On the need of special rules dealing with bank insolvencies [1]

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Contrary to literature on the prevention of bank crisis which is very developed, literature on bank resolution policies and insolvency law is still relatively small even if academic interest is growing. Because of the systemic repercussions of bank crisis which can dramatically affect both financial and real sectors, banks are subject to specific supervision and regulation by prudential authorities. The whole system of banking regulation is designed to induce a bank behaviour which makes insolvency relatively unlikely. Nonetheless, despite these prudential efforts, bank insolvency may arise and needs specific rules in order to be resolved. The need for such a reflection on banking resolution proceedings is nowadays exacerbated by the growing movement of bank consolidation both national and cross-border. Moreover this consolidation is also a cross-sector phenomenon characterized by the emergence of large financial conglomerates combining banking, insurance and securities business in a same group. These tendencies are now well documented and increase the potential for spill over effects of bank failure (De Nicolo and alii 2003, Schoenmaker D and Oosterloo, 2005). So, not only do we have to estimate the adequacy of national bank insolvency regime, but also the mutual compatibility between the different proceedings across countries, especially at the European level (even if a Directive on the reorganization and winding up of credit institutions exists).

This paper investigates the various issues related to the treatment of bank insolvencies. In a first part, by adopting a theoretical point of view, we explain why bank failures are different from failures of other companies and hence we argue in favour of a special bank insolvency regime distinct from the general insolvency law. Empirically, the fact that bank liquidation option are rare compared to the frequency of bank reorganization may be

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interpreted as an evident sign of the specificity of bank bankruptcy process. In the second part of this paper, we compare our previous theoretical analysis with the prevailing bank insolvency regimes in the US and in most European countries. Schematically, two antagonist regimes coexist: the administrative approach prevalent in the US and Canada and the general standard in European countries where court-based proceedings predominate. We conclude that the US regime is consistent with the theoretical analysis in favour of a special regime for banks and that it's not the case for the more frequent European insolvency regimes. In our conclusion, we explain why the US system is not only a better one from a domestic point of view but also from a European perspective in so far as it is conducive to a coherent framework for the management of cross border banking crisis.

§1 a special regime for bank insolvency: the arguments

Bank failures are different from the failure of other companies in many important aspects that can be mobilized to justify the exemption of banks from general corporate insolvency law and their subjection to administrative insolvency proceedings under the control of regulators. An important proportion of the arguments in favour of a special treatment of banks in insolvency proceedings is connected with the arguments justifying a stronger regulation for the banking sector compared to other commercial or industrial sectors. Nonetheless, this well known literature does not exhaust the arguments on behalf of a specific bank insolvency regime. In particular, two specific grounds have to be added: firstly, the goals of bank insolvency resolution are different from those of corporate bankruptcy codes; secondly, the general corporate insolvency framework could be inefficient to treat certain specific features of bank resolution. These two points are analytically different from the previous ones even if there are obviously linked to the specificity of banks.

- Banks are critically different from other companies because a sizeable portion of individuals' incomes (wages, pensions, social incomes, etc.) takes the form of bank deposits. These bank deposits collectively comprise the largest share of the country's money supply and the primary medium of exchange. So, bank's liabilities are the most usual media of exchange. The efficiency of the transaction system is conditioned by the absolute confidence of the users of this medium of exchange in its value. Indeed, an economic system where individuals would have to evaluate continuously the potential value of their monetary assets and so to judge the solvency of their banks would be a very inefficient system generating prohibitive transaction costs. That's an important reason to explain why in case of bank failure – at the opposite of a corporate failure - collective interests dominate private ones.

- The peculiarity of bank's balance-sheet is another major argument. The association of two characteristics is at the root of this specificity. As we have underlined previously, bank's liabilities are short term and mainly composed with deposits which are repayable at par on demand whereas its assets are longer term and largely non-marketable - even if this last characteristic is nowadays less pronounced -. This last characteristic is directly linked with the high private information content of bank loans compared to market financing. That's why bank assets are widely perceived to be more opaque than assets of most non-bank firms. In normal time, the association of these two bank's balance-sheet features does not generate problems but if there is a weakening of confidence in the bank's ability to meet its payments obligations, it can cause a massive withdrawal of deposits (conversion to cash or transfer to other banks) and hence a liquidity problem which is linked with the difficulty to sell off assets at a "normal price" (fire sales) and may threaten the bank's solvency. As we know, deposit insurance constitutes a solution to protect small depositors and to avoid bank runs (Diamond and Dybvig, 1983). Compared to other creditors, small depositors need a stronger protection because a large proportion of them have limited financial means and expertise. Therefore, in most deposit insurance systems, there is a limited coverage by depositors which is fixed to cover the balances that ordinary private individuals hold. However, insurance funds that are generally structured on the basis of relatively small banking accidents could face heavy fiscal costs in case of larger crises. The experience of the 90's with a multiplicity of banking crises both in industrial and developing countries, illustrates the fact that bank insolvency is not always an idiosyncratic event and can be a systemic phenomenon.

- Indeed, what distinguishes bank insolvency from a commercial or industrial bankruptcy is that the former may entail a risk to the entire economic and financial system by a propagation process through the defaulting bank's counterparties or by the informational channel [De Bandt O. and Hartmann P. 2000]. The exposure channel relates to the potentiality for "domino effects" through real exposures in interbank markets and/or in payment systems whereas the informational channel is linked to the lack of information on the mutual exposures of banks and on the type of shocks affecting banks (idiosyncratic or systematic) which can generate contagious withdrawals by non informed depositors.

- Banks perform financial services that are fundamental to the smooth functioning of the economy such as the extension of credit especially for agents who can not find alternative financing sources (households, small and medium companies etc.), taking deposits and payment processing. Banks remain the primary source of liquidity for most financial and non-financial institutions. So, potentially, bank failures can cause credit rationing, a substantial reduction in economic activity and eventually in the worst cases a spiral of commercial failures. Thus, the knock-on effect disturbs not only the financial system through the exposure and informational channel but also the commercial and industrial sector through the credit channel.

The arguments presented previously are traditionally used to justify both a stricter regulation for banks compared to other companies and a special bank insolvency regime. Nevertheless, specific arguments also exist justifying such a special treatment.

The insolvency concept is quite different for banks compared to other companies, vesting the regulator with a central role in the insolvency proceedings. Many reasons explain this specificity:

- First, while under general insolvency law, a trigger point for intervention is the default of the debtor institutions to honour their liabilities on due date, in the case of banks, because of their balance-sheet specificity previously analysed, any such inability to meet a short-term liability is not necessary a proof of insolvency but can simply result from a temporary shortage of liquidity. On the contrary, also due to the particuliarity of its balance-sheet which provides an on going source of cash flows, in a financial system endowed with deposit insurance, a bank experiencing financial difficulties could continue to honour the payments of its debts even if it is potentially insolvent. Being subject to special regulation which conditions their operations, banks benefit from special proceedings defining their viability. The bank supervisor has to assess the adequacy of the bank's capital to judge the quality of its assets and as a result of these prerogatives determines the point of insolvency. In fact, as remarked by Eva Hüpkes (2003): "a bank is insolvent when the supervisor says it's insolvent!". As per most general corporate bankruptcy codes, bankruptcy may be initiated either by a minimum number of creditors whose claims are in default or voluntarily by the firm itself in anticipation of a default. The proceedings differ in the case of banks. Compared to general insolvency regime, bank insolvency procedure gives a less active role to creditors committees and insolvency judges and grants a key role to the supervisor. If the supervisor judges that the bank's capital is impaired, he can intervene in a preemptive way to constrain the bank in its activities with the view to prevent insolvency. These pre-insolvency interventions which are part of the prudential policy can mobilize a large set of tools ranging from the informal to the more intrusive. In case of detected past misconduct including breaches of prudential rules, corrective and enforcement actions of the supervisory agency might at minimum include disciplinary measures such as forcible interventions in the bank's organization and/or operation. So, operationally, there is a kind of continuum between regular prudential policy and bank insolvency proceedings. The severity of such pre-insolvency measures constitutes a sort of protection against the moral hazard generated by the most usual banking resolution procedures. As a recent study on bank failures in mature economies analysing different national episodes in major banking crises has underlined (Basel Committee on banking supervision, 2004), liquidations were used just occasionally and typically only for smaller institutions or where only a small part of the banking system was impaired. When large commercial banks were in trouble, problems have been usually resolved through forced merged and some mix of capital injection and increased government control. Moreover, this paper examines changes in the legal and regulatory regimes that resulted from the crises and so illustrates the interdependencies between regulatory regimes and bank insolvency proceedings. Even if this special role of the supervisor in the troubled bank's resolution is largely admitted and well-documented, it creates a non-negligible problem. Indeed, in banking industry - as in other concentrated sector - the regulators are proned to be captured by the regulated industry and influenced in their decisions by its interests. Such a situation creates a tendency to forbearance affecting the supervisor's behaviour which can increase the final cost of the bank insolvency resolution. The treatment of the Savings & Loans crisis in the US constitutes a kind of school case of the adverse effects of regulatory forbearance. Besides, the analysis of this episode directly influenced one of the most important regulatory reform in the United States: the Federal Deposit Insurance Corporation Improvement Act (Benston and Kaufman 1998). Through this reform, the legal coercive powers of the deposit insurance have been strongly enlarged allowing and promoting prompt actions to correct institutions with inadequate capital and favouring the resolution of undercapitalized banks at least cost. Thus, this reform could be understood as a reinforcement of the pre-insolvency powers of the deposit insurer. Beyond the US case, an institutional solution to the potential capture of the regulator by the regulated has been recently investigated by the literature on regulatory and supervisory issues. So, the independence and accountability of supervisory authorities constitute another institutional solution to this potential capture of the regulator by the regulated which has been recently considered [Quintyn M and Taylor M., 2002].

- Another important difference between industrial or commercial corporate reorganization and bank reorganization proceedings concerns the potential use of general moratorium that blocks all the payment streams. While this option could be a good solution with regard to reorganization proceedings for industrial or commercial corporate, it could be an infeasible solution for a bank's restructuring. Indeed, the non-payment of existing liabilities will destroy any remaining goodwill, making it impossible for the bank to attract new deposits. Consequently, granting new loans will also become impossible. The complete suspension of bank's payments will almost certainly lead to the bank's death. That is why in the case of banks, when a moratorium seems necessary, it is generally partial. A moratorium is usually associated with some form of provisional administration or controlled management under a supervisor's patronage in which the supervisor is vested with the power to allow exemptions regarding the suspension of payments.

- The main objectives of a general corporate bankruptcy law are directly linked with the pursuit of solutions to a collective action problem as coordinating the debt collection efforts of multiple creditors to maximize overall recovery value and/or maximizing the realized value of the bankrupt firm assets and resolving creditor's claims in an orderly and collective manner. By contrast, even if these objectives exist in the case of bank failure, the principal goal of a bank bankruptcy procedure is to preserve the stability of the financial sector as a whole and to avoid systemic problems. So, in addition to private creditor, debtor and stockholders' interests, bank insolvency law has to take in account the public interest. The bank insolvency regime is concerned with externalities. In certain cases, this may justify the transgression of the principle of the equal treatment of all creditors which prevails in general insolvency law. For instance small depositors and creditors may be protected and fully repaid while larger creditors are compelled to engage themselves into a renegotiation of their claims. The same kind of arguments justifies a special treatment of the collaterals and hence a preferential treatment for the collateral taker. Indeed, the incapacity to enforce collateral immediately upon default of the provider of collateral may generate serious losses for the creditor and may impair his ability to face his own liabilities. This constitutes a non-negligible contagion channel and gives a good reason for protecting the collateral arrangements from the general rules governing corporate insolvency codes. These exemptions seem to conflict with the objective of fairness to all creditors but are consistent with the preservation of financial stability. In the same manner, the rules underlying the orderly and smooth functioning of payment and settlement systems which are based on the finality and irrevocability of the payments even in a case of bank failure could be interpreted as conflicting with the rules structuring corporate insolvency laws. Once again, the justification of such a preferential treatment to participants of payment and settlement systems has to be found in the primary goal of preserving financial stability.

§ 2 The prevailing bank insolvency regimes

The international banking regulatory community has recently admitted the need for coherent bank resolution policies. This recognition took the form of a report based on experiences in different countries. This statement clearly distinguishes between two situations: the first one, when problems have been detected but the bank insolvency does not seem ineluctable and the second one, when the bank is rapidly approaching the non-reversing point of non viability. In the former case, the report favours early corrective action using a broad set of tools. Clearly these pre-insolvency measures are included in the regulatory policy. In the case of imminent failure, it proposes a set of "guiding principles for bank resolution policy" which are supposed to influence the operational choice of resolution measures. Schematically, these principles are structured in a way limiting moral hazard, promoting -when it is possible- private sector solutions thereby limiting the costs on taxpayers, preserving competitiveness and above all minimizing disruption to market participants. The range of resolution techniques are then specified in a growing order of stringency. These options consist in: restructuring plans, mergers and acquisitions, purchase and assumption transactions, bridge bank, use of public funds for the resolution and finally the closure of the bank. So, if this report gives precise guide-lines for dealing with weak banks, it does not scrutinize the appropriate legal framework conducive to the best implementation of these principles. However, the implementation of the principles of resolution is basically subordinated to the legal device.

As we have previously seen, the theoretical analysis largely pleads in favour of a specific framework dealing with bank insolvencies but the disparity in national approaches is significant. In most countries, the general corporate insolvency regime, where court-based proceedings dominate, is complemented by special rules dedicated to banks. Nevertheless, in few countries, bank insolvency measures depend on special administrative proceedings. In such scant cases, the adoption of an administrative approach is mainly motivated by the integration of the bank insolvency process in the supervisory framework. This option seems consistent with the weak bank report.

So, schematically, two rival regimes coexist: the administrative approach characterised by special bank insolvency regime, such a framework is established in the US, Canada (and also in Italy) and the general stance of European countries where court-based proceedings prevail. Thus, the majority of European states chooses to apply ordinary insolvency rules to banks with special provisions or exemptions from the general regime justified by the specificity of bank insolvency. In Europe, the reluctance of legislators to transfer certain judicial functions linked with the resolution of problem bank to the supervisor is probably connected with the fact that the conduct of bankruptcy proceedings is traditionally the function of a court. Nevertheless, the future could be different. As a matter of fact, while insolvency frameworks vary widely from country to country (even within the European Union) with respect to the extent to which they trust special procedures to resolve bank failure, there is a general tendency toward granting the supervisor enlarged powers and to either complement or substitute powers previously exercised by judges (E. Hüpkes, 2003). The French and Swiss experiences constitute a good illustration of this trend. In France, the amendments to the Banking Act of 1999 reinforced the powers of the Banking Commission in dealing with weak banks. In particular, they strengthened the role of the Banking Commission and the liquidators appointed by it in the judicial insolvency proceedings. In Switzerland, the evolution of the system is still more pronounced. In early 2004, a new framework for the resolution of bank insolvencies entered into force. Under the new device, the Swiss Federal Banking Commission assumes functions traditionally exercised by bankruptcy courts. Therefore, consistent with the theoretical analysis, the drafters of the new Swiss framework introduced special provisions for reorganization and bank liquidation into the Banking Act and reassigned the powers to handle these proceedings from the bankruptcy courts to the bank supervisor (E. Hüpkes, 2004).

This consistency between the theoretical analysis and the operational design also characterizes the U.S. approach. Indeed, in the United States commercial banks, insurance companies and some other financial institutions are exempted from the corporate bankruptcy code. Instead, the statement and resolution of their insolvencies are managed by the provisions of the Federal Deposit Insurance Act and this special set of rules for banks differs drastically from the general corporate bankruptcy code (Bliss R. and Kaufman G., 2005). These discrepancies basically reflect the fundamental differences previously analysed between bank and corporate failures. For instance, the general corporate bankruptcy code in the U.S. is well known as being strongly pro-debtors. In contrast, the bank bankruptcy code favours depositors -the major group of bank creditors- over other creditors. This special treatment for banks is not a novelty in U.S. banking history. As a matter of fact, since 1933, the newly created FDIC has been the unique receiver for insolvent national banks and could be appointed receiver by state banking agencies for state chartered banks. In 1991, the FDIC improvement Act (FDICIA) reinforced the powers of the FDIC and Federal Reserve by enlarging their authority as a bank's main federal regulator to legally pronounce insolvency of a state licensed bank under their jurisdiction and appoint the FDIC as its legal receiver. The FDICIA clearly includes the bank bankruptcy proceedings in the new supervisory policy which is structured by two main pillars: the prompt corrective actions and the least-cost resolution. The Act specifies five capital/asset ratios (from well capitalized to critically under-capitalized). The banks are classified in these different categories and each class of capital/asset ratio is associated with mandatory provisions and discretionary provisions. When a bank is downgraded to a lower level of capital zone, the regulatory constraint is consequently reinforced. Supervisors are authorized to close down a bank within 90 days after it has crossed the threshold of critical undercapitalization. At this point, the FDIC is vested with the powers of the receiver which is the liquidator or with the authority of a conservator that acts as an administrator in order to resolve the institution's crisis

Summary of Prompt corrective action provision under the FDICIA

Zone	Mandatory provisions	Discretionary provisions
1.Well-capitalized		
2. Adequately capitalized	1 No brokered deposits except with FDIC approval	
3. Undercapitalized	1 Suspend dividend and management fees 2 Require capital restoration plan 3 Restrict asset growth 4 Approval required for acquisitions, branching and new activities 5 No brokered deposits	1 Order recapitalization 2 Restrict inter-affiliate transaction 3 Restrict deposit interest rates 4 Restrict certain other activities 5 Any other action that would better carry out prompt corrective actions;
4. Significantly undercapitalized	1 Same as for zone 3 2 Order recapitalization 3 Restrict inter-affiliate transactions 4 Restrict deposit interest rates 5 officers' pay restricted	1 Any zone 3 discretionary actions 2 conservatorship or receivership if the bank fails to submit or implement plan or recapitalize pursuant to order 3 Any other zone 5 provision, if such action is necessary to carry out prompt corrective action
5. Critically undercapitalized	1 Same as for zone 4 2 Receiver / conservator within 90 days 3 Receiver if still in zone 5 for quarters after becoming critically undercapitalized 4 Suspend payments on subordinated debt 5 Restrict certain other activities.	

Source : Benston G and Kaufman, 1998.

The sole numerical value for capital/assets ratio specified in the FDICIA is the threshold defining critical undercapitalization: 2 percent tangible equity to total assets. The setting of numerical values of zone 1 to 4 is delegated to banking agencies. According this prudential device, the FDICIA sanctions become compulsory only after discretionary sanctions have proven to be ineffective in recovering the bank's performance and re-establishing its capital at a suitable level. Thus, this system of coercive intervention cannot be interpreted as a simple replacement of regulatory discretion by rules. It's a more clever change in which the compulsory sanctions perform as credible support that should reinforce rather than weaken the regulator's discretionary powers. Moreover, the ex-ante influence of the regulator on the future behaviour of banks is strengthened by the ex-ante known of the prompt corrective actions. So, this device aims to achieve two main goals: on the one hand, it reduces the bank's moral hazard behaviour and on the other hand, it discourages the regulator's forbearance. Requiring and enforcing resolution at a pre-specified low but positive capital level constitutes a closure rule. Without such a coercive rule, experience proves that regulators are conducive to delay the resolution because deposit insurance has lowered the probability of run by depositors. That is why Benston and Kaufman (1998) write "deposit insurance has effectively shifted control of the timing of the closure of an insolvent bank from the market to regulators". This analysis is consistent with previously established facts on the pivotal role of the supervisor in bank insolvency proceedings. Another feature of the US device that has to be underlined is the fact that it creates a compatible incentive scheme between insolvency rules, prudential concerns and market discipline. As a matter of fact, since 1995 this policy has been completed by a new provision: the FDIC is prohibited from protecting uninsured depositors or creditors at any default bank if it would produce an increase of losses for the Deposit Insurance. Nevertheless, an exemption from this least-cost resolution principle is specified for banks judged too big to fail. This exemption motivated by the systemic risk needs to be activated by the Secretary of the Treasury, the agreement of two-thirds of the FDIC Board of Directors and the Board of Governors of the Federal Reserve. If such an approval is achieved, the additional losses suffered by the FDIC from this extension of its protection must be borne on all insured banks. The rule for sharing losses is based on the total insured bank's assets and so penalizes relatively more the large banks. The motivation of such a provision is evidently to favour market discipline and self-supervisory process in the banking community.

In this U S scheme, the resolution of problem banks is totally integrated in the prompt corrective action framework and so in the prudential policy and the consistency of the different components of this global prudential device has been thought in a way favouring their complementarities.

§ 3 Lessons for Europe

The current institutional framework for European prudential policy is characterized by the national decentralization of supervision. Indeed, the European Union's supervisory and regulatory design is based on the principle of subsidiarity. Consequently, the tasks of banking and financial supervision have been left to domestic agencies. The present European prudential system is hence based on the minimal harmonization of prudential rules as required by the Directives of the EU Commission on financial regulation and the mutual recognition of national regulatory standards and practices. The second European Directive establishes the control of the home country for supervisory purposes regarding solvency and the prevention of major risks on the one hand and the harmonization of capital standards, risk diversification and investor protection rules on the other hand.

Therefore, bank supervision in the E.U. is based on two associated pillars: the principle of mutual recognition between national regulators and the principle of control by the home country. The association of these two principles allows any bank coming under the prudential supervision of one Member State to offer its services throughout the E.U. by means of a single license (the so-called “single passport” principle). The full supervisory responsibility belongs to the home country with just one notable exception: the host country’s competence for the monitoring of the liquidity of foreign branches.

The European Community Directive on the Reorganization and Winding-Up of Credit Institutions which deals with cross border aspects of bank failure in the European Union is consistent with the “single passport” principle. The Directive does not attempt to harmonize the bank insolvency laws of Member States but it aims to allocate the powers linked to bank resolution according to the mutual recognition regime of both reorganization measures and winding-up procedures. So, if a bank is in trouble, the relevant proceedings will be initiated in the home State of the bank and these proceedings are to be recognised in all other Members States where the bank has either branches or assets. Host Member States have no choice under the Directive but to recognize and implement the procedure under the home Member State, no matter how much it differs from their national laws. So, the home country is given exclusive competence both for reorganization and for winding-up of credit institutions contrary to the E.C. Insolvency Regulation which recognizes the “secondary territorial proceedings” .

The objectives of the Directive on the Reorganization and Winding-Up of Credit Institutions are twofold: on the one hand, the equal treatment of creditors and, on the other hand, the principles of unity and universality (a single set of proceedings). According to the single entity approach which is a concept related to the “single passport principle”, all the assets of the institution will be included in a single liquidation or reorganization process, regardless of where they are located. So, in that case, the bank is treated as one entity and all the creditors, no matter where they are located, will be allowed to receive the same treatment as all the creditors of the same category.

This Directive represents undoubtedly an important development in the framework of E.U. banking laws but it does not constitute a panacea and does not completely achieve its goals. In particular, it does not eliminate the conflicts of interest between Member States concerning all the cross border aspects of bank insolvency.

- Firstly, as we have previous analysed, the administrative approach of bank insolvency which gives the supervisor a pivotal role is coherent with the theoretical analysis of the specificity of bank insolvency and it facilitates the design of a prudential framework favouring the complementarities between its different components. Unfortunately, the Directive does not give a compelling framework conducive to further harmonization of bank insolvency laws throughout all Member States. As C. Hadjiemmanuil (2004) underlines: "the European legislator is agnostic as to the legal form that the relevant proceedings should take". From our point of view, based on the large set of arguments previously presented, this agnosticism is detrimental to the efficiency of the system. The different national bank insolvency legal devices are not equivalent.

- Secondly, the Directive does not provide an adequate framework dealing with large cross-border banks or large cross-border financial conglomerates. A good comprehension of this point needs to clearly distinguish between subsidiary banks and branches. This distinction has major consequences with regards to the prevention and management of problems in cross-border banks. Authorities treat subsidiaries of foreign banks as domestic institutions having their own legal entity. Thus, the subsidiaries are subject to supervision in the country where they operate. On the contrary, branches are not considered as independent legal entities: branch and parent company are one and the same legal entity. As a consequence, in the event of a crisis in a foreign subsidiary, the host country supervisor that is the subsidiary's home country supervisor can take any measure available under its jurisdiction. These differences of regulatory treatment between branches and subsidiaries are problematic in the sense that they create a prudential framework conducive to regulatory arbitrage and team's moral hazard in the supervisors' community. In particular, in the event of a financial distress affecting a large pan-European bank, the actual device generates strong incentives to a massive transfer of risks towards subsidiaries located in countries where they represent a significant share of the market. Indeed, in that case, the potential systemic effects of the default of the subsidiaries could favour bail-out or forbearance on the part of the host country supervisor. The current European prudential and bank insolvency regime is adequate for cross-border establishment using branches. Unfortunately, this model is not the predominant one. The subsidiaries structure predominates but as underlined by the Basel Committee (1999) although subsidiary banks are formally maintained as independent companies, management of these banks is often centralised across global business segments with global risk management and control. So, the European legal framework is not adjusted to the practices of the large cross-border banks and this mismatch between global bank players and insular supervisors could produce damaging effects on financial stability. To alleviate the adverse effects generated by the current prudential device, it could be possible to transfer to the home's country supervisor a broader responsibility on global banking groups including both the activities of branches and subsidiaries at the European level (Osterloo S . and Schoenmaker D, 2004b). This proposal seems consistent with a subsidiary banks' model which do not function as independent entities but operate under centralised management and so could be assimilated as branch banks.

Concluding remarks

From a theoretical point of view, bank insolvencies are different from the failure of other companies. So a large range of arguments justifies a special regime that deals with bank insolvency and gives a pivotal role to the supervisor. The administrative approach which prevails in the United States is consistent with this analysis and favours the complementarities between the several parts of the prudential device including the bank insolvency regime. It creates a compatible incentive scheme between insolvency rules, prudential concerns and market discipline. At the opposite, the European situation is characterized by a damaging heterogeneity of the national insolvency regimes even though a European Directive on the Reorganization and Winding-Up of Credit Institutions provides a legal framework dealing with the cross-border aspects of European bank insolvency. The road to achieve a coherent and global financial safety net in Europe favouring the complementarities between prudential policy in a narrow sense (set of rules established by regulatory agencies, monitoring and supervision), market discipline and bank resolution policy is still long and probably difficult. The concept of regulatory regime [Llewellyn, 2003; Scialom 2005] which promotes a holistic approach to financial stability is probably the good level of analysis to propose improvements in the European financial safety net.

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