

Herstatt Bank

From Wikipedia, the free encyclopedia

Herstatt Bank (Bankhaus I.D. Herstatt K.G.a.A.) was a privately owned bank in the German city of Cologne. It went bankrupt on 26 June 1974 in a famous incident illustrating settlement risk in international finance.

It led to the creating of the Basel Committee on Banking Supervision a committee comprises representatives from central banks and regulatory authorities to help find ways to avoid such risks in future.^[1]

Contents

- 1 History
 - 1.1 Background
 - 1.2 Liquidation
 - 1.3 Aftermath
- 2 References

Herstatt Bank

Type	Private
Industry	Banking
Headquarters	Cologne, Germany
Area served	Worldwide
Products	Consumer banking



herstatt case

History

Background

Herstatt Bank was founded in 1955 by Ivan David Herstatt, and was majority owned by Hans Gerling, the head of an insurance company. By 1974 the bank had assets of over DM2 billion, making it the 35th largest bank in Germany. Herstatt Bank became a significant participant in the foreign exchange markets. During 1973 and 1974, the U.S. Dollar experienced significant volatility. The bank made wrong bets on the direction of the dollar, and by June 1974 had accumulated DM470 million in losses, compared with capital of only DM44 million.

Liquidation

On 26 June 1974, German regulators forced the troubled Bank Herstatt into liquidation. That day, a number of banks had released payment of Deutsche Marks (DEM) to Herstatt in Frankfurt in exchange for US Dollars (USD) that were to be delivered in New York. The bank was closed at 16:30 German time, which was 10:30 New York time. Because of time zone differences, Herstatt ceased operations between the times of the respective payments. The counterparty banks did not receive their USD payments.

Aftermath

Responding to the cross-jurisdictional implications of the Herstatt debacle, the G-10 countries (the G-10 is actually eleven countries: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States), Luxembourg and Spain formed a standing committee under the auspices of the Bank for International Settlements (BIS). Called the Basel Committee on Banking Supervision, the committee comprises representatives from central banks and regulatory authorities. This type of settlement risk, in which one party in a foreign exchange trade pays out the currency it sold but does not receive the currency it bought, is sometimes called Herstatt risk.

The failure of Herstatt Bank was a key factor that led to the worldwide implementation of real-time gross settlement (RTGS) systems, which ensure that payments between one bank and another are executed in real-time and are considered final. The work on these issues was coordinated by the Basel Committee on Banking Supervision under the Bank for International Settlements.

The continuous linked settlement platform (CLS), was launched almost 30 years later in 2002. This payment versus payment (PVP) process enables member banks to trade foreign currencies without assuming the settlement risk associated with the process, whereby a counterparty could fail before delivering their leg of the transaction.

References

1. "Basel Committee on Banking Supervision" (https://web.archive.org/web/20071109053955/http://www.riskglossary.com/link/basle_committee.htm). Risk Encyclopedia. Archived from the original (http://www.riskglossary.com/link/basle_committee.htm) on 2007-11-09.

- Schenk, Catherine R. *Summer in The City: The 1974 international banking crisis in London and its implications for regulatory reform*. 2011. (http://www.erim.eu.r.nl/fileadmin/erim_content/documents/1974_Crisis_and_Response_15_Nov.pdf)

Retrieved from "https://en.wikipedia.org/w/index.php?title=Herstatt_Bank&oldid=779381094"

-
- This page was last edited on 8 May 2017, at 15:40.
 - Text is available under the Creative Commons Attribution-ShareAlike License; additional terms may apply. By using this site, you agree to the Terms of Use and Privacy Policy. Wikipedia® is a registered trademark of the Wikimedia Foundation, Inc., a non-profit organization.