Living wills – an international perspective

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ILF Conference The Crisis Management Directive: Europe’s Solution for Too Big to Fail
Frankfurt, 3 May 2012
Outline

Where we came from - no capacity to resolve SIFIs

How the world has changed – the FSB Key Attributes and GSIFI requirements

Cross-border resolution planning – challenges ahead
The pre-crisis world

- Absence of suitable tools and authorities to resolve failing financial institutions
- Misalignment of supervisory and crisis resolution frameworks
- Differences in resolution policies and procedures across major financial centers
- Lack of effective cross-border arrangements – MoUs did not work
- No advance planning and inadequate information sharing – nobody was prepared
- Uncertainty and unpredictability about rights and obligations and customers’ access to their assets
- Time-inconsistent decisions and political pressures: forebearance
- Weak market discipline for TBTF firms
Lehman collapse sends shockwave round world
“Systemically important financial firms should develop internationally-consistent firm-specific contingency and resolution plans”

Pittsburgh, September 2009

“We are committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden”

Toronto, June 2010

“G-SIFIs should be subject to a sustained process of mandatory international recovery and resolution planning.”

Séoul, November 2010

“A new international standard for resolution regimes“

Cannes November 2011
“So if you're a big bank or financial institution, you are no longer allowed to make risky bets with your customers' deposits. You’re required to write out a "living will" that details exactly how you’ll pay the bills if you fail -- because the rest of us aren’t bailing you out ever again.”

President Obama
State of the Union Address
24 January 2012
The «FSB Key Attributes of effective resolution regimes for financial institutions» as a point of reference for reforms of national resolution regimes

Specific resolution planning requirements for 29 institutions designated by the FSB as “globally systemically important”
29 institutions designated as Global SIFIs*

- Bank of America
- Bank of China
- Bank of New York Mellon
- Banque Populaire CdE
- Barclays
- BNP Paribas
- Citigroup
- Commerzbank
- Credit Suisse
- Deutsche Bank
- Dexia
- Goldman Sachs
- Group Crédit Agricole
- HSBC
- ING Bank

- JP Morgan Chase
- Lloyds Banking Group
- Mitsubishi UFJ FG
- Mizuho FG
- Morgan Stanley
- Nordea
- Royal Bank of Scotland
- Santander
- Société Générale
- State Street
- Sumitomo Mitsui FG
- UBS
- Unicredit Group
- Wells Fargo

* See FSB, ‘Policy Measures to Address Systemically Important Financial Institutions’, 4 November 2011
## G-SIFI requirements

<table>
<thead>
<tr>
<th><strong>CMGs</strong></th>
<th>To develop group resolution plans and coordinate resolvability assessments pre-crisis and achieve effective cross-border cooperation in-crisis</th>
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<tr>
<td><strong>Institution-specific agreements</strong></td>
<td>To set out how CMGs cooperate and share information and implement jointly agreed resolution strategies</td>
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<td><strong>Recovery plans</strong></td>
<td>Living documents to be maintained by firms drawn up on the basis of severe stress scenarios</td>
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<tr>
<td><strong>Resolution plans</strong></td>
<td>Living documents to be maintained by authorities consisting of resolution strategies and operational plan to implement them</td>
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<td><strong>Resolvability assessments</strong></td>
<td>To evaluate the credibility and feasibility of resolution and identify actions to improve resolvability</td>
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Objectives

- Lower probability of failures: recovery
- Lower cost of failures: resolvability
- Maintenance of critical functions in resolution
- Losses to be absorbed by shareholders and creditors, not taxpayers
- Less complex structures
- Lower moral hazard: credibility of “no bail-out”
- Strengthened market discipline
Recovery plans

• Maintained by firms and regularly updated. To include recovery options that address both idiosyncratic and market-wide stress scenarios assuming no public support - arrangements to
  – maintain and fund operations of critical functions
    conserve/restore the firm’s own funds
  – ensure adequate access to contingency funding sources
  – reduce risk and leverage
  – to restructure liabilities and business lines
  – maintain continued access to FMIs and functioning of IT services and other firm infrastructure
• Estimated time for achieving each material part of the plan
• Processes to ensure timely implementation
Resolution plans

• Developed by the authorities and consisting of a substantive resolution strategy and a detailed operational plan setting out how to execute the strategy

• Components (cf. Key Attributes, Annex III)
  – Mapping of critical functions to legal entities
  – Suitable resolution options to preserve those functions or wind them down in an orderly manner
  – Funding arrangements
  – Relevant information on group structure, intra-group exposures and exposures to counterparties, other intra-group interdependencies, service level agreements, etc.
  – Potential barriers to resolution and actions which firms could take to address them
Resolvability

- **To review how good resolution plans and strategies are** and to identify actions to improve them

  Key Attribute 10: “Resolution authorities should regularly undertake, at least for G-SIFIs, resolvability assessments that evaluate the feasibility of resolution strategies and their credibility in light of the likely impact of the firm’s failure on the financial system and the overall economy.”

- **Key questions**:
  - Which functions are critical or core?
  - What are resolution strategies for maintaining their continuity?
  - Are these strategies feasible given the authorities’ legal capacity?
  - Can they be implemented over a “resolution weekend”?
  - Are they credible in the light of the impact of failure?
  - Are the cross-border cooperation and information sharing arrangements sufficiently robust? Will foreign authorities support a joint resolution strategy and refrain from ring-fencing?
The **home authority** to

- lead the development of the **group resolution plan** in coordination with all CMG-members
- conduct **group resolvability assessments** within the firm’s CMG, taking into account national assessments by host authorities.
- coordinate with **host jurisdictions where the firm has a systemic presence** (but is not represented on the CMG) and provide access to RRP(s) and other relevant information

**Host resolution authorities**

- may maintain their own resolution plans for local operations, cooperating with the home authority to ensure consistency

The top officials of the **home and key host authorities** are to review at least annually the overall resolution strategy.
Challenges

• Difficulties in relation to foreign law contracts, affiliate contracts with cross-default/termination provisions
• Access to information and information sharing
• Single vs. multiple points of entry into resolution - ring-fencing and liquidation triggers arising from foreign insolvency regimes
• Sources of funding for cross-border resolutions
• Local vs. global interests
• Political risk
Way forward

• Need for greater convergence of national resolution regimes – EU Directive will be important

• Need to develop group-wide resolution strategies that align local interests with a good global solution

• Need to enhance legal certainty and predictability of resolution measures
FSB Initiatives to foster reform

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<tr>
<th>Year</th>
<th>Initiative</th>
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<tr>
<td>2012</td>
<td>Elaboration of an assessment methodology for the Key Attributes for use in IMF World Bank FSAP and ROSC assessments</td>
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<td>Thematic peer review to assess implementation of the Key Attributes (second half 2012)</td>
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<td>G-SIFI resolvability assessments, recovery &amp; resolution plans and cross-border cooperation agreements (by end-2012)</td>
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<td>2013</td>
<td>Review of the implementation of the G-SIFI specific resolution requirements</td>
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<td>Assessment methodology for Key Attributes (“pilot assessments” and public consultation)</td>
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<td></td>
<td>Assessment methodology for Key Attributes (final)</td>
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