

## BANKRUPTCY AND CONTAGION RISKS IN BANKS

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**Abstract:** *This research aims to identify the effects of contagion risks on the European banking market, after the bankruptcy of the US Silicon Valley Bank. This is the biggest bank failure since the global financial crisis. Wall Street's biggest banks lost no less than 55 billion USD in market value in a single day. And also, the shares of some European banks registered a strong decrease as a result of contagion effects on the banking market. The fear and panic of depositors led to the withdrawal of liquidity. No bank can withstand such pressure. And also, the big European banks were under the pressure of contagion effects. All this has led to a loss of customer confidence in banks.*

**Key words:** *risks of contagion, bankruptcy, banking market, global financial crisis, banks.*

### INTRODUCTION

In the current global financial context, new regulations were issued, the Romanian financial and banking legislation was completed, and a series of European Union regulations were implemented, intended to improve the activity of credit institutions.

The legal framework governing the banking activity in Romania, after 1990, aims to reform the banking system and to continue the process of transposing into the domestic banking legislation of the European Community provisions, to consolidate the Romanian banking system and to strengthen its role in the economy [15].

Banks are considered the most disciplined financial entities in the economy, entities whose entire activity is strictly regulated by rules and regulations [6]. These banking regulations also have a positive impact on the quality of the portfolio of products and services that the bank offers to its customers.

From banking practice, it is noted that regulation is vital. A bank cannot conduct its activity without clear and precise rules, without specific internal rules and banking regulations governing the operations and activities conducted by the bank and its relations with the clientele [1].

The impact of regulation in the banking activity covers two dimensions, respectively:

- the organization and management of banks,
- the bank's relations with the clientele.

In the organization and management of banks, the regulation allows the delimitation of competences and responsibilities and ensures discipline, efficiency, professionalism, and performance in the bank's activity.

In conducting their activity, commercial banks are subject to the regulations and orders issued by the National Bank of Romania, given in the application of the legislation on monetary policy, credit policy, foreign exchange and payment policy, the insurance policy of banking prudence, and banking supervision [14].

In Romania, the National Bank of Romania is the regulatory authority in banking matters, but also the prudential supervisory authority of credit institutions.

Banking regulation can be approached under three aspects [8]:

- prudential regulation of banks;
- banking accounting regulations;
- regulations in the field of combating money laundering and terrorist financing.

These three regulatory areas provide a set of quantitative and qualitative rules regarding the administration framework of banks and the prevention of significant risks from banking activity [3].

The current financial crisis and its devastating effects on banking systems (the banking industry in general), highlight the fact that regulations in the international financial system are insufficient and require deep structural reforms. The financial crisis triggered in 2008 led to the deterioration of the quality of the bank loan portfolio, put pressure on the volume of established provisions, and their increase affected the banks' financial results [2]. On the other hand, banking regulation has become too demanding and too restrictive, thus leading to the restriction of financing that prevents the recovery of economic growth.

Banks organize their entire activity in accordance with the rules of prudent and sound banking practice and with the requirements of the law.

The legal framework that regulates the banking activity has a vital role in strengthening a modern and efficient banking system in Romania [7]. A major step in the line of rehabilitation of the Romanian banking system and the removal of non-viable banks from it was the regulation of the bank bankruptcy procedure.

This research aims to identify the effects of contagion risk for the European banking market, after the bankruptcy of the three American banks, namely: Silicon Valley Bank, Signature Bank and Silvergate Bank. Silicon Valley Bank is the biggest bank failure since the global financial crisis. The collapse of Silicon Valley Bank has caused a shock in the financial market and huge losses for major banks in the US and Europe. The impact of the three major US bank bankruptcies and to what extent they involve “a significant risk” to the European financial system is analyzed.

## **MATERIALS AND METHODS**

In this paper, the causes of the bankruptcy of the three American banks and the urgent measures taken by the Washington authorities were identified.

The risks of contagion caused by these bank failures have been identified, as well as their effects on the banking market in the United States of America and the European Union.

These main risks for major American and European banks were inventoried, as well as their impact on the value of the shares of these banks listed on the stock exchanged.

The information and data about these bank bankruptcies and their contagion effects on the international banking market have been taken from the articles published in the specialized press, due to the fact that they are up to date. The events they refer to have taken place since March 10, 2023, when Silicon Valley Bank was closed by the authorities in Washington because it was unable to cope with the massive withdrawals of deposits. The history of these events is also presented.

The scientific research methods used in this paper are: identification of the issues subject to research, selection and collection of relevant data and information, systematization, classification according to the importance of the identified criteria, definition of concepts, comparison, selection of banking regulations regarding the issues addressed in the research, analysis and scientific synthesis, generalization and scientific abstraction, induction and deduction, as well as professional reasoning.

Bank failures and the effects of contagion risks have been analyzed in the context of the globalization of the world economy and the interdependencies between financial and banking institutions [4].

## RESEARCH RESULTS

Bankruptcy in the banking area and the procedure for its execution are strictly regulated by the regulatory authorities of each country. They are also monitored with maximum rigor in the European monetary area. In Romania, by Law no. 278 of 23 June 2004, Government Ordinance no. 10/2004 regarding the bankruptcy of credit institutions is approved. This law contains the following elements [9]:

- Bankruptcy procedure of credit institutions;
- Participants in bankruptcy proceedings;
- Bodies applying this procedure and their powers;
- The syndic judge and his main duties;
- Confirmation of the distribution plan for the amounts obtained from liquidation;
- Approving the liquidation method and the transactions of purchase of assets and assumption of liabilities;
- Establishing the civil liability of the management bodies of the credit institution in the insolvency state;
- The main duties of the liquidator;
- The rules regarding the declaration, verification and acceptance of claims, and others.

In fulfilling their duties, the syndic judge and the liquidator may also request the opinion of the National Bank of Romania, in its capacity as a banking supervisory authority, regarding any aspects of a banking nature. The National Bank of Romania, in its capacity as a banking supervisory authority, can enter a request for the opening of bankruptcy proceedings against the credit institution.

In the context of the current international financial crisis and the contagion phenomenon, the prudential supervision activity of credit institutions, carried out by the National Bank of Romania, allows it to effectively manage financial crises and to plan for unforeseen situations.

The main purpose of prudential supervision is to ensure the stability of the banking system. With the evolution of the Romanian banking system and its registration on the performance corridor, the prudential supervision activity undertaken by the National Bank of Romania acquires two dimensions, namely:

- ***a national dimension***, given by the role of the banking system in allocating resources from the economy;
- ***an international dimension***, given by the interdependencies between financial and banking institutions, in the context of the globalization of the world economy and contagion phenomena.

Considering this international dimension of prudential supervision, it is interesting to analyze the effects of interdependencies between financial and banking institutions, in the context of bank bankruptcy and contagion risks.

This research aims to analyze the bankruptcies of the three American banks (Silicon Valley Bank, Signature Bank and Silvergate Bank) and their contagion effects on the American and European banking market [13].

The bankruptcy of the three American banks is due to the following causes:

- the massive withdrawal of deposits held by the customers of these banks;
- Silvergate Bank's privileged links with the cryptocurrency area;
- the state of panic that pushes depositors to massive withdrawals from banks, a "bank run" with potentially devastating effects;
- the financial difficulties faced by Silicon Valley Bank (SVB) and Silvergate Capital;

- Silicon Valley Bank’s impetuous sale of a 21 billion dollars bond portfolio, to cover the demands of depositors who wanted to withdraw their savings;
- financing start-ups in the initial stages, with large amounts of money;
- the vulnerability of banks, many of which were kept afloat by public funds, after the global financial crisis a decade ago;
- the global financial crisis and the economic consequences of the pandemic;
- the assumption of major risks in the activity conducted.

Silicon Valley Bank is the 16th largest bank in the United States, with half of Silicon Valley companies having an account with the bank. Silicon Valley Bank is the biggest bank bankruptcy since the global financial crisis. The collapse of Silicon Valley Bank causes shock in the financial market and produces huge losses for major banks in the US and Europe.

The losses recorded by the major US banks, by decreasing their market value, are presented in Table 1 below:

**Table 1.**

**The effects of the contagion risk of bank failures  
for US banks**

| <b>Main Banks in the US banking market affected</b> | <b>Decrease in their market value</b> |
|---|---------------------------------------|
| JPMorgan Chase, the largest bank in the US          | 22 billion dollars                    |
| Bank of America                                     | 16.5 billion dollars                  |
| Wells Fargo   | 10.3 billion dollars                  |
| Morgan Stanley                                      | 6.2 billion dollars                   |

Source: <https://www.euronews.ro/> [10]

JPMorgan Chase, Bank of America, Wells Fargo and Morgan Stanley, the largest banks in the United States, have registered, after the bankruptcy of the three US banks (Silicon Valley Bank, Signature Bank and Silvergate Bank), a loss of 55 billion in market capitalization, shows the data of the American company Refinitiv, cited by Business Insider [12].

Effects have also been felt on the financial market in Europe. European banks’ shares have depreciated strongly, as the contagion effect of the bankruptcy of Silicon Valley Bank has expanded. The decreases in the shares or securities of these European banks are shown in Table 2.

**Table 2.**

**The effects of contagion risk felt by banks in Europe,  
as a result of US bank failures**

| <b>European banks affected</b> | <b>Affected shares and securities</b> | <b>Decreases recorded (%)</b> |
|--------------------------------|---------------------------------------|-------------------------------|
| Deutsche Bank (Germany)        | Deutsche Bank shares                  | 9.85%                         |
| Commerzbank (Germany)          | Commerzbank securities                | 6.12%                         |
| Société Générale (France)      | Société Générale shares               | 5.14%                         |
| BNP Paribas (France)           | BNP Paribas shares                    | 4.33%                         |
| Crédit Agricole (France)       | Crédit Agricole securities            | 3.35%                         |
| Intesa Sanpaolo (Italy)        | Intesa Sanpaolo shares                | 3.24%                         |
| UBS (Switzerland)              | UBS shares                            | 4.00%                         |

Source: <https://www.euronews.ro/> - reports the AFP agency, quoted by Agerpres [10]

From the table above it follows that the highest decrease, of 9.85%, is recorded by the shares of the German bank Deutsche Bank. The contagion effects were felt the most acute by the German banking market.

Credit Suisse, one of Europe's leading banks, was rescued from bankruptcy by the intervention of the Swiss Central Bank. Credit Suisse shares have recovered after accepting a 53 billion loan from the Swiss Central Bank [11].

Rising interest rates have exposed banks in an area where the contagion effect is much stronger. The risk of other banks going bankrupt is high.

### CONCLUSIONS

The bankruptcy of the three major US banks requires the need to increase the requirements of banking regulations, the way in which banks set the risk management strategy. The United States Congress and the US banking authorities have set out to strengthen the rules for banks, meant to reduce the risk of a future bank bankruptcy.

The risk of contagion in the US and European banking sector is extremely high. In order to stop the domino effect of bank bankruptcy, a new business model in the financial and banking sector is required, as well as the efficient management of the risks faced by banks.

The increase in moral hazard in banking activity and the fragility of banks, precipitate even more these bank failures in times of money's price increase [5]. It also generates the domino effect, because all banks are remarkably similar and connected to each other. This inevitably leads to a loss of customers' confidence in banking entities. The loss of trust in banks is an extremely inconvenient situation to manage.

In order to limit the effects of the contagion risk and bank bankruptcy, it is necessary to increase the role of the prudential supervision activity of banking entities.

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