Deutsche Bank

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Svein Andresen
General Secretary
Financial Stability Board
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Dear Mr. Andresen,

Deutsche Bank response to Financial Stability Board consultation on guidance on arrangements to support operational continuity in resolution

Deutsche Bank welcomes the Financial Stability Board's (FSB) proposed guidance on operational continuity, to ensure that financial institutions undertaking resolution planning have arrangements in place to ensure continuity of critical shared services. Without these, as the guidance notes, the continuation of critical functions - a core objective of resolution - is unlikely to be possible.

Overall, we support the draft guidance, as it correctly focuses only services that are critical to continue in resolution and recognises that a central feature of operational continuity is effective contractual arrangements. The guidance also rightly does not prescribe a particular service delivery model and recognises that changes to achieve operational continuity in resolution should consider the impact on the effectiveness of firms' operations on a going concern basis. As with all aspects of resolution planning, changes to firms' operating structures to remove barriers to resolvability should only be considered where necessary and proportionate to do so.

There are some areas where we suggest that the final guidance could be clarified – e.g. on the definition of services in scope, on cross-border arrangements and on how arrangements should be adapted to specific service delivery models or resolution strategies.

In addition, we request greater recognition that it is not possible to anticipate what post-resolution restructuring will require, as this will vary depending on the circumstances that led to the firm's failure, market conditions and the shape of the bank at the point of resolution.

Finally, we strongly welcome the commitment to prepare a report - and to consider guidance - on continuity of access to financial market infrastructures (FMIs). This is a key area for operational continuity and one where firms can only make limited progress without regulatory support.

Our detailed responses to the questions are set out in the attached annex. Please let us know if you have any questions on the issues raised or if you would like to discuss any points further.

Yours sincerely,

Daniel Trinder
Global Head of Regulatory Policy

Annex - DB responses to consultation questions

Q1: Do you agree that the three service delivery models set out in Section 3 of the draft guidance represent, singly or in combination, current industry practice? Do you have any comments on the analysis of each model from a perspective of resolvability under different resolution strategies?

We agree that the models in 3.1 broadly reflect industry practice. However, model i) – provision of services within a regulated legal entity – subsumes two types, where services are provided either:

a) to critical functions performed within the same legal entity; or

b) from one operating entity within the group to another.

The final guidance should either define a) and b) separately, or revise model i) to clarify different resolvability implications depending on whether services are provided to the same legal entity or to others in the group. In our view, b) poses similar challenges to model ii) – that of providing services from an intra-group service company – insofar as there is an equal need for clearly defined intra-group service level agreements and arms-length pricing mechanisms. However, b) also has some similar advantages to model i), as providing services within a regulated entity makes it more likely that authorities can enforce continuity (although cross-border / regulatory coordination challenges may exist, see Q7) and, as the entity is subject to capital and liquidity requirements, measures will already be in place to ensure sufficient financial resources in resolution, (e.g. bail-in, funding plans).

More generally, we are concerned that the discussion on the scope of critical shared services under 2.3-4 is not sufficiently clear on how authorities and firms should determine which services are subject to the specific operational continuity arrangements outlined in the draft guidance. In particular, while we agree with the intent of 2.4 to make clear that these types of arrangements are not appropriate for every type of critical shared service, the introduction of the concept of "transactional" services with supporting examples creates confusion. Rather, we strongly suggest that 2.4 does not provide examples but rather makes clear that it will be part of resolution planning discussions between firms and authorities to identify for which critical shared services (and in which circumstances) it is appropriate to apply these arrangements. This is already implicit in the draft guidance, but it should be made explicit in 2.4 that identifying the appropriate scope of application of these operational continuity arrangements is part of the resolution planning process.

Q2: Are the arrangements to support operational continuity set out in Section 4 comprehensive and likely to be effective? What additional arrangements, if any, should be considered for inclusion? Should any elements be modified for specific service delivery models?

We agree that the arrangements set out in 4.4 are comprehensive and likely to be effective. However, as recognised in the discussion of resolvability in section 3, individual arrangements will be more or less relevant, depending on the service delivery model (and the resolution strategy, see Q3 below). For example, contractual provisions are essential when shared services are provided by a legal entity other than the one performing the critical functions (or by an intra-group service company or third party). Financial resources are less relevant where the services are provided within a regulated legal entity, as resolution planning should ensure sufficient capital and liquidity in resolution. Governance is obviously less relevant when it comes to a third party service provider, given firms have no direct control over this (with joint-venture entities as the exception).

We suggest that the final guidance clarify further under each type of arrangement in section 4 where the service delivery model requires that arrangement always be in place, versus where it may be less relevant. It would also be helpful to specify in 4.1 that, in addition to assessing the effectiveness of services models on a firm-by-firm basis, the relative importance of individual arrangements and the scope of critical shared services covered by them (see Q1) should also be assessed in this way.

Q3: Are any of the arrangements particularly important in the context of either a Single Point of Entry ('SPE') or a Multiple Point of Entry ('MPE') resolution strategy, or are they strategy-neutral?

We are concerned that the guidance does not sufficiently distinguish between SPE and MPE strategies, nor does it sufficiently recognise that what is needed in restructuring cannot be fully anticipated. For SPE strategies in particular, the form of restructuring will vary and depend on:

i) The circumstances that led to resolution – i.e. which were the businesses or activities that led to the bank's failure, and will they need dealt with separately;

ii) The market conditions at the time of resolution – if there is a systemic crisis it may not be possible to sell or to transfer functions without destabilising the purchaser;

iii) The shape of the bank at the time of resolution – given that management will likely have taken actions during the recovery phase (such as disposals) to restore viability; and

iv) The target operating model under the restructuring plan – as the FSB draft guidance on funding recognises, this will not have been formulated at the point of resolution.

As such, while we agree that contractual arrangements for SPE banks generally need to provide flexibility for "transferability" and allow for continuity beyond the stabilisation period, this should not require banks to pre-determine ex-ante which activities will be sold or transferred or wound down. The length of time that operational continuity is required following sale or transfer will also be subject to commercial negotiation, and the level of ongoing support (including financial or other resources to be transferred, pricing or access rights) would be reflected in the sale price.

We therefore suggest deleting of the reference in 3.2 to identifying "scenarios" for post-stabilisation restructuring, and revision of 2.6 to acknowledge that while all arrangements to support operational continuity are relevant irrespective of the resolution strategy, individual relevance for the post-stabilisation restructuring period will vary depending on the preferred strategy. Both 2.6 and 4.7 should make clear that it is only where MPE strategies are preferred that separation should be given particular focus in operational continuity arrangements. For SPE strategies, 4.8 should clarify the focus is primarily on ensuring sufficient flexibility in arrangements.

Finally, we disagree that financial resources should be required post-stabilisation, as by the end of the stabilisation period firms should have restored access to private sources of funding. The FSB's draft principles on funding in resolution recognise this, as they acknowledge one of the core purposes of the restructuring plan is to help restore market confidence and access to private funding. It would therefore be disproportionate to require financial resources for the restructuring period. The guidance partially acknowledges the need for proportionality, by recognising that entities may be "right-sized" during restructuring. We therefore recommend revising 4.4 iii) to state "in all cases, financial resources should be sufficient to cover the stabilisation period, which may be a few months. Transition from stabilisation until the firm returns to private sources of funding should be taken into account when developing the resolution funding plan."

Q4: Do you consider that any of the arrangements identified in Section 4 would be challenging to implement in the context of all or specific types of the service delivery models identified in Section 3?

As outlined above, we believe that some of the arrangements are more relevant for certain service delivery models. For example, where services are provided from a regulated legal entity, we do not believe that financial resources are necessary to ensure continuity of services, beyond the general obligation under resolution planning to ensure operating entities have sufficient capital and liquidity post-resolution to continue critical functions. Even for intra-group service companies or third party service providers, we believe it would be extremely challenging from a "business as usual"

perspective to maintain additional or ex-ante pre-funding of financial resources for the post-stabilisation restructuring period, beyond the timeframe envisaged in the broader liquidity plan to return to market funding (as outlined in the FSB's draft principles on funding in resolution). In addition, it is worth being aware that there may be circumstances where business continuity rules also require ring-fencing of financial resources. Authorities should allow firms to rely on these to avoid duplicating these arrangements, providing they are satisfied that financial resources that are depleted for business continuity purposes can be quickly replenished.

In addition, as mentioned in Q2, firms will often have no influence over the governance of third party service providers, but other arrangements may also be challenging in this scenario – e.g. operational resilience and resourcing, management information systems – as this relies on the third party service provider having these capabilities in place. There are also barriers to enforcing operational continuity where the resolution authority has no direct powers over third party providers, discussed in more detail below under Q5 and Q7.

Q5: Does the legal entity ownership structure for the provision of critical shared services (for example, wholly owned or partly owned through joint ventures) give rise to specific challenges in relation to operational continuity? If so, what are these challenges and how might they be mitigated?

As mentioned above in Q2 and Q4, where the service provider is a third party, financial firms and resolution authorities will have limited or no influence over their internal arrangements. In some circumstances, continuity would be covered in the contract / service level agreement (e.g. pricing structure, management information that would be provided) but in others it would not (e.g. governance, operational resilience and resourcing). In these circumstances, authorities should allow firms to rely on the vendor to ensure they have adequate arrangements in place.

There are also very significant challenges where the resolution authority has no direct powers in the resolution regime to enforce continuity from service providers. This is particularly challenging with third party providers. In the EU legal framework and the Hong Kong draft resolution bill, statutory powers exist over service providers based in their jurisdiction, including non-financial firms. However, as these firms are outside the scope of financial regulation, these powers are untested and so how effective they would be in practice is uncertain (see Q6 below). In addition, such powers are less likely to be effective if services are provided by entities based outside the home jurisdiction regardless of whether they are financially regulated or not (see Q7 below), but particularly if provided by a third party or joint venture and especially if these are not financially regulated.

Q6: Are there measures, in addition to those suggested in Section 4 of the draft guidance, that might reinforce contractual arrangements for the provision of shared services to support operational continuity in resolution? Do you foresee any challenges in adopting such measures in the context of all or specific types of service delivery model?

There are no specific additional measures we would suggest for section 4, beyond more clarity on when the arrangements apply (see Q1), where each arrangement is most relevant (see Q2) and more recognition of the different resolution strategies (see Q3).

In terms of challenges, when it comes to services provided by a third party, the biggest potential obstacle is the dependency on the service provider's goodwill to accept the insertion of contractual resolution provisions in existing contracts. This is a concern to a lesser extent for point i) under 4.6 – requirement to have robust service level agreements in place – as this is best practice for all service contracts. However, points ii)-v) – that the level of service provision should not alter upon entry into resolution and recognising the possibility of transfer and / or divestment in resolution – are entirely new concepts and so it is possible that service providers would push back on such provisions.

Even if such contractual provisions are agreed, it is difficult to predict whether the level of service provision will remain unaltered, especially if the resolution authority does not have powers to enforce this. As the draft guidance notes, the likelihood of such provisions being accepted and effective will depend on the level of confidence that third party providers have that they will continue to be paid.

The guidance should therefore also mention the importance of statutory powers in the resolution regime to ensure continuity of critical shared services, which should also be able to be applied to non-financial firms providing services (as in the case of the Hong Kong and EU resolution regimes). This would be consistent with the FSB's cross-border effectiveness principles, which recognise the importance of supplementing contractual measures with statutory ones.

Q7: Are there any arrangements that might mitigate challenges in connection with (i) service providers from outside the jurisdiction of the resolution authority and (ii) non-regulated third party or intra-group service providers that should be covered in this guidance?

We agree with the draft guidance that there are particular challenges to operational continuity where services are provided by an entity outside the jurisdiction of the resolution authority. This is mitigated to an extent where the services are provided within the group – particularly by a regulated entity – but may still rely on cooperation with host authorities and is particularly challenging where third party service providers are involved. The final guidance should therefore explicitly address cross-border provision, to commit all FSB member jurisdictions to:

i) Ensure domestic resolution regimes include powers to enforce operational continuity of essential services in their jurisdictions, including from outside the financial sector;

ii) Explicitly address operational continuity arrangements as part of cooperation agreements between home and host authorities; and

iii) Seek to identify specific support and / or recognition measures by the host authorities that may be necessary to ensure operational continuity arrangements are enforced.

In addition, authorities should recognise that this potential lack of enforceability stems from shortcomings in the legal framework, and seek to address it via regulatory cooperation. This option should be pursued before considering whether this presents a material barrier to resolvability, which may require a firm to take measures (e.g. legal, structural or operational changes) to overcome it.

Q8: Do you agree with the classes of information set out in the Annex as necessary to support firms and authorities in their assessment of operational continuity in resolution? Do you foresee any challenges for firms in producing and maintaining that information?

We fully agree that the classes of information set out in the Annex, are what firms eventually should be able to produce in a timely manner to facilitate operational continuity in resolution.

However, it needs to be recognised that it is not a quick and easy task for firms to gather this information, or to develop the systems to maintain it and capability to produce it quickly. Mapping of critical shared services, supporting contracts and personnel will take time given "critical functions" are a relatively new concept. Existing databases and systems will then need to be updated to facilitate quick access and data aggregation to give a view on either a global or individual country or legal entity basis; this is particularly challenging where interdependencies exist. While particular areas can be prioritised and tactical solutions developed, it needs to be recognised that meeting these expectations comprehensively will require significant systems development possibly over several years, which in turn needs to work with the existing IT investment cycle.

In addition, we would caution against authorities expecting a single centralised database for operational continuity. As long as there is a single repository detailing how to access all the

necessary information, and the information itself can be retrieved within a reasonable timeframe, it is neither necessary nor desirable to duplicate existing systems. This may in fact introduce new operational risks, as replicating information from one database to another may reduce accuracy.

Q9: Are there any other actions that could be taken by firms or authorities to help ensure operational continuity in resolution?

Although this will be dealt with in 2016, we would like to reiterate our strong support for the FSB commitment to do more to ensure continuity of access to payment, settlement and clearing services in resolution. Financial Market Infrastructure (FMI) continuity is a key issue, where industry faces similar challenges and FMIs similar constraints, from their own rulebooks, risk management standards and regulatory regimes. Balancing these issues to ensure continuity of access for participants while also protecting FMIs themselves requires support from regulators. This should at least take the form of detailed guidance or, preferably, the development of model language that could be adopted into FMI rulebooks to facilitate continuity of access. This would help ensure consistency in arrangements between FMIs and their participants globally, and help with market confidence during resolution by providing transparency to other participants.