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#### **CHAPTER 8**

# RECEIVERSHIP IN BANKING: THEORY AND PRACTICE

#### Introduction

Studies on bankruptcies show that one of the major causes of this phenomenon is dysfunction of ownership supervision including insufficient use of an early warning system. Business practice provides a lot of evidence, and the latest international financial crisis is a real laboratory full of examples for the lack of this supervision [Maczyńska, 2010, p. 301].

One of the most important barriers to changes aimed at preventing corporate disturbances and irregularities, which in extreme cases can lead to bankruptcies, is the underdevelopment of the broadly understood institutional and regulatory infrastructure and its maladjustment to the requirements of the contemporary market [Mączyńska, 2010, p. 302]. Part of this infrastructure is the support infrastructure of repair and bankruptcy processes; forecast and early warning support infrastructure; juridical, supervisory, and audit infrastructure; as well as research and scientific infrastructure. Receivership management (administration order in the UK) is an important instrument for effective rehabilitation of banks and prevention of an accelerating financial crisis.

If a bank finds itself in crisis, the institution of receivership management is indispensable:

- This is an important instrument of intervention of financial supervision when there is a risk of bankruptcy;
- Its use is justified by the responsibility of the State for financial stability and involves regulations introduced in the banking sector, licensing, state supervision, and the established system of deposit guarantees;
- The risk related to the reorganization process in a bank often lies in inefficient management and an incompetent board; hence it is important that financial supervision may enter into a bank with authority.

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Justification for the use of this management instrument can be found in the theory of intervention, crisis theories, and the doctrine of public good and other doctrines.

The thesis of the paper is as follows: receivership management is an effective legal and managerial instrument for rehabilitation of banks, but regulations in this field are insufficient in Poland.

Regulatory changes that would increase the effectiveness of this institution in the event of a crisis are needed since a banking crisis cannot be ruled out.

#### 1. Theoretical aspects of intervention during crisis

The growing social significance of banking, state regulation and supervision over the banking industry, as well as attempts to calculate the social costs of bankruptcies have led to the dissemination of two doctrines justifying state intervention (Too Big To Fail, TBTF, and Too Important To Fail, TITF). E. Gardener and P. Molyneux [1998] have devoted many works to these doctrines arguing that because of the importance of systemic risk, some banks (so-called strategic banks) deserve to be rescued by the state (also by nationalization) and the TBTF and TITF doctrines have become a recognized practice in many countries [Gardener and Molyneux, 1998]. C. James's research has shown that closures of insolvent banks are more expensive than their rehabilitation, acquisition by a healthy bank, or even nationalization [James, 1991]. Other theorists think, however, that trust in state help for banks leads to intensified moral hazard practiced by bank CEOs.

In their financial contagion model, F. Allen and D. Gale take into account the role of regulation and state intervention in banking. In their view, a crisis becomes contagious through inter-bank deposit markets. These markets do not generate liquidity, but allocate it. If the demand for liquidity is greater than the short-term asset reserves, there will be shortages of liquidity in some regions, followed by bank runs and bankruptcies. In addition, it is necessary to take into account the potential loss of public trust and the contagion effect in banks. In such cases, state intervention is required, also in the form of the lender of last resort [Allen, and Gale, 2000].

The new thesis offered by G. Corrigan, according to which banks are perceived not only as institutions of public trust, but even more broadly as a public good, and therefore the whole society should bear the costs associated with them (systemic risk is risk for the general public), has generated a lot of discussion and criticism [Corrigan, 1992, p. 3]. However, A. Greenspan also saw stability as a public good. He said that the function of the lender of last resort was, and is,

indispensable because "markets generally work, but from time to time they collapse. When this happens, government intervention is required to ensure stability, which is a public good" [Greenspan, 1988]. The doctrine of public good justified state help during the last crisis. It should be noted that the New Capital Accord, which defines the principles of risk management (called the CRD directive in the EU), includes the assumption that financial supervision will take corrective action towards banks in a situation of crisis [Masiukiewicz, 2011b, p. 35].

The security of the financial system and the protection of the clients' funds are public goods and justify the use of rehabilitation instruments (direct intervention) in banks by financial supervision [Journal of Laws, 2006]. The subprime financial crisis is an example of state intervention in financial institutions on an unprecedented scale; intervention measures are estimated at about 3.5 billion euros.

In the light of the theory of financial supervision receivership (administration order) is an instrument of direct intervention of state supervision. It is used when other supervisory instruments are no longer effective [Stocka and Kołacz, 2009; Davies and Green, 2008]. Such a decision is always risky for the government agency which assumes responsibility for the situation, and the clients' response can be unexpected (e.g., a run on banks) [Masiukiewicz, 2011b].

The institution of receivership management (administration order, compulsory administration) should also be considered in the context of its role in maintaining financial stability, as this type of management may fulfil the following tasks:

- Rehabilitation of systemically important financial institutions (SIFIs);
- Under conditions of a systemic crisis the introduction of such management to a large number of banks should inactivate panic and calm down the financial markets;
- Finding new strategic investors and quick sale or takeover of bankrupt banks. Receivership can be defined as a managerial body in a financial entity appointed by the state financial supervisory authority. This management has the task of effectively rehabilitating the entity and to this end it has been equipped by law with powers of ordinary management, supervisory board, and the general meeting of shareholders.

## 2. Corporate governance and receivership management

Financial market regulations are based on sound corporate governance both in the context of risk management and reliability of financial statements [Davies and Green, 2008, p. 134]. At the same time, regulators of the financial sector are generally not responsible for corporate governance, which covers a broader spectrum of issues [Davies and Green, 2008]. The OECD principles of corporate

governance adopted in 1999 provide guidance for legislative and regulatory initiatives [OECD, 2004]. The Financial Stability Forum found these principles to be some of the key standards for a robust financial system. However, consistent standards of corporate governance have not been agreed upon at the international level yet due to significant differences in legal options as well as in terms of their substantive content [Davies and Green, 2008, p. 135].

The regulations in force in Poland allow the Polish Financial Supervision Authority to affect the shape of the statute, the composition of the first supervisory board and of the management board and ownership structure (the licensing process) and then in every case the Authority approves the appointment of the President and the Vice-President of the bank, and also gives its consent to holding blocks of shares in excess of statutory limits.

A study conducted by McKinsey found that over 78 per cent of the surveyed investors in Western Europe were willing to pay a higher premium for companies with good corporate governance, enabling the growth of shareholder value over the long term [Jerzemowska and Campbell, 2008, p. 193].

In the light of the recommendations of the Working Group of the Basel Committee, the functions of banking supervision in the system of corporate governance are as follows [BCBS, 2006]:

- Supervision should provide banks with guidelines on good corporate practices;
- Corporate governance should be considered part of depositor protection
- Supervision should lead to the adoption and implementation of corporate governance rules in banks;
- Supervision should assess the quality of bank audits and internal control functions;
- Supervision should evaluate the results of bank groups;
- Financial supervision should inform the supervisory and management boards about the problems disclosed by its inspections.

These international documents do not refer to the institution of receivership management, but such reference to rehabilitation programmes and indirectly to receivership management can be found in the recommendations of the World Bank on the development of effective national systems addressing insolvency and creditor rights [World Bank, 2001]. The World Bank recommends including in legal regulations the possibility to quickly and effectively implement rehabilitation, ensuring legal supervision of such a rehabilitation process, and administration that enables stabilization and maintaining the company in business. The supervisory bodies responsible for supervising the activities of administrators should perform their functions independently and in a transparent manner.

In recent years, the issue of rehabilitation of companies and banks has become of particular interest in the European Union. The EU initiative "A second chance to entrepreneurs" promotes in the broad sense both re-starting a business after bankruptcy and rehabilitation or restructuring in the face of bankruptcy – within a rehabilitation process. The new EU regulations on state support for the rehabilitation processes in companies and banks include:

- a) Community guidelines on state aid for rescuing and restructuring firms in difficulty, Brussels, 2004 [European Communities, 2004];
- b) Directive of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions [European Parliament, 2001];
- c) EU Commission Communication "Bank Resolution Funds" [European Commission, 2010].

The issue of funding the rehabilitation processes in banks is currently the subject of extensive consultations and a banking tax is to serve this purpose [Masiukiewicz and Dec, 2011]. Both at the EU level (the Committee of European Banking Supervisors, CEBS) and at the international level work and tests are underway on rehabilitation and recovery plans which will be a key element of a future EU framework for crisis prevention. The new EU regulations are not sufficiently popularized or implemented in Poland.

The availability of financial leverage within a repair process is usually a key factor of success. According to M. Iwanicz-Drozdowska, "in most countries, there are no clear rules of responsibility and competence in the field of crisis management. In this respect, of key importance is the public authority, which is responsible for financing of rehabilitation actions" [Iwanicz-Drozdowska, 2008, p. 95].

In the light of the above analysis, it should be noted that many experts and a number of institutions appreciate the necessity of state intervention in a banking crisis, but there are also opposing positions both in science and business practice.

The use of receivership by Polish supervision was significant, as shown in Table 1.

 Number of receiverships established in Poland
 1991–1997
 1998–2010
 Total

 1. Commercial banks
 13
 10
 23

 2. Cooperative banks
 13
 6
 19

 Total
 26
 14
 42

Table 1. Receiverships in banks established by banking supervision in Poland

Source: National Polish Bank and the Polish Financial Supervision Authority data.

Not all receiverships have been successful as several banks under receivership have failed, including BSRz Poznań, Bank Posnania, and Bank Staropolski.

The institution of receivership is regulated by the Polish law not only for banks but also for other financial institutions, such as insurance companies [Journal of Laws, 2003].

### 3. Criteria for establishing receivership management

The rationale for introducing receivership management may vary:

- Loss of trust in a bank's governing bodies and auditors;
- Legal conditions (e.g., wrongful trading by the management board);
- Economic conditions, restoration of effective management (including financial liquidity);
- Risk reduction (also through recapitalization of the bank);
- Identification of criminal activity (including creative accounting);
- Protection of depositors' interests and preventing a panic of the clients;
- Restoring the trust of depositors and stakeholders.

Table 2. Entities reporting the need to initiate rehabilitation proceedings

No.	Types of banks	On-site supervision, Polish National Bank	Supervision analyst (so-called behind the desk control, Polish National Bank)	Bank management	Independent auditor	Total
1	Commercial banks					
1.1	Banks operating independently	17	10	12	4	43
	Merged or acquired banks					
1.2	TOTAL	15	5	6	3	29
	Structure in %					
X		32	15	18	7	72
X		44.5	20.8	25.0	9.7	100.0
2	Co-operative banks					
2.1	Banks operating independently	186	156	177	1	520
	Merged or acquired banks					
2.2	TOTAL	290	210	254	5	759
X	Structure in %	476	366	431	6	1279
X		37.2	28.6	33.7	0.5	100.0

Source: National Polish Bank data.

The unique analysis of entities reporting the need to initiate rehabilitation programmes conducted by the General Inspectorate of Banking Supervision of the Polish National Bank revealed that in most cases crises in banks were disclosed by bank supervision and not by the management following an internal audit. The results of this study are shown in Table 2. The question arises whether these issues were ignored by the management boards or perhaps the banks' internal audit departments (control departments, controlling posts in cooperative banks) did not have adequate skills. This is also a measure of the effectiveness of financial supervision.

The work of external auditors revealing the need to initiate rehabilitation programmes (Table 2) was almost negligible. This is a dangerous situation, both for financial supervision and in view of possible consequences for the entire national financial system. Thus, the supervisory authorities lost trust in banks' statutory governing bodies and auditors, which hastened the introduction of receivership.

The Polish Financial Supervision Authority is not entirely free to introduce receivership into banks; conditions justifying such decisions have been set out in the banking law. Such decisions are of special nature (no administrative appeal can be made) and the PFSA takes responsibility for the receivership introduced into a bank

The banking law strictly regulates the tasks and powers of receiverships. The tasks are specified in detail by the PFSA for each receivership management in individual resolutions establishing receivership.

In the light of Art. 145 of the Banking Act [Journal of Laws, 1997], if a bank's management fails to submit for approval the reorganization programme consistent with the requirements and in due time, or if the performance of that programme proves ineffective, the PFSA may decide to establish receivership management for the duration of the reorganization programme. The establishing of receivership shall not affect the organization and operation of the bank as a legal person, with the exception of the changes provided for under the Banking Act.

The receivership team shall assume the power to pass resolutions and take decisions in all matters reserved for the bank's governing bodies under the Banking Act and the bank's articles of association. On the day of establishing receivership, members of the its management board shall be dismissed *ex lege* and proxies and powers of attorney granted prior to that day shall expire. The competence of other bank authorities (the supervisory board and general meeting of shareholders) shall be suspended.

The supervisory board may appeal the decision to establish receivership (despite being suspended) to a commercial court, but this does not delay the execution of the decision. The establishment of receivership must be recorded with a court register under which the bank falls.

The receivership draws up a reorganisation programme and obtains approval for the programme from the PFSA, manages the programme and reports the results achieved under the programme to the PFSA and the supervisory board at least every three months.

Based on Art. 146 of the Banking Act, if necessary, members of the receivership team shall be granted unpaid leaves from their places of employment for the duration of their duties, and their remunerations shall be set by the PFSA. Art. 169 of the Act states that the institution of receivership shall render void any rights held by members of the bank's management bodies concerning severance pay and remuneration for the period following the termination of their contract of employment. <sup>2</sup> The expenses of receivership administration will be borne by the bank.

In accordance with Art. 148, as of the day specified in the decision of the PFSA for a bank to be taken over by another bank or to be liquidated, the management board and the receivership of the bank being acquired shall be dissolved and the decision-making powers of its management bodies shall be suspended, the supervisory board of the acquired bank as well, the proxies and powers of attorney issued by the acquired bank shall expire, and the acquiring bank shall assume administration of the assets of the acquired bank.

The acquired bank's own funds shall be assigned to cover balance sheet losses. If a bank's assets are not sufficient to cover its liabilities, the bank's administrators shall immediately notify the PFSA, which shall take a decision to suspend the bank's operations and thereupon a decision for the bank to be taken over by another bank or to file for bankruptcy with the competent court. The decision to suspend a bank's operations, or for it to be taken over or file for bankruptcy may also be taken by the PFSA on its own initiative. If a bank has ordinary management, then along with the decision on suspension, takeover or filing for bankruptcy, the bank may be placed into receivership.<sup>3</sup>

<sup>&</sup>lt;sup>1</sup> Articles 127 & 3 of the Code of Administrative Procedure shall not apply.

<sup>&</sup>lt;sup>2</sup> Undue severance payments made by ordinary management took place in practice, for example in Bank Czestochowa S.A.

<sup>&</sup>lt;sup>3</sup> Such a decision was made in relation to Bank Staropolski SA [Masiukiewicz and Mackiewicz, 2009].

The consequences of placing a bank into receivership are as follows:

- Specific restriction of the rights of shareholders and statutory bodies (the management board shall be dissolved and the supervisory board and general meeting of shareholders suspended);
- The receivership holds the full authority in the company (the powers of all its governing bodies);
- The aims and main tasks of the new body are determined by the financial supervision authority;
- The supervisory board may file an appeal against the decision of the financial supervision authority with an administrative court, which shall not, however, suspend the activities of the new body;
- The possibility to significantly reduce procedures resulting from the Commercial Companies Code (e.g., convening a general meeting of shareholders);
- Statutory obligation to cover the operating costs of receivership by the bank.

## 4. The risk of placing a bank in receivership

There are a number of risks linked to the management board (and the supervisory board); the literature usually indicates wrongful trading, recklessness, dishonesty, and lack of qualifications. In some EU countries such as Belgium, France, and Great Britain, CEOs may suffer severe consequences, set out in the law, for such conduct [Jerzemowska and Campbell, 2008, p. 202].

The introduction of a new ordinary management or of receivership team to a bank in order to rehabilitate it involves various risks. Such risks have been revealed over the last 20 years in banks undergoing rehabilitation. These risks include:

- The risk that the new management which undertakes rehabilitation will not know the specificity of a particular company and may not have sufficient experience in managing a crisis situation;
- The possibility of hostile behaviour of the owners, supervisory board and former management board (e.g., Posnania Bank, Bank Wschodni);
- The possibility of triggering bank runs by the very fact of placing banks in receivership and inaccurate media coverage (e.g., BSRz in Poznań, Bank Wschodni and Bank Częstochowa);
- A possible failure of the mission inability to obtain financial leverage or a new investor or acquiring bank, resulting in the bank's failure;
- Inability to identify creative accounting and, in the long term, after learning the real losses, inability to pursue effective rehabilitation, or bankruptcy (moral responsibility of banking supervision e.g., Bank Staropolski);

 Dishonesty of employees and former executives acting to the detriment of the bank, and thus also to the detriment of the receivership team (e.g., Bank Staropolski and other banks).

The presence of these risks to a large extent hampers the management of rehabilitation.

A full and fast verification of personnel is a prerequisite for a successful rehabilitation of a bank. In many cases, senior management is co-responsible for the crisis and is associated with the ousted management board (e.g., Animex Bank SA and Bank Wschodni SA, whose board members were convicted in criminal cases and sentenced to long terms) or with members of the supervisory board or shareholders.<sup>4</sup> In order to maintain the continuity of the institution and ensure sources of information, and also because of costs, it is important to restructure personnel in stages.

In the 1990s, a lot of executives in the rehabilitated banks were dismissed or replaced by professionals from other banks and other cities. Flexibility in this respect is by the nature of things limited because high-class professionals are reluctant to come to bankrupt banks. For example ING, which took over the bankrupt Barrings Bank, had to pay a bonus of about \$100 million to keep the staff from leaving the bank [Heffernan, 2007, p. 484]. E. Altman also shows the importance of this barrier. <sup>5</sup>

The percentage of senior management turnover in the banks surveyed by the author ranged from 40 to 85 per cent (see Table 3).<sup>6</sup>

Table 3. The scale of senior management turnover in banks under rehabilitation (under receivership)

No.	Bank	Senior management turnover rate (%)*	Remarks
1	Bank Posnania SA	60.0	* Applies to directors
2	Bank Staropolski SA	75.0	and deputy directors of
3	BPE Animex Bank SA	40.0	branches and branch
4	Bank Wschodni SA	70.0	offices (departments).
5	Bank Przemysłowy SA	85.0	

Source: Masiukiewicz [2011b, p. 154].

Personnel selection methods are important both in terms of staff honesty, loyalty, and competence. Complex social engineering techniques are used here and receivership works under time pressure and in conditions of incomplete information.

<sup>&</sup>lt;sup>4</sup> This was the case in Bank Społem SA and Bank Wschodni SA. Bank Społem hired former employees and members of consumer cooperatives without experience and formal qualifications.

<sup>&</sup>lt;sup>5</sup> More in Altman and Hotchkiss [2007].

<sup>&</sup>lt;sup>6</sup> More in Masiukiewicz [2011].

Another problem that may arise in the future is the recruitment of staff experienced in bank crisis management by the PFSA. Thus, the PFSA should develop a "human resource bank" and train personnel.

Analysis of litigation documents related to the establishment of receivership shows that this legal instrument has stirred a lot of controversy. Court records expose poor economic situation in banks and low professionalism of their management [Frysztak, 2009, p. 86]. The following issues have been found in cases heard by courts:

- Legitimacy of introducing receivership in objecting banks;
- Composition of the receivership team;
- Right of a bank's body to represent the bank before the commercial court in proceedings resulting from objection;
- Admissibility of court proceedings before the commercial court and admissibility of the subject of objection;
- Protection of objection.

The cases were eventually dismissed. However, the main reason for dismissals was the fact that the receivership was already over (so a court ruling was no longer necessary) or the bank had already been liquidated (so a court ruling was no longer possible). In this situation, there is no practice of judicature which could be drawn upon in the future [Frysztak, 2009, p. 86].

## 5. The first organizational decisions

The process of bank rehabilitation by receivership, especially in its initial phase, requires many tactical and operational decisions to be taken under conditions of uncertainty and high risk [Masiukiewicz, 2006]. At the beginning of receivership, which usually takes place in an unknown environment, it is usually necessary to take organizational decisions concerning:

- The choice of method of operational crisis management whether this management be performed by the receivership or crisis team or by some other body;
- The choice of strategy for a rehabilitation programme and the selection of a team to prepare it;
- The manner of development of an austerity plan and its scope;
- Review and verification of bank instructions and rules;
- Adjustment of the management information system (MIS) for emergency purposes, and determination of the scope of daily operational managerial information to be introduced in the bank;

- Assessment of the organizational structure and, if necessary, the development of a concept of changes;
- Determination of the extent of trust in the personnel and verification of powers of attorney and user access rights to IT systems;
- Construction of a public relations system for the needs of the rehabilitation process;
- Development of a system of deposit withdrawals in case of a panic;
- Establishing the form and frequency of cooperation with the shareholders and the present (suspended) supervisory board;
- Determining the form of cooperation with the trade unions.

Time is of the essence for the effectiveness of these decisions; they should be made within the first few days. Hence, it is important for the receivership team to study the basic internal regulations of the bank under rehabilitation in advance. Such opportunity was provided to receiverships by the General Inspectorate of Banking Supervision (GIBS) of the National Bank of Poland (NBP). Many managerial issues related to rehabilitation are determined by the specific characteristics of a particular bank. Receivership management (or ordinary management conducting rehabilitation) should take flexible organizational decisions depending on the available information and assessments; the fundamental thing is to rely on previous supervisory inspections and the results of internal controls and audits [Masiukiewicz, 2008].

It should be noted that, especially in the first period of receivership, decisions must be made under conditions of high risk, incomplete and sometimes erroneous information, without confidence that the current financial statement is accurate and true. <sup>7</sup> Hence, when appointing receivership, the NBP has always employed independent, reputable auditors to perform audit. In such extreme conditions the receivership teams were not insured (by the banking supervision or by the bank under rehabilitation) against third party liability claims. In Poland, directors and officers (D&O) insurance was launched already in 1992 by AIG Poland, and later also by other insurance companies. D&O insurance is designed for people serving on the management and supervisory boards, as well as for holders of commercial powers of attorney. Such insurance gives protection from the effects of improper action, but not from criminal liability [Pauch, 2009].

In a 2007–2009 survey banks were asked what the most important measures concerning organizational changes were that should be implemented in a time of crisis (Table 4).

<sup>&</sup>lt;sup>7</sup> More in Masiukiewicz [2006].

Responses of the Responses of the surveyed banks 2009 surveyed banks 2007 **Specification** N = 37N = 3663.9% 1. Perform reorganization of the bank 54.1% 2. Implement an austerity programme 89.2% 77.8% 3. Sell property unnecessary for operational activities 54.1% 50.0% 4. Outsource the sales of the bank's core products (reduce the bank's own network) 5.4% 2.8% 5. Centralize decisions, i.e., withdraw some powers of attorney 40.5% 38.9% 6. Increase the powers of the management board 16.7% 5.4% 7. Other measures 0.0% 5.4%

Table 4. The most important measures involving organizational changes that should be implemented in a time of crisis in a bank

Note: Percentages do not add up to 100% as the respondents could indicate up to 3 answers. Previously published in Masiukiewicz [2011, p. 134].

Most indications concerned the implementation of an austerity programme – 78% in 2007 and 89% in 2009. This was followed by bank reorganization and selling assets not critical to operational activities, centralization of decision-making (i.e., withdraw some powers of attorney), and outsourcing the sales of basic banking products. The banks themselves suggested soliciting advice from the associating bank. Preference was given to the traditional austerity regime and sale of assets; surprisingly, outsourcing of distribution was not appreciated. The surveyed banks did not produce any other original ideas about reorganization during crisis.

## 6. Decision-making determinants of receivership management and the efficiency of the process

Decisions in banks under rehabilitation are often unconventional in nature and give rise to ethical dilemmas. Legal regulations do not always create favourable conditions for solving such dilemmas.

According to the McKinsey report, the methods of rescuing troubled banks are similar all over the world. Rather than looking for a magic formula for bank problems, one should focus on three key issues decisive for the future, i.e., ensuring liquidity, reduction of credit risk, and provision of new capital [Barton et al., 2004].

However, in the process of bank rehabilitation many qualitative, non-programmable decisions are made that are absent in normal business activities [Masiukiewicz, 2011a].

Limitations of decision-making in a bank under rehabilitation occur in areas such as:

- Statutory limitations;
- Recommendations of financial supervision;
- Changes in customer behaviour (e.g., closing of bank accounts, deposit withdrawals, loss of public trust, risk of panic);
- Time pressure (resulting in the need for rapid, sometimes intuitive, decisions);
- False information and creative financial reporting in the bank;
- Conditions of considerable uncertainty and high risk during the functioning of receivership.

This is a traumatic situation for receivership teams. The estimation of the likelihood of the present (and anticipated) conditions for making a decision is highly difficult. Thus, decision-making, which becomes to some extent intuitive, increases the role of ethics in the process. It should also be noted that the sense of legalism is deeply ingrained in the minds of bankers. Under the circumstances, ethical decisions in the management of rehabilitation should be based on some basic criteria such as compliance with the objectives of the action undertaken, the lesser evil, greater moral value, and compliance with legal norms.

The receivership team is forced to make a number of unusual decisions in the bank under rehabilitation. Some of them affect the professional and financial interests of its employees and clients and may result in acts of discontent, violence and other unethical behaviour of the bank's stakeholders. Decision-making dilemmas are also produced by imprecise legal standards or inadequate knowledge of the law on the part of stakeholders. At the same time, some of the bank's stakeholders (including banks competing in a given region) try to advance their interests at the expense of the bank under rehabilitation.

In the practice of rehabilitation there are many decision-making dilemmas, such as:  $^{8}$ 

- The dilemma between honesty of information and the imperative of rehabilitation;
- The dilemma between social responsibility and additional profits;
- The dilemma between just remuneration and the priority of the austerity programme;
- The dilemma between corporate social responsibility and efficiency of activities.

These are typical dilemmas of managers; they must continuously choose between effective business without ethics or ethics without business.

<sup>&</sup>lt;sup>8</sup> More in Masiukiewicz [2006].

It is an urgent and necessary task to clarify legal provisions, define procedures for the operation of receivership teams in the first and most difficult phase of placing a bank under rehabilitation, and determine the objectives of state aid for receivership. Perhaps receivership teams should be provided with legal protection similar to that granted to civil servants. The decision to appoint a receivership team should define priorities, strategy of rehabilitation, competence framework (scope of duties) as well as remuneration and compulsory civil liability insurance for managers at the expense of the bank under rehabilitation.

It would be helpful for receivership teams to develop decision-making standards at the stage of their assuming control over banks (including replacement of powers of attorneys for employees, range of debt collection, turnover of staff in the bank, the scope and timing of inventory-taking, relationships with customers, including payments of clients' deposits in the case of fortuitous events at the moment of suspending the bank's operation, relations with the media, and others).

Rehabilitation requires financial leverage. Two types of leverage should be considered in the situation of a liquidity crisis, i.e., short-term and long-term leverage. Quick access to funds in the event of trouble would be possible at the Polish National Bank in the form of lombard credit, which is expensive and requires first-class collateral, and thus does not appear to be a good instrument for rescuing liquidity during a crisis at a bank. Expensive loans do not solve problems; for example, during the recent subprime crisis, the FED and ECB offered loans at a discount and with lower collateral requirements, perhaps recognizing that there was a need to help, and not to "finish the banks off" [Masiukiewicz, 2009]. S. Hefernan believes that "if the LoLR considers that the root of the problem lies in a bank run or bank panic, and not in the bank's financial situation, it can reduce the necessary collateral requirements and reduce the punitive rate of interest" [Heffernan, 2007, p. 574].

It should be noted that during a bank panic banks may additionally be affected by adverse conditions resulting from a national or international systemic crisis (e.g., the domino effect that occurred in the subprime crisis in the U.S.).

The history of bank failures in Poland shows that some of them could have been saved if financial leverage had been used early enough. The late use of financial leverage for some banks under rehabilitation resulted in a prolonged process of rehabilitation. At the same time, an exceptional example of Bank Wschodni indicates that thanks to the intervention of the General Inspectorate of Banking Supervision of the Polish National Bank and early use of financial leverage (the deposit of the future investor, the deposit of Bank Społem as a future acquiring bank), the bank managed to avoid bankruptcy, even though it had met all criteria for bankruptcy [Masiukiewicz, 2011b, p. 296].

The role of the Bank Guarantee Fund (BGF) in the process of bank rehabilitation needs to be redefined. The BGF, which has significant financial resources, should actively participate in the management of rehabilitation already at the stage of commencing receivership proceedings. The BGF could temporarily own newly issued shares of a bank under rehabilitation, being guaranteed some seats on the ordinary management board, receivership team or supervisory board, as well as having a guaranteed exit from the investment. Loss and profit sharing under purchase and assumption (P&A) transactions could be a good instrument supporting acquisitions. If the institution acquiring the endangered bank is concerned that it may suffer losses as a result of acquiring a portfolio of assets, it can sign a contract on partial compensation of losses with a guarantee institution. However, if the acquiring institution achieved an unexpected profit from this transaction, it would have to share it with the guarantee institution.

Another issue to be considered is the abolishment of certain instruments used by financial supervision during rehabilitation, such as the ban on advertising and the introduction of maximum interest rate ceilings on deposits and loans. These instruments raise doubts and significantly hamper the management of the rehabilitation process.

The recommendation to cover losses with equity during rehabilitation and the introduction of maximum interest rates for deposits and loans prevents the receivership team from conducting further lending process due to the lack of capital adequacy and due to competitive barriers. So how can one carry out rehabilitation facing such barriers without breaking the law?

The rules for selecting managers for the receivership team should be legally defined. The requirement of at least ten years of practice in banking does not seem to be excessive. It is necessary to organize a system of training for future receivers (including curators, liquidators and others) under the auspices of the Polish Financial Supervision Authority.

#### Conclusion

Poland has a unique experience in rehabilitation of banks by receivership teams. A period of financial stability is a good time to work on improving the model of receivership.

There are a number of barriers present during the operation of receivership in banks that need further analysis and legislative changes; these include the interest rate ceiling and a ban on advertising introduced by the financial supervision authority for the period of bank rehabilitation, and other problems. An essential barrier is difficult access to financial leverage during rehabilitation, while the function of the lender of last resort has not been regulated by the Polish law.

Because of the great responsibility and powers of receivership, the eligibility requirements for members of receivership teams must be clarified and receivers should be better protected (e.g., with statutory liability insurance).

Recommendations in the field of business practice are as follows:

- The institution of receivership has turned out to be an efficient and effective tool of rehabilitation (proven in the Polish banking sector) and should be maintained;
- The legal framework for the functioning of receivership and the reduced decision-making competence of receivership do not fit into the current changes in the market and require legal corrections;
- Legal uncertainty concerning appealing decisions to establish receivership are groundless;
- The supervision authority should have at its disposal a supply of staff and ensure training for future receivers;
- The possibility of establishing such bodies in certain non-banking institutions should be considered

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