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European Banking Union D: Cross-Border Resolution—Dexia Group

Rosalind Z. Wiggins
Yale Program on Financial Stability

Natalia Tente
Deutsche Bundesbank

Andrew Metrick
Yale University

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Rosalind Z. Wiggins[2]
Natalia Tente[3]
Andrew Metrick[4]

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Abstract

In September 2008, Dexia Group, SA, the world's largest provider of public finance, experienced a sudden liquidity crisis. In response, the governments of Belgium, France, and Luxembourg provided the company a capital infusion and credit support. In February 2010, the company adopted a European Union (EU)-approved restructuring plan that required it to scale back its businesses and cease proprietary trading. In June 2011, Dexia withdrew from the government-sponsored credit support program before its expiration date, and in July, the company announced that it had passed an EU stress test. However, just three months later, Dexia wrote down its substantial position in Greek debt and posted its largest loss ever. The company's shares plummeted, and its Common Equity Tier 1 capital became negative. To avoid a disorderly resolution, the governments of Belgium, France, and Luxembourg nationalized Dexia's assets. This case examines the attempted rescue of Dexia, provides an analysis of the successes and failures of that cross-border effort, and discusses the impact that Dexia's holdings of sovereign debt had on the company's viability and on the ability of its host countries to rescue it.

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[1] This module is one of four produced by the Yale Program on Financial Stability (YPFS), considering the European Banking Union. Other modules are:

- *European Banking Union A: The Single Supervisory Mechanism*
- *European Banking Union B: The Single Resolution Mechanism*
- *European Banking Union C: Cross-Border Resolution—Fortis Group*

Cases are available from the Journal of Financial Crises.

[2] Director, The Global Financial Crisis Project and Senior Editor, Yale Program on Financial Stability.

[3] Economist, Deutsche Bundesbank, Frankfurt/Main Financial Stability Department and Research Department. This coauthor's contribution represents her personal opinions and does not necessarily reflect the views of the Deutsche Bundesbank or its staff.

[4] Janet L. Yellen Professor of Finance and Management, and YPFS Program Director, Yale School of Management.

1. Introduction

In September 2008, Dexia Group, SA, a Belgian-French financial institution that was a leader in public finance experienced a sudden liquidity crisis. The company's financial position was stressed from two sources: possible losses in its US subsidiary because of exposure to the subprime mortgage market and a multibillion euro credit to a troubled Irish real estate financial institution. The governments of Belgium, France, and Luxembourg rallied to provide Dexia a capital infusion of €6.4 billion, and to guarantee up to €150 billion of its liabilities and bonds in order to keep it afloat. Since Dexia had a New York banking office, the company also borrowed as much as $58.5 billion from the US Federal Reserve.

Despite the size of the assistance, Dexia continued to struggle during 2009, still troubled by its US portfolio and the looming crisis in Eurozone sovereign debt. In February 2010, an EU-approved restructuring plan that required Dexia to streamline its operations and cease proprietary trading was announced.

In June 2011, Dexia withdrew from the government-sponsored credit support, a supposed indication of financial health. In July 2011, the bank passed an EU stress test and announced that it had a "strong capital base." However, just three months later, Dexia wrote down its substantial position in Greek debt and posted its largest loss ever. The company's shares plummeted, and its Common Equity Tier 1 capital became negative.

In order to avoid the negative systemic impacts of a disorderly dissolution of the bank, the Belgian, French, and Luxembourg governments nationalized the majority of Dexia's assets. The EU approved the recovery plans and found that they met state aid requirements. However, as a result of the support required to allow for an orderly wind-down of the bank, the states, especially Belgium, were placed at risk for failing the EU limits on public deficits and faced the possibility that their credit ratings might be downgraded.

In this module, readers will examine the attempted cross-border rescue of Dexia, a systemically important financial institution, and analyze the successes and failures of that effort. Readers should consider Dexia's holdings of sovereign debt and how this impacted its viability and the ability of its host countries to rescue it. They should also seek to identify factors that strengthened or detracted from cross-border resolution cooperation.

The rest of this module is organized as follows. Section 2 provides a brief history of the Dexia Group. Section 3 discusses the impact that the 2008 financial crisis had on Dexia's operations. Section 4 describes the 2008 restructuring plan. Section 5 describes the impacts of the European sovereign debt crisis. Section 6 discusses Dexia's exposure to sovereign debt. Section 7 describes the 2011 resolution plan, and Section 8 presents conclusions about what has been learned from the Dexia situation.

Questions

1. What factors contributed to the ability of Belgium, France, and Luxembourg to successfully coordinate the resolution?
2. What were the results for depositors, counterparties, shareholders, and taxpayers in the various countries where Dexia operated?
3. Were there particular characteristics of Dexia's business model that made an effective rescue difficult? What factors enabled or impeded its success?
4. What does Dexia reveal about the viability of pan-European financial institutions?

5. What does Dexia reveal about the "circular connection" between sovereign governments and their significant financial institutions?
6. Could the new EU Single Supervisory Mechanism5 have prevented Dexia's collapse?
7. How do these results compare to what might have been achieved through a coordinated resolution under the new EU Single Resolution Mechanism?6

2. History of Dexia Group

The Dexia Group was created in 1996 when Credit Communal de Belgique (a Belgian institution founded in 1860 to provide financing to local administrations) merged with Credit Local de France (a French institution established in 1987 to also service local governments). At the time of their merger, both Credit Communal de Belgique and Credit Local de France had expanded their services and geographic reach beyond their initial markets. Credit Communial de Belgium had begun to accept retail deposits from individuals in 1947 and in the 1990s expanded its operations into Luxembourg. Credit Local de France expanded its business internationally to several European countries and to the United States. The French bank underwent an initial public offering on the Paris Stock Exchange in 1991. (For more on the origins of Dexia's precursor companies, see the company history at Reference for Business).

Following the merger of the two companies in 1996, the Dexia Group became one of the first pan-European financial institutions.[7,8] The company pursued an aggressive growth strategy through organic expansion and acquisitions, expanding its operations into Italy, Israel, Turkey, and Germany. In 2000, Dexia acquired Financial Security Assurance (FSA) a US provider of credit enhancement for municipal bond issuers and insurance. The acquisition made Dexia into the world's leader in financial services for the public sector. Dexia also strengthened its retail banking, asset management and insurance services in Belgium, France, and Germany. This growth was funded by a 1999 dual listing of Dexia Group on the Brussels and Paris stock exchanges (See Figure 1 for a diagram of Dexia's corporate structure.).

By 2005, Dexia was one of the 20 largest banks in Europe with €509 billion in assets. For the year, it reported €2.04 billion in net profits on revenues of just under €6 billion. It operated two business lines. The bank's universal banking business line (retail, asset management, insurance, investor services, and capital markets) was centered in Europe (Belgium, Luxembourg, Slovakia, and Turkey) and serviced 55 million retail customers, as well as institutions of all sizes. The bank's public/project finance business, which accounted for more than half of its profits, operated in 30 countries (Dexia Annual Report 2006, 10). This part of the bank prided itself on its innovations and offered a wide variety of products and services to build infrastructure, such as basic lending, bond execution, highly structured

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[5] See YPFS case study Wiggins, et al 2014A.

[6] See YPFS case study Wiggins, et al, 2014B.

[7] "By its location in Brussels, in the heart of the European Union office district, Dexia's head office and its counterpart in Paris, the Crystal Tower, symbolize the Group's European identity. Half of the staff of the holding company, Dexia Group, works in Brussels, and the other half in Paris, thereby respecting Dexia's French and Belgian roots" (Dexia Annual Report 2001).

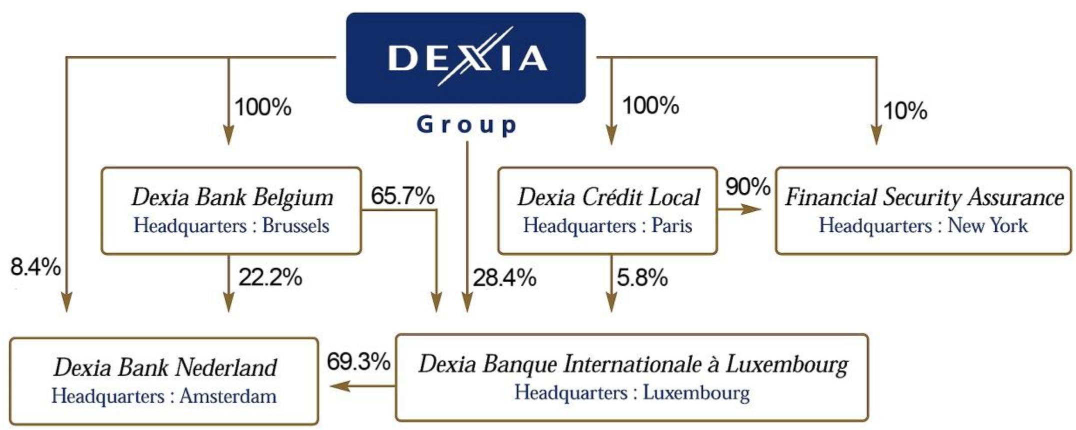
[8] See Wiggins, Tente, and Metrick (2019), *European Banking Union C: Cross-Border Resolution–Fortis Group* for consideration of Fortis, another cross-border financial institution battered by the financial crisis.

projects and credit enhancement, insurance, credit management, and asset management (Ibid.).

The 2006 Strategic Plan: Two Pillars

In late 2005 Alex Miller, former Dexia General Counsel, was appointed Chief Executive Officer (CEO) and Pierre Richard, the prior CEO, was elevated to Chairman of the Board of Directors. The company also adopted a new management structure designed to better integrate its operations (See Dexia 2005 for further description of the enhanced corporate governance structure.) Miller and Richard were the architects of Dexia's growth strategy.

Figure 1: Dexia's Corporate Structure



Source: Dexia Annual Report 2001.

In early 2006, the company adopted a 10-year strategic plan that clarified its vision of building upon its "two pillars of success." First, Dexia would develop its universal banking activity beyond its traditional markets to become a leading European banking institution. This plan would allow the company to take advantage of the expected robust growth of the European market as it converged around the euro. It was also seen as providing synergies with its second pillar, public/project finance.

Dexia would maintain its world leadership in public/project finance by continuing to strengthen its position through "geographic expansion, based on an innovative and varied range of products." The target was for its historical markets (Belgium and France) to account for no more than a third of its earnings. Growth would be organic but the firm would also utilize other strategies as well (Dexia Annual Report 2007). Figure 2 shows key indicators of Dexia's growth from 2005-11.

Figure 2: Dexia Group Key Indicators 2005-11

	Revenues*	Profits (After Tax)*	Profits / Revenues	Assets*	Equity*	Equity / Assets	Employees
2005	5,976	2,038	34.1%	508,800	11,500	2.3%	24,418
2006	7,005	2,750	39.3%	566,700	14,400	2.5%	33,321
2007	6,896	2,533	36.7%	604,600	16,100	2.7%	35,202
2008	3,556	(3,326)	N.A.	651,000	17,500	2.7%	36,760
2009	6,184	1,010	16.3%	577,600	18,500	3.2%	35,234
2010	5,310	723	13.6%	566,700	19,200	3.4%	35,200
2011	(4,383)	(11,639)	N.A.	412,800	7,600	1.8%	22,461

*All numbers in millions of euros.
Source: Dexia Annual Reports 2005-11.

3. Impact of the Global Financial Crisis, 2008-09

US housing prices rose at an unprecedented rate through much of the late 1990s into the mid-2000s, a situation that combined with low interest rates to create a booming mortgage market. This market started to crash in late 2007, led by a crisis in subprime mortgages. Because subprime mortgages had been bundled into different forms of structured debt and derivatives, when defaults on subprime mortgages increased, there was widespread panic concerning where the risks lay and how big they were. To compensate for unknown and unquantifiable risks, companies began to horde cash, causing a severe contraction in the overnight interbank lending markets in late 2007. Because the structured debt and derivatives had been sold broadly in the global financial markets, the effects soon spread beyond the US.

See YPFS case study Wiggins, et al 2014H for a discussion of the financial crisis and its worldwide effects.

The US Subsidiary—Financial Security Assurance

Dexia had exposure to the subprime mortgage crisis largely through its US subsidiary, Financial Security Assurance (FSA), a monoline insurer which operated (1) a financial guaranty business providing credit enhancement and insurance services related to residential mortgage-backed securities and (2) a financial products business which provided guaranteed investment contracts to municipal issuers. Like many of its counterparties, FSA borrowed short-term to finance long-term lending and so was severely challenged when the overnight credit markets dried up.

Because FSA had largely avoided insuring the more exotic collateralized debt obligations (CDOs) backed by subprime mortgages, it was able to maintain its Aaa rating from Moody's as other companies' securities were downgraded. (Richard 2008). Customers retreating from downgraded firms boosted FSA's revenues during the first half of 2008. However, FSA ultimately was caught in the increasing turmoil in the markets.

On June 23, 2008, Dexia announced that it would provide a $5 billion stand-by line of credit to FSA in order to quell negative rumors about its liquidity. (The company also provided a $500 million capital injection.) Despite this, on July 21, Moody's Investor Service placed FSA's claims-paying ability on review citing, "elevated risks with the financial guaranty insurance market" (Richard 2008).

FSA continued to struggle and on November 14, 2008, Dexia announced that it had entered into an agreement to sell FSA's financial guaranty insurance business to Assured Guaranty Ltd. The deal was facilitated by $16.9 billion in support from the Belgian and French governments, which assumed responsibility for FSA's liabilities and risks. The deal and aid package was approved by the EU Commission.

On November 21, 2008, Moody's downgraded FSA to Aa3 reflecting its "view of FSA's diminished business and financial profile resulting from its exposure to losses on US mortgage risks and disruption in the financial guaranty business more broadly" (Moody's 2008).

In 2008, Dexia recorded a loss of €1.66 billion with respect to the sale of FSA, after recording a €1.49 billion loss at FSA from the US mortgage crisis. It also suffered value deterioration and impairments relating to certain counterparties in its investment portfolio, resulting in a fiscal year loss of €3.3 billion. Included in this figure was €810 million relating to adjustments on investment portfolios. Of this amount, significant sources were exposures to Lehman Brothers (€473 million), the Icelandic banks (€174 million) and Washington Mutual (€57 million) (See Dexia Annual Report 2008, 71 for further details regarding the financial crisis impact on Dexia.)

Hypo Real Estate

Throughout 2007-09, Dexia also was buffeted by exposure to Hypo Real Estate, AG, a German bank, and its Dublin-based subsidiary, Deutsch Pfandbriefbank (Depfa), which was a competitor to Dexia in the public finance arena (Duhigg 2008). Depfa also sold CDOs and German bonds that were backed by loans or securities issued by municipalities. When the bonds were downgraded, Depfa experienced difficulty raising funds to buy them back as required. As a result, Depfa's liquidity became a major concern, and this concern extended to its parent, Hypo, which was also experiencing troubles with its real estate activities (Ibid.) Fearing that Hypo's collapse might cause a chain reaction, in October 2008, the German government and a consortium of banks extended €50 billion to bail out Hypo (Parkin and Suess, 2008).

Hypo's problems reverberated to Dexia not only due to the signals Hypo's distress sent about the public financing market, but also because Dexia had extended a multimillion euro loan to Depfa. However, on October 5, 2008, Dexia issued a press release contending that risks related to Hypo/Depfa would have little impact on its solvency and that Dexia had adjusted its capital requirements to account for any adverse effects (Dexia 2008).[9]

4. The 2008 Restructuring Plan

On September 30, 2008, Dexia sought government assistance after failing to raise needed operating cash.[10] On October 9, the governments of Belgium, France, and Luxembourg combined to support the bank and provide €6.4 billion of capital injection and a guarantee of Dexia's liabilities and bonds up to €150 billion, divided among the countries as shown in Figure 3. When the bailout was announced, Dexia's CEO Axel Miller and Board Chairman Pierre Richard announced their resignations.

In addition, because it had a New York bank subsidiary, Dexia was eligible to borrow from the US Federal Reserve, and it did so repeatedly with a maximum outstanding amount of $58.5 billion.

Figure 3: Dexia 2008 Rescue Aid

	Belgium	**France**	**Luxembourg**	**Total**
Capital injections	€3 billion	€3 billion	€376 million	€6.376 billion
State guarantee (maximum amount)	€90.75 billion (60.5%)	€54.75 billion (36.5%)	€4.5 billion (3%)	€150 billion
Guarantee of impaired FSA assets	—	—	N/A	€16.9 billion

Source: Dexia 2008, Dexia 2008B.

European Union State Aid Approval—2010

Under the laws of the European Union, the governments of the member states are prohibited from injecting funds into private companies that might give them an unfair advantage. However, the laws do recognize that some government assistance (state aid) may be necessary, and it is allowed if it is within certain parameters. Such assistance by a member state is subject to review and adjustment by the European Commission (European Commission 2004).

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[9] At one point, the impact to Dexia was estimated to be between €200-300 million (Tanghe 2008). Ultimately, however, Dexia booked a charge of €9 million relating to Hypo/Depfa bond investments but does not appear to have also recorded a loss on the loan; perhaps this is because of German government and private support of Hypo/Depfa (Dexia 2008). In December 2008, the German banking regulator began a criminal investigation of Hypo and Depfa, and in 2009 the German government nationalized Hypo.

[10] The effect of the crisis would be severe. Dexia's stock price would fall from a high of €20.80 on December 31, 2006, to €17.22 at year-end 2007, to just €3.20 at December 31, 2008. In 2008, it lost €14.655 billion in market capitalization, from €20.295 billion to €5.640 billion.

In reviewing the aid provided to Dexia, the European Commission, on November 20, 2008, approved the state-provided guarantees for a six-month period. With respect to the capital infusion, it required that a restructuring plan be submitted justifying the investment and preventing unfair competition. This plan was submitted in February 2009 and ultimately approved by the Commission on February 26, 2010.

The plan as proposed by Dexia provided that:

- Dexia would focus on its core banking activities and its traditional markets—Belgium, France, and Luxembourg.
- Dexia would reduce its public-sector lending activity outside these markets and its bond portfolio, which would be ring-fenced in a specific division in the bank in line with a predefined write-down plan.
- Dexia would continue to reduce its market activities and would cease proprietary trading.

The Commission imposed an additional condition:

- Dexia would also make a significant contribution to the restructuring costs by suspending, for two years, dividend payments on cash equities and interest payments on instruments constituting own funds.

The Commission concluded that with the conditions, "the gradual cessation of certain activities provided for in the restructuring plan will be enough to offset the distortions of competition caused by the aid."[11]

5. European Sovereign Debt Crisis 2009

The EU had always had limits applicable to sovereign debt levels and budget deficits, but such limits had not previously been vigorously enforced or had been creatively skirted through aggressive financing techniques (Nelson et al. 2012, 7; Brown and Chambers 2005). As countries transitioned to the euro, spreads on sovereign bonds clustered in a narrow range with little differentiation across the member states, even though they had very different economies (Mody and Sandri 2011, 3). The failure to enforce the debt levels and budget deficit standards led to soaring public debt in some countries (Nelson et al. 2012, 7). As analyst Rebecca Nelson noted:

> Many analysts agree that the crisis was caused by a set of common challenges facing some Eurozone countries, as well as factors specific to each country. The inflow of capital and subsequent build-up of public and private debt over the past decade into the Eurozone "periphery" countries was a key factor in the build-up to the current crisis. As these countries prepared to adopt the euro and transitioned from national currencies to the euro, their bond spreads fell dramatically, converging to the interest rates paid by the traditionally stronger economies of Eurozone "core" countries. However, as the public and private sectors in the periphery countries took advantage of access to new, cheap credit, the capital inflows were not always sufficiently used for productive investments in the economy that could generate the resources with

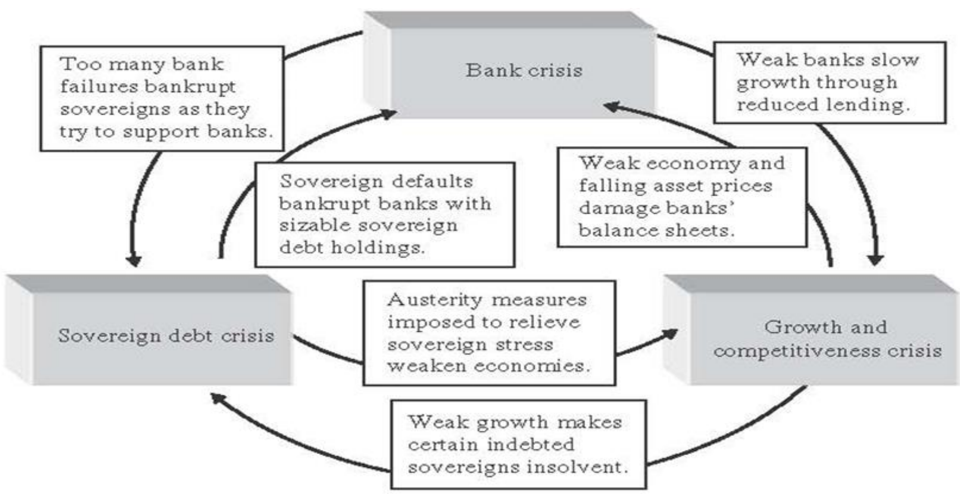
[11] See European Commission opinion approving state guarantees (IP/08/1745) and European Commission opinion approving restructuring plan (IP/10/201).

> which to repay the debt. As a result, debt levels started rising. In some countries, this debt was concentrated in the public sector, such as in Greece, where public finances were severely mismanaged. In other countries, debt accumulated in the private sector—such as in Ireland and Spain, which had serious banking and real estate bubbles. The unsustainable nature of these debts was exposed during the global financial crisis of 2008-2009, when capital markets froze up, and it became difficult for governments, households, and firms to access new loans and roll over existing debt. Additionally, the financial crisis and ensuing recession strained public finances, as government spending increased and tax revenues fell. In some cases, the government assumed private sector debt, perhaps most notably in Ireland, where the government guaranteed bank debt. Some governments verged towards default on their debt (Original footnotes omitted.) (Nelson et al., 3-4).

The Circular Connection between EU Banks and Sovereigns

Many observers have blamed the European debt crisis on the interrelationship of three elements (1) a banking crisis, (2) a sovereign debt crisis, and (3) slow growth in the EU economy (Shambaugh 2012, 157). This phenomenon is illustrated in Figure 4.

Figure 4: The Three Interrelated Crises



Source: Shambaugh 2012.

As the financial crisis heated up, EU member states sought to respond by supporting their financial sectors, some of which had ballooned to become a size that dwarfed the country's gross domestic product (GDP), as is shown in Figure 5 with respect to Dexia.

As member states sought to raise funds to support their banks, the considerable banking troubles caused the market to link the sovereigns' debt-raising with the country's financial sector's troubles. As sovereign debt came into question, so did the close linkages of many member states' banks with those governments and the recognition that many of the EU banks held significant amounts of their sovereign countries' debt, creating a "vicious cycle" that put both governments and banks at risk. As Jay Shambaugh writes:

Figure 5: Dexia Group Assets vs. Belgium and France GDPs, 2005-2011

Year	**Assets***	**Assets as % of GDP Belgium**	**Assets as % of GDP France**
2005	508,761	168	30
2006	566,743	178	31
2007	604,564	180	32
2008	651,006	188	29
2009	577,630	170	31
2010	566,735	159	29
2011	412,759	112	21

*All numbers in millions of euros.
Source: Dexia Annual Reports 2005-2011; Bankscope.

> First, the sovereign debt holdings of euro-area banks are so large that if some of the debt-stressed sovereigns (Greece, Ireland, Italy, Portugal, and Spain, hereafter referred to as the GIIPS) cannot pay their debts, the banking system as a whole is insolvent. Second, and at the same time, attempts at fiscal austerity to relieve the problems due to sovereign stress are slowing growth. Yet without growth, especially in the stressed sovereigns, the sovereign debt crisis will persist. To complete the circle, continued troubles for the banks could bankrupt certain sovereigns, already struggling under the weight of supporting the banks within their jurisdictions, and failure of these banks could lead to a broken credit channel, which in turn could become a further constraint on growth" (Shambaugh 2011, 158-9).

Because of this phenomenon, beginning in 2008, "[a] sovereign's spread responded increasingly to the weakness of its own financial sector. It was as if the sovereign's implied debt burden was recalibrated as news became available about its financial sector's likely claims on the public purse" (Mody and Sandri 2011, 3).

The Grecian Meltdown

In November 2009, Greece forecast that its public debt would hit 120.8% of its GDP, double the Eurozone limit of 60%. It also revised its 2009 budget deficit up to 13.6%, the second highest in the world relative to GDP. It was also revealed that previous governments had seriously underreported Greece's budget deficit. Rating agencies downgraded Greek bank and sovereign debt, and eventually Greek debt was reduced to junk status.

Investors worried that Greece would not be able to meet its bond payments, and these fears quickly spread to other heavily indebted member states, such as Ireland, Portugal, Spain, Cyprus, and Italy. As countries came under scrutiny, the market increased the haircuts on their borrowings, making it more difficult for them to pay their bonds or refinance amounts (Shambaugh 2012). The worries about the sovereigns who issued the debt quickly spread to the banks that had purchased large amounts of it, which caused widespread anxiety, since traditionally EU banks have held significant amounts of EU sovereign debt.[12]

In May 2010, the IMF and EU member states announced a €110 billion bailout package for Greece in an effort to avoid its defaulting on its debt and to stave off contagion among other EU countries. In November, a similar package was granted to Ireland in the amount of €85 billion. Countries receiving the bailout funds had to meet austerity measures designed to slow down the growth of their public sector debt. Fearful that other countries might also fail, Eurozone finance ministers replaced temporary measures, such as the above, with a permanent fund with capacity up to €500 billion, the European Stability Mechanism, to provide support to Eurozone member states in future crisis situations (See the BBC interview in which former Citigroup Chairman William Rhodes discusses Dexia, the Eurozone crisis, and the risk of contagion among the area's banks).

6. Dexia's Sovereign Debt Exposure

At first, Dexia's restructuring plan of September 2008 appeared to work. It was able to quell a run on deposits. The company refocused on its core businesses and geographic area and reduced its balance sheet by 21% through sales of noncore assets (Dexia Annual Report 2011). On June 30, 2010, Dexia announced that it was exiting the liquidity framework that the Belgian, French, and Luxembourg governments had provided, four months earlier than its original expiration date. By then, it had succeeded in raising €35.5 billion in medium and long-term debt (Ibid.) That same year, the bank passed the EU stress test with "flying colors." A press release issued by the company on July 23 stated: "The stress test results confirm our view that the Group has the financial strength to weather adverse macroeconomic conditions"[13] (Dexia 2010) (See Dexia Annual Report 2011, 1-20 for further discussion of its restructuring plan from 2008 to 2011).

However, given its high concentration in public finance, it was almost inevitable that Dexia would be impacted by the brewing sovereign debt crisis. As soon as the solvency of Greece and other Eurozone countries began to be questioned, rumors abounded regarding Dexia's stability. Dexia had a €3.4 billion exposure to Greek sovereign bonds at the end of 2009, as reported on its EU stress test documentation, and had a credit risk exposure to the country of €4.8 billion. It also had additional exposure of about €20 billion to the debt of Italy, Spain, Portugal, and other troubled EU countries (See Figure 6).

During the summer of 2011, Dexia's access to funding began to evaporate. On October 4, 2011, Dexia announced a €4 billion loss, the biggest in its history, largely due to writing down its significant holdings of Greek debt. At the same time, it announced that it had once again appealed to the Belgian, French, and Luxembourg governments for assistance. Dexia shares sank 22% in a day, closing at just above €1. Customers withdrew €300 million from the bank. Moody's announced that it would consider lowering the firm's ratings. As a result, on October

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[12] See YPFS case study Wiggins, et al. 2014B for more discussion of the bank-sovereign debt feedback loop.

[13] See YPFS case Wiggins, et al. 2014A for discussion of the European Union bank stress tests.

5, trading in Dexia shares was halted on the Euronext stock exchange at the request of its Belgian regulator while a resolution was devised.

Figure 6: Dexia Sovereign Debt Exposure 2009

	Debt (in millions of euros)	Debt as % of Dexia's 2010 common equity
Italy	15,831	82.5%
Germany	12,069	62.9%
Belgium	4,980	25.9%
Greece	3,462	18.0%
France	2,300	12.0%
Poland	2,276	11.9%
Eastern Europe non-EEA	2,097	10.9%
Portugal	1,927	10.0%
Austria	1,789	9.3%
Hungary	1,770	9.2%
Japan	1,624	8.5%
Spain	1,455	7.6%
All Others	5,899	30.6%
Totals	**57,479**	**299.3%**

Source: EBA 2011.

7. The 2011 Dexia Resolution Plan

On October 10, 2011, for a second time in three years, the governments of Belgium, France, and Luxembourg announced a plan to save the bank, detailed in Figure 7. The Belgian government would purchase Dexia Bank Belgium, Dexia's Belgian retail bank, for €4 billion. A Qatari investment group would buy its Luxembourg private banking unit, and the rest of the bank would be wound down. While it was anticipated that some additional assets and operations might be sold, the majority of its troubled assets, including a €95 billion bond portfolio, would be isolated in a "bad bank," supported by 10-year government guarantees totaling €90 billion. The guarantee was apportioned among the supporting countries as follows: €54.45 billion (60.5%) from Belgium, €32.85 billion (36.5%) from France, and €2.7 billion (3%) from Luxembourg (See BBC News Briefs, *Dexia Bank gets huge bailout;* Blenkinsop and Laurent 2011).

Figure 7: Dexia 2011 Recovery Plan

	Belgium*	France*	Luxembourg*	Total*
Sale of Dexia Bank Belgium	4.00	N/A	N/A	4.00
10-year guarantees to bond portfolio isolated in bad bank	54.45 (60.5%)	32.85 (36.5%)	2.70 (3%)	90.00
Total	58.45	32.85	2.70	94.00

*All amounts in billions of euros.
Source: Dexia 2011A.

On October 17, 2011, the European Commission granted temporary approval of the rescue aid for Dexia Bank Belgium and opened an in-depth state aid investigation. Ultimately, on December 21, 2012, the European Commission approved the restructuring plan, finding that the support was acceptable as the entities were exiting the market (with the exception of Dexia Bank Belgium).

On November 9, 2011, Dexia reported that it was likely to record a €11 billion loss for the year, including a €4.07 billion loss from the sale of its Belgium bank and €2.32 billion loss from writing down its Greek bonds at a 55% discount. Despite this, it also reported at the end of December 2011 that its maximum exposure to credit risk from Greek government bonds, after the write-down, was still €747 million.

The Aftermath

As of December 31, 2013, the Dexia Group remained 94% state-owned by the Belgian (just over 50 %) and French (44.40 %) governments. The remaining management continued to wind down the bank's portfolio of bonds. The company no longer had any commercial activities and had disposed of the majority of its operating entities. Dexia's balance sheet had shrunk from €413 billion at the end of 2011, to €357 billion at the end of 2012, to €223 billion and year-end 2013. It was the largest run-off for a banking group in Europe. Eighty-six percent of its portfolio was investment grade, and the portfolio was by nature one of long-term commitments. Its plan of orderly resolution sets out a trajectory for its asset portfolio to be reduced to €91 billion by 2020 and to €15 billion by 2038 (Dexia Group Annual Report 2013, 4-7).

Pursuant to the Single Supervisory Mechanism, the European Central Bank conducted a comprehensive assessment (asset review and stress test) of Dexia and released its report on October 24, 2014.[14] Dexia was the only bank in resolution that was subject to the comprehensive assessment, and on November 1, 2014, it became subject to direct supervision by the European Central Bank (See Dexia 2014).

The retail banking unit purchased by the Belgian government changed its name to Belifius and continues to operate under that name as of June 2014.

[14] See YPFS case study Wiggins, et al. 2014A for a description of the Comprehensive Assessment.

8. Lessons Learned

In March 2010, the Basel Committee on Banking Supervision issued a Report and Recommendations of the cross-border Bank Resolution Group that included an analysis of the Fortis (Belgium)[15], Dexia (Belgium), Kaupthing (Iceland),[16] and Lehman Brothers (US)[17] resolutions. The report highlighted the shortcomings of the cross-border crisis resolution frameworks among the European member states and cited "group structure, liquidity, and information sharing among supervisors as examples where improvements are needed" (Basel Committee 2010, 10).

Specifically with respect to the Dexia resolution, the Committee made the following findings:

- The tension between the cross-border nature of a group and the domestic focus of national frameworks and responsibilities for crisis management does not necessarily lead to a break-up of the firm along national lines. . . .In general terms, the division of the burden for guarantees among the three national authorities was premised on the proportions of share ownership held by the institutional investors and public authorities of the three countries.

- Therefore, while the centralization of liquidity management within a cross-border group could lead to some tensions in case of liquidity problems, these tensions can be overcome by adequate cooperation between the relevant central banks.

- The cross-border nature of the group makes the resolution process more time-consuming, but this problem is not insurmountable in a case in which home and host authorities clearly state their joint support to the group (Ibid., 11).

The Committee's recommendations informed the recent changes in the EU bank supervisory laws (See YPFS case study Wiggins, et al. 2014A for a description of these changes). New bank resolution rules, including a uniform set of resolution tools and increased cross-border cooperation and information sharing were also adopted and are discussed in YPFS case study Wiggins, et al. 2014B.

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[15] See YPFS case study Wiggins, et al. 2014C.

[16] See YPFS case study Zeissler, et al. 2014C.

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