

The Banking Crisis in the UK and Europe: Evolution, Policy Responses and Lessons for the Future

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Introduction

- Setting the scene
 - Lets start with the horror story - UK banking collapse
 - Crisis in UK banking – key events
- European experience
- Policy lessons

Figure 1 Number of Banks and Building Societies 1985 to 2008

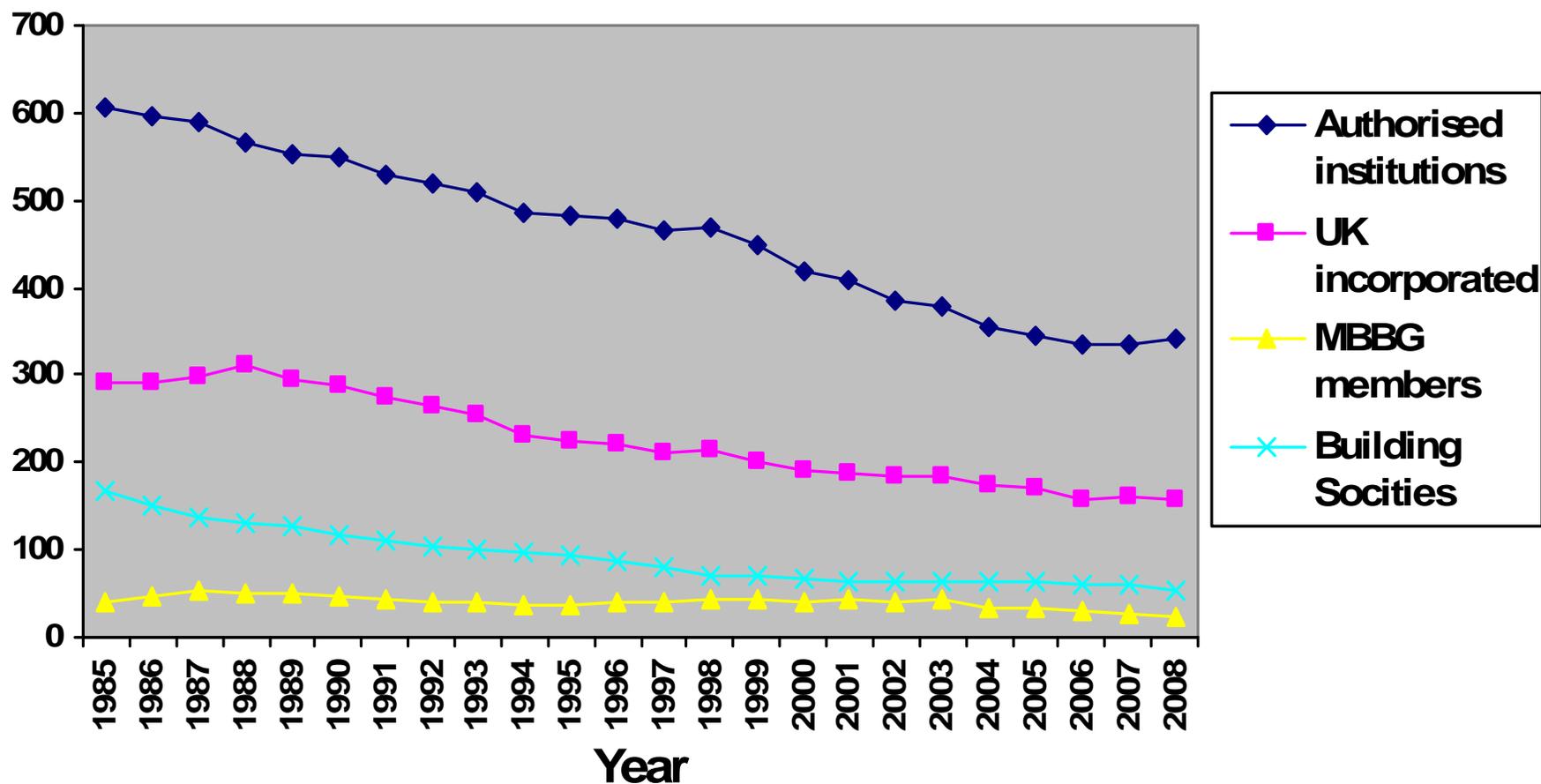


Figure 2 All Banks in the UK: Asset Structure 1985 - 2007

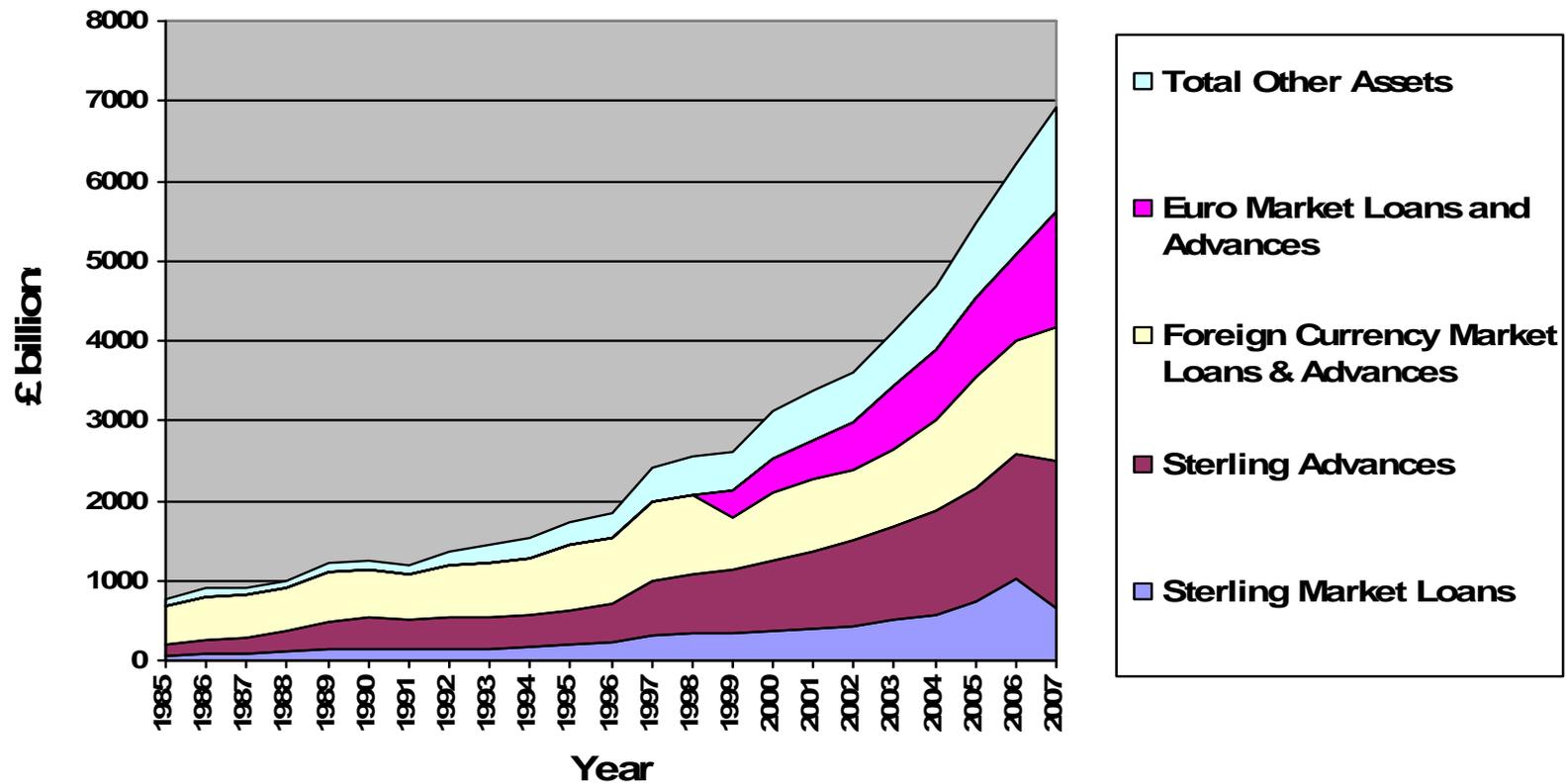


Figure 3 All Banks in the UK: Liability Structure 1985 -2007

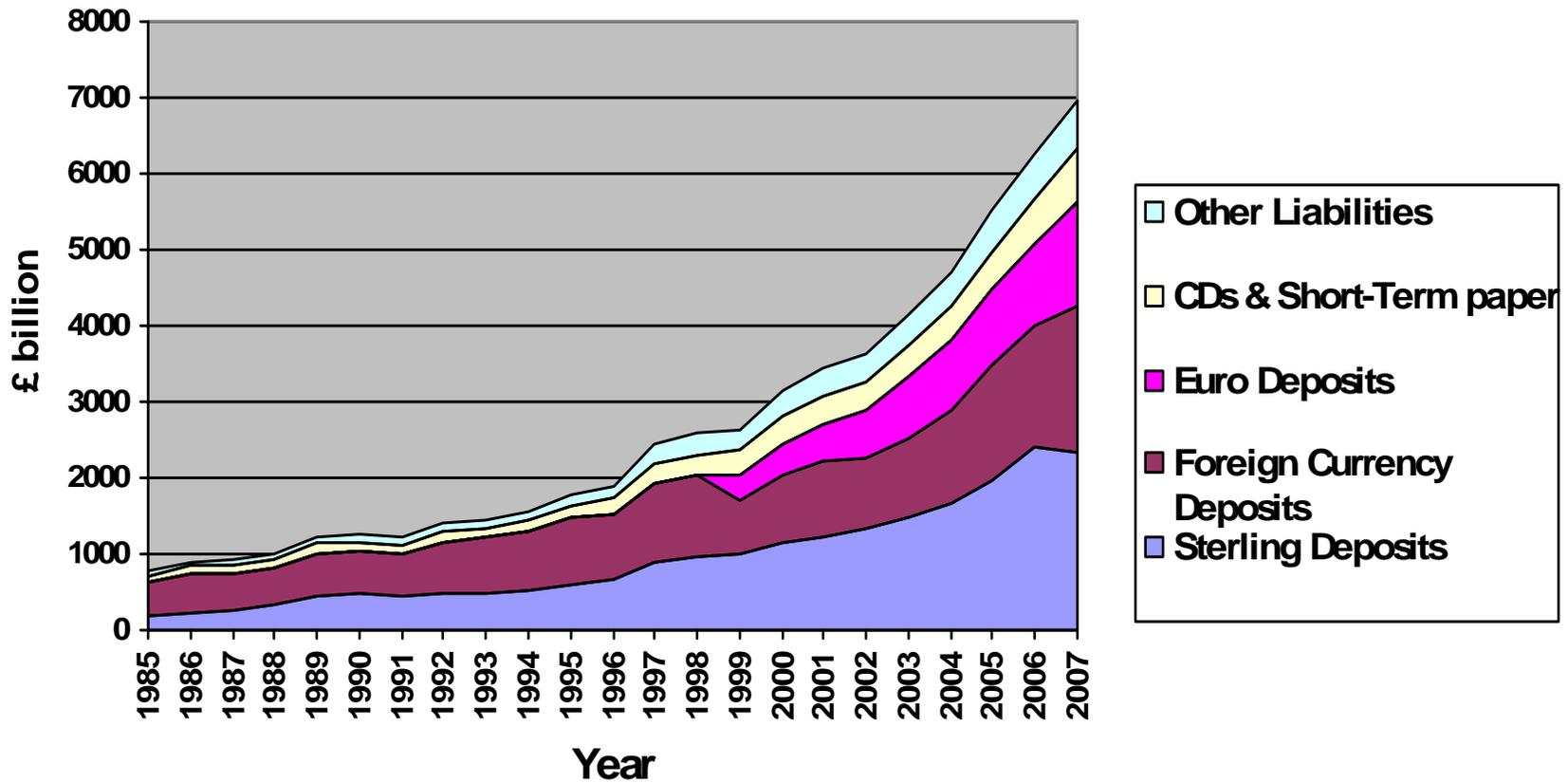


Figure 4 MBBG Sterling Lending to UK Residents 1985-2007

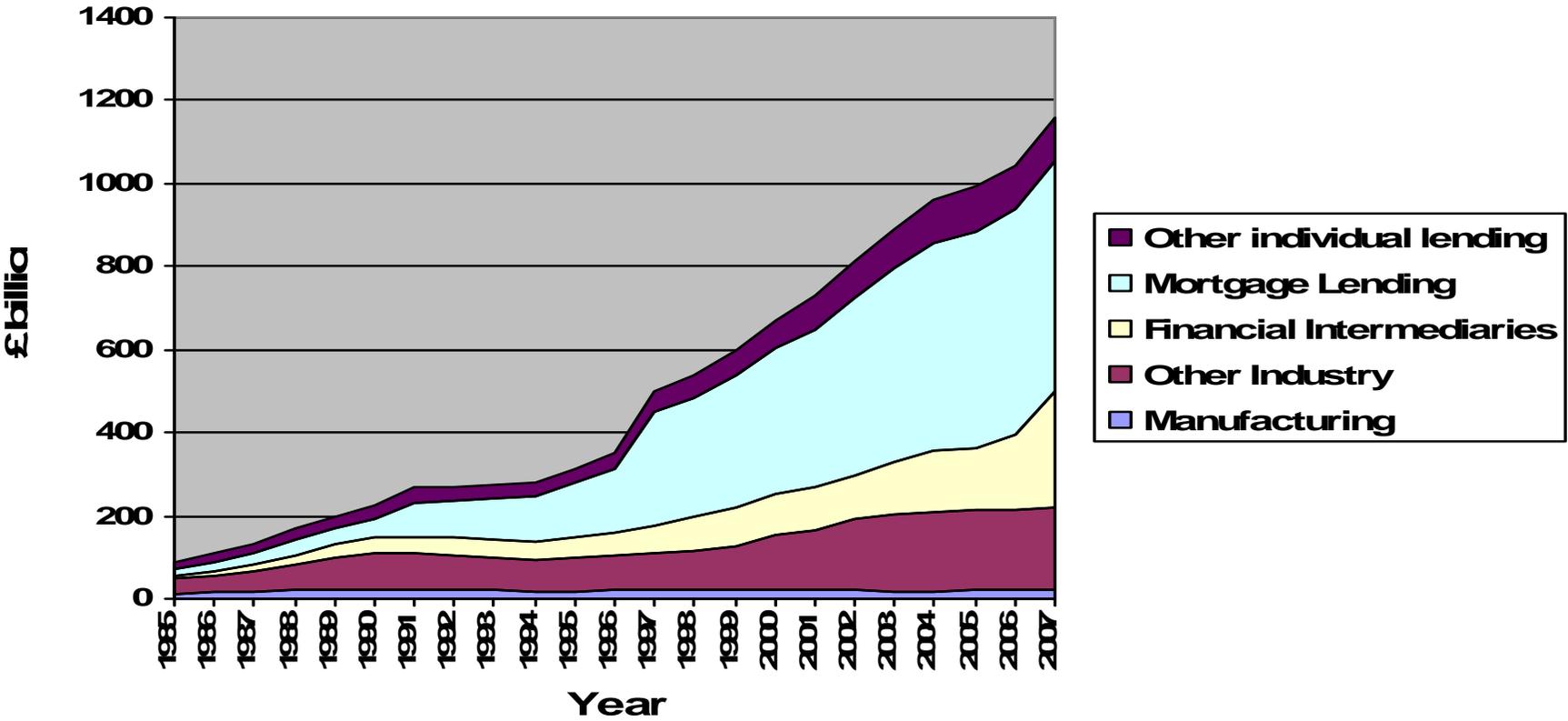


Figure 5 Net Lending for Consumer Credit 1985-2007

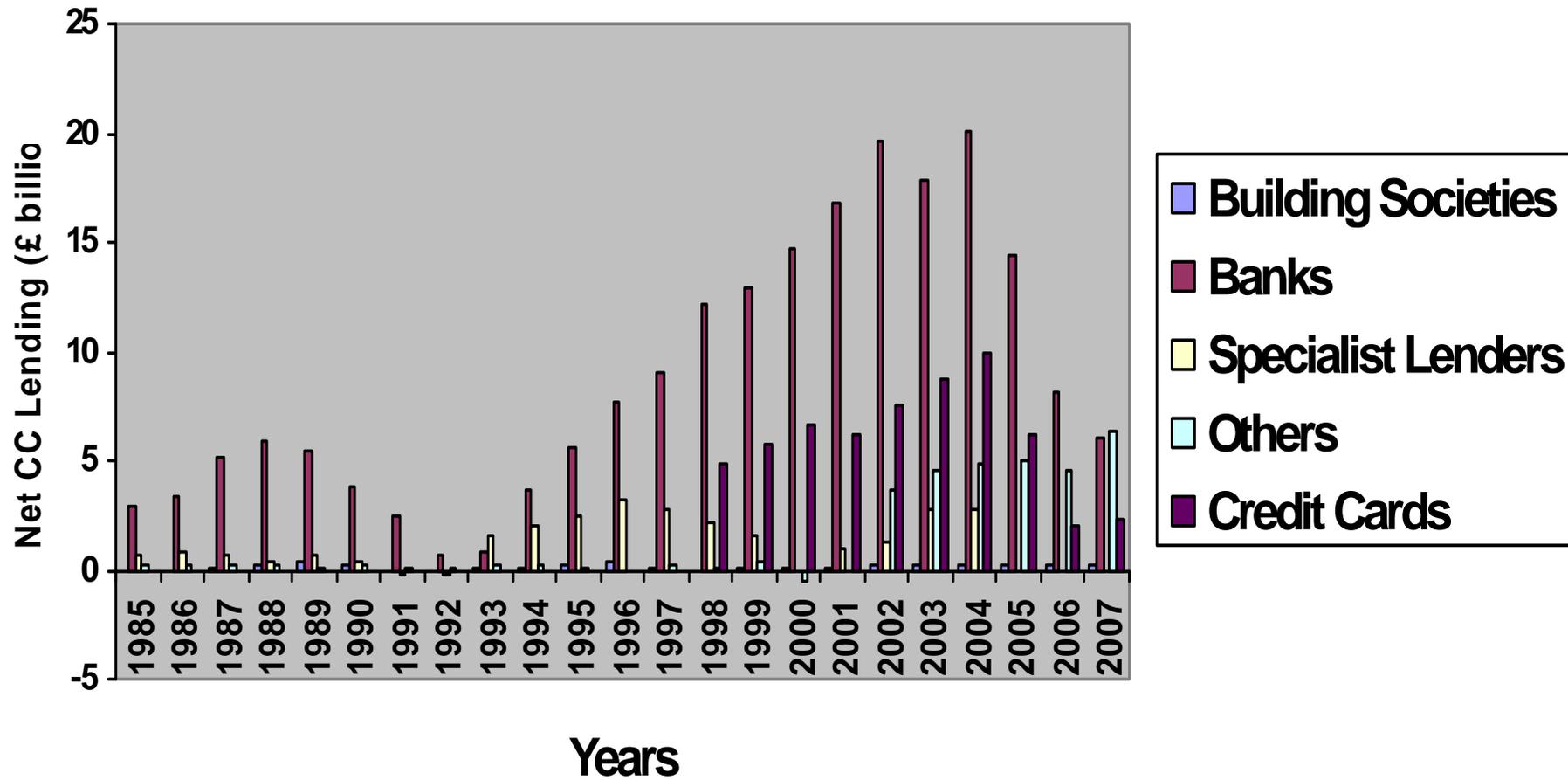


Figure 6 Net Mortgage Lending 1985-2007

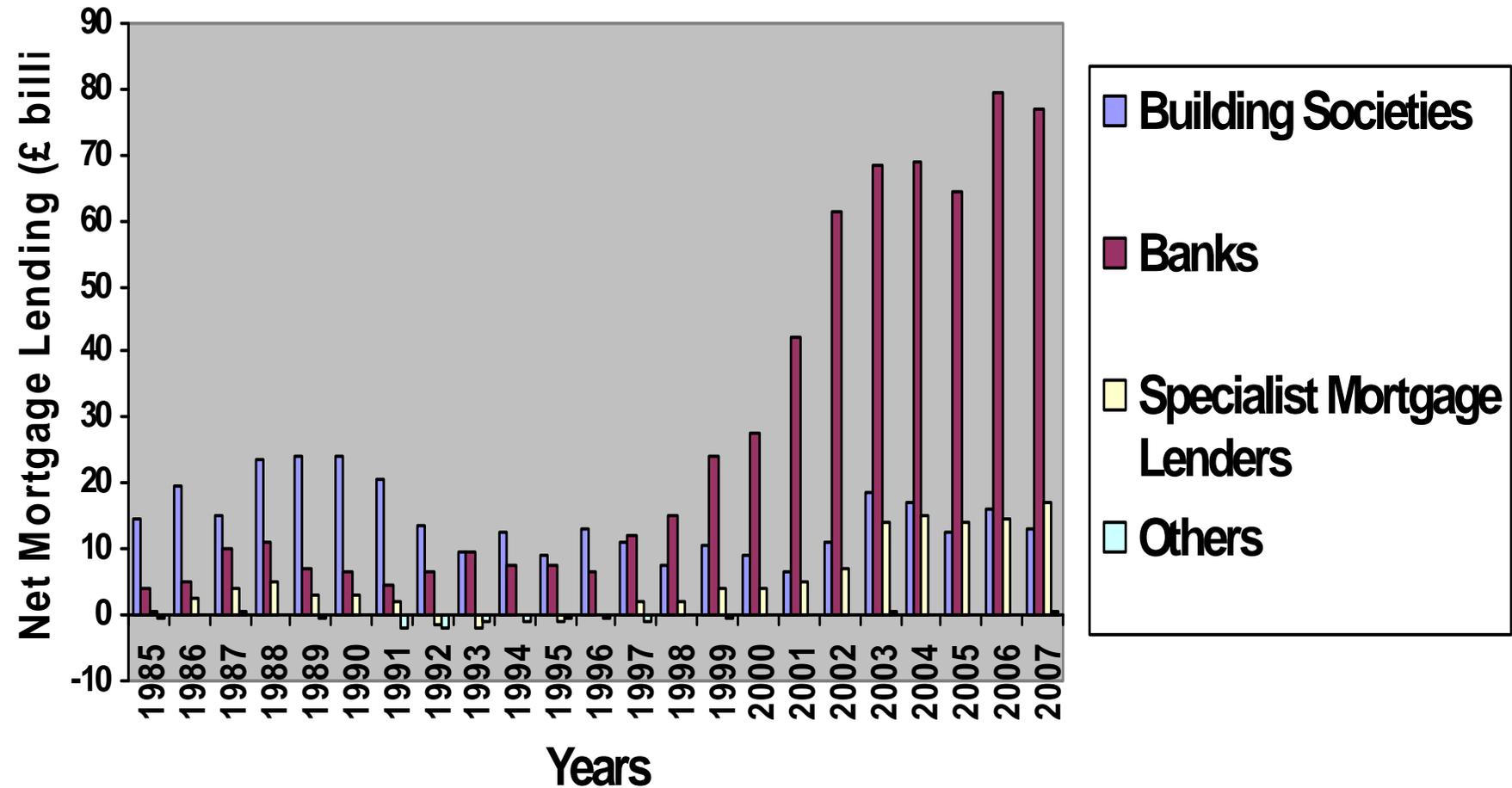


Figure 7 Share of Top Four Banks' Assets 1985-2007

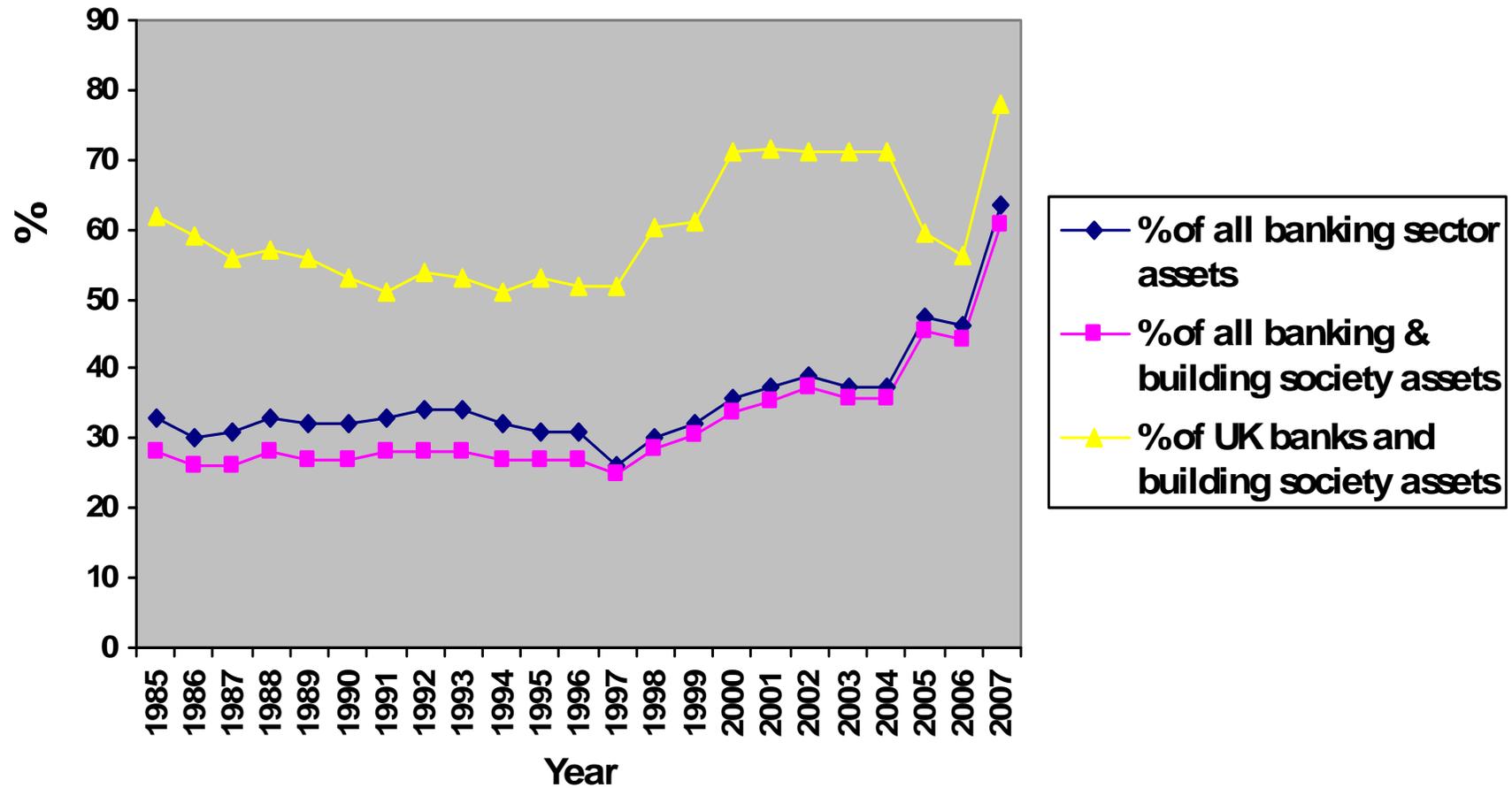


Figure 8 Income of Major British Banking Groups 1985-2007 (% of gross income)

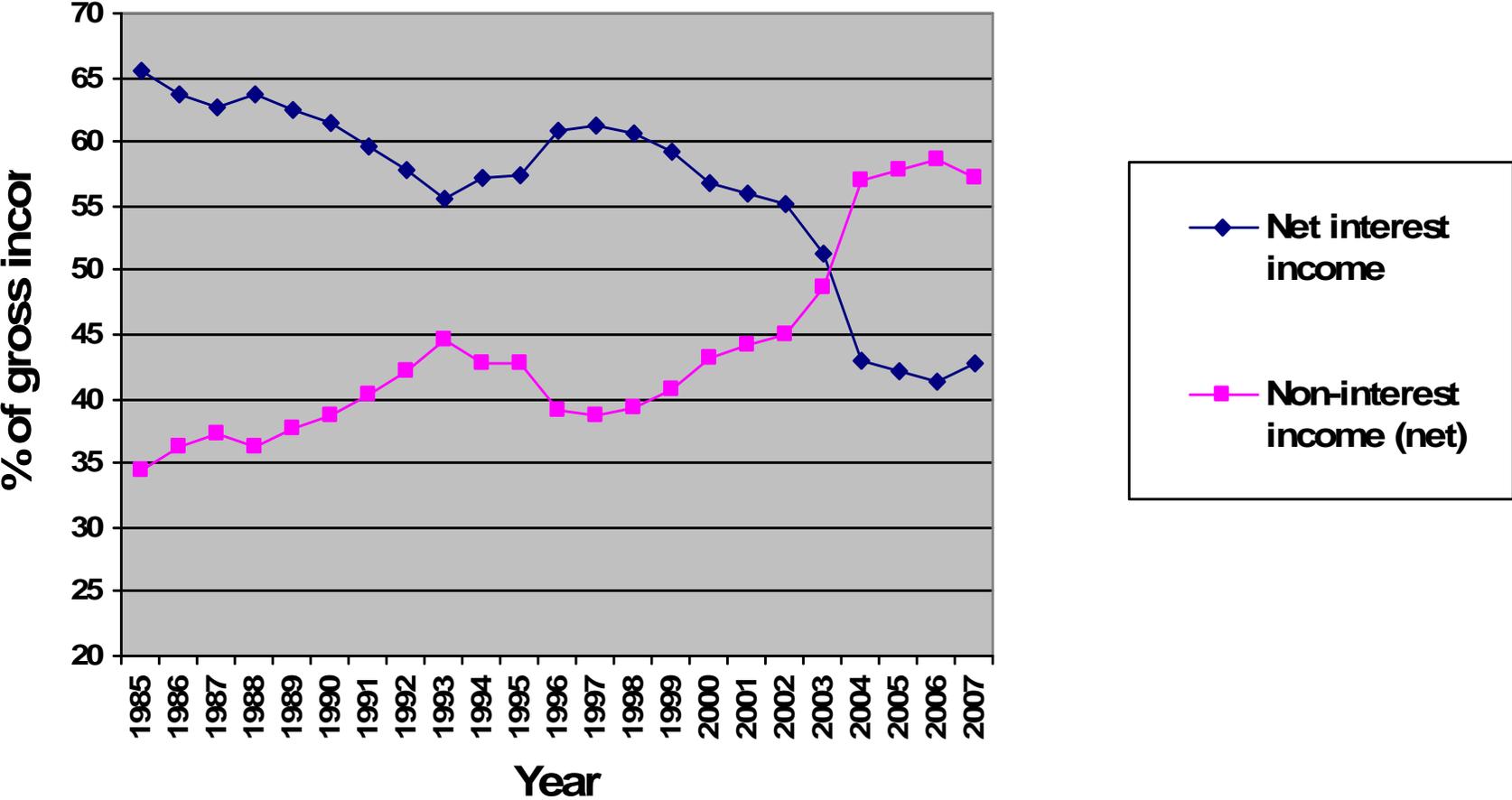


Figure 9 Costs of Major British Banking Groups 1985-2007 (% of gross income)

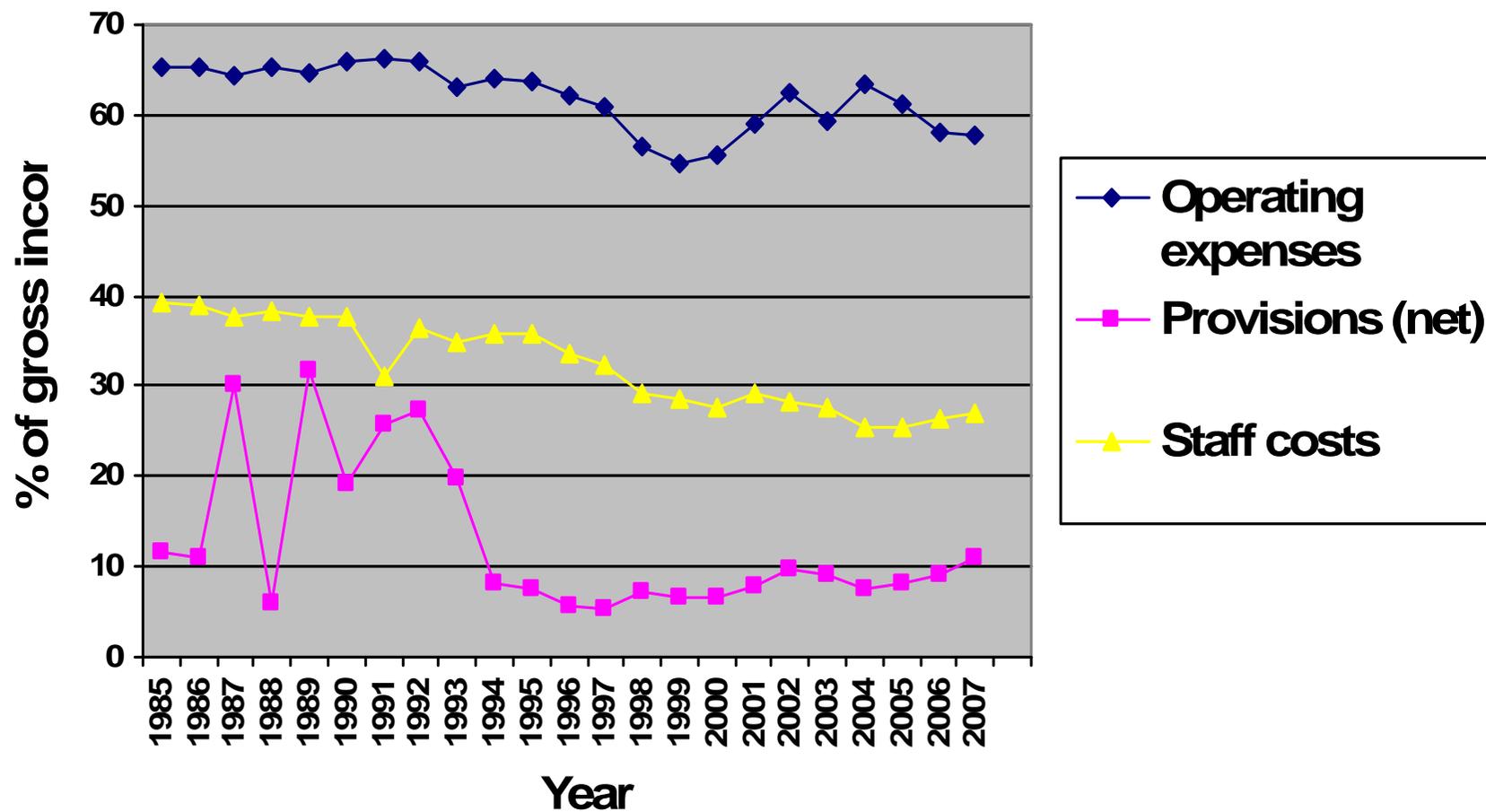
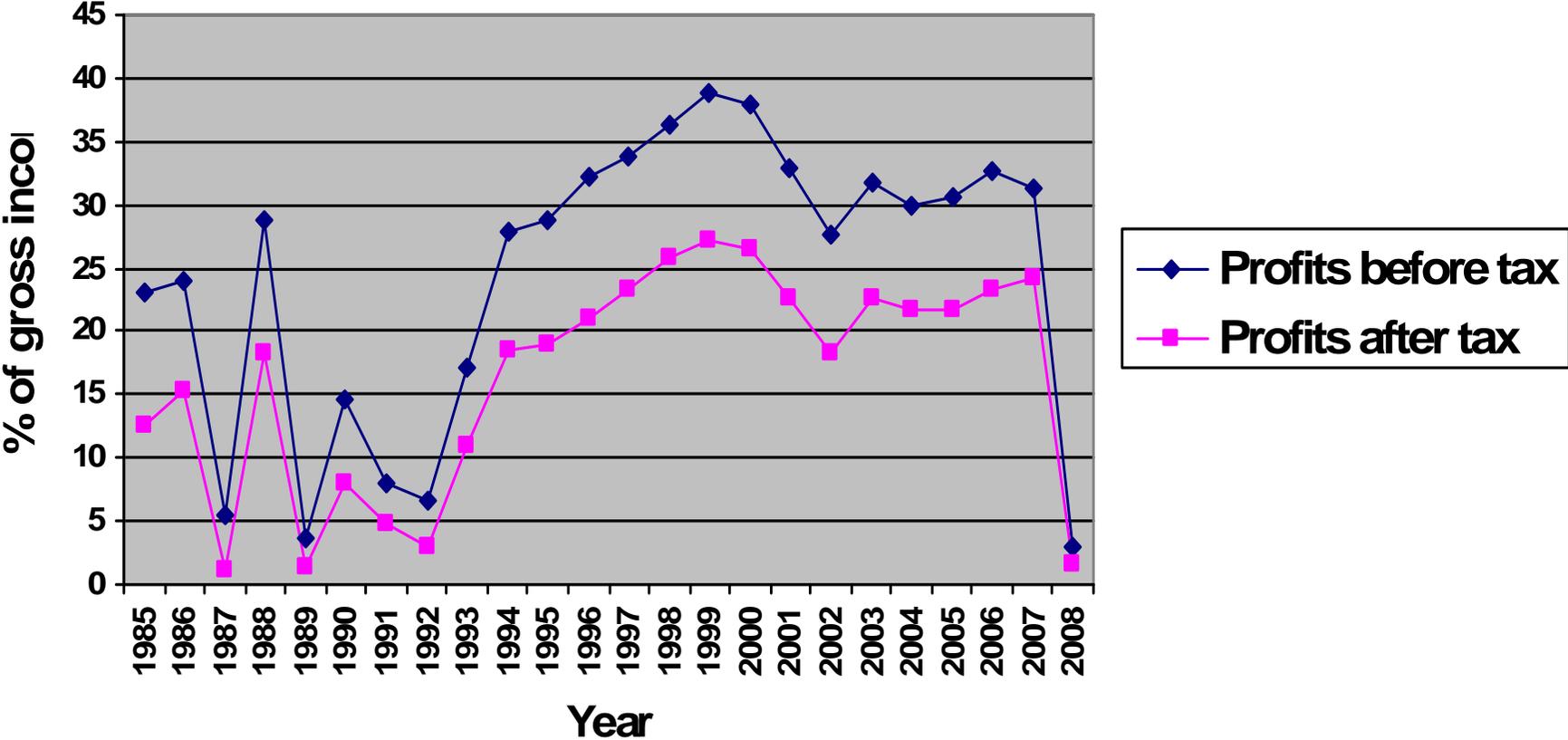


Figure 10 Profits of Major British Banking Groups 1985-2008 (% of gross income)



Crisis – Key UK Events 2007

- Ripples of the US sub-prime crisis in the summer of 2007 created on-going liquidity shortfalls in wholesale money markets
- **Northern Rock**, a major mortgage lender, revealed on 13th September 2007 that it had sort emergency financial support from the Bank of England – the following day over £1 billion in deposits was withdrawn from the mortgage lender leading to the largest run on a UK bank for over a century.
- To stem deposit withdrawals the government had to step in and guarantee depositor's savings.
- Northern Rock **nationalised in February 2008**
- The main cause of failure was cited as a reckless business model, **over dependence on short-term wholesale funding** as well as failings in regulatory oversight (HM Treasury, 2008)

UK Crisis Key Events - 2008

- FIRST QUARTER
 - Mortgage products were rapidly being pulled from the market – by early April over 20% of mortgage products had been withdrawn including the last home loan available without a deposit (the end of the 100% mortgage)
 - Annual house prices had fallen – the first decline in 12 years
 - Wholesale short-term lending by banks had dried-up.
 - Bank of England announced on 21st April details of a 'Special Liquidity Scheme' that allowed banks to swap temporarily their 'high' quality mortgage-backed other securities for UK Treasury Bills. The Scheme would provide funding of around £50 billion enabling banks to shift securitised mortgage assets off their books in return for higher quality assets.
- SECOND QUARTER
 - Rights Issues - all major banks announced plans to raise more capital via rights issues – with limited success (Barclays obtained Qatari investment, HBOS failed to raise cash)

UK Crisis Key Events - 2008

- THIRD QUARTER
- September – following collapse of Fannie, Freddie and Lehman's, ML/BA deal, and bailout of AIG – the day after AIG rescue HBOS stock collapsed and UK government encouraged LloydsTSB to acquire. Bradford & Bingley mortgage bank nationalised
- Between September 15th and October 8th – major problems in the US + elsewhere – WaMu (bought by JP Morgan), Wachovia (Citigroup), US Treasury's \$700billion rescue package, Fortis nationalisation (Belgium/Neths), Dexia bailout (France/Lux), Irish government blanket deposit guarantee, Hypo Real Estate (Germany)
- UK authorities announced £50 billion plan on October 8th that provided more capital, extended the remit of the Special Liquidity Scheme making at least £200 billion available for borrowings against eligible collateral and also provided other guarantees that sort to boost lending activity.

UK Crisis Key Events - 2008

- FOURTH QUARTER
- October 13th UK government announced it was to **pump taxpayers funds into three banks** in what some say is the UK's biggest ever nationalization. Capital injections into Royal Bank of Scotland (£20 billion), and Lloyds TSB and HBOS (£17 billion combined). Barclays announced that it planned to raise £6.5 billion by private means thus avoiding government interference.
- The three banks had to make a number of commitments relating to lending to homeowners and small businesses; support for individuals struggling to make mortgage repayments; remuneration for senior executives and so on
- On the 3rd November the Government set-up a new 'arms-length' company – **UK Financial Investments Limited (UKFI)** – to manage these bank investments and to manage the state holdings in Northern Rock and Bradford and Bingley.
- By the end of 2008 **a large chunk of the UK banking system was under Government** control – RBS 60%, Lloyds TSB 40% + other nationalisation

UK Crisis Key Events - 2009

- **More of the same - Policy response 2009 – capital and asset protection (+ liquidity support, capital injections and guarantees)**
- **January – Special Liquidity Scheme replaced with a barrage of new measures enabling liquidity injections**
- **January – more capital injected into RBS**
- **February – new Banking Act strengthening regulatory responsibilities and actions between Bank of England, FSA and the Treasury. Created a permanent Special Resolution Regime (SRR) that provides the Authorities with a variety of tools to deal with banks facing financial problems.**
- **Recourse to the capital and liquidity protection schemes meant that by mid-2009 RBS was 75% owned by the state (Lloyds TB was 55% owned by state) + Northern Rock + Bradford + Bingley in full state ownership – around one third of the UK commercial banking industry**
- **NATIONAL AUDIT OFFICE REPORTED IN DECEMBER 2009 THAT BAILOUT COST STOOD AT £850 billion – although cost to taxpayers over time could grow to £1.5 trillion**
- **Looking at tax on financial transactions**

European experiences – Rescued Banks - October 2008 and June 2009

Austria			Belgium		
	Erste Bank Group AG	State guarantees (Euro 6 billion) Recapitalisation (Euro 1 billion)		Dexia	State guarantees (Euro 150 billion) ^a Recapitalisation (Euro 3 billion)
	Kommunalkredit AG	State guarantees (Euro 5.2 billion) Recapitalisation (Euro 1.2 billion) Nationalisation on 5 th January, 2009		Fortis	State guarantees (Euro 150 billion) Recapitalisation (Euro 15.9 billion)
	Austrian Clearingbank AG	State guarantees (Euro 4 billion)		Fortis NV/SA	Recapitalisation (Euro 9.4 billion)
	Volksbanken AG	State guarantees (Euro 3 billion) Recapitalisation (Euro 1 billion)			Nationalisation on 5 th October, 2008 Acquisition by BNP Paribas
	Raiffeisen Zentralbank AG	State guarantees (Euro 4.25 billion) Recapitalisation (Euro 1.75 billion)		Fortis Bank Netherlands NV	Recapitalisation (Euro 2.04 billion)
	Hypo Alpe-Adria-Bank International AG	State guarantees (Euro 1.35 billion) Recapitalisation (Euro 0.9 billion)		KBC	Recapitalisation (Euro 7 billion)
				Ethias Group	Recapitalisation (Euro 1.5 billion)

France		
	Dexia	State guarantees (Euro 150 billion) ^a Recapitalisation (Euro 3 billion)
	Banque Fédérale des Banques Populaires	Recapitalisation (Euro 0.95 billion)
		Access to Euro 50 billion emergency Loans Merger with Caisse Nationale des Caisses d'épargne with Euro 5 billion capital injection
	BNP Paribas	Recapitalisation (Euro 2.55 billion) Access to Euro 50 billion emergency loans
	Caisse Nationale des Caisses d'épargne	Recapitalisation (Euro 1.1 billion) Access to Euro 50 billion emergency loans Merger with Banque Federale des Banques Populaires with Euro 5 billion capital injection
	Crédit Agricole	Recapitalisation (Euro 3 billion) Access to Euro 50 billion emergency loans
	Crédit Mutuel	Recapitalisation (Euro 1.2 billion) Access to Euro 50 billion emergency loans
	Société Générale	Recapitalisation (Euro 1.7 billion) Access to Euro 50 billion emergency loans
	Banque PSA Finance	Access to Euro 50 billion emergency loans
	Caisse centrale du Credit Immobilier de France	Access to Euro 50 billion emergency loans
	GE Capital SAS	Access to Euro 50 billion emergency loans
	Groupe Banque RCI	Access to Euro 50 billion emergency loans
	Societe des Paiements Pass-S2P	Access to Euro 50 billion emergency loans

Germany	Aareal Bank	State guarantees (Euro 4 billion) Recapitalisation (Euro 0.53 billion)
	Bayern LB	State guarantees (Euro 15 billion)
	HSH Nordbank AG	State guarantees (Euro 30 billion) Recapitalisation (Euro 3 billion)
	Hypo Real Estate AG	State guarantees (Euro 52 billion)
	IKB	State guarantees (Euro 5 billion)
	SdB	State guarantees (Euro 6.7 billion)
	Sachsen LB	State guarantees (Euro 2.75 billion)
	Nord LB	State guarantees (Euro 20 billion)
	Commerzbank AG	Recapitalisation (Euro 10 billion)

Greece		Netherlands	
Agricultural Bank of Greece SA	Recapitalisation (Euro 0.675 billion)		State guarantees (Euro 7.85 billion)
Alpha Bank SA	Recapitalisation (Euro 0.95 billion)	Fortis Bank Nederland (Holding) NV	Recapitalisation (Euro 1.96 billion)
Aspis Bank SA	Recapitalisation (Euro 0.09 billion)		Nationalisation on 3 rd October, 2008
Attica Bank SA	Recapitalisation (Euro 0.1 billion)		State guarantees (Euro 11.4 billion)
EFG Eurobank Ergasias SA	Recapitalisation (Euro 0.95 billion)	ING Bank NV	State guarantees (Euro 4.8 billion)
General Bank of Greece SA	Recapitalisation (Euro 0.18 billion)	NIBC Bank N.V.	State guarantees (Euro 5.488 billion)
Millennium Bank SA	Recapitalisation (Euro 0.065 billion)		Recapitalisation (Euro 0.75 billion)
National Bank of Greece SA	Recapitalisation (Euro 0.35 billion)	SNS Bank N.V.	Recapitalisation (Euro 3 billion)
Piraeus Bank SA	Recapitalisation (Euro 0.37 billion)	Aegon N.V.	
Proton Bank SA	Recapitalisation (Euro 0.079 billion)	ING Groep N.V	Recapitalisation (Euro 10 billion)

Portugal			Sweden		
	Banco Espirito Santo	State guarantees (Euro 1.5 billion)		Carnegie Investment Bank AB	State guarantees
		State guarantees (Euro 0.1 billion)			State loans (Euro 0.225 billion)
	Banco Finantia	State guarantees (Euro 0.55 billion)			
	Banco Internacional do Funchal	State guarantees (Euro 0.025 billion)			State guarantees
	Banco Invest	State guarantees (Euro 0.45 billion)		SBAB	State guarantees
	Banco Privado Portugues	State guarantees (Euro 2 billion)		Swedbank AB	State guarantees
	Caixa Geral de Depositos			Swedbank Hypotek AB	State guarantees
	Banco Portugues de Negocios S.A	Nationalisation on 11 th November, 2008		Volvofinans Bank AB	

Source: PETROVIC A., TUTSCH R., "National Rescue Measures in Response to the Current Financial Crisis", ECB Legal Working Paper Series, No. 8, 2009

National Rescue Measures in Response to the Current Financial Crisis

Summary chart

Member State	State guarantee	Recapitalisation	State loans	Acquisition of impaired assets	Nationalisation	Individual rescue decisions
Austria	X	X	X		X	X
Belgium	X					X
Bulgaria						
Cyprus						
Czech Republic		X (draft)		X (draft)		
Denmark	X	X	X	X		X
Estonia	X	X	X	X		
Finland	X	X (draft)				X
France	X	X	X			X
Germany	X	X		X	X	X
Greece	X	X	X			
Hungary	X	X	X			X
Ireland	X	X		X	X	X
Italy	X	X		X		

Source: PETROVIC + TUTSCH (2009)

National Rescue Measures in Response to the Current Financial Crisis

Summary chart

Member State	State guarantee	Recapitalisation	State loans	Acquisition of impaired assets	Nationalisation	Individual rescue decisions
Latvia	X				X	X
Lithuania	X (draft)	X (draft)	X (draft)	X (draft)	X (draft)	
Luxembourg						X
Malta						
The Netherlands	X	X			X	X
Poland	X	X (draft)			X (draft)	
Portugal	X	X	X (draft)		X	X
Romania	X					
Slovakia	X (draft)	X (draft)				
Slovenia	X		X			
Spain	X	X		X		X
Sweden	X	X		X		X
United Kingdom	X	X		X	X	X

Source: PETROVIC + TUTSCH (2009)

European Policy Response

- Similar to UK
- A broad array of measures as highlighted in previous table:
 - State guarantees
 - Recapitalisation
 - State loans
 - Acquisition of impaired assets
 - Nationalisation
 - Individual rescue decisions

POLICY LESSONS – as elsewhere

- The main policy lessons learned from the crises typically focus on:
 - strengthening capital, liquidity and risk management in the financial system;
 - improving the transparency of bank balance sheets and off-balance sheet activities;
 - changing the role and use of credit ratings
 - strengthening authorities' responsiveness to risks; and more robust arrangements for dealing with stress in the global financial system
 - Making regulations tougher to limit banks 'game the system'