Bridge Bank

Incubator Bank of Japan (2010)

Background and context

Table 4: Profile of IBJ at point of failure on 10 September 2010

Total employees	Total branches	Total depositors	Total deposits	Total loans
782	114	126,779 Uninsured: 3,405	¥581.8 billion ($5.1 billion) Insured: ¥570.9 billion, Uninsured: ¥10.9 billion	¥434.6 billion ($3.8 billion)

Established in April 2004, the business model of the Incubator Bank of Japan (IBJ) involved lending to small and medium sized firms, and buying of large amounts of loan assets from non-banks. IBJ held only time deposits and did not provide any payment and settlement services.

Before its failure, the former Chairman of IBJ had embarked on an overly ambitious expansion of business and a series of allegedly illegal transactions. IBJ also had a controversial business model that purchased loan claims from money lending businesses. The bank had rapidly expanded its business with major borrowers and failed to perform adequate credit checks. Consequently, IBJ had to set aside a large amount of additional reserves. In July 2010, the former Chairman of IBJ, Takeshi Kimura – who had also been an ex- advisor to the Japan Financial Services Agency (JFSA) – was arrested for allegedly obstructing JFSA inspections. The IBJ was placed under the control of the Deposit Insurance Corporation of Japan (DICJ) and filed for civil rehabilitation in September 2010. The JFSA recognised that causes of the failure of IBJ were unique to the bank. IBJ did not have a settlement function and had a small size of depositors relative to other commercial banks. As such, IBJ's failure would not affect the stability of the Japanese financial system and IBJ was deemed a non-systemic institution.

To resolve IBJ, financial assistance (through P&A) was expected to be more cost efficient and less disruptive to markets and the local economy. In this case, DICJ estimated that the cost of financial assistance would be less than a pay out to depositors. IBJ was resolved over the weekend and resumed business on Monday DICJ had publicly solicited candidates to take over IBJ but required more time and decided to temporarily transfer IBJ to the Second Bridge Bank of Japan (Bridge Bank) on 25 April 2011.

Japan's limited deposit guarantee programme had been established in 1971. However, IBJ's failure was the first time the Japanese government had limited 'payoffs' or deposit guarantees, with the cap of ¥10 million ($123,000) per account, including interest earned. Between 1996 and 2005, this cap had been suspended to prevent runs on banks, but was subsequently reinstated as part of the financial sector reforms. IBJ's customers with more than ¥10 million in their accounts had to rely on pro-rata distribution to creditors for amounts of non-insured deposits exceeding ¥10 million.

> ***Since the decisions on the final assuming financial institution and the business transfer were expected to take some time, the DICJ decided to transfer IBJ to a bridge bank***
>
> Deposit Insurance Corporation of Japan

Resolution of IBJ – Timeline of Key Events

May 2010
JFSA ordered temporary suspension of business of IBJ.

10 Sep 2010 (FRI)
IBJ declared insolvent and was ordered to stop business.
DICJ stepped in as Financial Administrator and IBJ petitioned for civil rehabilitation. Court accepted the petition and ordered assets of IBJ to be preserved.

11-12 Sep 2010 (SAT & SUN)
DICJ obtained depositors data from IBJ segregated between insured and uninsured.

13 Sep 2010 (MON)
IBJ resumed business and reimbursed insured deposits.
Court ordered to commence civil rehabilitation procedure.

Mar 2011
Invitation sent out to potential assuming banks.

Apr 2011
Transferred IBJ's business to Bridge Bank 100% owned by DICJ.
DICJ provided financial aid to Bridge Bank and IBJ.

May 2011
Filing of claims by creditors.

Jul 2011
IBJ submitted rehabilitation plan to Court.

Sep 2011
AEON Bank selected as assuming bank.

Nov 2011
Court issued an order of confirmation of rehabilitation plan.

Dec 2011
All equities of Bridge Bank sold to AEON Bank.

Apr 2012, Sep 2014 and Sep 2016
First, second and third repayments to holders of claims and settlement payments to depositors who received the estimated proceeds.

Sep 2012
Liquidation of IBJ commenced.

May 2017
Liquidation of IBJ completed.

Resolution actions

The DICJ is organised under the Deposit Insurance Act and is supervised by the Ministry of Finance and the JFSA. While the JFSA is responsible for supervision and resolution of banks, the DICJ is responsible for deposit protection and the execution of the resolution of failed banks. Upon a deposit-taking FI's failure, the JFSA would appoint the DICJ as financial administrator.[55] The Civil Rehabilitation Act 23 – rather than the Corporate Reorganization Act 24 – applies to failures of deposit-taking institutions.[56] In a civil rehabilitation proceeding, only amounts in excess of the deposit insurance scheme (¥10 million) would be treated as depositor claims. The resolution methods available to the DICJ depend on whether the failed bank is systemically insignificant (ordinary resolution) or significant (exception applied). For systemically significant resolutions, there are additional resolution options (nationalisation, blanket guarantee, and capital injection). The Financial Crisis Response Council, which is chaired by the Prime Minister, is responsible for high-level crisis coordination.

In September 2010, IBJ filed for commencement of the civil rehabilitation procedure with the Tokyo District Court and made preparations for a business transfer while continuing operations. In terms of resolution procedures, IBJ faced specific challenges relating to data. There was insufficient data on borrowers, complicated fund transfers among affiliated companies within IBJ, purchased assets that were twice transferred to other parties, and borrowers that became creditors by virtue of 'overpayments' to the bank (due to IBJ charging higher interest rates above that permitted by law). As a result, DICJ needed a longer time to reassess IBJ's assets.

In April 2011, part of IBJ's business (sound assets and deposits within the insured amount)[57] was transferred to the Bridge Bank. The DICJ then provided the Bridge Bank with grants to cover the necessary costs for the transfer. The Bridge Bank was a 100% subsidiary of the DICJ, with the objective of temporarily assuming the business of IBJ and later, to transfer the business to a final assuming FI (Assuming FI). The management of the Bridge Bank by DICJ was to be concluded by two years from the failure of IBJ or up to a maximum of three years. As shown in illustration 2, DICJ also provided financial assistance to facilitate the resolution scheme.

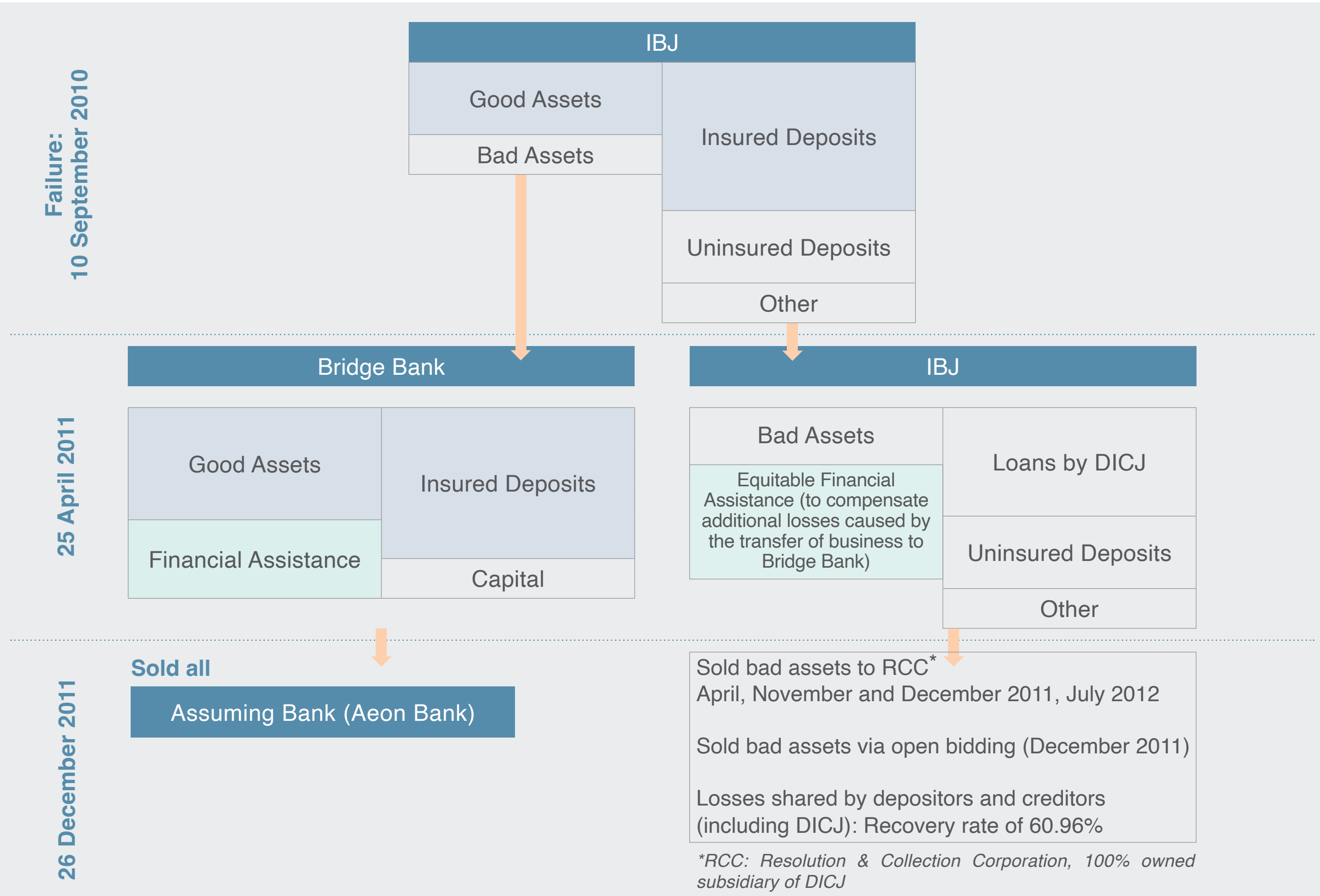
On 26 December 2011, all outstanding shares of the Bridge Bank were transferred to AEON Bank, as the Assuming FI. As for the uninsured deposits and general claims, these remained with IBJ, and were reimbursed through civil rehabilitation procedures after about six years. On 2 May 2017, the liquidated IBJ completed all repayments and terminated operations.

[55] The JFSA may, alternatively or additionally, appoint attorneys-at-law, certified public accountants and / or other financial specialists as financial administrators
[56] An insolvent FI that commences civil rehabilitation proceedings would not automatically lose its licence. It is generally perceived that the Civil Rehabilitation Act (rather than the Corporate Reorganization Act) is better for the failure of a deposit-taking institution because, in a civil rehabilitation, the appointment of a trustee by the court is not mandatory
[57] Reimbursements were made to IBJ's depositors within the insured amount from 13 September 2010 onwards. The remaining insured deposits were transferred from IBJ to the Bridge Bank in April 2011

Illustration 1:
Procedures for resolving IBJ over the weekend

Friday	**Bank Failure and Closure**
JFSA:	Orders for IBJ to stop business, Appoints DICJ as Financial Administrator.
DICJ:	Steps in as Financial Administrator, Seeks data on depositors from IBJ.
IBJ:	Files for the commencement of civil rehabilitation proceedings.
Saturday and Sunday	
DICJ:	Receives depositor data from IBJ, Conducts name based aggregation of depositors, Returns results to IBJ.
IBJ:	Divides the accounts of depositors to insured and uninsured deposits, Prepares for resuming business on Monday.
Monday	**Resume Business**
IBJ:	Reimburses Insured Deposits for Depositors. Resumes business as needed including loans at 16 major branches.
Court:	Orders to commence civil rehabilitation.

Illustration 2:
Procedures for Bridge Bank, transfer of assets to AEON Bank and dealing with bad assets



Source: Deposit Insurance Corporation of Japan

Key takeaways

This case is an example of the use of the bridge bank tool to resolve a non-systemic bank by Japanese authorities. The bridge bank temporarily assumed insured deposits and good assets, thus providing the resolution authority with additional time to look for a suitable buyer. Notwithstanding the additional time, it was also important to have a timeframe for the eventual sale of assets from the bridge bank to a purchasing institution. In IBJ's case, the transfer of assets from the Bridge Bank to AEON Bank was completed in approximately 15 months, well within the maximum timeline of three years from the date of IBJ's failure. This case also demonstrates how the resolution authority dealt with non-performing assets through a separate structure, and applied effective strategies to maximise recovery of the bad assets. Claims were also reimbursed in stages within a timeframe of about six years.

Sound governance and communications were key success factors for the resolution. Other key factors included having clear and transparent processes, clear demarcation of roles among financial safety net players and legal certainty. Having over the weekend procedures to resume business on Monday for prompt resolution of IBJ was also critical. This enabled the resolution authority to announce the immediate measures that would apply on the re-opening of IBJ on Monday morning, provide assurance to depositors of IBJ, and maintain overall public confidence in the financial system. In IBJ's case, since the media had also begun reporting on IBJ's failure, the authorities (JFSA and DICJ) had to commence resolution activities on the morning of Friday instead of the evening as originally planned. Having earlier established clear plans, they were able to quickly effect the necessary communications and manage media.

The experience of IBJ highlights another essential facet of bank resolution, namely the need for data integrity, given its impact on the time needed for asset valuations. Efforts to maintain robust data during good times are essential for the effective execution of bank resolution procedures and actions during time-critical periods.

> ***On 26 December 2011, all outstanding shares of the Bridge Bank were transferred to AEON Bank; the business management of the Bridge Bank was thus completed***
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> Deposit Insurance Corporation of Japan