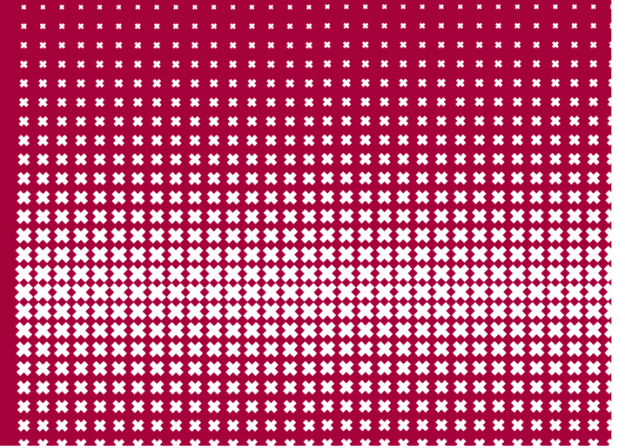




Marleen Wessel – 17th Ius Commune Conference 30 November 2012

Workshop Judicial protection and law enforcement: 'Beware and prepare: financial supervision for times of crisis'



'Living wills':

A key to reducing systemic risk?

Systemic risk

- Not a new concept (Clement 2010)
- Not limited to the financial sector
- **New as a regulatory focus since 2008**
- Why the paradigm shift? Crisis rubbed in :
 1. Regulatory focus on individual companies missed build-up of **system-wide risks**, while
 2. Individual companies had/have no incentives to track these risks, which, moreover,
 3. **Cannot be diversified away at company level**

Living wills (LWs): Contingency plans

- Legal document preparing for terminal illness, or permanent incapacity (life support, or not)
- **In financial regulation (EU, UK): combination of a **Recovery and Resolution Plan (RRP)****

 - Recovery plan (EU) shall be ‘governance arrangement’ ex article 22 Directive 2006/48/EC (proposed art. 5(1))

- In U.S.: resolution plan (DFA § 165(d))
- **Objective: no more bailouts !**

This presentation:

1. LWs in financial crisis management
2. LW quick scan: when, where, scope?
3. **Informational content LW: structural, operational**
4. **Data control: 'framing' input, monitoring output**
5. Will LWs reduce systemic risk?

1. LWs: Crisis prevention *and* resolution

- **Planning** = ongoing prudential supervision (‘micro’ from a ‘macro’ perspective)
- Includes testing ‘**resolvability**’
- **The plan** = guidance for CEO/authorities in recapitalising or unwinding the company

2a. LW quick scan

- **Inter- and transnational:** States (G20), and standard setters (FSB, BCBS, BIS, IOSCO)
- **U.S.:** Dodd-Frank Act 2010, Regulation QQ (\$50bn banks; non-banks supervised by Fed)
- **EU:** Directive proposal June 2012 (banks); consultation Oct. 2012 (other than banks)
- **EU:** EBA template recovery plans, May 2012

2b. LW quick scan

- **United Kingdom (UK):** Financial Services Act 2010; FSA feedback May 2012 (banks, £15bn UK investment firms); HM Treasury consultation on FMIs (August 2012)
- **The Netherlands (NL):** nothing in Intervention Act; blueprint DNB, July 2012 (banks); pilots
- **Germany:** legislation expected in 2013; pilots

3a. Informational content (EU): Recovery plan– structural and operational

- **Structural info:** ‘significant’ branches and legal entities; ‘core’ business lines; ‘critical’ functions; business model and strategy
- **‘Material’ impediments** to execution plan
- Recovery options, measures, triggers, assumptions, and scenario’ s
- Rapid availability data? Info management

3b. Informational content (EU): Resolution plan– structural and operational

- Mapping critical operations and core business lines to legal entities: separation possible?
- Interdependencies: ‘critical’ counterparties
- **Internal processes**: risk control functions, management information systems (MIS)
- **Resolution strategies**, financing, impact

4a. Data control: Great Expectations !

- Regulators should **continuously monitor intermediaries' exposures and financial innovations**
- **and intervene when necessary**

Nicola Gennaioli, Andrei Shleifer, Robert Vishny, 'A Model of Shadow Banking', NBER Working Paper No 17115, 2011 (in: FSB, *Securities Lending and Repos*, 27 April 2012, p. 39-40)

4b. Data control: Key challenges

- Inadequate or lacking standards, templates or formats **distort ‘framing’ data input**
- Malfunctioning internal systems (company *and* regulator) **hinder monitoring data output**
- (Legal) barriers to data exchange: privacy, confidentiality
- Ineffective (cross-border) cooperation arrangements
- IT related problems (e.g. security)

4c. Data control: 'framing' input

Standardisation - a public-private, multi-level regulatory process:

- EU: Regulatory and implementing technical standards, drafted by EBA, adopted by the Commission (new 'comitology' procedure)
- Global (FSB): Legal Entity Identifier (LEI)

4c. Data control: ‘framing’ input EU regulatory and implementing acts

Technical standards recovery and resolution (plans):

- Articles 290-291 TFEU (Lisbon; recast ‘comitology’)
- Articles 25, 1(2), 8, 10-15, and 37 Regulation (EU) 1093/2010 establishing EBA
- Proposed Directive recovery and resolution framework : articles 4(2), 5(6), 5(7), 6(5), 9(5),10(3), 13(3), 14(8)

Triangular dynamic: EU (COM, EBA, EP, Council) – Member States - private stakeholders

With a double focus: political, expert

4d. Data control: ‘framing’ input Global Legal Entity Identifier (LEI)

- G20, FSB: Unique **ID of parties to financial transactions** (≠ article 8(1)(j) Reg ESAs)
- Relevance for LWs: map **interconnectedness**
- **Presented as ‘win-win’ : a rare bird indeed**
- Designed as a ‘federal’ plug-in system
- Operational as of March 2013 (= the plan)

4e. Data control: monitoring output

Too many degrees of separation?

Dependent on supervisory review of design and governance internal control systems financial companies, e.g. recovery plans (art. 22 CRD), and

- Risk management systems (e.g. credit risk, market risk, liquidity risk, **operational risk**)
- Management information systems (MIS)
- But what if: ‘London Whale’, or Kweku Adoboli?

5a. Conclusion:

Will LWs reduce systemic risk?

- **Not (yet) as a plan for orderly liquidation:**
 - SIFIs are still ‘too complex to depict’ (Henry Hu), ‘too complex to price’ (Andy Haldane), = too opaque for effective oversight, thus ‘too dangerous to permit’ (Richard Fischer)
- **Two solution strategies:**
 - Shape up ‘depicting’ language (‘framing’ data input)
 - Downsize - and simplify – financial firms

5b. Conclusion :

Will LWs reduce systemic risk?

- Yes, in the course of **planning** + updating
- Institution-specific and inter-institutional risks could be spotted (conditional on effective data control and other factors)
- In which case: **preventive restructuring** by CEO or regulator (case by case)

5c. Conclusion: LWs - *preventive case by case* restructuring

- As against ***ex post (crisis)*** market driven ***case by case*** restructuring (current practice)
- As against ***ex post (State aid)*** ***case by case*** restructuring by competition authorities (e.g. ING)
- And complementary to ***preventive systematic*** restructuring by law (Volcker, Vickers, Liikanen, Wijffels' *Commissie structuur NL banken*)