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