LIVING WILLS: starting point for a global cross-border bank resolution regime

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(Bryan Marsal Handelsblatt March 24, 2010)
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Absolute Minimum: European Resolution Regime including LIVING WILLS
Justification for the introduction of living wills:

- to understand and reduce complexity of a bank’s corporate structure
- to enhance compatibility of national resolution regimes, and
- to improve cross-border coordination of supervising authorities, central banks and finance ministers.
Missing cross-border coordination = systemic risk
The cross-border resolution and insolvency procedure for international banks is currently a nightmare for depositors, creditors, and shareholders, but a paradise for insolvency lawyers.

medical prophylaxes ⇔ prudential regulation
emergency surgery $\Rightarrow$ resolution and insolvency law
Living Wills as Interface

reduce probability of failure

reduce impact of failure
limited support from taxpayers / central banks
Insolvency Law in the Light of Institutional Economics

- **corporate law**
- **insolvency law**

Integration facilitated by means of contractual solutions

**economic wealth**
Connection between insolvency law and wealth creation

- Resolution / Insolvency Law
- Interest rates (debt financing)
- Level of investment
- Economic wealth
Policy recommendation for general insolvency law

- Maximize the insolvency state return to creditors as a group
- Focus on interest rates rather than on ensuring fairness to individual creditors
- Facilitate contractual arrangements instead of insisting on mandatory resolution rules and procedures
- Ignore social costs of economic failure (no bail-out with the use of taxpayer money)
Difference between banks and other firms (I)

- prudential regulation
- cost of equity capital
- corporate governance
- resolution / insolvency law
- credit offer - interest rates
- level of investment
- economic wealth
Difference between banks and other firms (II)

- Interconnectedness of banks: risk for microeconomic stability
- Impact on payment and currency system: risk for macroeconomic stability
- Micro and macroeconomic stability as preconditions for growth and economic wealth
- Effective crisis response depends on a multiparty consensus (e.g. supervisors, central banks, and finance ministers)
Policy recommendation for systemic bank resolution law

- Maximize the insolvency state return to creditors/depositors as a group!
- Focus on (refinancing) interest rates rather than on ensuring fairness to individual creditors!
- Consider impact on cost of equity capital!
- Develop early intervention mechanism!
- Prepare an unavoidable state intervention on a tailor-made basis (“contractual“ approach)!
- Consider impact on moral hazard!
Regulatory framework needed to facilitate living wills (I)

- Supervisory colleges for systemic cross-border banks
  - “negotiation” of living wills
  - declaration of “trigger-event” for special resolution process

- Modification of standard corporate law for systemic banks:
  - clauses suspending shareholders’ voting rights
  - limitation of shareholder litigation (no suspension effect)
  - fully harmonized rules for debt-to-equity swaps
    [ IMF: specific corporate charter for European banks ]

- Fully harmonized rules of bondholder decision making and limitation of bondholder litigation
Regulatory framework needed to facilitate living wills (II)

- Systemic bank specific modification of insolvency law
  - fully harmonized rules on competence over asset transfer (e.g. to bridge bank)
  - fully harmonized “standstill period” (5-10 working days) to wind down relevant contracts in an orderly manner

- Systemic bank specific group resolution regime:
  - concentration of decision making (EBA?), or at least framework for recognition of foreign decisions
  - pooling assets across domestic and foreign subsidiaries as agreed by supervisory college in the Living Will

- Burden sharing agreement tailored for each LIVING WILL
Summary and Conclusion

prudential regulation  living wills  specific resolution law
European (global) level playing field for systemic bank groups

- reduction of “bail-out” risk (moral hazard)
- specific equity asset class (cost of equity capital)
- reduction of refinancing costs

- less stress on taxpayer and more stability
- competitive advantages for smaller banks
- credit offer for investments

economic wealth
Building the EU resolution regime on a Basel-Accord

G20-Summit
Outline of Regulation Task and Aim

mandate to IMF, FSB etc.

International Institution
Drafting an International Standard

“soft” transposition duty

EU
Systemic Bank Resolution Regime

evaluation

Financial Stability Board (FSB)
Evaluation of Standard Adherence
Thank you!

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Example: distribution of assets Unicredit (2007)

- Germany 25%
- Italy 42%
- Austria 12%
- Rest of EU 18%
- 3%

Supervisory College - EBA

- negotiation of living will (asset pooling)
- negotiation of burden sharing agreement
- declaration of trigger event
- enforcement of living will