



When there's a will

An integrated version of the truth ticks the living will box, says Simon Shepherd

Recently, a large client of ours mentioned that the MYRIAD platform is now a major part of its 'living will' planning and that without the platform, putting in place a coherent resolution plan, should the bank in question get into difficulty, would have been much harder.

My reaction to this was twofold: pleased that here was another use that the platform can accommodate, but also an acknowledgement that we need to push these different angles a little harder when talking to clients and prospects alike.

It set me thinking on a subject: what is the extent to which the middle office and specifically the network management function should have

input in living wills? Often characterised as 'the link between the front-office and the back-office', the role of network management in particular, in any workout situation, must be crucial. After all, where do all the records sit that identify where all the assets are? It is clear that providing part of the solution for a living will is becoming a bigger part of the overall decision and having a system that genuinely underpins a living will is enormously supportive of a business case.

As a consequence, the announcement in the first week of August that US regulators had rejected the living will plans of 11 too-big-to-fail banks might not be such a big surprise. Doubtless, bank executives and their legal teams

focused heavily on the headline departments—trading, sales and the back-office—and too little on what really makes each bank run smoothly and effectively. Two of the five actions highlighted by the Federal Reserve board were:

- Ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process; and
- Demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner.

The point is that the Federal Reserve board is now very focused on seeing that each bank's thinking has moved beyond a better apprecia-

tion of risk and onto the provision of coherent operational systems and processes, which persist in the event of a resolution.

At Sibos in 2009, McKinsey coined a great phrase: “High intensity but no depth.” The phrase had nothing to do with living wills at the time. It was more a comment made in the height of the crisis about a lot of activity around risk management, without big banks actually having the systems and processes in place to manage the unfolding risk situation, as the banks lacked depth in terms of robust operational systems. Part of the message then was that in the absence of systems that persist and provide near to real-time or even instantaneous access to data—there is really very little management can do but to wait for a crisis to blow over before dealing with the fallout.

Banks and other financial institutions that do not understand and appreciate the depth of their operations—and the lack of depth in their systems—will at some point struggle to pin down the right course of action and might therefore open themselves up to all sorts of unnecessary risk and unfortunate fall-out.

This is ‘passive’ management rather than ‘active’ management, which would normally get to grips with any particular developing situation. A living will has been requested of the too-big-to-fail banks precisely because they do not have the systems in place to deal proactively with a crisis and, in the absence of such, the regulators anticipate the need for a workout or a winding down from someone at some point in the future.

A living will is supposed to demonstrate how a large bank can continue its operations in the event of a new crisis or following a shock, or in the words of the Financial Times, “without creating havoc”. It does not necessarily mean the bank will shut down. Those drafting living wills, which have been rejected, have doubtless looked at the high intensity activities that get all the attention, without drilling into the real depth of how a workout might actually work and what might be needed to make it work.

The key—and this is the importance of having a system in place—is that information is available and can be readily interrogated and that procedures are at hand with which to continue the effective running of the firm, pending disposals or the arrival of new capital or liquidity or the appointment of new management. The network management function must be central to this and having the right systems in place now helps to run the bank, as part of business as usual, and underpin any living will or resolution plan.

Now put yourself in the position of an auditor or consultant actually tasked with executing a living will. This is not the case at Lehman Brothers in Administration (LBIA), because Lehman Brothers did not have a living will in place, but the problem remains absolutely the same: what accounts do you have where and with whom? The person in whose head this information resided probably left the bank on the first day of the crisis, but the problem remains the same. Not having a robust, durable and persistent sys-

tem in place will always compromise the day-to-day running of a major financial institution before a crisis, in the same way that it would hinder any resolution plan for the same institution, should the need ever arise, after a crisis and during a transition.

Asking the question now about which systems and procedures an auditor would most like to have in place to underpin a future workout might be very informative on how to overhaul current capabilities: a comprehensive database of all accounts ever opened? Check. A list of all related documents, including old or expired versions? Check. Current fee schedules and associated reconciliations? Check. The ability to pull a report that, if not quite comprehensive or detailed enough, can be re-defined at a whim and re-run? Check.

All of these would be basic facets of a system that would be most useful to people in operations in a workout situation. It would be interesting to know how many operations and network management staff have been retained at LBIA as part of the resolution of the Lehman Brothers estate. This would provide a good guide for the shape and content of a major part of living wills. It is a worthwhile pointer to the 11 banks that have just had their living wills rejected that if they haven’t consulted with the administrator at LBIA, this might be a pretty good starting point.

The regulator’s focus is still on getting banks to clean up their balance sheets and the imposition of living wills is a stick with which to beat the banks. The political value of using one to drive the other should not be overlooked, but the operational value of having to put in place a living will should also not be overlooked. The value of a living will should encourage banks to take a long, hard look at how they actually run and what, in essence, would be required to work things out if they or their executive successors had to wind the institution down.

A look at the Federal Reserve board’s 2013 Model Template for §165(d) Tailored Resolution Plan highlights a lot of ‘what’, but leaves much of the detailed planning—the ‘how’—to the banks themselves. One suspects that this is where many institutions fall down. Not being able to demonstrate which systems are in place and how a workout might be effected could well be key criteria where the authorities can mark these institutions down.

Understanding who you work with, what it costs and how those relationships work is a critical element in a living will. It is doubtful that many of the 11 banks whose living wills have been rejected really went to the time and trouble to lift the lid, not just on how their balance sheet might be compromised (and how to avoid it), but how to resolve the situation, should such a compromise have taken place. Understanding the nuts and bolts might help a workout inform how current, pre-crisis operations can be better organised to head off the eventuality.

Moore Stephens, the London law firm, came up with a useful checklist asking ‘are you ready?’ in

the context of heightened scrutiny from the UK Financial Conduct Authority and the Prudential Regulation Authority. The checklist covers off-client agreements and disclosure documentation as well as compliance manuals and procedures and monitoring programmes.

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Significantly, it also talks about management frameworks and systems within which risk registers, policies, BCP-DR plans and a plethora of other material can sit. The underlying message is inescapable: you have to do this and if you do not you will be in trouble. It is a simple extension of this thinking and approach to ask the question, why not have it all in place beforehand and make it be part of your current day-to-day activities?

We have written many articles on the move towards more comprehensive, integrated frameworks for information and risk management, in relation to network management. Having a unified, centralised platform in place can help drive and maintain standards, which can consolidate knowledge and mitigate risk is key to future success. If having such an integrated version of the truth helps tick the living will box, then so much the better. But bank executives grappling with how best to demonstrate their living will capability would be well advised to look at current operational needs and gaps as part of their analysis of what might be required in any workout situation. **AST**



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