Resolution planning
Realizing business value on the path to compliance

A new beginning

Large systemically important financial institutions (SIFIs) are likely feeling the impact of new regulations being imposed around the world and for many, developing mandatory resolution plans can be a source of angst. For U.S. institutions affected by the rule,[1] resolution plans (an important component of living wills) must clearly demonstrate how the organization can resolve itself in a rapid, orderly manner without creating systemic risk to the U.S. economy. While this is a tall order for complex organizations, the exercise could present an opportunity for building business transparency and proactive, positive strategic change.

While most SIFIs are aware of resolution plan requirements and time frames for submissions covering both holding companies and insured depository institutions, proposed enhanced prudential standards[2] and requirements for early remediation and stress testing compound the necessary effort. Each of these requirements has one thing in common—a reliance on reporting data, often in formats that are not easily derived from current data systems. To make efforts even more challenging, financial institutions will likely have to go beyond traditional financial data to report on lines of business (LOB), material legal entities, and critical operations. Unfortunately, in many cases organizations may not have this data in the required formats, nor can they consistently link LOBs or legal entities to supporting infrastructure, operations, real estate, or contracts—as the data is not captured or attributable.

This preparatory effort will require remediation work for financial institutions impacted by these rules. In addressing these challenges, they could use this exercise as a catalyst for positive business change—not just another regulatory compliance exercise—as effective data governance has been a critical capability of a well-run institution. Building on new resolution planning requirements will help banks to identify and address weaknesses, improving their approach to capturing and managing data and supporting systems.

So what is the potential business impact of this "living will" exercise beyond compliance? We believe it is strongly linked to the intrinsic value of the data being gathered and stored. In our view, there are three areas in which resolution planning could have a positive impact on broader organizational goals. Here are some insights on where and how organizations can get business value from these compliance efforts.

Strategic positioning

In many financial institutions, it may be hard to determine which business lines contribute to shareholder value and which detract. But in a challenging economic environment, it is even more critical to have a clear picture of how assets align from both a business line and legal entity perspective. This information has the potential to help financial institutions direct investments and resources to the right parts of its business portfolio.

Executives use information derived from resolution planning to more clearly discern which parts of their business may not justify the accompanying risks, versus those that deserve more focus and investment. This information can be utilized to drive a growth strategy that helps build parts of their business while deemphasizing or dissolving others. The entire process can be influenced by regulatory requirements on liquidity and capital that hold the potential to change the economics of operating models.

By profiling different parts of their business and redirecting assets accordingly, institutions can prepare for potential acquisitions or divestures that could strengthen core parts of the business. Resolution profiling has the potential to set up the organization for smarter, more focused restructuring by making its legal entity structure and operational footprint easier to understand and alter. As a result, banks may be able to build more effective plans that enable the carve-out and sale of "good" assets, wind down or liquidate others through bankruptcy or fire sale, and identify core versus non-core assets to strengthen core businesses and divest those that are considered non-core—all as a result of more credible, business-focused resolution plans.

[1] http://www.federalreserve.gov/newsevents/press/bcreg/20120629b.htm
[2] Ibid

It can be helpful to view the preparation of these regulatory requirements as a continuum stretching from stress testing and early remediation to resolution. This approach should require executives to identify their institution's exposure to risks, determine how they transfer risk throughout the organization and their impact on funding sensitivities, and understand how these risks can be addressed, either through modifying a business structure or divesting parts of the business. It's an approach that may have the potential to enhance an institution's ability to survive in a period of severe stress.

Driving operational efficiency

Large, complex financial institutions tend to share infrastructure, operations, personnel, and vendor relationships, resulting in operating platforms that are so intertwined and interconnected that in many cases it may not be clear which business has responsibility for individual processes or parts of the infrastructure. Additionally it may not be clear as to the contractual relationships that support the business. Operations and supporting infrastructure evolve and build up over long periods of time and in many cases, this may lead to redundant platforms resulting from acquisitions or organic growth. This can make it challenging for executives to make smarter, more informed decisions as it is difficult to link assets to lines of business. Profiling lines of business as required by resolution planning could potentially lead to more transparent, holistic views of the organization and operations, giving executives an opportunity to rethink their operating structures. With this level of transparency, executives may decide (or even be required) to divest product lines or entire business lines, or simply streamline supporting operations and infrastructure. The profiling exercise could result in a picture of organizational assets aligned with lines of business or legal entities. It may also show where there are gaps in this level of understanding, namely:

- Missing data on operating components—about people, systems, real estate, and vendors
- Inability to attribute core components of the operating platform to lines of business/legal entities
- The level that agreements do or do not exist between legal entities for services that are shared and required for operational continuity
- Ability to assign vendor relationships to those that rely on services provided by those vendors
- Competent details/documentation for all services so that operational continuity can be affirmed as business structural change is considered

These issues may become the "barriers to implementation" of the resolution plans and these data gaps will likely need to be addressed to provide the required level of operational transparency. For starters, these gaps could point to ineffective and inaccurate data collection and storage practices and highlight data redundancies. Executives may be able to uncover and streamline structural inefficiencies and establish a governance system to address data accuracy. For example, understanding which legal entity structures align more tightly with core business goals may not only be helpful in the case of resolution, but can lead to simplified reporting and easier divestiture if necessary.

Resolution planning data can also help executives identify ways to make their technology systems and applications more efficient. They can exploit this opportunity to enhance their data management capabilities and improve the accuracy and timeliness of data to better manage their operations. Whether in times of financial stress or a business-as-usual environment, these capabilities have the potential to lead to significantly improved decision making. Regulatory compliance may be the only catalyst for this change.

Risk mitigation

As institutions develop an enhanced strategic view of their business and gain better operational transparency, they are likely to be better able to identify and reduce risk across the enterprise. This information could help them better understand which of their business lines tend to have higher risk profiles and in which legal entities these business lines reside. Just as important, those institutions that are most effective at structuring themselves to withstand financial stress and resolve their operations in an orderly manner will likely be required to hold less liquidity and fewer capital buffers. They should also gain a better understanding of how the various risks are transferred around the organizational structure, which could result in a more effective means to allocate capital and funding costs. The supervisory process has moved to one that has a far greater reliance on data to monitor systemic risks.

Organizations that understand and embrace these requirements, using them as a lever to enhance their data management capabilities, are likely to be better equipped to manage themselves successfully in the new regulatory environment—and better manage their businesses in the face of economic uncertainty.

What now?

Today, many large financial institutions may not have ready access to the data they need to develop sound resolution plans. While it's widely understood that the process to enhance data management capabilities will take time, pressing regulatory requirements mean that action is required sooner than later. Regulators expect this process to be addressed in the business and strategic planning process. Institutions that are making investments in these processes and technologies are likely to have both a regulatory and business advantage over those that don't. Given the level of effort that they're exercising today, executives appear to be looking for ways to translate their investments into business value beyond compliance. The good news is that there likely are plenty of points of convergence between business goals and resolution planning exercises—if you know where to look. This doesn't have to just be a regulatory compliance exercise. It can also be about more familiar concerns: increased profitability, reduced complexity, improved risk management, and more.

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