CNMV ADVISORY COMMITTEE'S COMMENTS TO FSB PRINCIPLES ON BAIL-IN EXECUTION

CNMV's Advisory Committee has been set by the Spanish Securities Market Law as the consultative body of the CNMV. This Committee is composed by market participants (members of secondary markets, issuers, retail investors, intermediaries, the collective investment industry, etc) and its opinions are independent from those of the CNMV.

Spanish CNMV Advisory Committee welcomes the FSB initiative of drafting a set of principles which should govern the implementation of a bail-in process carried out by the Resolution Authorities during an orderly resolution case whatever the jurisdiction is.

We find the FSB principles will help overcome lot of challenges embedded in the bail-in process. First, every single resolution process has its own specificities even when the same resolution authority applies the same resolution tools in the same jurisdictions; secondly, the resolution legal framework is not the same in all jurisdictions therefore finding a set of principles which are applicable in every jurisdiction seems challenging; third, depending on the resolution tool applied, the bail-in needs and even the process may differ; etc.

We would like to highlight the main messages which will be developed more in detail when answering the questions.

- The success of the resolution process depends, to some extent, on the information quality provided by the resolution entity. Aiming to improve the efficiency and the information quality, more visibility for entities on their own resolution plan would be useful.

- Although we admit that transparency is crucial to ensure financial stability, other unintended side effects linked to transparency should be considered (i.e. regulatory arbitrage in the ex-ante disclosures by entities, uncertainties about what is bailinable and eligible or, excess of litigation in the decision of consider confidential the valuation).

- Different criteria applied by different resolution authorities when implementing the discretionary power to exclude liabilities from bail-in could create a problem of level playing field. A set of common enforceable principles to be used by all resolution authority is recommended.

- As we mentioned before, information is crucial to achieve the resolution objectives. However, we think that information requirements should be governed by two principles.

    - Stability: Information requirement should remain stable during the resolution planning stage.

    - Materiality: Entities are involved in thousands of operations every day. It is worth exploring what relevant information must be provided "on-line" as a closed and accurate vision of every liability line might not be neither useful nor relevant.

- No creditors worse off principle is a key element in the resolution framework. For that reason, authorities should make efforts to align the rankings in the resolution framework and the insolvency framework.

- Capabilities required to the resolution entity to support valuations should be limited to the capacity to provide with accurate information to the valuer. Other requirements could undermine the independence of the valuer. The burden/capabilities of the valuation, but the information, should fall under the valuer responsibility.

1. **Do the principles in the draft guidance address all relevant aspects of a bail-in transaction, including cross-border aspects? What other aspects, if any, should be considered?**

In our opinion the document covers all relevant aspects of a bail-in transaction. In fact, as we will develop in other questions, most of the principles mentioned in the document could be applied to every resolution tool.

However, we think that some of the principles should not be part of the resolution planning but should be part of the general knowledge of the Resolution Authority and should be common for every entity.

Particularly, principle 9 "development of the bail-in exchange mechanic", principle 11 "ex ante identification of securities law and securities exchange requirements" should not be part of the resolution planning stage but part of the general knowledge of the resolution authority included in their own procedures manual.

2. **Should any of the principles differentiate, or further differentiate, between different (i) resolution strategies (e.g., single point of entry vs. multiple point of entry); (ii) resolution entities (e.g., operating bank vs. holding company); or (iii) approaches to bail-in (e.g., open bank vs. closed bank bail-in)? If so, please describe how.**

We don´t find elements which should be different depending on the points mentioned in the question (i), (ii), (iii). In fact, we think that most of the principles developed in the document are also applicable to other resolution strategies. For that reason, we don´t support, for example, the differentiation about of the timeframe between "closed bank bail-in" and "open bank bail-in" that we can read in page 4.

In that sense we would like to draw your attention regarding to the Principle 2 "Discretionary exclusions of liabilities from the bail-in scope". It is our understanding that this power can be applied regardless the resolution strategy was applied.

Although the application of the principle should be exceptional, we think that it is crucial that when implementing it, all the resolution authorities should consider the same set of principles. Otherwise, a problem of level playing field could be created. If investors know that resolution authorities are more flexible in certain jurisdictions, they could prefer to invest there. It could have an impact on the interest rates charges by investors to those entities located in jurisdictions where the principle is applied with more stringent standards.

3. **Do you agree with the information and disclosure requirements on the scope of bail-in as identified in principles three and four, respectively? Is the provision or disclosure of certain information likely to present any challenges for firms?**

Information is a key element during a resolution process and entities assume their relevant role providing with accurate information to the resolution authority.

In this sense, it would be very useful for entities to have more visibility and feedback from the resolution authority on the whole resolution plan. It could help them to understand and improve the resolution information requirements.

Additionally, resolution information requirements should be designed taking into account two principles.

- Principle of stability. Stability must be ensured for resolution information requirements. Aiming to gain efficiency, entities need certainty that no continuous developments on information requirements could entail more investments in software. Changing a predefined information and reporting system requires high costs which undermine entities efficiency.

- Principle of materiality: it is relevant to consider that entities enter in thousand of new operations and thousands of operations expire every day (more pronounced when referring to GSIBs). For that reason, it is worth exploring what relevant information must be provided. A very closed and accurate vision of every liability line might not be neither useful nor relevant on an "on-line basis" during the resolution planning stage or at a short notice from the resolution authority. Of course, during the bail-in period entities have to be involved in providing all the information requested by the resolution authority.

Regarding to the specific requirements set forth in principle 3, we don't find useful, in the definition of the scope of bail-in, some elements proposed in the document:

- Carrying amount (balance sheet figures) pursuant to both national GAAP and IFRS. We do not see the need to provide the relevant information based on several accounting standards. The information should be provided in the relevant Group reporting standard, which could be IFRS, US GAAP or any other national accounting standard.
- Any hedge accounting, including type of hedge and hedge ID accounting to national GAAP and IFRS.

The statement "Information on the type and name of holder is also desirable, but on a best efforts basis…." could create regulatory expectations that would go beyond what is realistic or possible. As it was mentioned before, gathering some information related to liabilities which will suffer loses in a bail-in process is not straightforward. Furthermore, tracing the holders of the instruments at a given point in time cannot be feasible. The bank may provide the names of the initial holders but once the instrument is traded the bank is not able to trace the owner of every single bailinable liability. Even more so during the stages leading to resolution when, for obvious reasons, the frequency of trading increases.

Regarding principle 4, it is important to point out that, except the legal exclusions, every liability is under the scope of the bail-in. On the other hand, not all the liabilities are eligible for TLAC. However, in some jurisdictions the scope of bail-in may extend beyond the one envisaged in the TLAC term sheet and reflected in the BCBS's Pillar 3 requirements. In such cases authorities should consider a level of ex ante disclosure of the potential scope of bail-in under the law of this jurisdiction

Additionally, it could create incentives to benefit from regulatory arbitrage. Ex-ante information about which liabilities are excluded, could lead to certain investors of non-excluded instruments to sell their investments and buy other excluded liabilities.

Regarding Principle 5, it should be regulated that the experts and evaluators must be professionals with a university education / degree in the economic-financial area or from other related areas but with specialization and / or master in financial matters.

In addition, we consider it is essential that continuous training should also be required for these professionals in these areas of high financial technical expertise specialized in an increasingly changing socio-economic environment.

4. **Do you agree with the approach for valuations in resolution set out in principles five to eight, including with respect to (i) the valuation process and type of valuations that are necessary to inform a bail-in; and (ii) the methodology and assumptions for the valuations?**

Principle 6 "management information systems and capabilities of firms to support timely and robust valuation" in some extent could jeopardize the valuer´s independence.

As we have said before, information is a key element during a resolution process. In this sense, entities must be prepared to provide with the most complete and accurate package of information that the valuer might need. A robust valuation is crucial to reduce the litigation risk linked to a resolution process.

Nevertheless, principle 6 says that entities have to build capabilities "*to support the provision of data at a sufficient level of granularity and on a*

time basis. This capability should be assessed as part of ex ante resolution planning (e.g. assessment of ***key assumptions, development and testing of valuation models****)."*

We think that the elements which should be assessed as part of ex ante resolution planning (last paragraph in brackets) should be part of the capabilities that valuers have to contribute. If the resolution entity contributes with valuation models, key assumptions, etc., the independence of the valuer could be undermined.

Regarding the principle 7 "valuation methodology and assumptions", we think that resolution authorities should publish guidelines with general principles which should govern the valuation (methodologies to assess assets and liabilities, methodologies to build scenarios and assumptions, etc.). These general principles should not impact on the valuer´s independence.

In our opinion Principle 8 should be redefined. Entities´ investors and creditors need certainty about the ex post information on valuation that a resolution authority has to release in every single resolution case. A common set of information must be defined and be disclosed in every resolution case. If needed, more detailed information should be released in a case by case basis.

Not applying similar disclosure principles on valuation can increase the litigation risk. It might be better not to publish anything in every case than not apply similar principles in every case.

Finally, no creditors worse off principle is a key element in the resolution framework. For that reason, authorities should make efforts to align the rankings in the resolution framework and the insolvency framework.

5. **Does principle 10 identify all relevant challenges to the development of a bail-in exchange mechanic? What other challenges, if any, do you see?**

Principles 10 identifies a number of aspects that have to be considered by the resolution authority in the design of the bail-in exchange mechanics. In our opinion, it offers a wide view of the relevant factors and provides for specific examples that would be appreciated by the market when disclosing the exchange mechanics (among others, announcements outside market hours and setting a record date for the processing of the exchange).

As regards the identification of liability holders, in line with what has been said in answer to question 3 above, we understand that the home state resolution authority may take into consideration the different tools available on its own jurisdiction, or the jurisdiction where securities in scope of the bail-in process are located or registered (e.g. CSD processes that offer information regarding holders of securities registered within its systems; or information available through the Paying Agent, obtained in the course of

periodic payments). Were available, we would recommend to include this knowledge in the resolution authority own procedures manual.

As a general comment to the need to engage with relevant market infrastructures, the statement contained in Principle 9 lacks a specific mention to central counterparties. This type of infrastructures, due to their intense interaction with trading venues and CSDs, have to be included in the communication channels to be opened ex-ante. It is crucial to ensure that CCPs are in a position to manage appropriately the risks arising from the implementation of the bail-in mechanics.

6. **Do you agree with the approach to meeting securities law and disclosure requirements set out in principles 11 to 14? Are there other aspects of securities law or securities exchange requirements that should be considered by resolution authorities as part of resolution planning?**

The approach taken throughout principles 11 to 14 seem to be consistent and could help to avoid regulatory arbitrage in a bail-in with cross-border impact.

Moreover, in would also be desirable, in order to avoid different application of the bail-in mechanics in a cross-border scenario, to remark in the Principles the need of market infrastructures receiving coordinated instructions from the home resolution authority. In the execution of the plan, infrastructures have to follow clearly defined instructions that eliminates any risk of misinterpretation or divergent application by different infrastructures.

7. **Do principles 15 and 17 adequately describe the actions that the home resolution authorities should carry out regarding (i) the management and control of the firm during the bail-in period and (ii) the transfer of control to new owners and management?**

In our opinion, Principle 15 is already regulated in some jurisdictions (i.e. Europe).

However, either regulated by law or included in the resolution plan (in those jurisdictions where this issue has not been regulated), we think management and control of the resolution entity is an important issue which should be planned by the resolution authority before the entity is declared failing or likely to fail.

Clarity about who and how will manage and control the entity during the bail-in period is crucial to provide with stability and certainty to the entity in resolution.

Principle 16 is also included in most of the jurisdictions. Removal of the former management board is a key point in most of jurisdictions. In some cases, even when according to the law former managers have been removed from the board, the resolution authority or the new management might need from their assistance. It is crucial to achieve the resolution objectives that the resolution authority has the power to force them to assist the process.

8. **Does principle 21 adequately identify all relevant types of information that the home resolution authority should communicate at the point of entry into resolution? What other information might creditors and/or market stakeholders require?**

After the entity is declared in resolution, a convincing communication plan has to be launched since the post-bail-in stage is expected to be very unstable. Communication plan is relevant not only, as the document mentions, to avoid queries from unaffected creditors and stakeholders but also to grant stability (to the system and the entity in resolution).

The aims of the communication plan must be: 1) strengthening the market confidence (wholesale markets); 2) provide with certainty to retail customers and critical services providers; 3) avoid "domino effects"; 4) calm employees and so on.

In this sense, the most relevant concern the resolution authority will have during a resolution process might be the liquidity post resolution. It is likely that the entity in resolution will loss huge number of clients, if goals mentioned before are not achieved.

Therefore, for those jurisdictions where a liquidity backstop is part of the resolution infrastructure, publicly statements mentioning that the backstop will work to solve liquidity problems should be made.

As the FSB points out, and banks have witnessed in recent cases, resolution authorities are not the only authorities that might be involved in the process. Therefore, coordinated communication is key to preserve the credibility of the process. Markets and litigators can seize on potential differences to allege that authorities were divided. Coordinated communications messages among authorities are key to assure a united front when intervention becomes necessary.

9. **Are they any other actions that could be taken by firms or authorities to help facilitate the execution of a bail-in transaction and enhance market confidence?**