

Bridge Institution

✓ **Bridge institution is**

- A temporary institution established and operated to acquire some of all of the assets and liabilities of a failed institution until final resolution can be accomplished.
- Charter has limited life

✓ **Introduced in US in 1987**

- Also authorized in Korea, Taiwan and Japan
- Currently under consideration by the FSA
- Permits regulators to keep bank in operation for a limited period to rehabilitate and privatize, merge or liquidate piecemeal

Bridge Institution

✓ Advantages

- Like Purchase & Assumption (P&A) or Nationalization permits continued operation and limits disruption from closure
 - Allows customers continued access to banking services, but controls risk
 - Maintains franchise value of bank
- Allows time to design and implement optimal resolution
 - Allows potential buyers additional time for due diligence

✓ Unlike P&A or Nationalization, can maintain some market discipline

- For banks the emphasis is on distinguishing insured from uninsured depositors.
- The model would need to be redesigned for I Banks

Key issues

- ✓ What entities should discipline investment banks?
 - Shareholders concern is with NPV of investment, not externalities in event of failure
 - Knock-on losses to counterparties are internalized, not externalities
 - Relative to supervisors may have superior incentives & technical ability to monitor
- ✓ If market discipline is to be effective, at least some of these entities must be subject to risk of loss in a bridge bank

Key Issues (cont'd)

- ✓ Should least cost resolution principles apply with a parallel process for determining systemic risk exceptions?
- ✓ What authority should underwrite the costs establishing a bridge institution for investment banks?
 - How should that authority be reimbursed?
- ✓ What authority should serve as prudential regulator to oversee a prompt corrective action regime?
- ✓ What authority should make the decision to take control rights from the shareholders and establish a bridge institution?
- ✓ What authority should act as receiver to oversee the bridge institution?

Now that regulatory Rubicon has been crossed

- ✓ Should be better prepared to deal with the next investment bank failure
- ✓ Better resolution policies deserve an urgent place on the policy agenda in the US and internationally
- ✓ For market discipline to be effective, regulators should be able to safeguard the financial system from spillovers following the failure of even the largest, most complicated, most inter-connected financial institution
- ✓ No firm should be too-inter-connected to fail