

Asian Resolution Experience CDIC Perspective

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FINANCIAL STABILITY INSTITUTE



BANK FOR INTERNATIONAL SETTLEMENTS



International Association
of Deposit Insurers



中央存款保險公司

Central Deposit Insurance Corporation

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I. Overview of Taiwan's Bank Resolution Mechanism under Financial Restructuring Fund

Introduction of CDIC

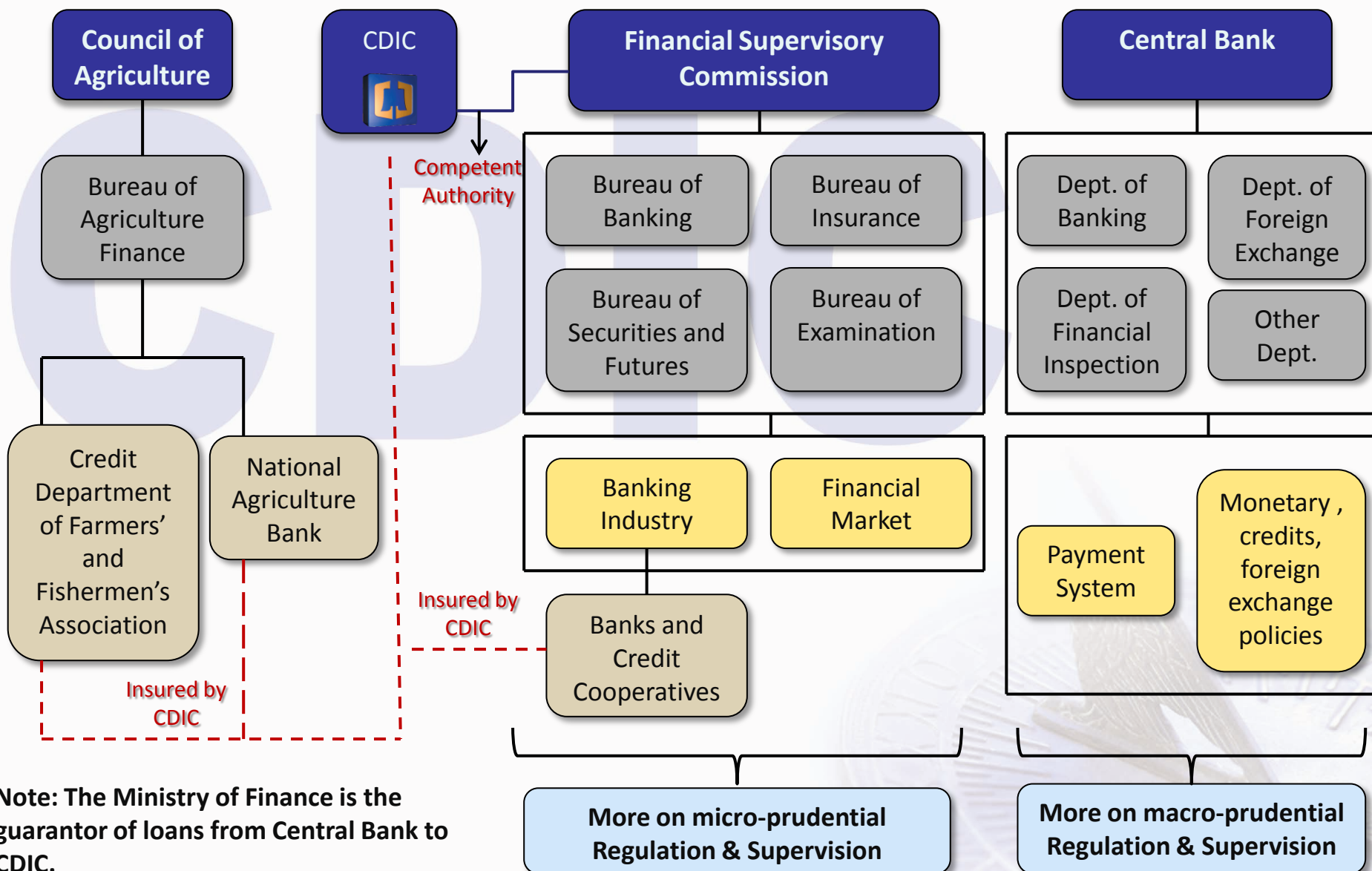
- Establishment in 1985  28 years
- The only deposit insurer in Taiwan
- Major shareholders: Financial Supervisory Commission (FSC) and Central Bank.
- Mandate and Powers
 - Manage deposit insurance business
 - Control deposit insurance risk
 - Deal with problem insured financial institutions

Pay Box



Risk Minimizer

Financial Safety Net in Taiwan



Bank Resolution History

- **Before deposit insurance system in place (~ 1985)**
 - Policy/administrative guidance by the government
 - Government-owned bank as the 1st choice of the acquirer
- **In the period of voluntary DIS (1985~1999)**
 - Non-member institutions of CDIC: Assumed through government guidance; acquirers assumed the loss
 - Member institutions of CDIC: Handled according to the *Deposit Insurance Act*; no failure cases during this period
- **In the period after compulsory DIS (1999~2001)**
 - CDIC resolved problem insured institutions by P&A transactions after 1999
 - No market mechanism before 2001
- **Financial Restructuring Fund (2001~2005)**

Establishment of Financial Restructuring Fund (FRF)



Macro factors

- Real estate market mired in recession after the burst of economic bubbles in late 1990's
- Situations exacerbated by 1997 Asian financial crisis
- The shock of big earthquake in Sept. 21, 1999 further impacted real estate market
- Bad loans continued soaring, but no NPLs secondary market until 2001
- Rampant rumors of domestic systemic financial risk

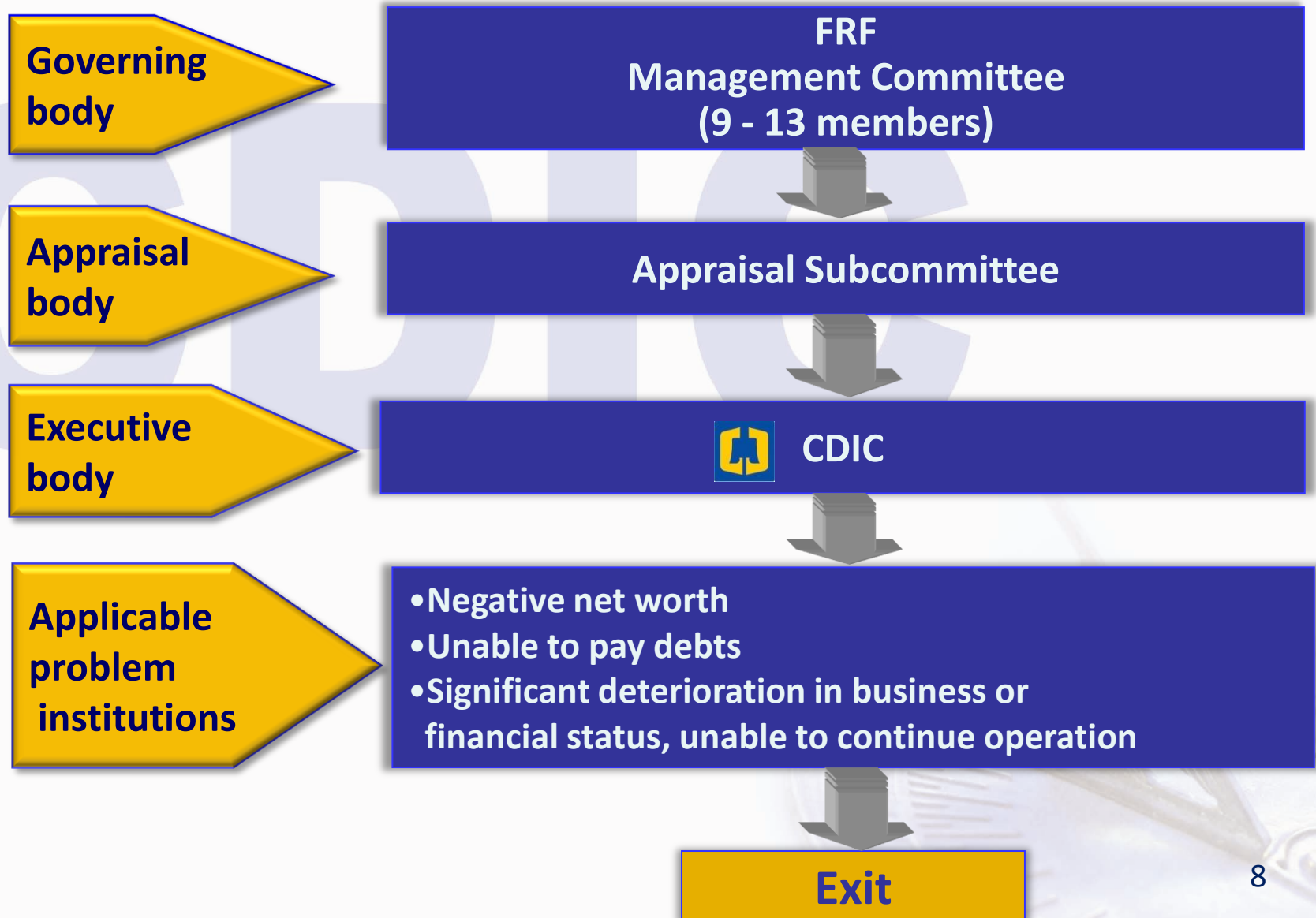
Non-macro factors

- Unqualified member FIs in voluntary DIS became a member in compulsory DIS and continued deteriorating in business
- No PCA mechanism for problem FIs to exit from market until net worth turned negative

July 2001

Government appropriated US\$ 8.3 billion to provide blanket guarantee for bank resolution

Management Structure of FRF



II. Resolution Mechanism under FRF - Conservatorship and P&As

First Step of Bank Resolution

- Conservatorship

*Ongoing Risk
Management*



Conservatorship

**On-site
guidance**

**Off-site
guidance**

**Self-
assistance**

**On-site
inspection**

First Step of Bank Resolution

- Conservatorship (cont'd)

Banking Act: PCA Mechanism

If BIS ratio < 2%,
the bank should be put under
conservatorship within 90
days

If unable to pay liabilities and could
harm depositors' interests, or has
losses exceeding 1/3 of capital and
cannot make improvement within
the stipulated timeframe,
the bank should be taken over

Resolution Methods

Payout

Deposit transfer

P&A

Bridge bank (systemic crisis)

Open bank assistance (systemic crisis)

Friday:
Bank closure

Entrusted bank makes payout on behalf of CDIC

Recruit consulting firm to design disposition strategies

Submit the disposition strategies to FSC and get approval

Non-transfer of assets and liabilities

Transfer of domestic businesses, good assets and some necessary liabilities

Conditions:

- Problem bank is critically under-capitalized and put under conservatorship
- Bank failure will trigger a systemic crisis
- Competent authorities deem it non-viable and decide to close

Sunday:
Print & mail letter notices to depositors, including payout amount

Open bid announcement

Due diligence by potential investors

Decide reserve price

Open bid

Sign P&A contract with bid winner

Settlement

CDIC continues to deal with unsettlement items

Receivership

CDIC Bridge bank

Providing Loans

Others

P&A

Placing Deposits

Monday:
Depositors receive notices and can receive payout payment soon

P&A - Types of P&A

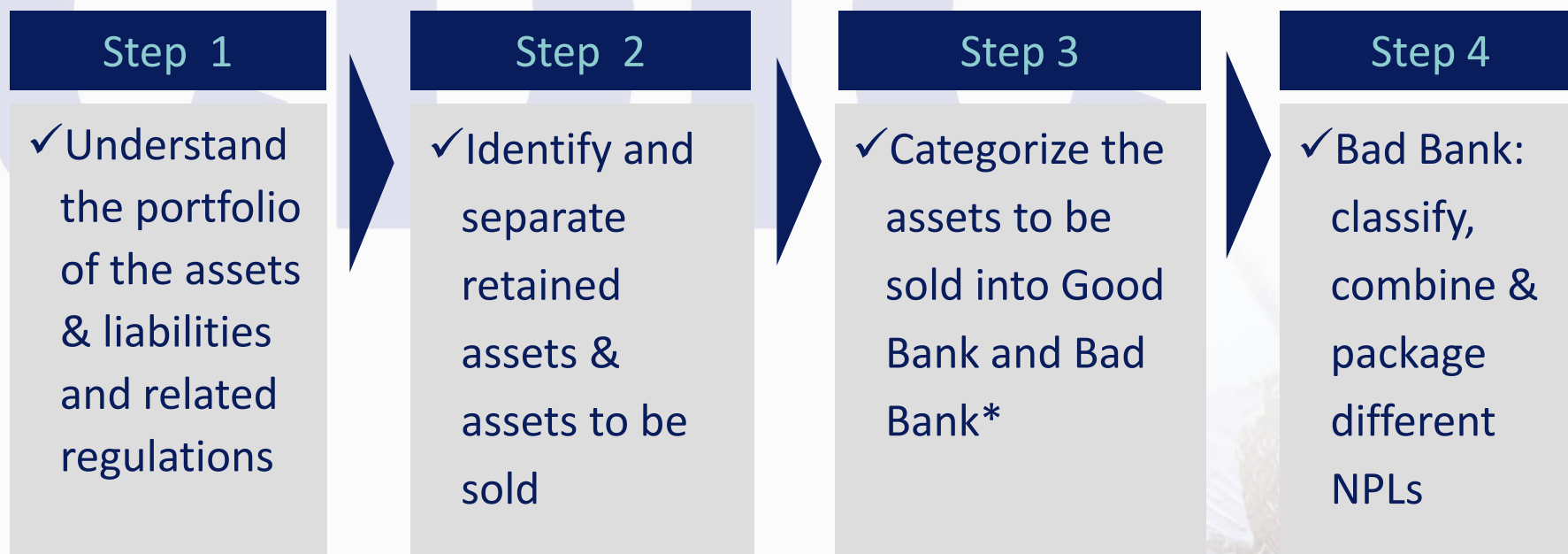
Year	Banks	Credit cooperatives	Credit departments of farmers' & fishermen's associations	Methods
2001		7	29	Whole bank P&A
2002		1	7	Whole bank P&A
2004	1	1		Whole bank P&A and Partial P&A
2005	1		1	Whole bank P&A and Partial P&A
2007	3		1	Whole bank P&A and Partial P&A
2008	3			Partial P&A and P&A with put back option
2010	1			Partial P&A
Subtotal	9	9	38	
Total	56			

P&A - Outsourcing

- **Methods of resolution**
 - ✓ CDIC as the conservator
- **Outsourcing resources**
 - ✓ Consulting firm: Design disposition strategies and manage open bid process
 - ✓ Accounting firms: Assess assets and liabilities
 - ✓ Appraiser: Appraise specific real estates
 - ✓ Lawyers: Pursuit of civil and criminal actions against responsible parties and employees of problem insured institutions
- **Sell the target insured institutions through open bids or negotiations**

P&A - Designing Transactions

Objective: To maximize the successful rates of open bids through well-designed disposition strategies of the assets, liabilities and operations



* “Good Bank” includes assets and liabilities, excluding NPLs and retained items.

“Bad Bank” consists of NPLs and certain real estate.

P&A - Strategies

- **Strategies of open bids**

- ✓ Banks: Auctioning off in separate parts
 - Bad bank: NPLs by several tranches
 - Good bank: Non-NPL assets/liabilities and operations in one tranche (in principle)
- ✓ Community FIs : Whole in one block

P&A - Incentives for Good Bank- Branch Licenses

	W Bank	X Bank	Y Investment and Trust Companies	Z Bank
Original Number of Branches	30	31	15	36
Branch relocation without restriction*	15	21	7	18
Branch relocation only within the same city	15	10	8	18
Others	Simplified branches* and the trust unit can be upgraded to full-function branches (*Only offers saving & withdrawing deposits)	Same as W Bank	All branches can be converted to branches of commercial banks and the 5 revoked branches can be reopened	Trust unit, department of international banking, OBU can be converted to branches of commercial banks and relocated without geographic restriction.
*Limitation	Branch relocation with geographic restriction	Same as W Bank	None	No more than 6 branches allowed to be relocated to Taipei metropolitan.

Note: In average, 50% of branch relocation is free from geographic restrictions.

P&A - Incentives



Bid Strategies for Failed Banks I

Failed Banks	Good Banks	Bad Banks	
Biz Bank	1 Batch	Corporate Accounts	
		Consumer Accounts	
CS Bank	1 Batch	Tranche A	Corporate Accounts
			Consumer Accounts
		Tranche B	Tranche 1
			Tranche 2
			Tranche 3
T Enterprise Bank	1 Batch	Tranche A	
		Tranche B (Credit card & cash card)	
		Tranche C (Credit card & cash card)	

Bid Strategies for Failed Banks II

Failed Banks	Good Banks	Bad Banks	Others
CH Bank	1 Batch	Tranche A	-
		Tranche B (Credit Card & cash card)	-
		Tranche C (Credit card & cash card)	
C Trust & investment Corp.	1 Batch	Specific NPLs	To dispose real estate through individual auctions
BW bank	1 Batch	Tranche A	-
		Tranche B (Credit card & cash card)	

Bid Strategies for Failed Banks III

Failed Banks	Good Banks	Bad Banks	Other
A Trust & Investment Corp.	Tranche 1	Tranche A	-
	Tranche 2	Tranche B	-
CF Bank	Tranche 1 (Local branch)	Tranche A	To dispose of antiques through individual auctions
	Tranche 2 (Local branch)	Tranche B	
	Tranche 3 (Overseas branch)	Tranche C (Credit card & cash card)	
	Tranche 4 (Credit card business)	Tranche D (Credit card & cash card)	

Employees' Rights & Interests

- To give a pension and severance pay to the employees according to the *Labor Standards Law*
- To request the buyer to rehire more than 50% of the employees of the failed financial institution for at least one year
- To convince the buyer to compensate for employees' losses caused by the severance of their working years

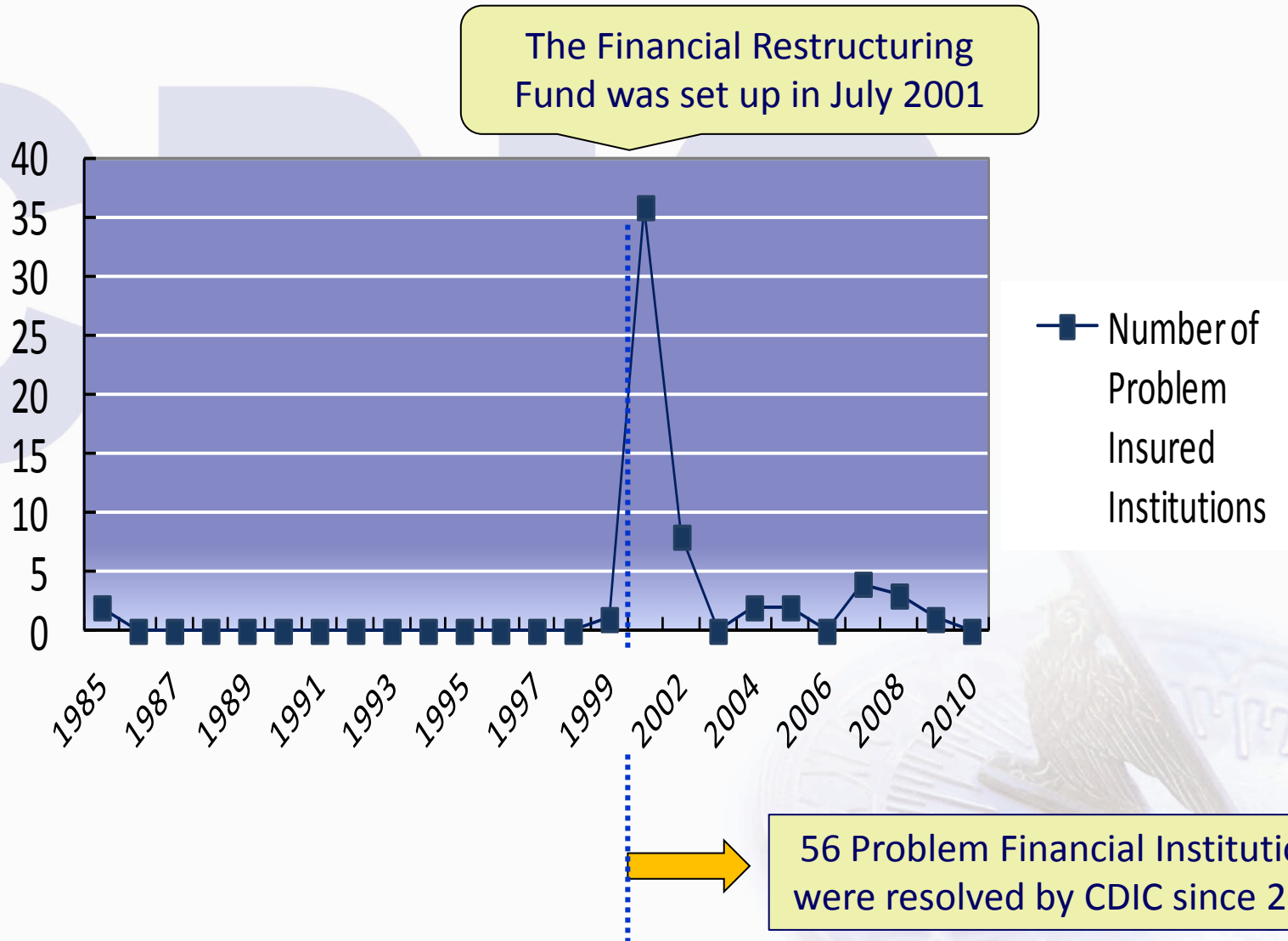
Key to Facilitate P&A – External Factors

- Overall economic and financial market conditions need to be considered
- Benign economic and financial conditions greatly increase the success rate of P&A transactions

Key to Facilitate P&A – Internal Factors

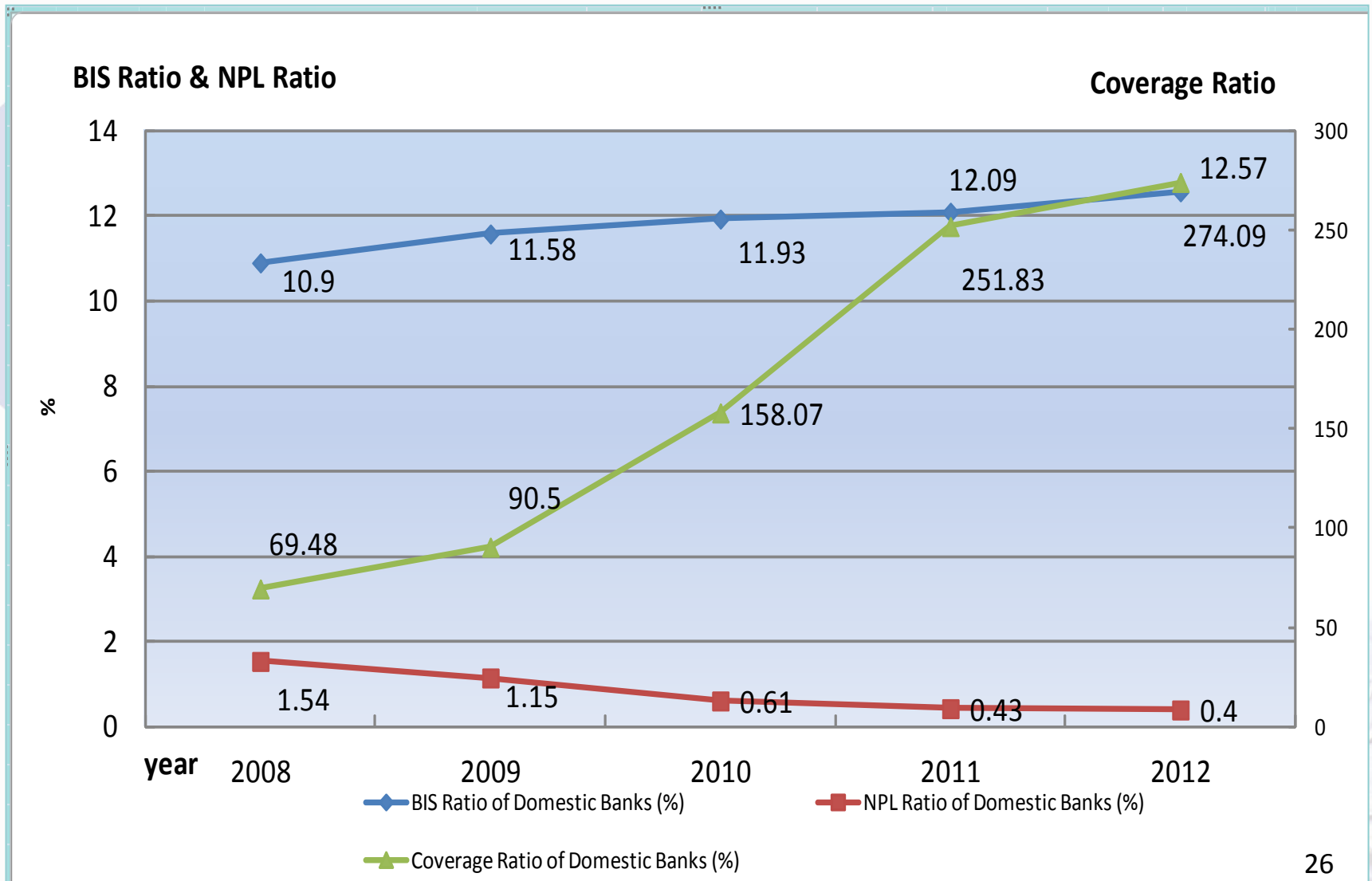
- Well-designed disposition plan
- Reserve price determination in the “Good Bank” and the “Bad Bank” transactions
- Flexibility and adaptability to market needs

Problem Insured Institutions Resolved by FRF



Better Banking Conditions

- High BIS%, Low NPL% & High Coverage%



Effectiveness of FRF

- A systemic banking crisis successfully resolved
- 56 problem insured institutions exited smoothly from the market
- Over 5 million depositors' rights & interests were safeguarded
- Over 6,800 (67%) employees of failed financial institution were rehired
- Total resolution cost to 2011 GDP was only 2.1%

III. Future Perspectives & Lessons Learned

Future Perspectives & Lessons Learned

- **Strengthening resolution mechanism for dealing with problem insured financial institutions**
 - To receive the authority by law to assess the assets and liabilities of a problem insured institution in a confidential manner so as to prepare for resolution before it is closed
 - To establish clear regulatory policies on the procedure and criteria to trigger the extraordinary measures for a systemic crisis



Future Perspectives & Lessons Learned

- **Developing better risk management mechanism for DIS**
 - Off-site monitoring for insured financial institutions' operation conditions
 - On-site inspection for data accuracy of call reports
 - Cooperation with supervisors to assist insured institution's self-restructuring, control insurance risk and avoid payout loss



Future Perspectives & Lessons Learned

- **Shaping a strong institutional framework for financial system to reduce risk of bank failures or crises**
 - Crises do occur – in Taiwan and Globally
 - Lessons should be learned and reforms should be taken
 - Formal institutional cooperation mechanism in dealing with banking crisis should be in place
 - Effective tool kit for failure resolution should be developed



Future Perspectives & Lessons Learned

- Early prevention and enforcement of problem institutions is better than passive payout or resolution
 - Prompt corrective action mechanism
 - Risk-based or risk-centric examinations





Thank You !

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