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In-Depth

From Bailouts to Bail-ins: Will the Single-Point-of-Entry Concept End "Too Big To Fail"?

By Jim Fuchs

In the wake of the financial crisis, many troubled financial firms were rescued by their sovereign governments. The undesirability of "bailouts" has led global policymakers to shift their focus to new "bail-in" approaches as a means of minimizing the impact of the failure of a large financial institution.

Last year, the Federal Deposit Insurance Corp. (FDIC) and the Bank of England (BOE) issued a joint paper outlining the merits of a single-point-of-entry (SPOE) strategy for resolving a large, internationally active financial firm.¹ A May 2013 report by the Bipartisan Policy Center concluded that the SPOE approach should generally allow a systemically important financial institution to fail "without resorting to taxpayer-funded bailouts or a collapse of the financial system."²

The SPOE strategy is, in essence, a bail-in strategy because it implements a resolution process that imposes losses on shareholders and unsecured creditors. Resolution powers would be applied at the top-tier level of holding companies by a single-resolution authority, which, in the U.S., would be the FDIC.

Bailouts vs. Bail-ins

One way to think about the difference between a bailout and a bail-in is to consider the source of funding. In a bailout, the funds essentially come from outside the institution, usually in the form of taxpayer assistance via a direct intervention by the sovereign government. Conversely, in a bail-in, rescue funds come from within the institution as shareholders and unsecured creditors bear the losses.

The SPOE Approach

Under the FDIC/BOE proposal, a U.S. financial institution for which a determination has been made that it go through resolution under the SPOE approach, instead of bankruptcy, would be subject to the following:

1. The FDIC would be appointed as the receiver of the institution's top-tier holding company.
2. Assets of that holding company would then be transferred to a bridge holding company, enabling domestic and foreign subsidiaries to remain open and operating.
3. Work would then begin to transfer ownership of the bridge holding company to the private sector.
4. The subordinated debt, or even the senior unsecured debt, of the troubled firm would be used as the immediate source of capital for the new private-sector entity.
5. Remaining debt claims would be converted into equity claims that would also serve to capitalize the new private-sector entity.
6. The FDIC would provide assurances, as appropriate, that the ongoing operations of the firm and its attendant liabilities would be supported.

So, Will It Work?

Critics of SPOE question two underlying assumptions of the approach: that market confidence will be quickly restored, minimizing contagion; and that the underlying business model of the institution is sound. If even one of these conditions is not met, critics believe the overall process could be much more chaotic than the SPOE approach suggests.

Ultimately, the credibility of the SPOE approach won't be known until it is actually tested. The FDIC has made it clear that the first consideration, in any potential resolution, is to assess whether the bankruptcy code provides an appropriate tool for resolving a troubled firm. In fact, the Bipartisan Policy Center, in its May report, makes several recommendations for amending the bankruptcy code to avoid resorting to extraordinary, and untested, measures for resolving global systemically important institutions. Regardless, the approaches discussed under SPOE and under the bankruptcy code suggest that future remedies for handling troubled financial firms will focus on bailing-in the firm by imposing losses on shareholders and unsecured creditors, instead of bailing out firms and putting taxpayers at risk.

Endnotes

1. "Resolving Globally Active, Systemically Important Financial Institutions," a joint paper by the Federal Deposit Insurance Corp. and the Bank of England, Dec. 10, 2012, www.fdic.gov/about/srac/2012/gsifi.pdf. [[back to text](#)]
2. "Too Big To Fail: The Path to a Solution," a report of the Failure Resolution Task Force of the Financial Regulatory Reform Initiative of the Bipartisan Policy Center, May 2013, <http://bipartisanpolicy.org/sites/default/files/TooBigToFail.pdf>. [[back to text](#)]

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