

BRIDGE BANK AS A BANK FAILURE MANAGEMENT TOOL: UKRAINE'S CASE

Yashchenko Kateryna

DOI <https://doi.org/10.61345/1339-7915.2023.4.17>

Annotation. The article aims to present an overview of Ukraine's framework and experience on application of the bridge bank as a bank failure management tool. Ukraine's regime, which is a single-track regime, allows using a bridge bank to deal with failures of any bank, including small and medium sized banks. System analysis of first and second level acts, as well as available scientific publications served as a methodological basis for the research. It may be concluded that Ukraine's framework includes two variations of the bridge bank. As a general rule, a bridge bank shall be created for three months and the investor must be found in advance. Such bridge bank has simplified corporate governance and is not subject to mandatory economic standards, currency position limits, the procedure for forming and maintaining required reserves, forming provisions for losses on bank asset transactions and determining the amount of credit risk on all bank asset transactions. For systemically important banks and complex cases as defined in the law, a bridge bank can be created for a period not exceeding one year with a possible extension for up to one year. Such bridge bank may be established in advanced, which shall be considered a banking secrecy. It shall comply with almost corporate governance requirements envisaged for banks and in three months after its establishment must ensure compliance with the requirements capital and liquidity ratios. The law provides for simplified procedure for establishment and licensing of a bridge bank, and the DGF shall be exempt from payment of taxes and other fees in connection with creation of a bridge bank. The authorized capital of the bridge bank shall be formed at the expense of the DGF. Ukraine has two cases of applying a bridge bank tool, and both proved to be efficient.

Key words: Deposit Guarantee Fund, National Bank of Ukraine, bank insolvency, transfer of assets and liabilities, creditor.

1. Introduction.

FSB Key attributes of Effective Resolution Regimes for Financial Institutions provides that resolution authorities should have at their disposal a broad range of resolution powers, which should include, inter alia, powers to establish a temporary bridge institution to take over and continue operating certain critical functions and viable operations of a failed firm (point vii of Key attributes 3.4) [1]. The bridge bank tool allows to preserve critical functions of failed bank until an investor willing to purchase the bank is found [2, p. 126]. It could also be beneficial in complex, cross border cases when various national authorities are involved and time is needed for coordination and decision making [3, p. 432]. On the other hand, the costs of the bridge bank tool might be high, and there might be a need for liquidity support [4, p. 9-10].

In some jurisdictions a bridge bank is only allowed in case of systemically important banks failures [3, p. 432]. In EU countries, the bridge bank tool is available under resolution regime provided by the Directive 2014/59/EU, or BRRD (Article 40 of the BRRD) [5]. However, we have not found special provisions on bridge bank under the current EU countries national insolvency laws which should be applicable for small and medium sized banks. At the same time, there is an ongoing discussion about a reform of the EU Crisis Management and Deposit Insurance (CMDI) framework [6, p. 9]. Furthermore, there is a wider work on developing a set of international recommendations on how to deal effectively with the failure

of small and medium-sized banks led by the UNIDROIT [7]. Thus, discussions on suitable tools and applicability of transfer strategies for small and medium sized banks sounds are at high importance.

To contribute to the discussions, the article describes Ukraine's case which has a single-track regime for bank failure management and which has variations of bridge bank to deal with failures of small and medium sized banks.

2. Analysis of scientific publications.

The US deposit insurance and bank resolution regime has a long history. The Federal Deposit Insurance Corporation is 90 years old. So there are publications on the US regime from different periods. Some examples of authors who wrote about the US regime include Rosalind L. Bennett, Stanley V. Ragalevsky, Sarah J. Ricardi, Janis Sarra, J. Further Chatterjee. A lot publications were inspired by the standard setting work and newly introduced regional and/or national frameworks after the Global financial crisis of 2007 – 2009. The EU resolution regime was described by Martin Cihak, Erlend Nier, Mejra Festić, Maciej Podgorski, Antal Streda. The comparative study of US and EU regimes and/or EU countries national frameworks was conducted by Marco Bodellini, Michael Schillig and others. In Ukraine, scientific publications on bank insolvency were triggered by the reform introducing special regime for bank failure management in 2012. A bridge bank tool in scientific publications was mostly described from economical or financial perspective (Leonov S.V., Mishchenko S., Mishchenko V.). There is also a recent publication from judicial perspective provided by Petrik I.I., Judge of Kyiv Administrative Court of Appeal.

3. The aim of the work.

The aim of this article is to provide an overview of Ukraine's framework to date and experience in applying a bridge bank tool to deal with bank failures.

4. Review and discussion.

Ukraine's bank failure management regime is provided by the Law of Ukraine 'On Households Deposit Guarantee System' № 4452-VI dated 23.02.2012 (hereinafter, the DGS Law) [8]. The DGS Law vested the Deposit Guarantee Fund, which previously was only in charge of deposit payouts, with the resolution mandate. The DGS Law also introduced a toolkit to deal with failed banks which was gradually improved as the framework was amended and new tools were added. It currently includes transfer of assets and liabilities (Article 40), sale of insolvent bank to an investor (Article 41), bail-in (Article 41-1), direct government recapitalisation (Article 41-1), and bridge bank (Articles 42-43). In the following years, the clean-up of the banking system was conducted. To date, 105 banks were transferred to the DGF for the resolution and liquidation, which is almost 2/3 of the banking sector of Ukraine [9]. In most cases failed banks were liquidated, but in 10 cases tools were applied, including two bridge banks.

Article 42 of the DGS Law entrusts the DGF with the power to adopt a decision to establish a bridge bank with the conveyance thereto a part of the assets and all, or a part of, liabilities of one or more insolvent banks (Article 42(1) of the DGS Law). A bridge bank can be created in advance to manage a failure of a systemically important bank. In such cases, the decision to establish a bridge bank shall be endorsed by the National Bank of Ukraine (hereinafter, the NBU), and any decision of the NBU, DGF, Securities Commission or other state authorities related to establishment and operation of the bridge bank shall be considered a bank secrecy until the bank is declared insolvent (Article 42(2) of the DGS Law). The incorporation, registration of a shares issue, issuing of the banking license to a bridge bank shall be performed in accordance with the simplified procedure established jointly by the DGF, the NBU, and the Securities Commission (Article 42(6) of the DGS Law; Resolution on procedure for incorporation, registration of a shares issue, issuing of the banking license to a bridge bank approved by the decision of the Executive Board of 21.09.2020 № 1715). The DGF shall be exempt from payment of taxes, levies, state duties, and fee for services rendered by state bodies in connection with creation of

a bridge bank (Article 42(9) of the DGS Law). The authorized capital of the bridge bank shall be formed at the expense of the DGF (bullet 8 of Article 20(2) of the DGS Law). The DGF shall supervise the bridge bank's operations until the bridge bank loses its status. (Article 42(23) of the DGS Law).

A bridge bank shall acquire all or part assets and liabilities of the insolvent bank according to the resolution plan. While transferring liabilities, the DGF shall ensure an unbiased treatment of all creditors of the insolvent bank in line with the priority provided in the law. This said, liabilities of the bank under deposits of individuals guaranteed by the DGF shall have the highest priority and may not be transferred in part (Article 42(12) of the DGS Law). The law includes a safeguard for depositors that deposits transferred to the bridge bank shall be guaranteed by the DGF on the same terms that had existed as of the date of their transfer (Article 42(19) of the DGS Law). A bridge bank shall be exempt from any payments (taxes, levies, state duties) related to receipt of assets and liabilities (Article 42(15) of the DGS Law). A bridge bank shall acquire all rights under transferred assets (including rights under agreements on pledge, in particular suretyship) in the order of legal succession, and shall assume debtor's liabilities under claims of creditors (depositors) related to the transferred liabilities without introducing any changes to the relevant agreements. The DGF shall be obliged to notify debtors and creditors of the transfer of assets and liabilities of the insolvent bank to the bridge bank by means of the publication of the generalized information on official websites of the DGF, the insolvent bank, and the bridge bank (Article 42(16) of the DGS Law).

The DGF shall sell the bridge bank to an investor selected as a result of holding an open tender (Article 42(10) of the DGS Law), the result of which must meet the principle of the least-cost resolution of the insolvent bank (Article 42(11) of the DGS Law). The investor must meet the requirements of legislation on banking and may not be related parties of the bank, whose assets and liabilities are to be conveyed to the bridge bank. The investors are required to obtain an endorsement from the NBU for the acquisition of a substantial interest in the bank, and a concentration permit from the Antimonopoly Committee (Article 42(13) of the DGS Law). The law includes safeguards for investors stating explicitly that after the entry into a contract for the sales of shares in a bridge bank and the transfer of such shares to the investor: (1) an investor may not be deprived of the ownership of shares purchased by the investor in the bridge bank; (2) an owner of shares in an insolvent bank and the insolvent bank may not require reimbursement from the investor and/or bridge bank for any losses incurred as a result of the transfer of assets and liabilities of the insolvent bank to the bridge bank (bullets 1 and 3 of paragraph six of Article 42(16) of the DGS Law).

As a general rule, a bridge bank will be created for three months. It can only be created if there is an investor which submitted a written obligation to purchase the bridge bank and transferred a guarantee payment to the DGF account. The requirements towards such bank are simplified. The DGF only appoints a manager (director), a chief account and their deputies which shall conduct the functions of the managing and control bodies of a bank (Article 42(4) of the DGS Law). No consent from the NBU for their appointment or checks of the professional suitability is required (paragraphs three and four of Article 42(4) of the DGS). The authorized capital of the bridge bank is formed in the amount that meets the minimum requirements for the authorized capital of a joint-stock company (bullet 1 of Article 42 (21) of the DGS Law). Such bridge bank is not subject to the requirements established by the NBU on mandatory economic standards, currency position limits, the procedure for forming and maintaining required reserves, forming provisions for losses on bank asset transactions and determining the amount of credit risk on all bank asset transactions (bullet 2 of Article 42 (21) of the DGS Law). The investor undertakes an obligation to bring the bridge bank in line with banking legislation of Ukraine in terms of capital and liquidity standards or to merge a bridge bank with an existing solvent bank (bullet 5 of Article 42 (21) of the DGS Law). The bridge bank loses its status of the bridge institution after the investor fulfils its obligation under sales purchase agreement (Article 42(17) of the DGS Law). So the fulfilment of the obligations by the investor results in terminating of DGF's participation in operation of the bank [11, p. 93]. The failure to fulfil this condition serves the basis for termination of the contract of sale of shares of the bridge bank at the request of DGF (bullet 8 of Article 42 (21) of the DGS Law). After the investor has taken measures to bring the bridge bank in line with the requirements of the banking legislation of Ukraine in terms of capital and liquidity standards, the NBU shall conduct an inspection. If the results of the inspection do not confirm the compliance, the NBU makes a decision to revoke the banking license and liquidate the bank. The DGF may transfer all or part of the property (assets) and all or part of the liabilities to another bridge bank (paragraphs 25–27 Article 42(21) of the DGS Law).

A bridge bank may be established for a period not exceeding one year with a possible extension for up to one year in case of failure of a bank with state participation, a bank whose liabilities equal two or more percent of all banks' liabilities in the banking system, or systemically important bank, or simultaneous failure of two or more banks provided that there is an investor willing to participate in bank failure management (bullet 2 of Article 42(21) of the DGS Law, paragraphs 8 – 12 of sub-bullet 3.5.11 of bullet 3.5 of Section 3 of Chapter IV of the Resolution on withdrawal of the insolvent bank from the market approved by the decision of the DGF Executive Board of 05.07.2012 № 2) [12]. The DGF appoints managers to such a bank and establishes management and control bodies of the bank in accordance with the requirements of banking legislation, except for the requirements for the bank's board to have independent directors. The functions belonging to the competence of the supervisory board and the management board of the bridge bank shall be determined by the charter of the bridge bank (paragraph two of Article 42(4) of DGS). No consent from the NBU for their appointment or checks of the professional suitability is required (paragraphs three and four of Article 42(4) of the DGS). The authorized capital of the bridge bank is formed in the amount that meets the requirements to the authorized capital of a bank (bullet 1 Article 42(22) of the DGS Law). The bridge bank must ensure compliance with the requirements established by the NBU regarding capital and liquidity ratios, three months after its establishment (bullet 3 Article 42(22) of the DGS Law). All or part of the property (assets) and all or part of the liabilities of the failed bank should be transferred to the bridge bank without financial support from DGF (bullet 5 of Article 42(22) of the DGS Law). The DGF shall sell the bridge bank within a year from the date of its establishment. Given the reasonable grounds, this term may be extended by the DGF Executive Directorate for up to one year (paragraph 12 of Article 42(22) of the DGS Law). The bridge bank loses its status of the bridge institution after acquisition of the bridge bank's shares to ownership by the investor (Article 42(17) of the DGS Law). If the investor does not intend to buy a bridge bank within the terms specified in this part, DGF enjoys the right to transfer all or part of the property (assets) and all or part of the liabilities of such bank to another assuming bank, or submit to the NBU a proposal to liquidate such bank (paragraphs 13 of Article 42(22) of the DGS Law).

As mentioned, the bridge bank tool under Ukrainian framework was used in two cases. The first case was the establishment of the bridge bank JSC "Krystalbank" to resolve insolvent PJSC "Terra Bank" on December 11, 2013 [13]. JSC "Krystalbank" acquired part of assets and liabilities of the insolvent PJSC "Terra Bank" [13]. JSC "Krystalbank" was created for three months and sold to an investor on March 12, 2014. The case allowed to test the legal framework.

The second case was the establishment of the bridge bank JSC "RVS" to resolve insolvent JSC "OMEGA BANK" on June 26, 2015 [14]. JSC "RVS" acquired all assets of the JSC "OMEGA BANK" in the amount of UAH 229,1 mln (USD 10,9 mln according to the exchange rate at the time) and almost all the liabilities in the corresponding amount. The DGF sold bridge bank JSC "RVS" to the company "Ukrainian business group" for UAH 31,86 mln. As a result of sales, the DGF not only received income from the sales of 100 percent of the shares of the bridge bank, but also saved more than UAH 7 mln (USD 1,5 mln according to the exchange rate at the time) on the liquidation of PJSC "OMEGA BANK" [15].

5. Conclusions.

In Ukraine, a bridge bank tool as a bank failure management tool is applicable to all banks, including small and medium sized banks. As a general rule, a bridge bank shall be created for three months and the investor must be found in advance. Such bridge bank has simplified corporate governance and is not subject to mandatory economic standards, currency position limits, the procedure for forming and maintaining required reserves, forming provisions for losses on bank asset transactions and determining the amount of credit risk on all bank asset transactions. For systemically important banks and complex cases as defined in the law, a bridge bank can be created for a period not exceeding one year with a possible extension for up to one year. Such bridge bank may be established in advanced, which shall be considered a banking secrecy. It shall comply with almost corporate governance requirements envisaged for banks and in three months after its establishment must ensure compliance with the requirements capital and liquidity ratios. The law provides for simplified procedure for establishment and licensing of a bridge bank, and the DGF shall be exempt from payment of taxes and other fees in connection with creation of a bridge bank. The authorized capital of the bridge bank shall be formed at the expense of the DGF. Ukraine has two cases of applying a bridge bank tool, and both proved to be efficient.

References:

1. FSB (2014). The Key Attributes of Effective Resolution Regimes for Financial Institutions.
2. World Bank (2016). Understanding Bank Recovery and Resolution in the EU: A Guidebook to the BRRD. World Bank, Vienna.
3. Cihak, M., & Nier, E. (2012). The need for special resolution regimes for financial institutions the case of the European Union. *Harvard Business Law Review*, 2(2), 395–434.
4. McGuire, Claire L. (2012). Simple tools to assist in the resolution of troubled banks. World Bank, Washington, DC.
5. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.
6. A reform of the CMDI framework that supports completion of the Banking Union. URL: A reform of the CMDI framework that supports completion of the Banking Union (europa.eu).
7. UNIDROIT Bank Insolvency Project. URL: Bank Insolvency – UNIDROIT.
8. Pro systemu harantuvannia vkladiv fizychnykh osib: Zakon Ukrainy vid 23.02.2012 № 4452-VI. Retrieved from: Про систему гарантування вкл... | від 23.02.2012 № 4452-VI (rada.gov.ua).
9. Deposit Guarantee Fund. Statistics. URL: Статистика (fg.gov.ua).
10. Resolution on procedure for incorporation, registration of a shares issue, issuing of the banking license to a bridge bank approved by the decision of the Executive Board of 21.09.2020 № 1715. URL: Про затвердження Положення про ... | від 21.09.2020 № 1715 (rada.gov.ua).
11. Petryk. Stvorennia ta prodazh perekhidnoho banku yak sposib pryvedennia diialnosti neplatospromozhnoho banku do vymoh ekonomichnykh normatyviv. *Problemy zakonnosti* 2020. № 148. DPL: <https://cyberleninka.ru/article/n/stvorennia-ta-prodazh-perehidnogo-banku-yak-sposib-privedennia-diyalnosti-neplatospromozhnogo-banku-do-vimog-ekonomichnih/viewer>.
12. Resolution on withdrawal of the insolvent bank from the market approved by the decision of the DGF Executive Board of 05.07.2012 № 2. URL: Про затвердження Положення про вив... | від 05.07.2012 № 2 (rada.gov.ua).
13. Deposit Guarantee Fund Report for 2014. URL: <https://www.fg.gov.ua/articles/48393-zvit-pro-diyalnist-fondu-za-2014-rik.html>.
14. Deposit Guarantee Fund Report for 2015. URL: <https://www.fg.gov.ua/articles/49641-zvit-pro-diyalnist-fondu-za-2015-rik.html>.
15. FGV sold Omega Bank for UAH 32 million. Bankruptcy & Liquidation. URL: ФГВ продав Омега Банк за 32 млн грн | Банкрутство та Ліквідація в Україні | Банкрутство и Ликвидация в Украине (bankruptcy-ua.com).

Kateryna Yashchenko,
Ph. D. candidate
Department of Private Law
National University of "Kyiv-Mohyla Academy"
E-mail: k.yashchenko@ukma.edu.ua
ORCID ID: 0000-0002-3356-1483