EBS/09/29
Correction 1

May 26, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Group of Twenty—Note by the Staff of the International Monetary Fund on Stocktaking of the G-20 Responses to the Global Banking Crisis**

The attached corrections to EBS/09/29 (3/10/09) have been provided by the staff.

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 5, Table 1, "Capital Committed" column under the headings "Resolution" and Recapitalization," row for the United States: for "750" read "700"
row for Total: for "1,184" read "1,134"
"Asset Purchase Plans" column under the headings "Resolution" and Asset Management," row for Japan: footnote reference "6/" added
Footnote 6: added, to read: "6/ Japan's program includes Yen 1 trillion to purchase securities held by Japanese banks and US$17 billion to purchase, through state-owned banks, stakes in small and medium-sized companies."
Source notes: for "Exchange rates as of 2/23/09" read "Refer to Annex I for exchange rates."

Page 9, Table 3 and Table 4: "(As of February 2009)" added in table heading
Table 4: footnote 1 removed

Page 11, Table 6: footnotes modified

Annex I on Exchange Rates Used for Tables: added

Questions may be referred to Mr. Hoelscher (ext. 37046) and Mr. Johnston (ext. 38980) in MCM.

This document will shortly be posted on the secure page of the extranet, a website for Executive Directors and member country authorities.

Att: (1)

Containment of the crisis

7. **The September 2008 failure of Lehman Brothers was taken as a signal in the markets that the rules of the game were changing.** Unlike the treatment of earlier failures—Northern Rock, Countrywide, IndyMac, and Bears Stearns—the closure of Lehman imposed significant losses on creditors. The result was a marked deterioration in market sentiment and concerns among most G-20 authorities about contagion even to strong banks. This led authorities to strengthen their creditor protection programs.

8. **Despite the loss in confidence generated by the failure of Lehman, G-20 countries typically responded with selective rather than comprehensive creditor protection schemes (Table 2).** This may have reflected the absence of immediate pressures from creditor runs, which permitted countries to use a combination of measures including increased deposit insurance protection, full guarantees to selected sectors, and, as funding difficulties merged, guarantees of bank debt instruments.

Table 2. Creditor Guarantees

	Any change in deposit insurance	Wholesale borrowing guaranteed	Both	Date of first guarantee
United States	√	√	√	3-Oct-08
Germany	√	√	√	6-Oct-08
Spain	√	√	√	7-Oct-08
United Kingdom	√	√	√	7-Oct-08
Netherlands	√	√	√	7-Oct-08
Australia	√	√	√	12-Oct-08
Italy	√ /1	√	√	13-Oct-08
France		√		19-Oct-08
South Korea		√		19-Oct-08
Mexico		√		20-Oct-08
Russia	√	√	√	21-Oct-08
Canada		√		23-Oct-08
Indonesia	√			23-Oct-08

1/ Italy did not increase its deposit insurance limit or expand the coverage; however, the government will provide a "supplementary" guarantee meaning that if the private scheme is unable to cover all losses, the government will reimburse.

- **The most frequently used containment measure was an increase in debt guarantees for banks.** By October 2008, twelve countries provided some form of wholesale debt guarantee (Australia, Canada, France, Germany, Italy, Mexico, the Netherlands, Russia, Korea, Spain, the United Kingdom, and the United States) and eight countries guaranteed interbank liabilities (France, Germany, Italy, Russia, the Netherlands, Saudi Arabia, the United States and the United Kingdom). Most of these guarantees were extended in the second half of October, following the collapse of Lehman.

- **Only limited actions were adopted by the G-20 countries to maintain depositor confidence.** Most countries (12 countries of the 21 reviewed) left deposit insurance levels unchanged. While the European Union authorized an increase in such coverage, most of the European countries in the G-20 already had protection levels at or above the enhanced level (France, Italy, and Germany). Within the European Union, the Netherlands and Spain increased the level of deposit insurance and Germany expanded coverage to guarantee all household deposits. Outside the European Union, five countries increased depositor protection (Indonesia, Russia, Saudi Arabia, the United Kingdom and the United States). Australia for the first time adopted a deposit insurance system.

- **Measures to enhance market liquidity were adopted by eight G-20 countries.** Most G20 countries deployed a number of tools to provide additional liquidity to the markets. Actions taken included lowering reserve requirements (eight countries: Argentina, China, India, Russia, Saudi Arabia, Brazil, Indonesia, and Turkey); establishing new swap facilities (nine countries: Australia, Brazil, Canada, China, Japan, Mexico, Korea, U.K., and U.S.); and easing access to lender of resort facilities (Russia, U.K., and the U.S.).

- **Eight countries did not adopt additional measures to protect creditors.** Depositor confidence and bank funding mechanisms were considered sufficiently strong that no immediate policy response was necessary. In some cases, countries considered their existing safety nets to be adequate to address any problems.

9. **Despite the wide variation in measures taken, creditor confidence has been maintained and depositor runs avoided.** Before the failure of Lehman, creditors' confidence in the stability of the system had been strong and individual failures were attributed to narrow issues arising from the subprime market. Subsequent to Lehman's failure, authorities had to take actions to reassure creditors that the governments would not allow a collapse of the financial system. For example, in the United States, in rapid succession, protected primary dealers and brokers (March), AIG (September), money market mutual funds (September), unsecured debt (October), commercial paper (October) asset-backed securities (November), Citi (November), and Bank of America (January).

15. **Few conditions were initially placed on banks receiving public resources.** Nine countries placed some form of requirements on banks, including some form of directed lending or restrictions on dividends (France, Germany, Italy, Japan, Russia, Saudi Arabia, Korea, the United Kingdom, and the United States). Only one country (Italy) required the presentation of a restructuring plan. As the programs have evolved, however, capital support plans are increasingly including a range of limitations and conditions that institutions need to meet to access to government capital (Table 5).

Table 5. Conditions to Use Public Funds

	Dividends	Salary Restrictions	Directed Lending 1/	Code of Ethics	Board Membership
France		√	√	√	
Germany	√	√	√		
Italy	√		√	√	
Japan			√		
Netherlands		√			√
Russia			√		
Saudi Arabia			√		
South Korea			√		
United Kingdom	√	√	√		√
United States	√	√	√		

Source: Various government announcements and information on official websites.

1/ Governments have announced that funds be directed toward domestic economies to increase lending in mortgage markets, SMEs, and households in general.

16. **About half of the G-20 countries now have programs that can provide capital quickly to banks when needed.** Nine countries established direct capital support plans (France, Germany, Italy, Japan, the Netherlands Russia, South Korea, the United Kingdom, and the United States). Most of these plans envision provision of capital support to sound banks.[8]

- Some governments established conditions for accessing such programs. For example, some programs restricted dividends, executive pay, and bonuses, and established codes of ethics. Italy required a restructuring plan and government priority for dividends, Germany placed limits on executive compensation and suspension of

[8] However, the capital plan for France allowed capital injections to troubled banks and Italy allowed capital injections to both sound and troubled banks.

dividends, and the United States placed restrictions on dividends and executive salaries.

- Some governments announced that these public funds should be directed toward the domestic economies particularly to increase lending in mortgage markets, small and medium sized enterprise sectors, and households in general. For example, the recently announced Financial Stability Plan in the United States, "comes with conditions to help ensure that every dollar of assistance is used to generate a level of lending greater than what would have been possible in the absence of government support." Similar actions are being taken in France, Italy, and the United Kingdom.[9]

Asset management

17. **Asset management policies for the purchase of toxic assets have evolved slowly.** Reflecting the difficulties in pricing structured products, only two countries authorized the purchase of "toxic assets" — Germany and the United States (Table 6). Germany was the first G-20 country to commit to using public funds to purchase risky assets (Euro 70 billion). In October 2008, the U.S. Troubled Asset Relief Program (TARP) was also envisioned as such a program but the complexities of valuing toxic assets led the authorities to shift to a Capital Assistance Program (CAP). In February of 2009, the U.S. announced its intention to create a $500 billion asset purchase program, the Private-Public Investment Fund to manage such assets purchased from banks.[10]

18. **Eight countries have also announced programs to purchase a wide range of higher-quality assets.** Governments will purchase both high quality structured products and loan portfolios (Table 6). In January 2009, the UK announced a £50 billion asset purchase program to purchase high quality assets and established the Bank of England Asset Purchase Facility Fund Limited, a wholly-owned subsidiary of the Bank.[11] In addition, Australia authorized the purchase of performing RMBS, Japan introduced a program to purchase investment securities of banks, and Canada authorized the purchase of insured mortgage loans via auctions.

---

[9] Outside the G-20, Switzerland is allowing domestic lending to be excluded from its leverage ratio for UBS and Credit Suisse. The Swiss Banking Commission has indicated that domestic lending activities are important to the Swiss economy.

[10] While details have yet to be announced, the design will include a market mechanism to value assets.

[11] This asset protection scheme will protect a portion of the banks' balance sheets so that the healthier core of the bank will be "untainted" and able to proceed with normal lending activities. The 'first loss,' incurred on future losses will remain with banks and the protection provided by the government will cover 90 per cent of the remaining loss.

19. **Asset guarantee programs have also been introduced.** Six countries have committed to guarantee certain loan portfolios held by their banks: four EU countries (France, Germany, Italy, and Spain), the United States, and the United Kingdom (see Table 6). Most countries appear to have issued general guarantees noting that new lending operations (Spain), potential defaults (Germany), or loans issued by local banks and branches (Italy) will be covered. In addition, some countries (Brazil, France, Japan, Russia, and the United States) have introduced new or expanded existing programs to provide direct support to borrowers in an effort to limit deterioration in banks' loan portfolio.

Table 6. Summary of Asset Plans Established

	Quality of Assets Purchased		Amount Committed	Type of Asset Purchased						Loans Guaranteed
				Loans	Structured Products		Other	Mixture	Unclear	
	Toxic	High quality	in bns of US $$	Mortgage loans	Mortgage securities	Other securities	Unsold Houses	Mixture	Unclear	
Australia		√	5.2		√					
Brazil		√	3.8		√	√		√		
Canada		√	59.6	√						
France										√
Germany	√		6.3						√	√
Italy										√
Japan		√	27.6			√				
Russia		√	6.0			√				
Spain		√	62.8						√	√
South Korea		√ 1/	3.8				√			
United Kingdom		√	71.0	√	√	√		√		√
United States 2/	√	√	1,100	√	√			√		√
Total			**1,346**							

1/ South Korea will purchase unsold houses, difficult to categorize as toxic or not.
2/ Funds committed under private/public investment fund ranges between US$500 billion and US$1 trillion, and funds committed under GSE/MBS purchases = US$600 billion.

IV. Have Measures Been Successful?

A. The Market Response

20. **While it is still too early to judge effectiveness, the measures described above have so far had only a limited impact on the financial position of banks.** Central bank intervention has been successful in addressing pressures on bank liquidity since mid-2008, but the underlying financial position of financial institutions, particularly the large complex financial institutions (LCFIs), remains precarious. LCFI profitability and earnings have deteriorated and no major improvement is envisaged by market analysts. Moreover, although Tier 1 ratios have been boosted through the capital injections, tangible common equity (TCE) remains at a critical level for most institutions. Asset quality is weakening, and credit spreads

for LCFIs have remained wide. Finally, measures have not stemmed the market-driven de-leveraging process, and lending surveys point to a continued deterioration for the next year in the United States, Europe, Canada and Japan.

21. **Developments in credit and funding markets also confirm that measures thus far have not stemmed the weakening of confidence.** Although government guarantees for senior bank debt have relieved some of the funding pressures, this has not averted the collapse in bank stock prices, and a sharp increase in the cost of capital. In broader credit markets, the situation remains difficult and highly dependent on official support. While highly rated issuers may have access to central bank facilities, lower rated issuers are credit-constrained. Moreover, structured product markets have remained largely frozen except for agency guaranteed issues and support operations by central banks.

B. The Policy Response

22. **Efforts by the authorities to contain creditor flight were largely successful but coverage has been uneven.** The containment measures have been of an ad hoc nature, responding to events. Moreover, the containment strategies may not be sufficiently robust to accommodate a deepening crisis. As the crisis evolves, creditors may become increasingly worried about the solvency of the financial system. To this end, countries need to prepare deeper and more comprehensive strategies.

23. **National policies have not yet grappled with the implications of the evolving global crisis.** Different approaches open the possibility of arbitrage and liquidity flows from relatively less protected to more protected jurisdictions. A home country bias in approaches risks disrupting cross border flows. This cross-border nature of financial systems and institutions makes it important to coordinate crisis containment measures.

24. **Even on a national basis, resolution strategies for the banking problems have taken place on a case-by-case basis, rather than as part of an overall assessment of the distress in the financial system.** Capital injections were often not accompanied by an assessment of bank viability or by restructuring plans. Moreover, the injection of preferred shares in distressed institutions, while giving the authorities some upside benefit should the institutions recover, did not give governments a way to control or influence the bank's use of public money.

25. **While the crisis is in an early stage and G-20 members have yet to feel the full brunt of the crises, it is important that they avoid complacency and take early action to incorporate important elements.** Specifically, most national programs contain no systematic assessment of bank viability or restructuring plan. Such an assessment would include an evaluation of the losses in the banks and also require an agreed-on restructuring plan designed to return viable banks to profitability. Such a plan would have to include elements ensuring that bank restructuring is adequate and that future capital injections by the

Annex I. Exchange Rates Used for Tables

(Conversion Rate for U.S. Dollars)

	Guarantees	Capital Committed	Capital Injected	Asset Management
Argentina				
Australia				0.64
Brazil				
Canada				0.79
China				
France	1.26	1.26	1.26	
Germany	1.26	1.26	1.26	1.26
India				
Indonesia				
Italy		1.26		
Japan		0.01		0.01
Mexico	0.07			
Netherlands	1.26	1.26	1.26	
Russia		0.03	0.03	
Saudi Arabia			0.27	
South Africa				
Spain	1.26			1.26
South Korea		0.00078	0.00068	
Turkey				
United Kingdom	1.42	1.42	1.42	1.42
United States				