

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

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**Lehman was not too big to go bust,  
but rather too complex.  
A similar global meltdown  
could only be prevented  
if there were **global regulations** for companies  
that are also as complex and global  
as Lehman was.  
Banks are growing globally,  
but die locally,  
that's the problem.**

**(Bryan Marsal Handelsblatt March 24, 2010)**

Lehman was not too big to go bust,  
but rather too complex.

Global meltdown

ated

panies

**Absolute Minimum:  
European Resolution Regime  
including LIVING WILLS**

Bank

but a

that's the problem.

(Bryan Marsal Handelsblatt March 24, 2010)

## **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.**

**(Avgouleas/Goodhart/Schoenmaker  
Journal of Financial Stability (2012))**

**medical prophylaxes ⇒ prudential regulation**



**emergency surgery ⇒ resolution and insolvency law**





## Living Wills as Interface

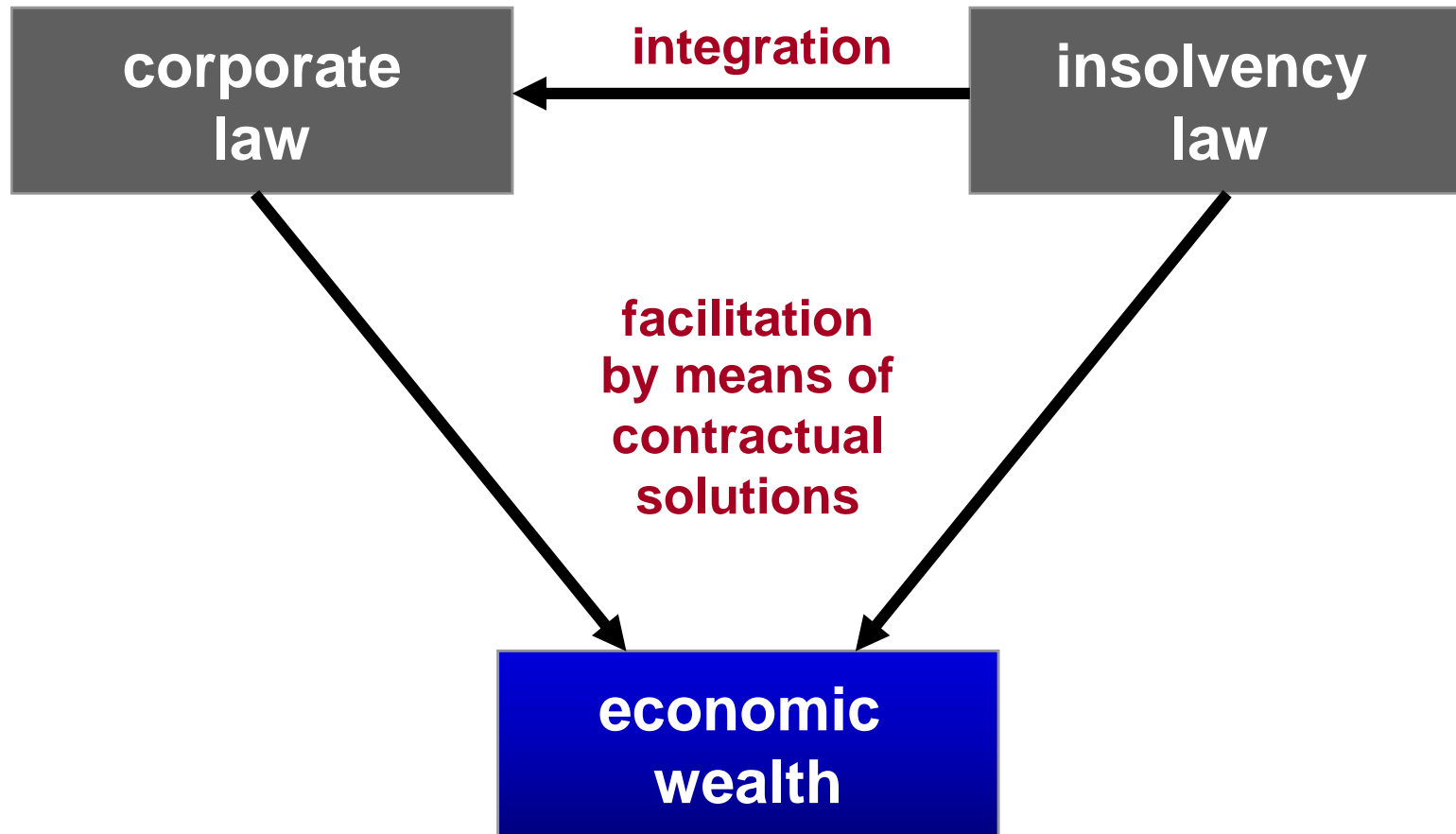


**reduce  
probability of failure**

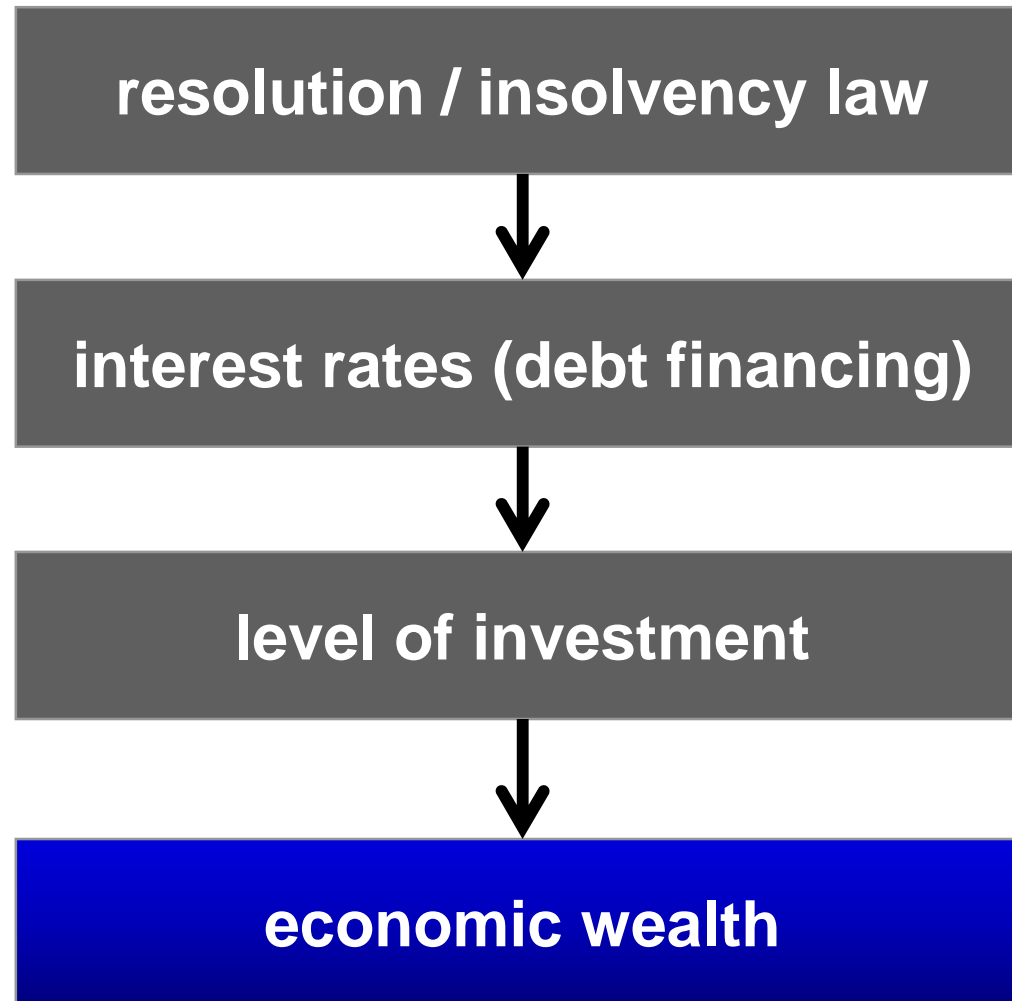


**reduce impact of failure**  
**limited support from  
taxpayers / central banks**

# Insolvency Law in the Light of Institutional Economics



# Connection between insolvency law and wealth creation

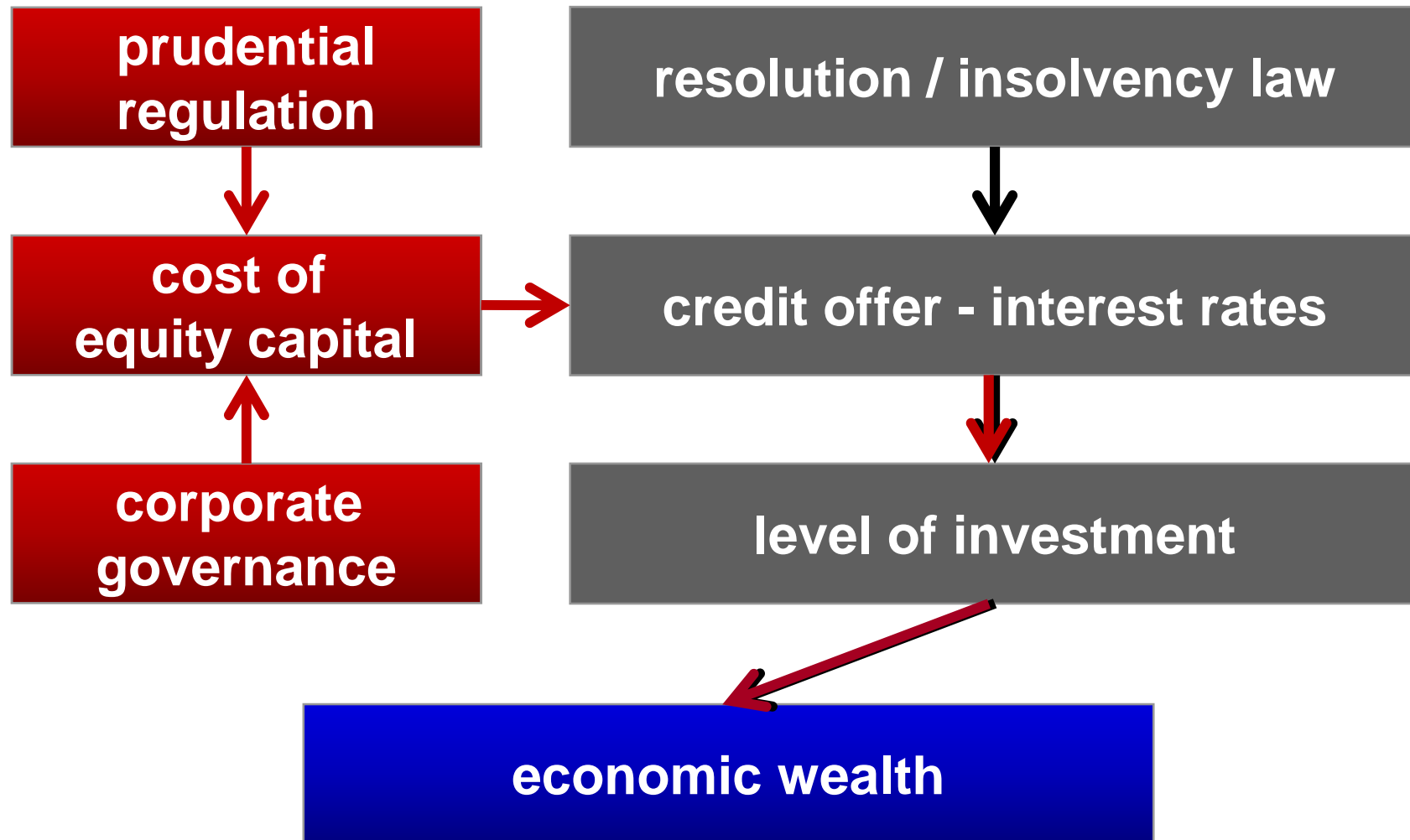


## **Policy recommendation for general insolvency law**

- **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)



## **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!
- } LIVING WILLS



## 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 periode” (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**



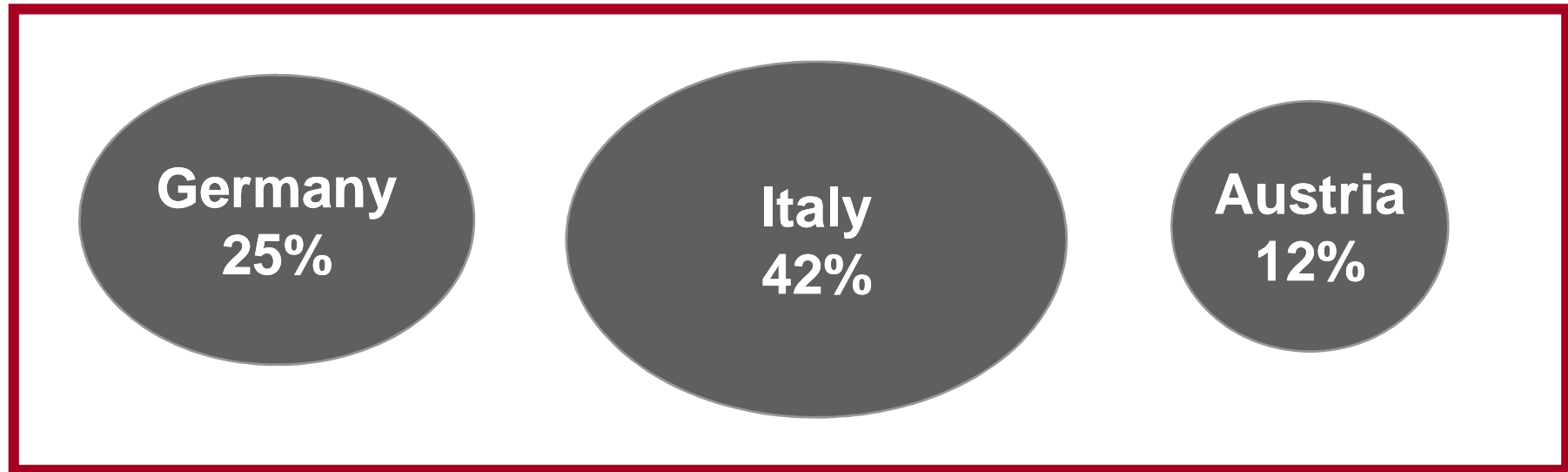
# Building the EU resolution regime on a Basel-Accord



**Thank you!**  
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## Example: distribution of assets Unicredit (2007)



### Supervisory College - EBA

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

