Issue

As a result of the financial crisis and the difficulties encountered by regulators in managing the resolution of large, complex financial institutions such as Lehman Brothers, large and systemically important financial institutions in the United States and Europe will be required to develop resolution plans, or “living wills.” The objective of these living wills is clear: Provide authorities with a roadmap for dismantling financial institutions generally deemed “Too Big to Fail” in a manner that preserves economic value and limits or eliminates the need for government assistance.

From a public policy standpoint, it is difficult to argue with the intent of this strategy. From a practical standpoint, however, many questions remain about how such living wills should be developed and how effective they will be during the next crisis.

Challenges and Opportunities

In its May 2011 report on Standards for Rapid Resolution Plans, the Pew Financial Reform Project identified four significant challenges to the ultimate effectiveness of living wills:

1. International legal issues need to be resolved – conflicts of law; access to information; treatment of employees, customers and counterparties; and coordination of resolution efforts all need to be considered. While efforts to address these issues have begun at the Financial Stability Board (FSB), much remains to be done, not all of which the FSB may have the authority to determine.

2. Credible failure assessments will need to be developed and maintained on an institution-by-institution basis – regulators will still need to assess whether a failing company can be wound down without causing systemic risk. This means that regulators will need to be evaluating the connectivity among systemically important financial institutions on an ongoing basis.

3. Clear triggers for a resolution must be defined. For depository institutions in the United States, for example, these triggers exist when capital levels fall below established minimums, but triggers will need to be determined for all types of financial institutions that are required to develop living wills.

4. Expert judgment will play a large role – the best-developed living will may prove ineffective if those charged with implementing it do not manage the situation well. The reality thus far and the hope for the future are that failures of systemically important institutions will be rare, which by definition means that managing these situations will likely draw on regulators whose skills and experience for managing situations of this magnitude are untested.

Another key challenge likely to be faced by multinational banks is addressing the concerns and requirements of multiple regulators in the absence of a harmonized, global insolvency regime.

These macro considerations don’t even begin to address the challenges that will be faced by individual institutions that are required to develop living wills. In a high-level survey conducted by Protiviti, executives in the financial services industry highlighted a lack of clarity over the criteria that regulators will use to determine which institutions will be required to develop living wills and, to date, a lack of engagement by their regulators. They also expressed the view that the value of living wills would not exceed the effort needed to develop and maintain living wills and further suggested that living wills would only be somewhat helpful to regulators.

Among the particular data points that will likely be necessary for developing and maintaining living wills, respondents in the survey indicated the following would be most difficult:

- Identifying all of the interdependencies (e.g., IT, HR, intercompany transactions among legal entities)

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2 In March/April 2011, Protiviti undertook a brief survey of executives in the financial services industry on the recovery and resolution plan/living will requirements that are part of the United States’ Dodd-Frank Wall Street Reform and Consumer Protection Act and the United Kingdom’s Financial Services Act 2010.
• Reaching agreement on prioritization of actions that should be taken in the event of a crisis
• Identifying jurisdictional issues/obstacles to orderly liquidation (such as policies in some jurisdictions that would result in “ring fencing” assets within their borders)
• Evaluating all contractual arrangements
• Identifying and describing all counterparties

Despite the significant effort that the survey respondents think will be required to develop their living wills, they indicated mixed feelings on whether a living will would serve as a useful document for a financial institution's purposes or simply as “a document prepared for the regulators and not a business tool.” Potential benefits of the living will process could be the streamlining and harmonization of an institution’s contingency planning processes (capital, liquidity, operations, etc.) and better management of supplier contractual arrangements, which could result in efficiencies and cost savings.

In addition, while most respondents believe their living wills would be held in confidence by the regulators, almost as many indicated that they had concerns about confidentiality being maintained by the regulators and/or concerns that some portions of their plans will need to be disclosed under securities laws.

Our Point of View

While it is clear that uncertainties about the effectiveness of living wills exist and many questions remain unanswered, we may in fact not be able to determine the usefulness of these plans unless and until they are tested in real crisis mode. Notwithstanding this uncertainty, it seems inevitable at this point that systemically important financial institutions will have no choice but to develop living wills given the financial crisis experience.

PROVEN DELIVERY

How We Help Companies Succeed

Protiviti's Global Financial Services Team understands the challenges our clients will encounter in developing and maintaining effective living wills, ranging from extensive data collection needs to project management. Our experts can team collaboratively with our clients and their counsel to:

• Assist in the gathering of required data.
• Identify organizational interdependencies.
• Identify market connectivity.
• Evaluate business options and alternatives.

• Understand the impact of jurisdictional obstacles.
• Develop a process for refreshing a living will.

Example

Protiviti assisted a major international banking group in drafting a recovery plan and designing the process for its periodic review. The objective was to develop a framework that combines contingency capital and funding planning. Key elements of the framework are the governance principles for crisis management, the definition of stress scenarios, and the analysis of management actions and potential impediments. Development of this recovery plan is a precursor to the company’s development of its living will.

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