that will not threaten the financial stability of the countries concerned is to have adequate co-operation on all of the stages of regulation and supervision, from normal times, through poor performance, non-compliance and the need for prompt corrective action, right down to the procedures for handling exit themselves. Unless the early stages of correction, finding a private sector solution and early intervention work well and minimise the potential demands on public funds, the prospects for avoiding a systemic crisis will be weak. Section 2 then sets out the lessons that can be learned from the New Zealand approach, which is effectively based on the assumption that cross-border co-ordination will be difficult and hence the host country has to have in place a regime where it can handle the threat of a systemic event, whatever the level of successful international co-operation. The final section offers some reflections.

1 Putting Together a Framework

In many countries the framework for financial regulation, supervision, the treatment of problems and the handling of systemic events has been put together in a series of steps, rather than being the result of a single process of careful design. In particular, major changes have tended to be the result of unfortunate experience, be it the Savings and Loan crisis that led to FDICIA (Federal Deposit Insurance Corporation Improvement Act) in the US, or the Nordic crises.[24] The rethink in Australia

[24] It has been argued that the new disclosure based regime in New Zealand in 1996 was motivated strongly by the problems with DFC (the Development Finance Corporation), which failed in 1989 and the Bank of New Zealand, the largest bank, where the government had a majority shareholding, which required major capital injections in 1990 (P. Honohan and D. Klingebiel, 'The Fiscal Cost Implications of an Accommodating Approach to Banking Crises', 27 *Journal of Banking and Finance* (2003) pp. 1539-1560; E. Kane, 'Confronting Divergent Interests in Trans-Tasman Regulatory Arrangements', mimeo, Boston College, July (2005). The New Zealand disclosure regime is explained in

with the Wallis Commission is rather more unusual,[25] although a number of European countries, such as Ireland and the Netherlands, have changed their structures in recent years without any immediate pressures. The decision by Nordea to move to adopting the European Company Statute is therefore a welcome opportunity to rethink aspects of the system without the pressures of an imminent, current or recent crisis. In this case what has to be rethought is how a regulatory system designed primarily for closed national environment, where the ownership and management of the banks, location of their borrowers, depositors and creditors, and the wider systemic impact on taxpayers and society at large all fell within the same jurisdiction, should be extended to one which is primarily cross-border.

It is not just a matter of whether the hopefully rare (nonexistent) systemically important crises that run across borders can be handled satisfactorily in prospect but whether the whole framework of joint operation from bank regulation, registration and supervision through to prompt corrective action and resolution will operate well. For the system to work well in crisis it must be perceived to have worked well in the previous periods, i.e., under normal conditions. Handling difficulties involves the painful process of allocating losses and unless each of the national authorities are convinced that the procedures for avoiding and minimising the losses were satisfactorily handled by the other administrations involved with the cross-border banks in question during the previous normal times they will find agreement on burden sharing at the time of crisis difficult. In a crisis there is no time for fundamental argument and the process of initial resolution at any rate needs to take place within the settlement 'day' on which the failure becomes known to the authorities.[26] Banks are unlike other firms in that depositors, counterparties and other financial claimants can all rush to claim immediate payment at the first hint of a problem, even if none actually exists. Central banks stand ready to provide all the liquidity necessary – against collateral – in an emergency and normally simply the knowledge that this is the case will prevent a run on a bank as no one need fear that they will not get paid. If the bank has run out of collateral then no further support from the

pp. 24-32 of G. Mortlock, 'New Zealand's Financial Sector Regulation', *Reserve Bank of New Zealand Bulletin,* vol. 66(4), pp.1-45. The *Banking Supervision Handbook* that contains the detailed regulations is available at http://www.rbnz.govt.nz/finstab/banking/regulation/0094291.html. See also below, Section 2 and Box 3 in particular.

[25] Financial System Inquiry Final Report, Canberra: Australian Government Publishing Service, March 1997.

[26] This may simply be overnight rather than the proverbial weekend before the bank has to re-open in its new guise on the Monday morning. Much of the traditional discussions are based on the idea that transactions are batched and deferred to the end of the day but nowadays many operations are real time and in markets that do not close, so the effective interval for decision-making may be very short.

central banks is available and the governments must decide immediately whether to use taxpayers' money and how the various countries involved should contribute, otherwise the bank will fail.

It is therefore essential that the opportunity for a set of recriminations over whose fault the problem is and a debate over fair distribution of losers and beneficiaries is minimised. As has been emphasised before, the earlier in the process the authorities can intervene and hence the smaller the losses, the easier it will be to resolve debates over equity.[27] Indeed if intervention can occur before a bank's capital is exhausted then there are no losses to argue about and resolution can remain a technical and not a political task. However, this would require the problems to mount slowly and not to be the result of a sudden shock or a fraud. If there is no prior and public agreement on what to do in the event of a problem this is unlikely to be 'constructive ambiguity'[28] but a threat to the viability of deposit insurance schemes and recipe for a crisis rather than for its avoidance.

The authorities who are between them facing possible systemic outcomes from problems in a particular bank need to be convinced that the framework will function well in all circumstances. We can effectively divide the possible conditions into five for the purposes of analysis:

1. 'Normal times' when the bank is regulatory compliant and performing competitively in the market
2. 'Difficult times', when although the bank is regulatorily compliant, it is underperforming in the market
3. 'Problems', when the bank has become undercapitalised and the authorities require action if the bank is to remain in business
4. 'Systemic events', when although the bank is itself regulatorily compliant its viability is affected by outside shocks to the system

[27] In D.G. Mayes, L. Halme and A. Liuksila, *Improving Banking Supervision* (Basingstoke: Palgrave 2001), ch. 8-10 and D.G. Mayes and A. Liuksila, *Who Pays for Bank Insolvency* (Basingstoke, Palgrave 2003) ch. 1, we argue for intervention at the latest when the net worth of the bank is adjudged to be zero and at best at a small positive capital ratio, as in the US. (See D.G. Mayes, M. Nieto and L. Wall, 'Multiple safety net regulators and agency problems in the EU: Is Prompt Corrective Action partly the solution?', Bank of Finland Discussion Paper 07/2007, for a discussion of how US-style early intervention before losses mount might be implemented in the EU.

[28] The idea behind 'constructive ambiguity' is that if banks are unsure what the authorities will do when they get into difficulty, they will assume that governments will *not* help them and hence take extra efforts to avoid getting into difficulty in the first place. Our argument here is that they will do the exact opposite in the present EU environment. EU governments have been keen to avoid bank failures, as the actions in the Nordic crises round the beginning of the 1990s illustrate. If the authorities cannot show convincingly how such intervention will be avoided in the future then the banks will assume that they will be bailed out as in the past even if that is actually not what the authorities intend to do. Any government will say before the event that there will be no bail out – the question is 'will it be believed?'.

5. 'Actual or imminent default' when the bank can no longer continue in normal operation and the authorities have to step in.

Most of the discussion, both in practice and in the literature, focuses on Case 1, whether in the organisation of supervision under Basel 2 or across Europe.[29] This is natural as it covers most banks in most time periods. However, this case is not the most difficult one to sort out. With some exceptions we discuss shortly, this is well on the way to agreement in the case of Nordea. Similarly the arrangements for handling system-wide shocks (Case 4) are also well advanced.[30] The Eurosystem has had an MoU on how to organise Emergency Liquidity Assistance since 2003 and the Nordic central banks are clear on how the responsibilities go and how they co-ordinate in the event of market problems, whether they are in the payments system or other parts of the infrastructure. They have conducted joint simulation exercises for the handling of such cross-border problems. The remaining three cases are less well addressed at the cross-border level, although for different reasons.

For ease of exposition, we take these five steps in turn.

1.1 *Normal Times*

A cross-border bank, even though operating through branches, has problems of compliance with host country regulations, particularly in the areas of tax and conduct of business. The issue of prudential regulation in case of a cross-border bank operating through branches is, however, straightforward in the EU/EEA. Here compliance is the responsibility of the home country – in Nordea's case, Sweden (see box 2). It is for the Swedish Finansinspektionen to work out with the other supervisors how it wants to run the new structure of supervision, and a working group already exists, which in any case has the task of working out how to handle consolidated supervision under Basel 2. The Swedish authority could in theory just employ its own local staff, presumably recruited from among the ranks of the newly unemployed supervisors in the other countries, since being able to speak the local language and having some experience are essential. The other authorities would then only gain access to information about Nordea officially through what the Swedish authority disclosed under the present or some new MoU. Thus although the Finnish authority remains

[29] See, for example, D. Schoenmaker and S. Oosterloo, 'Cross-border issues in European financial supervision', in D. Mayes and G. Wood, *The Structure of Financial Regulation* (London, Routledge) and Masciandaro, D 'Allocating financial regulatory powers: the twin views' in Mayes and Wood (2007), op.cit., pp.213-231, for suggestions about how cross-border supervision might be organised.

[30] A significant shock to an economy, which can be thought as not being the 'fault' of any specific group in the country, is an obvious case for governmental intervention to spread the impact across society.

responsible in its charter for the stability of the financial system it would be only supervising parts of the banking activity (given that some (non-systemic) foreign banks already operate through branches).

Box 2

The Nordea Case

The Nordea Banking Group, which is currently headquartered in Sweden and has subsidiary banks in Norway, Denmark, Finland and Poland, branches in other countries including Estonia, Lithuania, Latvia, the United Kingdom, Singapore and a branch in New York, an investment services arm and an insurance company, is planning to take advantage of the European Company Statute (Regulation, 2157/2001). According to the statute, a European company is created through an international merger of public companies, and Nordea's manoeuvre is likely to be the first such move by a major international bank and hence a substantial departure from the traditional parent and subsidiary model. As a result of the restructuring, the bank will operate as a single bank based in Sweden with branches in all the other countries.

From the viewpoint of market stability, Nordea is clearly of systemic importance. As at 2006 it had a 30% share of the Finnish banking market, 20% of the Danish, 15% of the Swedish and 10-15% of the Norwegian. Its share of the insurance markets was somewhat smaller: Finland 30%, Denmark 15%, Norway 8% and Sweden 4%. Nordea's share of the Estonian banking markets is smaller, being clearly of less than systemic proportions.*

The current framework for supervision and the treatment of the solvent bank is straightforward. Each of the constituent banks (i.e., judicial entities in respective countries) is supervised by their own authority and the group is supervised from Sweden. The same applies to the parts of the insurance arm, although in Finland, the insurance supervisor is at present a separate supervisor. However, beyond that the structure becomes more complicated. Nordea Bank (Finland) has, e.g., a branch in New York and a branch in Estonia.

There is thus overlapping responsibility. In the New York case the branch is supervised by the Finnish authority (Rahoitustarkastus), the New York Federal Reserve Bank and New York state authorities. All are involved in on-site inspections. In the Estonian case the position changed on 1 May 2004 when Estonia joined the EU. Up till then the position was similar to New York with overlapping supervision. Now Estonia, in theory, has no role in prudential supervision, though according to the existing MoU, there is an exchange of information. (Conduct of business regulation as well as liquidity oversight are still national concerns.)

* All data from Rahoitustarkastus.

To operate systemic responsibilities realistically in the host countries it will be necessary for these countries to have the same sorts of information available on a cross border bank such as Nordea that they have on their own home country banks. The Finnish authorities have suggested that the way to do this is to have a 'college' of supervisors under Swedish leadership who have access to a common database, an idea also promoted by the European Financial Services Round Table.[31] Thus the supervisors from the various countries would in practice be jointly responsible for the supervision of Nordea and through the common database would have access to information on the other parts of the group as well as those within its own national boundaries. This would actually increase the information available but would make it more relevant from the point of view of assessing stability. There are other options through agency agreements and the like but some form of voluntary closer arrangement than that laid down under the current home-host rules in the EU will be required if the systemic concerns are to be satisfied. As Vesala (*op cit*.) points out, the practical differences between a bank operating as a subsidiary and the same bank operating as a branch are likely to be small and hence having a substantial change in supervisory arrangements between the two circumstances does not prime facie seem logical. If the change is necessary for the branch arrangement then it was probably also necessary for the subsidiary arrangement or, conversely, if the arrangements for the subsidiary structure were satisfactory little change is needed for a switch to branch status. The EU legislation introduces an artificial divide.[32]

Exactly the same argument applies to the home country supervisor. It needs to be fully informed of the risks and trends in the markets of the host countries where the cross-border bank has significant exposures. The joint access to information needs to be two-way – and timely in the sense that all have access to the information at the same time.

Experience in the United States also suggests that the process of supervision of cross-border institutions needs to be highly co-ordinated so that banks cannot move assets round inside the group to meet the requirements of each of the supervisors one at a time. Consolidation needs to take the

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[31] J. Vesala, 'Prudential supervision and deposit insurance issues raised by the European Company Statute', Colloquium on the European Company Statute, ECB, Frankfurt, 23 February(2005); European Financial Services Round Table (2004) 'Towards a lead supervisor for cross-border financial institutions in the European Union', Brussels, June.

[32] There is one important difference between branch and subsidiary structures if a bank gets into difficulty. Then it may be possible to concentrate the losses in a particular subsidiary and let that fail, while allowing the rest of the group to continue in a manner that would not be possible if it were organised as a single entity with branches in different jurisdictions. Thus, to some extent, the putative protection offered by the need for a subsidiary to hold its own capital can be a misleading indicator of the relative position of the two legal forms in the case of difficulty.

group as a whole not add up the separately assessed activities in each supervisor's responsibility.[33]

Although there has been substantial regulatory convergence among the different countries involved with the systemic risks associated with Nordea, assisted by the work of CEBS, this will represent a step up in the level of regulatory competition, with consumers being able to make a very real choice between banks from different regimes. There is no discussion of creating a new Nordic-Baltic level supervisory authority, although that might be the most straightforward way to address a common issue. Given the size of the region this would not be larger than some regulators that already exist in Europe. To some extent this lack of interest is because there is no great wish to spend considerable effort creating regional institutions when there may be changes at the European level. However, creating a European supervisory authority, even if it were only to have a co-ordinating or monitoring role, has not been actively discussed outside the academic literature by policy makers.[34] The bigger the difference in regulatory and supervisory practices then the more difficult it is for there to be a joint regulatory arrangement or a delegation of responsibility from one regime to the other. In the EU/EEA as a whole some of the differences are still substantial.

There are still a number of wrinkles to be sorted out before an agreement can be reached, one of which relates to deposit insurance. Although all of the EU/EEA members have to have deposit insurance up to a certain minimum standard under the Deposit Insurance Directive,[35] there is a wide range of options that govern how that can be organised, what the coverage should be beyond the minimum in terms of types of account, size of deposit, whether the scheme is industry owned, how quickly it pays out, what extent it is funded, whether contributions are risk-based – the list is long.[36]

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[33] Larry Wall has drawn the following example to my attention. The FDIC reported in its assessment of the 1982-3 year – <http://www.fdic.gov/bank/historical/managing/Chron/1983/index.html> – that 'The Butcher organization, including approximately 40 loosely affiliated banks and savings and loan associations, operated in two FDIC regions and three Federal Reserve Districts. A total of seven different regulatory agencies were responsible for supervising the institutions, making the detection of problems within the combined organization extremely difficult. The insolvency of United American Bank and, subsequently, of other Butcher-related institutions, was discovered only because the FDIC undertook a simultaneous examination of the major Butcher-affiliated banks, committing to the task nearly 10 percent of its field workforce for almost three months. At the end of 1983, the FDIC estimated that its losses in connection with the eight failed Butcher banks would amount to approximately $382.6 million.'

[34] Schoenmaker and Oosterloo (2006) *op. cit*.

[35] The Baltic States have a derogation and will not reach the EU minimum standard of protection until 2008. The European Commission re-opened the Deposit Insurance Directive in 2004 and invited submissions on revision. Proposals for change have not followed.

[36] Appendix 2 in A. Demirgüç-Kunt, E.J. Kane and L. Laeven, 'Determinants of Deposit-Insurance Adoption and Design', mimeo, World Bank (2005), provides an update of the detail on deposit insurance schemes. G. Garcia and M.

The conditions of the Nordic and Baltic countries are by no means the same.[37] A bank licensed in one EU/EEA country, when operating in another EU/EEA country, can apply to join the local fund to top up its insurance to the locally prevailing level to avoid being at a competitive disadvantage. (There is no corresponding opportunity to worsen it except through choice of corporate allocation.) Who is responsible for deposit insurance matches the responsibility for supervision, so Nordea would need to switch to the Swedish scheme.[38] However, under current rules that would involve making new contributions to the Swedish scheme, as it is not possible to withdraw the contributions to the other funds and transfer them. Not surprisingly Nordea would like the rules changed and the Deposit Insurance Directive reviewed.[39]

One possible way forward, suggested by Eisenbeis and Kaufman (2007)[40], is to offer a new European level insurance scheme for cross-border banks provided that they become European companies and adhere to a number of conditions that make resolving their problems easier (we return the these conditions below). This scheme could be offered at a discount over other schemes, first of all because the conditions reduce the risk of losses but second because large banks are themselves less likely to fail as they are diversified and have adequate resources to withstand many of the one-off shocks such as fraud or natural disaster that would cripple a small bank. This arrangement is unlikely to cover the ‘lost’ contributions to existing schemes but at least makes the idea of changing to a better cross-border arrangement more attractive.

It is also worth noting that since deposit insurance is intended to provide comfort to depositors outside the institution in trouble, so that there are not runs on healthy banks that cause a systemic crisis, depositors themselves have to be convinced that the home country is going to offer that protection if the primary cause of the problem is in a domestic institution. Thus the deposit insurer

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Nieto, ‘Banking Crisis Management in the European Union: Multiple Regulators and Resolution Authorities’, 8 *Journal of Banking Regulation* (2005) pp. 206-226.

[37] See J. Sigurdsson, ‘Small countries, large multi-country banks: a challenge to supervisors – the example of the Nordic-Baltic area’, chapter 5 in Mayes and Liuksila (2003) *op.cit*, Appendix, pp. 158-162.

[38] Topping up, of course, deletes the neatness of the match between supervisory responsibility and deposit insurance. In theory under the strict interpretation of the home-host relationship, the host country that was providing the top up would not be involved in the direct supervision or have any specific say in minimising the losses to the fund.

[39] European Commission (2005) ‘Review of the Deposit Guarantee Schemes Directive (94/19/EC), DG Internal Market, 14 July, DGS 001/2005.

[40] R. Eisenbeis and G. Kaufman, ‘Cross-Border Banking Challenges for Deposit Insurance and Financial Stability in the EU’, paper presented at the Bank of Finland/Journal of Financial Stability conference on ‘Financial Stability Supervision and Central Banks’, Helsinki 7-8 June 2007, available at: <http://www.bof.fi/NR/rdonlyres/F92ECD28-B005-41D2-820A-EFAF6631735E/0/JFS2007_EisenbeisKaufman_paper.pdf>.

would need to be offering credible protection against the consequence of events outside its control. Where that is a large exposure, there could be doubts and people might fear the ex post imposition of a cap along Swiss lines, for example.

The form of the agreement among the countries would need to be spelt out. Since the 'college' of supervisors would be operating together but under the home supervisor leadership and rule system, this presumably would not look like a traditional Memorandum of Understanding but would be a rather more detailed and explicit agreement, involving both the provision of services and the specification of the rule system to be followed.

1.2 *Poor Market Performance*

Ideally poor market performance by a bank would be sorted out by normal market forces – market discipline. Its market price would fall, it would lose business and ultimately it would be bought by a competitor. However, once we get to banks of systemic size they are already pushing the limits of concentration in the market and it is unlikely that their immediate competitors would be allowed to purchase them outside a crisis even if they could raise the funds to do so. It would have to be a large bank that was not currently a major player in the markets where this cross-border bank operated that could step in. How possible this would be is somewhat debatable and as recent events have shown, there are difficulties buying in to some European countries, Italy in particular.[41] To some extent of course the pressure on the bank will come through the existing shareholders as they see their returns waning and through the management who see the chance of losing their jobs increasing. Stakeholders in the bank need both to be able to monitor effectively how the bank is performing, and to take action if they regard performance as inadequate.[42] It is also debatable whether the amount and relevance of information publicly available permits this, despite the role of ratings agencies and subordinated debt markets.[43] Market discipline as the result of extensive public

[41] Most of the discussion has been journalistic concerning the purchase of Antonveneta by ABN-Amro and Banco Bilbao Vizcaya Argentaria's (BBVA) abandoned bid for Banca Nazionale del Lavoro (BNL).

[42] Llewellyn and Mayes (2003) 'The role of market discipline in handling problem banks', pp. 183-210 in G.G. Kaufman, ed., *Market Discipline in Banking: Theory and Evidence* (Amsterdam, Elsevier), identify ten stakeholders who could have the incentive both to monitor and take action to discipline banks through various markets: depositors, managers, borrowers, supervisory agencies, rating agencies, market traders, shareholders, boards of directors, debt holders and employees. R. Bliss and M. Flannery, 'Market discipline in the governance of US bank holding companies: monitoring vs. influencing', Federal Reserve Bank of Chicago Working Paper 2000-3 (2000).

[43] Even the new pillar 3 of Basel 2 is not insisting on standards of disclosure that are as relevant as those that have been required since 1996 in New Zealand; Mayes et al (2001) op cit for a discussion of the disclosure requirements and the Appendix to chapter 7 for an example of a General Disclosure Document (made by Deutsche Bank).

disclosure is the second pillar of the New Zealand framework after the control of registration of banks.[44] Insofar as market discipline does not work well it puts increased pressure on the supervisory authorities who will always be at one remove from the market and hence will tend to be slower and less efficient in the task.[45]

There has not been an extensive debate in Europe or in the Nordic-Baltic region in particular about whether the forces of market discipline are adequate. Margins are relatively high in a number of the Nordic countries,[46] which suggests that perhaps this is not the case, although it may assist in the creation of strong banks.

1.3 *Emerging Problems*

One of the consequences of FDICIA in the US has been that there is clear path of Prompt Corrective Action (PCA) as part of a requirement of Structured Early Intervention and Resolution (SEIR) laid down for the authorities should a bank become undercapitalised and hence offer an unacceptably high risk of failure (box 3).[47] On the one hand the bank is given a timetable to recapitalise and on the other there are restrictions on its actions, which limit its ability to take on increased risk and prevent the shareholders from extracting capital from the bank in order to improve their position in the event of eventual closure. As the capital ratio falls so the requirements and restrictions become harsher until the point is reached that the bank has to be closed within 90 days if it becomes 'critically undercapitalised'. This final intervention takes place when the leverage ratio falls below 2% so it is not actually a requirement that the bank be insolvent in the sense that its creditors could not be paid out in full, although this has normally turned out to be the case.

[44] The indications are in New Zealand that various aspects of the disclosure regime have been very effective. Making directors legally responsible for the disclosures has helped ensure that they apply sufficient effort to ensuring their accuracy. Disclosure has also helped sharpen competition and market structure has changed quite considerably in the last 10 years, with a number of acquisitions.

[45] R.A. Eisenbeis and L.D. Wall, 'The Major Supervisory Initiatives Post FDICIA: Are They Based on the Goals of PCA? Should They Be?' Federal Reserve Bank of Atlanta Working Paper 2002-31 (2002).

[46] See the Bank of Finland Financial Stability Review for 2005, for example, and H. Koskenkylä, ed., *Financial Integration*, Bank of Finland Study A:108 (2004).

[47] The requirements for PCA in the US are set out in D.G. Mayes, M. Nieto and L. Wall, 'Multiple safety net regulators and agency problems in the EU: Is Prompt Corrective Action partly the solution?', Bank of Finland Discussion Paper 2007/7.

Box 3

The Federal Deposit Insurance Corporation Improvement Act of 1991

In December 1991, the US Congress enacted the Federal Deposit Insurance Corporation Improvement Act (FDICIA). The Act was motivated by the severity of the U.S. banking and thrift crisis of the 1980s and represented the most important banking legislation since the Banking (Glass-Steagall) Act, which was enacted in 1933 at the depth of the previous most severe banking crisis in U.S. history. The large number and high cost of the failures were in large measure attributable to serious flaws in the extant government-sponsored deposit insurance program that encouraged insured institutions to assume excessive credit and interest rate risks and bank regulators to delay imposing corrective sanctions on troubled institutions and resolving economically insolvent institutions.

The FDICIA greatly increased the powers and authority of the FDIC. Major provisions recapitalized the Bank Insurance Fund and allowed the FDIC to strengthen the fund by borrowing from the Treasury. The act mandated a prompt corrective action approach (PCA) and a least-cost resolution method (LCR) to problem and failing banks and ordered the creation of a risk-based deposit insurance assessment scheme. Brokered deposits and the solicitation of deposits were restricted, as were the non-bank activities of insured state banks. FDICIA created new supervisory and regulatory examination standards and put forth new capital requirements for banks. It also expanded prohibitions against insider activities and created new Truth in Savings provisions.

The prompt corrective action approach (PCA) mandated a series of both discretionary and mandatory sanctions that the regulators first may and then must apply as an institution's financial health progressively deteriorates as reflected in a number of capital-to-asset ratios. These sanctions are intended to encourage the institutions to reverse their deterioration before it is too late. But if they fail to do so, PCA requires resolution of the institution before their book-value capital is fully depleted. This is intended to minimize any losses from failure.

Other countries, such as Mexico, have similar requirements but they are not normally so transparent nor so mandatory, which weakens the point of the arrangement, as it is intended to both as a discipline on the authorities to ensure action[48] and as a means of reducing moral hazard among the banks. The current and prospective actions will act as a strong incentive for them to find a way out and not to exacerbate the problem through further risk taking. Furthermore, one of the motivations behind FDICIA was to restrict the ability of the FDIC to offer open bank assistance,[49] i.e. forms of support for the bank that enable it to keep open even though it is not regulatorily compliant. Some European countries, among them Finland, have used open bank assistance in recent years[50] and, hence, even though this may now be more difficult, especially since direct subsidies are not permitted in the EU and have been challenged successfully in the cases of Credit Lyonnais and the German LandesBanken, for example, it is by no means clear that banks believe that such support will not be forthcoming in the future. Indeed, there will no doubt be political pressures for this to occur. Joint rules for PCA are not in place in the Nordic-Baltic region and since different approaches were followed in the Nordic crises it seems likely that one authority would not necessarily act in the same way as another under pressure.

This opens up the opportunity for a dispute if a systemic cross-border bank were to reach insolvency, as a host might claim that the home country had not done enough to force recapitalisation say by merger and acquisition.[51] If the owners hoped for a bailout they might well resist an acquisition that they would accept if they were more certain that the alternative was that their share value was wiped out entirely.[52] Kane (2005) suggests that in the case of Australia and New Zealand the dispute could start over point of insolvency itself, as the New Zealand criteria relate to an economic valuation of net worth that is likely to cut in before the Australian accounting or book value definition. Thus there could possibly be recriminations in one direction for acting too late and in the other for acting too soon.

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[48] I.e., avoid forbearance.

[49] R.T. Helfer, 'What Deposit Insurance Can and Cannot Do', *Finance and Development*, March (1999) pp. 22-25. Helfer was Chairman and CEO of the FDIC from 1994 to 1997.

[50] T.G. Moe, J.A. Solheim and B. Vale, *The Norwegian Banking Crisis* (Oslo, Norges Bank Occasional Paper 2004) p. 33.

[51] G. Hoggarth, J. Reidhill and P. Sinclair, 'Resolution of banking crises: theory and evidence', mimeo, Bank of England (2002), produce a neat list of the options open for bank assistance.

[52] T. Padoa-Schioppa, *Regulating Finance: Balancing Freedom and Risk* (Oxford, Oxford University Press 2004), argues that peer pressure might be rather successful in the European environment in ensuring that supervisors actually conform to the rules they set themselves.

One of the big differences in the European environment is the role of the deposit insurance fund. There is no equivalent of the FDIC, which has the duty of risk minimisation and taking the appropriate corrective actions including ultimately resolution. In many countries the deposit insurer is simply a pay box with virtually no staff. The Finnish Deposit Insurer, Talletussuojarahasto, for example, is run by the Finnish Bankers Association, Pankkiyhdistus; it has one part-time employee. (The Swedish Deposit Insurer, Insättningsgarantinämnden, has two employees.) This is somewhat different from the FDIC which has 5,200 employees, even allowing for the 60-fold difference in population or the size of insured deposits or number of banks. The Nordea case is thus somewhat easier to address than other cross-border groupings might be as the institutions match in character across the countries involved. The German deposit insurance system for example operates more in the form of an industry club.[53] Since it is financed by the banks they have tended to try to find a least cost solution and as a result to find way to takeover the bank without having to go as far as the costs of insolvency. Such a system can work if the banks in trouble are relatively small compared to the rest of the industry. It largely meets the requirements of a market based solution although it no doubt favours domestic over foreign acquirers.

Ironically the difficulties are in some respects greater if the cross-border bank is operating through subsidiaries and not branches. Then different authorities are responsible for different parts of the organisation, some may prefer one form of resolution to another and try to enforce it in separate proceedings. However, unless the bank is truly divisible in the New Zealand sense, dismemberment may be difficult without promoting just the systemic event it is hoped to avoid. Having a cross-border bank that is operating through branches enforces a prior co-operative arrangement, which probably is a better match for the actual structure of the bank as the opportunity for independent decision under insolvency may be illusory but not fully apparent until it is tried - unsuccessfully.

If the bank is operating through branches then the countries need to come to an agreement in advance on the PCA that is to be applied by the consolidating (home country) supervisor and other competent authorities in the home country. Such a framework has to be legally binding to minimise the chances of backtracking in a crisis. There are some clear complexities here because the corrective action to be applied has to have regard for the systemic consequences in each of the partner countries. A drastic halt to loss-making operations in one part of a group might save the group but not avoid the systemic event in a particular country.

[53] T. Beck, 'The incentive-compatible design of deposit insurance and bank failure resolution: concepts and country studies', pp. 118-141 in Mayes and Liuksila (2003) *op. cit.*

A second way to try to ensure prompt corrective action is the ‘four eyes’ principle. In this case both the supervisor and the deposit insurance fund will be examining the bank in difficulty. The deposit insurance fund would be setting up the procedures necessary for an orderly resolution of the bank should the point of insolvency (or other compulsory intervention, such the 2% leverage ratio in the US) be reached. The most important aspect of this is trying to get a basis for a rapid valuation of the claims as this will be needed in the first step of resolution. Since the deposit insurance organisation may not have the capability for doing this in many European countries, the alternative might be to create a ‘resolution agency’. This might be particularly suitable in cases like Nordea. The agency could be bank specific. As is clear from Table 1 drawn from Schoenmaker and Oosterloo (2006)[54] the number of such banks is quite small and different groups of authorities need to come to an agreement under a particular consolidator or leader in the home country. The terms of that agreement and the approach to any potential burden sharing, such as the consequences of any guarantees that are to be made with respect to the new entity after intervention, could vary from case to case. The countries involved in the Nordea case cannot wait for Europe wide agreement otherwise they would run the risk of holding up the restructuring and greater efficiency of the bank for an indefinite period.[55]

The advantages of setting up a new agency in this regard is that it can be transnational from the start and its charter can set out the principles for equitable treatment of the partner countries and how they would handle any burden-sharing should there be a cost. Otherwise, as with supervision, the attempt is to ask a national agency in one country to act on behalf of all of the countries. In a crisis domestic pressures may outweigh the foreign ones, even if only inexplicitly. Such a separation would mean that the nature of the agreements over the supervision of institutions through an enhancement of the home-host principles can be different from that for the resolution agency, which has to bear in mind the interests of financial stability and loss management in each of the countries where the bank is of systemic concern.

[54] D. Schoenmaker and S. Oosterloo, (2006) *op. cit.* The number is a little greater than the nine ‘European’ banks shown in the first category in the table but a number less than 20 sounds plausible even allowing for banks with a very uneven country coverage.

[55] Many of the other member states are not under similar pressure to find a rapid solution as they do not face similar systemic concerns .It is not clear when if ever an EU-wide agreement would be reached.

Table 1 *Categories of banking groups* (top 30 EU banks in 2003)

Category	*Banking group*	*h* (in %)	*e* (in %)
European	1. Deutsche Bank	25	41
	2. Nordea Group	28	71
	3. ABN AMRO	28	36
	4. KBC Bank	40	40
	5. Fortis Group	44	28
	6. BNP Paribas	47	25
	7. Westdeutsche Landesbank	48	43
	8. HypoVereinsbank	48	33
	9. Groupe Caisse d´Epargne	50	38
International	1. HSBC Holdings	24	6
	2. ING Group	29	24
	3. Banco Bilbao Vizcaya Argentaria	44	3
	4. Santander Central Hispano	45	16
Domestic	1. Dexia	54	37
	2. Société Générale	56	21
	3. Dresdner Bank	59	29
	4. Crédit Agricole Groupe	61	19
	5. UniCredit	71	13
	6. Bayerische Landesbank	72	14
	7. Commerzbank	75	15
	8. Rabobank	75	9
	9. Crédit Lyonnais	77	8
	10. Royal Bank of Scotland	77	5
	11. Banca Intesa	78	10
	12. Barclays	80	8
	13. HBOS	91	5
	14. Lloyds TSB Group	94	3
	15. Abbey National	97	3
	16. Crédit Mutuel	n.a.	n.a.
	17. Groupe Banques Populaires	n.a.	n.a.

Source: Schoenmaker and Oosterloo (2006).

Notes: ‘Home’ is defined as a bank’s business in its home country (denoted by *h*); ‘Rest of Europe’ is defined as a bank’s business in other European countries (denoted by *e*); ‘Rest of the world’ is defined as a bank’s business outside Europe (these figures are not shown). The three categories add up to 100 per cent. Banks in each category are ranked according to the share of their international business. The abbreviation ‘n.a.’ means ‘not available’.

One might want to go further and argue for a European resolution agency or even European Deposit Insurance Corporation but their likelihood seems relatively small.[56] The national authorities seem to be quite firmly wedded to their current arrangements. However, having the second authority involved helps align the incentives better. For the supervisory agency there will always be an

[56] D. Mayes, ‘The role of the safety net in resolving large financial institutions’, Systemic Bank Crises: Resolving Large Bank Insolvencies, Federal Reserve Bank of Chicago, 1 October (2005); D. Mayes, ‘Preparing for Cross-Border Bank Failures’, 11 *The Financial Regulator* (2004), pp. 58-63.

element of worrying that bank failure is equated with supervisory failure and hence a temptation to delay final action if it is plausible. Moreover the supervisor normally has to balance the interests of a number of groups in society of whom the insured depositors/deposit insurance fund is only one. The central bank is perhaps the obvious alternative choice for siting the resolution agency as its interests are also in bringing the problem to a head early so that systemic problems can be minimised.[57] This could pose a problem where the central bank is also the supervisor, although it need not be so as the New Zealand case illustrates.

1.4 *System-wide Problems*

One area where there is little need for discussion is emergency lending by the central bank in the Eurosystem and more widely in Europe. It has been agreed that lending will be on the traditional Bagehotian terms: collateralised, short term and at an above market rate of interest.[58] In the Eurosystem the list of eligible collateral has been agreed in advance and in the Nordea case there is already an MoU among the Nordic central banks that establishes how each lends in the circumstances and how they co-ordinate. There should thus be only a limited chance of lending to an insolvent institution. In any case the expectation is that such lending will be general to the market rather than to a single institution as the chance of market lending to a solvent institution drying up is small. Similarly this restricts the number of players in the resolution process as the routes to accessing public money will be limited.

This facet of generalised action applies more widely to systemic problems. Many can be addressed by macro-economic policy rather than by intervention in the banking system per se. Nevertheless it is clear that if major problems arise more extreme measures are taken whatever the prior rules.[59] It is not at all clear how this might be applied to cross-border banks, especially if the systemic problem is in the host country. A natural reaction of a foreign bank might be to curtail its exposures which in itself would contribute to worsening the crisis. Firms (and households) that might otherwise expect to roll over their lending may find themselves forced to close or to realise their assets prematurely at heavily discounted prices, thereby lowering collateral values and pushing others into imbalance or insolvency – the typical debt-deflation problem (King, 2004).[60]

At some point system-wide problems and problems for individual banks will coincide. This then poses a problem for the interaction between agencies responsible for handling cross-border

[57] At a European level, therefore, this might imply assigning the role of resolution agency to the ECB.

[58] W. Bagehot, *Lombard Street: A Description of the Money Market* (London, Henry S. King and Co. 1873).

[59] Moe *et al.* (2004) *op.cit.* gives a good range of examples from the Nordic crises.

[60] M. King, ‘Debt deflation: theory and evidence’, 38 *European Economic Review* (1994) pp. 419-455.

systemic banks and those responsible for handling more general problems of financial stability. This concern also exists in the US where the Federal Reserve and the Controller of the Currency, as well as the US Treasury, become involved along with the FDIC.[61]

1.5 *Failure*

The solution to the problem if a bank becomes insolvent or reaches the intervention point depends very much on the powers of the authorities to act. There are strong attractions to having a *lex specialis* or public law under which an Authority such as the supervisor or the deposit insurance agency can step in, as is the case in the US, Canada, New Zealand, Switzerland[62] and to a lesser extent Italy,[63] for example, as opposed to having banks subject to a *lex generalis*, private law, as in much of the rest of Europe, including Germany and England and Wales. The *lex specialis* approach in effect transfers some of the judicial functions that need to be applied to the authority, enabling it to act with the necessary speed. However, this in itself is one of the main objections raised by some of those who support the *lex generalis* approach[64] in that those adversely affected may not be given adequate opportunity to defend their position.[65]

In Mayes et al. (2001) we argue that an effective exit policy requires all of the previous facets of good regulation and supervision that we have just described to be in place. However, should they be insufficient and the bank still approach insolvency, we argue that the necessary process entails three steps:[66]

[61] As set out in Stern and Feldman (2003) op cit., for example.

[62] The Swiss system is set out and explained in Hüpkes, E. (2003) op cit.

[63] See L. Wall and M.J. Nieto, 'Institutional Preconditions for a Successful Implementation of Supervisors´ Prompt Corrective Action: Is There a Case for a Banking Standard in the EU?', mimeo Banco de España and Federal Reserve Bank of Atlanta (2005) for a description of the position of Italy.

[64] See Hadjiemmanuil (2003) op.cit. for a clear exposition of the issues and arguments in favour of the 'London Approach' whereby the interested parties, assisted by the authorities, have proved themselves able to achieve rapid effective solutions through the courts.

[65] The European Shadow Financial Regulatory Committee (2005) in its Statement No. 23 (21 November) on 'Reforming Banking Supervision in Europe' tries to cut through the legal difficulties by suggesting the formation of a European Standing Committee for Crisis Management that would bring together representatives of the national central banks, supervisory authorities and ministries of finance involved to manage the problem. But while they could resolve cross-border conflicts the national authorities would still be bound by the prevailing law.

[66] See pp. 198-255. The detail is not repeated here.

- the authorities are required to step in and take control of the bank under the provisions of public law at some prescribed benchmark, with the objective of maximising the value of the bank/minimising the systemic cost.[67]
- the administrator who is appointed as a result of the first step summarily values the assets and liabilities of the bank as of time of failure and writes down the claims, respecting the order of priority of claimants under insolvency, so as to return the bank to 'economic solvency' (non-negative net worth). This would involve the wiping out of the claims of the existing shareholders first and probably the subordinated debt holders but how much further the write off would have to go is debatable. Even in the case of the largest failure in the US, Continental Illinois, it was possible to pay out 96% of claims eventually even after allowing for the costs of the insolvency. There are various ways to perform this restructuring, which can in effect transform the claims from debt in the old bank to equity in the new one, as set out by Aghion et al. (1992) for example.[68] The important feature is that no party should be worse off than under insolvency.[69] There are some major problems in how such a rapid assessment and restructuring would be made as discussed inter alia by Harrison (2004).[70] In particular, it is necessary to avoid any triggering of close out netting in derivatives markets or other contract closures through rating downgrades, otherwise just the systemic event which is being guarded against will occur.[71] Hüpkes (2004) suggests an alternative way of treating the same problem by

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[67] In systemic cases the overall objective is to minimise the loss to the country at large by avoiding systemic consequences to the extent possible. Nevertheless in seeking to resolve the individual bank, given the overriding intention of keeping it operating, the traditional approaches of trying to maximise the value of the bank or equivalently minimise the loss to the deposit insurance in the framework we outline might be similar given that a taxpayer bailout of the existing shareholders is ruled out.

[68] P. Aghion, O. Hart and J. Moore, 'The economics of bankruptcy reform', 8 *Journal of Law, Economics and Organization* (1992) pp. 523-546.

[69] Clearly other aspects of 'fairness' also need to apply. I am grateful to Larry Wall for pointing out that the scheme should be fair in the ex ante sense of dealing with people as they expect from the nature of their contracts. This is to be distinguished from ex post fairness, where governments might wish to take a view on how burdens are distributed across society irrespective of their contractual incidence.

[70] I. Harrison, 'Systemic Bank Crises: Resolving Large Bank Insolvencies', Federal Reserve Bank of Chicago, 1 October (2004). Harrison argues that only a limited portion of claims need to be dealt with immediately as most do not mature on the same value day and will not be subject to a disorderly rush for early closure thereafter if the new bank is guaranteed against further loss by the authorities.

[71] In some markets and contracts, simply a downgrading of creditworthiness entitles counterparties to terminate their contracts prematurely. Should this occur with a large institution or one that has substantial market share, this could have an important effect on asset prices and spill over into the rest of the financial system.

addressing only what she describes as the systemic functions of the bank in this manner, i.e. one's whose failure would have systemic consequences.[72]

- the bank reopens for business under the new control/ownership the next 'day' without any material break in operation, with a guarantee against further loss. (This concept is described in the context of the New Zealand approach in the next section.) Thus the operation of the bank continues but the ownership does not.

The rapidity of the process will no doubt result in some errors of assessment that need to be corrected if they have deprived holders of value – this would even apply to the former shareholders if it were discovered that the bank did in fact have positive net worth. However, the transfer of ownership would be irreversible. Errors of overvaluation would have to be borne by the authorities under the terms of the guarantee.[73] The earlier the resolution agency can enter the bank before the point of intervention is reached the greater the accuracy of the assessment is likely to be.[74] Many other preconditions have to be met for this system to be operational, such as clear and reliable auditing standards, freedom from political interference, which apply in the EU/EEA countries but not necessarily elsewhere.[75]

While Mayes et al. (2001) argue that fixed mandatory intervention points are needed in order to reduce the risk of forbearance and ensure that there is no delay, the Swiss scheme has implemented a more discretionary approach for exactly the same reasons.[76] They permit intervention if the authorities in the form of the Swiss Federal Banking Commission (SFBC) deem that there is a threat to depositors' interests. Severe undercapitalisation is not the only threat and hence it is possible to intervene in a bank earlier before it gets to the point of zero net worth if the threat seems real enough.

Implementing this scheme for a cross-border bank entails that it needs to be treated as a single entity (common pool) and that an administrator can act rapidly and early. This could not be achieved by a 'committee' approach and entails that one body has to be in charge with a

[72] E. Hüpkes, '"Too big to save" towards a functional approach to resolving crises in global financial institutions', Systemic Bank Crises: Resolving Large Bank Insolvencies, Federal Reserve Bank of Chicago, October 1 (2004).

[73] See B. Blowers and G. Young, 'The economic impact of insolvency law' pp. 164-179 in Mayes and Liuksila (2003) *op.cit.* for a cautious assessment.

[74] In the US case the FDIC is involved in the continuing supervision of institutions, so the issue becomes the point at which they realise they have to step up their surveillance as the bank approaches difficulty.

[75] See D. Mayes, 'Who pays for bank insolvency in transition and emerging economies', 29 *Journal of Banking and Finance* (2005) pp. 161-181.

[76] Hüpkes (2003) *op.cit.*, p. 251.

predetermined mandate from the various countries and authorities involved - hence the previous suggestions about a resolution agency or at least a designated authority among those currently involved, preferably with a clear mandate to minimise the loss to society at large, rather than the more mixed objectives that may face the supervisors. As suggested, the presumption is that this would be an authority based in the home country although it could be in some sense neutral, say, by being a European institution. Clearly it will need to draft in staff from the host countries to deal with the local legal environment, communicate with the claimants in their own language etc.

The scope of the prior agreement on the rules governing the administrator's actions is very considerable even in a tightly specified regime such as the one here.[77] A large complex institution cannot be sold overnight and might have to continue in administration for some time in the interim. There needs to be prior agreement that covers issues such as the rolling over of loans and the making of new loans. Losses may be concentrated in only some countries, hence, expanding lending in others might appear to be a strategy that maximised the value of the bank, even though it did not minimise losses equally in each country. Similarly the distribution of losses could be heavily affected by whether the bank is sold as a single entity or broken up. The extent of the incentives needed to encourage purchase and the form of the break up could have important implications for the systemic consequences in various markets. Minimising the total burden does not necessarily minimise it in each jurisdiction. Moreover, avoiding systemic events in some jurisdictions may place burdens on others. The issue of ex post compensation therefore needs to be addressed ex ante. A more committee style approach to resolution could open up issues such as the criteria for which bid to accept and whether to require acquirers to purchase problem loans.

2 The Antipodean Approach

Although New Zealand's banks are almost entirely foreign owned, largely with Australian parents,[78] New Zealand faces circumstances that differ crucially from the EU/EEA environment. First of all it does not have depositor protection. Second Australia operates domestic depositor preference so New Zealand depositors would be disadvantaged in a common pool, universalist resolution operated from Australia. If it wants to manage the impact of a closure or other form of resolution it therefore has to go for a territorial approach that will be effective. Hence it is insisting that the banks operating in New Zealand be viable entities in their own right that could operated independently should the parent group get into difficulty, if they are of large enough size that their

[77] See, for example, the suggestions in European Shadow Financial Regulatory Committee (2005) op. cit.

[78] See Reserve Bank of New Zealand, *Financial Stability Report* (May 2005).

failure would be a systemic threat to the New Zealand financial system.[79] This last remark reflects a clear advantage that New Zealand has over its host country counterparts in the EU/EEA in that it can lay down its own conditions for registration of a bank that allow it to operate a credible exit regime. The Reserve Bank Act 1989 and its recent amendment the Reserve Bank Amendment Act 2006 comprise the principal banking law in New Zealand and are summarised in Box 4.[80]

New Zealand already has had in place, since 1996, a clear regime setting out how problem banks will be treated, which follows very closely the same principles set out in Mayes *et al.* (2001). The Reserve Bank Act empowers the Reserve Bank, as the supervisor, to apply to the courts for the appointment of a statutory manager to take over the operation of an insolvent bank. At the same time the Reserve Bank has made it clear that public money would not be available in the event of such a failure. Over the ensuing years it has made clearer how the process of resolution would be likely to go – assuming that is that prior attempts to get the back to recapitalise either through an injection from the existing shareholders or agreed outside injection through acquisition have failed.

The RBNZ requires in its policy on 'Outsourcing'[81] that the bank (or a statutory manager) could ensure that

- The bank's clearing and settlement obligations due on a day can be met on that day
- The bank's financial risk positions on a day can be identified on that day
- The bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days
- The bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

This requires a 'legal and practical ability to control and execute' these functions. Hence this includes having personnel with the necessary technical and business knowledge and physical access to and control of the required systems and data. There are also requirements to make sure that the bank is managed from within New Zealand and that the New Zealand Board has control over it.

[79] Large banks are not defined by market share but by absolute size, namely, as those having New Zealand liabilities, net of amounts due to related parties in excess of $10bnNZ.

[80] See also Mayes et al (2001, op cit) chapter 7 for a more detailed exposition of the New Zealand regime. G. Mortlock, 'New Zealand's Financial Sector Regulation', 66 *Reserve Bank of New Zealand Bulletin* (2003) pp. 5-49, gives the picture for the whole system and L. DeSourdy, 'The Reserve Bank of New Zealand Amendment Act 2006, 69 *Reserve Bank of New Zealand Bulletin* (2006) pp. 22-25, explains the recent changes. A. Yeh, J. Twaddle and M. Frith, 'Basel 2: A New Capital Framework', 68 *Reserve Bank of New Zealand Bulletin* (2005) pp. 4-15, covers Basel 2.

[81] Reserve Bank of New Zealand, Financial Stability Department Document BS11, October 2005, available on <www.rbnz.govt.nz>, p. 2.

Box 4

Banking Legislation in New Zealand

The Reserve Bank Act 1989 and the Reserve Bank Amendment Act 2006 comprise the main banking law that applies in New Zealand. (The main point of the 2006 amendment was to take account of the problems of cross-border banking.)

The Reserve Bank (RBNZ) is the supervisor of banks and since 2007 of the rest of the financial system as well. The Act gives the RBNZ extensive powers which it translates into detailed requirements via regulations and Orders in Council (of which there are four in force dated March 2007). These are set out in an online Banking Supervision Handbook which has 11 main sections <http://www.rbnz.govt.nz/finstab/banking/regulation/0094291.html>. The RBNZ has the power to control who can label themselves a bank and applies strict entry criteria relating to size, purpose, corporate structure and governance, fitness of the directors. All banks have to have a local management with directors who are responsible, even if they operate as a branch, and all banks that are systemically significant have to be locally incorporated, as of It requires banks to furnish it with detailed information and to run themselves in a prudent manner consistent with the observance of the Basel Accord – Basel 2 will be implemented from the beginning of 2008 (see Box 1) and the International Financial Reporting Standards. However, while it has the normal powers of on-site inspection it acts primarily through requiring the quarterly public disclosure of a wide range of information not just on the income statement and balance sheet but on exposures, asset quality, risk management methods, off balance sheet items, directors and their interests. These statements are subject to regular independent audit and the directors making the disclosure are held liable for their accuracy with penalties including up to 3 years imprisonment and civil liability for consequent losses.

The RBNZ also has strong powers over insolvent banks (section 5 of the Act), which can be taken into statutory management an equivalent of receivership, restructured and run until disposal or closed.

The 2006 amendments require the RBNZ to cooperate with its Australian equivalent APRA in providing information and consulting before taking action that may prejudice financial stability in the other country. Matching legislation has been passed in Australia (The Financial Sector Legislation Amendment (Trans-Tasman Banking Supervision) Act 2006.)

The reason for the use of the word outsourcing is simply that the RBNZ expects that bank groups will want to rationalise their functions as far as is cost efficient across the group and hence

want to ensure that while permitting that process they do not expose the New Zealand financial system to any undue threat were some system-provider inside or outside the group to fail.

These arrangements permit the RBNZ to be convinced that in the event of failure it could continue to have a viable prospect of keeping the system banks open under the normal terms of statutory management. However, applying territoriality and dismemberment in this fashion is not perhaps in line with the ideal way in which one might choose to operate the closer economic relations (CER) that Australia and New Zealand have been developing over an extended number of years with a view to creating a single economic market. In recent years there has been developing co-operation with the Australian Prudential Regulatory Authority (APRA) reflected inter alia in the Reserve Bank Amendment Act 2006. They have a Memorandum of Understanding on information sharing for crisis management purposes[82] and a new Trans-Tasman Council on Banking Supervision has been set up to develop further cooperation. APRA as the supervisor of the banking groups also has the power to conduct inspections of their operations in New Zealand. In 2004 there was a joint committee among the two countries' treasuries and reserve banks and APRA to explore the possibilities for closer co-operation, that considers a model of APRA being the sole supervisor and an enhancement to the prevailing home-host arrangements. The latter was the chosen route. A second committee that reported in February 2005, extended this to consider adding a joint committee to assist in harmonisation of regulation and the option of a joint regulator. This led to the formation of the Trans-Tasman Council on Banking Supervision.

While it might appear at first blush that the two countries were good candidates for a joint system, they are considerably further apart in the way in which they operate supervision than is the case among the Nordic-Baltic countries.[83] Australia operates a traditional relatively intrusive supervisory approach, with regular on-site inspections. New Zealand on the other hand, with a tradition of more light-handed supervision, opted for a largely disclosure-based regime in 1996, with a requirement for all banks to make a quarterly public disclosure of their structures, recent accounts and balance sheets, peak exposures to related and other parties etc., with a view to imposing greater market discipline. The banks are of course similarly required to be fully compliant with standards well up to the Basel Committee norms. The disclosure regime is a means of enforcing that, with all directors being liable for the correctness of the disclosure, whether they are

[82] <http://www.rbnz.govt.nz/finstab/banking/supervision/0137035.html> July 2003.

[83] Kane (2005) op. cit, provides a comparison of Australian and New Zealand regulatory 'cultures'. This reveals several fundamental differences, starting with institutional scope. There is a clear mismatch between the various agencies in the two countries over which institutions and which functions they regulate, which itself makes a dialogue difficult as it is not straightforwardly one on one.

executive or non-executive. While they can be sent to prison for up to three years for infringements, they can also be civilly liable for losses incurred as a result of failures to ensure accurate disclosure. This provides a strong incentive for those who know and can control the activities of the bank to ensure prudence.[84]

Marrying these two systems would not really be possible and the only plausible joint solution would probably be the adoption of a version of the Australian system, given the country's much larger size and need to supervise local banks that are not systemic in New Zealand. This makes an agreement on joint supervision less likely. Whether the same would apply to crisis resolution is also debatable. The current regime is for co-operation while each country tries to deal with its own problems. Any joint approach would require a prior agreement in burden sharing. If the previous supervision is conducted on different bases then it would be more difficult to agree in advance on steps to be taken in the event of difficulty except in very general terms.

3 Mutual Lessons

The Antipodes provide an illustration of how a host country can protect its own financial stability and power to act on systemic problems despite the fact its banking system is foreign owned. This approach is not possible in the EU/EEA because the host country does not have such a control over the registration of banks whose home is elsewhere in the area. Secondly if the banks choose to operate as branches, their supervision and some of the associated safety net also becomes the responsibility of the home country. This creates a serious mismatch with the host country's continuing responsibility for financial stability within its borders. There is thus no choice but to co-operate closely and thoroughly if a jointly acceptable scheme is to be found, probably involving substantial harmonisation of the detail of regulation and supervision and the setting up of a joint institution to handle the resolution of problems. While this may be possible for the Nordic-Baltic region and the case of Nordea in particular, this would be much more difficult to extend generally as there are far greater differences between the member states at all stages of the process from registration to exit regimes.

Thus, in one sense the Antipodes offer a plan B, if it does not prove possible to get the closer co-operation to work well. However, such a plan B would represent a major step backwards for authorities bent on forming a single market. In another sense they show the difficulty of achieving

[84] These incentives and obligations to disclose extend to auditors (Kane, 2005, op.cit.) who have to report to the RBNZ any suspicions they have about solvency problems or concerns about whether the information provided represents a 'true and fair view'.

such co-operation. The EU/EEA on the other hand offers the possibility that some measure of closer cooperation may be possible in the Antipodean environment. The Trans-Tasman Council on Banking Supervision may prove to be a framework through which that can take place.

What is clear is that the intention of Nordea to become a European Company brings to the surface a problem in home-host control that already exists as the material change to the operation of the company is likely to be relatively small, although the legal and taxation problems may be reduced. Moving to a branch structure will to a considerable extent be recognising the reality of the structure of the company. Although most of the branches are currently incorporated as subsidiaries, they are in many cases more dependent and would not meet the outsourcing criteria laid down by the New Zealand authorities. Thus it is largely an illusion that a systemic problem could be sorted out any better before the change in legal structure than it could afterwards. The changes advocated, with greater regulatory harmonisation, a more collegial approach to supervision and data sharing, more scope for market discipline, more transparent and agreed PCA, and reform of the laws governing insolvencies so that a single agency can step in early and act swiftly on a predetermined mandate, are thus required already. The great advantage of this occurring in the Nordic-Baltic region rather than in many other parts of Europe is that the greater similarities in procedures and institutions among the countries make a favourable outcome easier to achieve and practical arrangements that voluntarily go beyond the provisions of current EU law more likely.