By email

1 February 2015

The Financial Stability Board Secretariat
Basel
Switzerland
fsb@bis.org

Dear Sir/Madam,

Comments on Consultative Document – Adequacy of loss-absorbing capacity of global systemically important banks in resolution

The Dubai Financial Services Authority (DFSA) is grateful for the opportunity to provide its comments on the above FSB Consultative Document, published on 10 November 2014.

The DFSA is the independent regulator of financial and ancillary services conducted in or from the Dubai International Financial Centre (DIFC), a purpose-built financial free-zone in Dubai, the United Arab Emirates. The DFSA regulates a broad range of financial firms based in the DIFC, including banks, insurers, fund managers, advisory firms and brokers, exchanges and clearing houses. In addition, the DFSA's regulatory remit includes credit rating agencies, auditors and AML/CTF regulation of other designated non-financial business and professionals. The DFSA is a host regulator for 24 of 31 global systemically important banks (G-SIBs) (as of January 2015), most of which operate in the DIFC through branches.

The DFSA will undertake work on reviewing its resolution regime for financial institutions, including banks, financial markets infrastructures and insurers in 2015.

Please find our comments below to the questions set out in the Consultative Document. In instances where the DFSA does not have a strong or settled view we have not provided any comments.

If you require any clarification in respect of our comments please do not hesitate to contact me on +971 4362 1660 or by e-mail on psmith@dfsa.ae.

Yours faithfully,

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General Comments

The DFSA generally supports the FSB proposals in respect of adequacy of loss absorbing capacity (TLAC) of G-SIBs as a way of addressing systemic consequences of a potential G-SIB collapse and of avoiding public funds having to be deployed to rescue the failing institution. We agree that, in order for TLAC to achieve its objective, its use needs to be accompanied by a range of additional credible resolution tools and strategies such as, for example, appropriate resolution planning, stays or bridge institutions.

We consider that the FSB proposals address substantially all issues necessary for the TLAC concept to become operational, subject to the additional standards being developed and to the results of the Quantitative Impact Assessments, as set out in the Consultative Document.

Calibration of the amount of TLAC required

Question 2

We believe that the proposed initial exclusion of G-SIBs headquartered in emerging market economies (EMEs) is appropriate at this point in time. However, as these institutions expand internationally, their exclusion from the TLAC requirement will no longer be justified. An appropriate monitoring of these developments and resulting exposures would be necessary, both to ensure systemic risks arising from increased exposures and increasing inter-connection are addressed and to ensure a level playing field.

Question 3

Additional Pillar 2 requirements should appropriately reflect the degree of connectivity between the G-SIB and the rest of the financial system, as this is likely to be a complicating factor in recapitalisation/resolution.

Ensuring the availability of TLAC for loss absorption and recapitalisation in the resolution of cross-border groups

Questions 4 and 5

We agree with the FSB that achieving the TLAC objectives and its practical operation in the event of resolution hinges strongly upon trust in cross-border relationships between home and host supervisors. For this reason, a strong culture of inclusiveness and co-operation in relation to the operation and resolution planning within Crisis Management Groups (CMGs), and with host authorities which do not form part of CMGs, is of paramount importance.

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We consider that in order for host authorities to achieve sufficient comfort, and prevent ring-fencing, the pre-positioning of TLAC in material subsidiaries is advisable and it should indeed be proportionate to the size and risk of their exposures. The levels of pre-positioned TLAC should be continuously maintained. It is stating the obvious, but worth saying, that the greater the extent of pre-positioning, the greater degree of comfort that host authorities will have.

We would not be in favour of collateralised guarantees as an alternative means of pre-positioning. We are generally not supportive of encouraging greater use of collateral within the financial system, in the interests of reducing inter-connection both between banks and between banks and other institutions. Additionally, we are not convinced that the criteria in the Term Sheet (section 23) would prevent the re-use of collateral provided to support such a guarantee; such re-use may heighten existing risks or introduce new risks.

The criteria suggested in the Term Sheet for the identification of Material Subsidiaries (section 21) raise further questions. Firstly, it may be more appropriate to think of such subsidiaries in relation to the size/activities of the resolution group of which they form a part, rather than to the size/activities of the G-SIB as a whole. Secondly, there needs to be some recognition of the interaction between the G-SIB process and national approaches to recognising domestic systemically important banks (D-SIBs). There will be D-SIBs, particularly in emerging and developing markets, which would not meet the criteria suggested in section 21 and may not meet them if they were calculated on the basis of the resolution group. A process that ignores D-SIBs is unlikely to engender the degree of trust and confidence between national supervisors that is necessary to prevent ring-fencing and to allow for effective cross-border resolution.

Interaction with regulatory capital requirements and consequence of breaches of TLAC

Question 10

We agree that the integration with Basel III set out in this question is the right sequence, so that minimum TLAC requirements are met first, followed by making any surplus CET1 available to meet Basel III buffers.

Transparency

Question 11

We consider that appropriate disclosure to investors, that assets are going to form part of a G-SIB's TLAC, is essential to prevent the risk of asset sell-off by investors uncertain whether the assets they hold would be subject to write-down/bail-in.

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Limitation of contagion

Question 12

It is understandable, and desirable, that G-SIBs should be restricted in holding the TLAC of other G-SIBs. However, we are of the view that appropriate consideration should also be given to the role of other G-SIFIs, which may well be likely TLAC investors. Otherwise, trying to address systemic risk in one area of the market may result in creating substantial risk of contagion to another part.

Market impact and other aspects

Question 15 and 16

The impact of the introduction of TLAC and the resulting need to raise sufficient debt is likely to incur cost for G-SIBs: TLAC investors will expect to have their risk appropriately priced. Exactly how high the cost of this risk would be estimated at this stage, given the historically low yields in the global markets, would need to be tested and the FSB's QIS is likely to reveal this in more detail.

However, it would appear that this cost is unavoidable. There is a price for being a G-SIB; the alternative of mobilising public funds to save such an entity, as demonstrated in the recent crisis, can have significant consequences for national economies.

The introduction of TLAC would need to be accompanied by enhanced monitoring of non-G-SIBs and shadow banking activities, i.e., activities of entities which could carry out banking-like functions whilst escaping banking regulation and the need to bear the costs of TLAC. This is because, as pointed out in the Consultative Document, the introduction of T-LAC could cause the shift of banking activities, and as a result the building of risks, from G-SIBs to other banks or to other institutions. The shift of activities and risks to non-G-SIBs could potentially be a positive development addressing, through indirect means, the Too-Big-To-Fail problem, but only if the entities taking on greater risk are adequately supervised and monitored.