Recovery & Resolution:
Past Lessons & Operational Continuity Challenges

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Lehman Brother’s – Operational Challenges

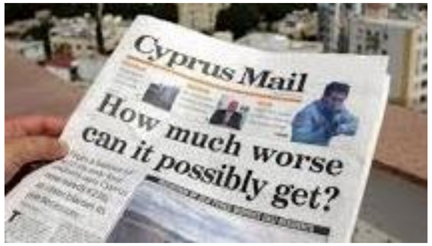
The Lehman collapse illustrated the lack of preparedness in dealing with a significant banking failure, and drove home the material difficulties in winding down an institution.

What happened

- Very quick timetable around Chapter 11 filing (Sept 15 2008)
- Near immediate sale of businesses – LBI USA & data centres (Barclays), LBTI Asia (Nomura), LB India (Nomura), LBIB Europe & ME (Nomura)
- Trading systems shut down and data feeds ceased
- Various administrators outside US shut down bank’s systems
- Negotiation of TSAs/SLAs with Barclays for IT / data
- Lack of legal entities or organisation structure charts / mappings
- Key personnel let go and then had to be re-hired
- Solvency and liquidity of different entities was unclear
- Individual businesses acted in their own interest – tried to sell parts of business separately resulting in a ‘fire-sale’ mentality
- Derivative positions remained opened and exposed for several weeks
- Cash is king - cash still keeps flowing in but large banks starting applying ‘offset’
- Communication to stakeholders after Chapter 11 was limited

What had to be done?

- **Retain control of all assets and create liquidity**
- **Build a fact base**
- **Stabilise the business**
- **Do not be rushed into action**



Cyprus – Operational Challenges

The Cypriot crisis emerged immediately prior to the finalisation of the BRRD. Actions were therefore taken mindful of, and in line with, future policy implementation, but without the legal basis and support provided by the directive.

What happened

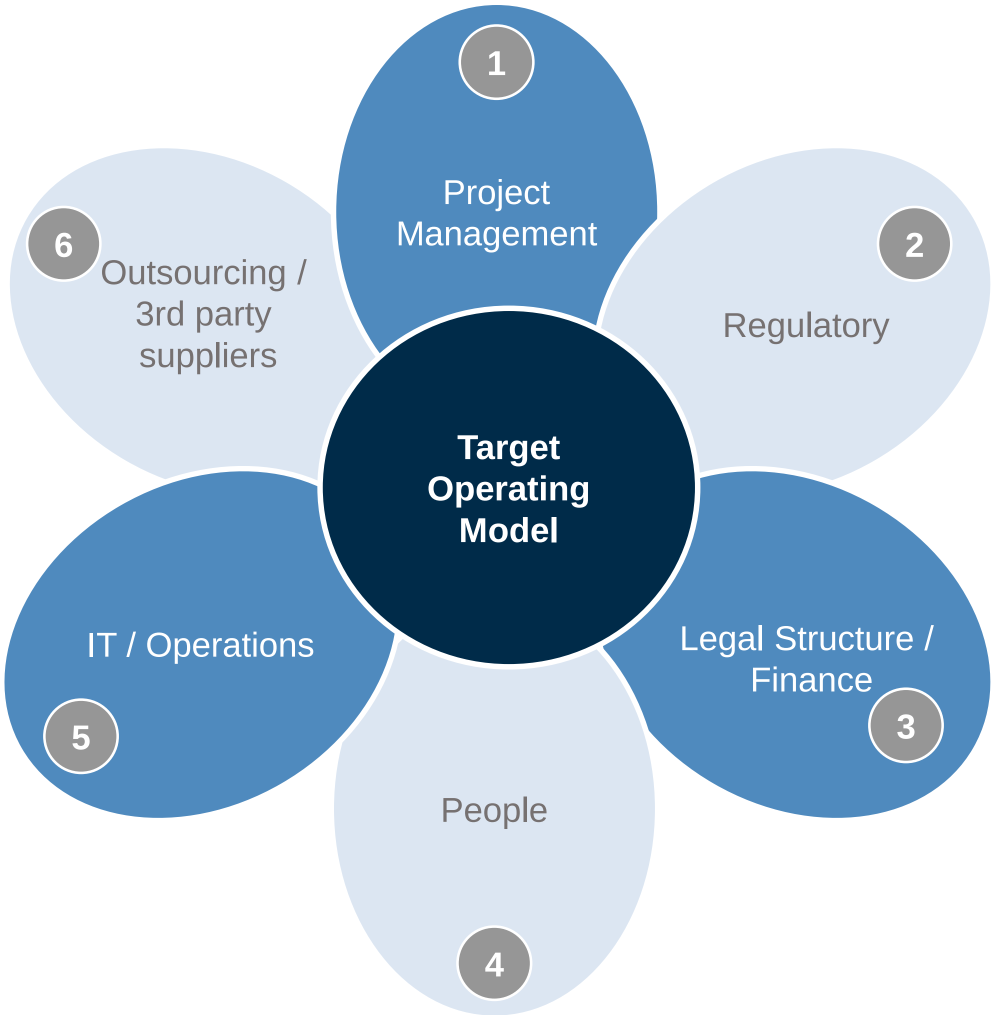
- Entire banking sector was effectively put into resolution (BoC, Laiki, CoOps) – 25/3/13
- No resolution law was in place so new law had to be drafted and passed quickly
- Resolution actions were complex including:
  - Capital controls (16/3/)
  - Sale of Greek operations (€16.4bn)
  - Carve out of Laiki CYP and wind-down of Legacy Laiki (29/3)
  - Bail-in of BOC creditors & uninsured deposits (47.5%)
  - BoC / Laiki CYP merger (29/3)
- High IT, operations and fraud risk due to the imposition of these complex arrangements
- Cypriot bank holidays 18 – 28 March ("”resolution weekend") & re-opening of the banks)
- Valuation of banks with no 'guidelines or handbook'
- Constant leaking of information
- Visible battle between Governor, ECB and Cypriot President
- Co-ordination between Troika, IMF, HMT, etc. but still different agendas
- How do you get a bank out of resolution – resolution exit steps?

What had to be done?

- **Establish a plan and a crisis management mentality**
- **Engage and align stakeholders**
- **Strong intervention team on the ground**
- **Retain staff & management to run the banks and stabilise**
- **Constant and continuous communication**
- **Deal firmly with all legal claims (e.g. derivative closures)**
- **Proactive dealing with overseas authorities on international businesses**
- **Manage liquidity tightly (capital controls, ELA, etc.)**
- **Be aware of political interference and public outcry**

Key Considerations – Operational Continuity

When defining a suitable target operating model, each bank will need to take account of many different factors, and resolve the resulting conflicts and trade-offs. Any proposed solution must, whilst meeting regulatory requirements, also satisfy ongoing operational requirements



1
- Coordinate internal and external resources
- Monitor and track progress

2
- Any strategy developed must be capable of satisfying current and anticipated regulatory developments relating to structural change e.g.
  - UK ring-fencing
  - BRRD, EBA
  - PRA proposals on operational continuity
  - FDIC/FRB expectations

3
- How does the group's legal entity structure facilitate their preferred resolution strategy?
- What barriers are there to movement of capital across the Group?
- How to ring-fence entities which provide critical operations?

4
- How to ensure staff support critical services provision in a resolution scenario
- How to handle provision of staff across entities
- Review employment and pensions implications of transferring staff if necessary

5
- How to track and manage the often complex dependencies and linkages across Legal Entities
- How to handle cross-entity provision of services
- How to provide heavily mutualised technology and services in a discrete manner by Legal Entity

6
- Flexibility of third party contracts in a resolution scenario (assignment, resolution-proof clauses)
- Resilience of external parties

2018 – A Better Foundation

The changes made in the last decade lay a better foundation for failures today. The authorities, and tools available, have advanced considerably. Improvements and enhancement will be on-going. We do not know what is coming next.

June 2017

- SRB transferred all shares of Banco Popular Español S.A. (Banco Popular) to Banco Santander S.A (Santander)
- Banco Popular continued to operate under normal business conditions as a solvent and liquid member of the Santander Group with immediate effect. RE NPLs sold to Blackstone.

June 2017

- ECB declared Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A. as 'failing or likely to fail'
- SRB decided that resolution action by the SRB was not warranted
- Winding up of the banks under national proceedings by the Italian authorities

February 2018

- ECB declared ABLV Bank, AS and its subsidiary ABLV Bank Luxembourg S.A. as 'failing or likely to fail'
- SRB decided that resolution action is not necessary as it is not in the public interest for these banks
- Winding up of the banks under the law of Latvia and Luxembourg ('self-liquidation' option)

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Key drivers and lessons

There were significant lessons to be learned, and acted upon, from the financial crisis.

- **Lack of preparedness exacerbated precarious situations and hindered the actions and responses open to authorities**
- **Complex structures, data quality, high levels of interconnectedness are problematic when looking for solutions**
- **Lack of available liquidity source is detrimental in avoiding some failures**
- **Bail out is not a preferred (or publicly supported) tool**
- **Derivatives markets needed stronger oversight and the inability to prevent closing of derivative positions led to significant loss of value**
- **Absence of formalised internationally coordinated response to firm specific events**