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EBF Response to FSB consultation on Principles on Bail-In Execution

The European Banking Federation welcomes introduction of clear principles for both credit institutions and authorities the operationalisation of bail-in.

Key messages

- 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 on the resolution plan would be useful.
- Information is crucial to achieve the resolution objectives. However, we think that information requirements should be governed by two principles.
    - Stability: Information requirements should remain stable during the resolution planning stage.
    - Materiality: Entities are involved in thousands of operations every day. For that reason, proportionality should apply (in particular only information that is necessary for the preferred resolution strategy should be required)
- 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.
- The "no creditor 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.

For your consideration, we have provided the following answers to the consultation questions below.

Answers to consultation Questions

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 **Do the principles in the draft guidance address all relevant aspects of a bail-in transaction, including cross-border aspects?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?**

We deem that the draft guidance address most relevant aspects of a bail-in transaction. Nevertheless, we note that the FSB consultative document does not deal with the

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conversion of instruments different from securities, which are also bail-inable under the EU rules In addition, term deposits and loans that can be used for the internal MREL should be addressed.

Furthermore, we recommend that the main jurisdictions, which have implemented the FSB key attributes, ensure the mutual recognition of resolution frameworks and the related powers (in particular bail-in) and rights of the competent resolution authorities: more in detail we refer to EU vs US, and also UK in light of the Brexit effectiveness. These recognitions would ensure that the resolution framework (in terms of laws and regulation) is acknowledged and therefore legally valid and applicable also under third countries' laws and regulations. This means that all the resolution powers and rights granted to the resolution authorities with regards to the right of declaring a credit institution entering into resolution and the execution of the resolution tools, such as the bail-in tool, is effectively applicable and enforceable according to the laws and the regulations of these third countries. The above is necessary for the following two reasons:

I. It would ensure the resolution authorities on the feasibility and enforceability of the resolution and the bail-in of instruments issued under third country laws and distributed in different countries than the home jurisdiction without relying on contractual acknowledgment that will be difficult to include in every contract.
II. It would allow banks to count liabilities governed by third country laws towards TLAC/MREL requirements, assuming the compliance with all the other regulatory provisions prevailing in the relevant jurisdiction (e.g. in accordance with Art. 55 of BRRD in the EU) without the need to provide a legal opinion.

Finally, we would suggest that the guidance requires authorities to disclose details about the implementation of any moratorium tools and how the instruments in-scope of such moratorium could compare to the instruments in-scope of the bail-in tool.

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 do not 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 do not support the differentiation about of the timeframe between "closed bank bail-in" and "open bank bail-in" that we can read on page 4 of the FSB's draft guidelines.

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

principles. Otherwise, a problem of level playing field could be created, e.g. investors which know that resolution authorities are more flexible in certain jurisdictions, may prefer to invest there instead. It also could have an impact on the interest rates charges by investors.

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 of providing resolution authorities with accurate information. In this sense, it would be very useful for entities to have more visibility on the whole resolution plan. It could help to understand the resolution information requirements.

Additionally, information and reporting systems are expensive investments for entities. For that reason, resolution information requirements should be designed taking into account two principles.

I. 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. Changing a predefined information and reporting system requires high costs and IT resources which undermines the entities' efficiency.

II. Principle of materiality: It is relevant to consider that entities enter in thousands of new operations and thousands of operations expire every day (this even more so the case for G-SIBs). For that reason, proportionality should apply and priorities must be clearly identified. Regarding the specific requirements set forth in principle 3, in the definition of the scope of bail-in:
    a. We do not see the benefit to publish balance sheet figures both in national GAAP and in IFRS. The workload would be increased significantly for banks with limited benefits for resolution.
    b. We do not see the benefit to publish any hedge accounting, including type of hedge and hedge ID accounting to national GAAP and IFRS.

The authority should clarify ex ante under which standard data will be required.

The statement "Information on the type and name of holder is also desirable, but on a best efforts basis…," could create regulatory expectations beyond what is realistic or possible. As it was mentioned before, gathering some information related to liabilities which will suffer losses in a bail-in process is not straightforward.

The consultation paper states that *"authorities should ensure as part of ex ante resolution planning that firms can produce the required information within sufficiently short timeframe and on an up-to-date basis"*. Sufficient time should be given to institutions to implement the necessary information systems as it would require huge and costly IT developments.

Principle 4: The principle requires to disclose on an ex-ante basis information regarding the nature and quantum of liabilities that could be subject to bail-in. Regarding international requirements (Pillar III - TLAC), it should be specified that this BCBS principle covers only debts included in the minimum bail-in liabilities ratio (i.e. TLAC/MREL) and not all contracts subject to bail-in. The scope should therefore be extended to debts that are bail-inable under the applicable law but not included in the ratio. It is of upmost importance that stakeholders are aware that they can be bailed in even if their debt is not eligible to a ratio.

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?

Whilst we agree with the approach set out in the consultative document, we would like to ask the FSB to clarify the definition and sequence of the three valuations.[1]

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

Information is a key element during a resolution process. Entities must be prepared to provide authorities with the most complete and accurate package of information the valuer might need. A robust valuation is crucial to reduce the litigation risk linked to a resolution process.

Although home/host cooperation is indeed welcome in valuation, as per principle 5, the role of host authorities in valuation should be examined under the relevant resolutions strategy. Indeed, host regulators' requests for valuation input in times of crisis could add additional operational burden to the firm at a moment of strained resources, without adding value for resolution purposes, e.g. because of entities that are not themselves resolution entities.

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 as well.

[1] It is our understanding that Valuation 1 (the financial valuation) is to determine FOLTF. Valuation 1 runs prior to any resolution actions. Valuation 2.i (a valuation of assets and liabilities to inform the extent of losses) is the result from valuation 1 which is then used as the input, for the financial position of the firm, in the bail-in tool. Finally, Valuation 2.ii (also considered the franchise valuation) is to determine the market value of new equity and the relevant conversion rates.

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 the valuer´s independence.

We recommend further that Principle 8 should be redefined. Entities investors and creditors need certainty about the ex post information on valuation that a resolution authority should 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 on a case by case basis.

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

Finally, the "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.

Regarding the potential consequences of a large disclosure of a variable valuation to the market, Principle 8 should also be considered more carefully. It should be considered that in some cases the valuation should be only shared between the credit institution and the resolution authority, in order to prevent economic instability.

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?

On Principle 10, the industry would appreciate clarification that the disclosure needs to be limited to the preferred resolution strategy for each of the relevant banking groups. In particular this means that in several jurisdictions "trading of claims" might not be applicable, as the bail-in regime is designed to recapitalise the failing bank within days instead of months. Moreover, jurisdictions could consider legislating for instruments that facilitate bail-in.

In terms of delivery of equity, it is possible to deliver via the custody chain if proper mechanisms are in place. For an orderly resolution, we should avoid that debt holders have to identify themselves to banks for exchange of equity.

Finally, it should be permitted that, in a context of a bail-in, some legal constraints on capital issuance that would apply in a going concern situation are temporary simplified. This simplification -if needed according to the national law- would ensure that obstacles to a rapid recapitalisation are overcome.

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?**

Principle 12: We welcome the consideration on how firms' communications should benefit from temporary exemptions or postponements in order to continue to comply with the European directive on market abuse. The last paragraph "The relevant home authority should […] of their impending disclosure requirements" seems to prevent market abuse. However, the wording is not clear enough and should be clarified.

Same clarification would also be welcome on how to mitigate the risk of asymmetric information being disseminated in different jurisdictions. Lastly, firms' communications with rating agencies during the bail-in period should also be clarified ex-ante, in order to ensure coordination between firms and the resolution authorities.

We would also recommend that authorities exempt banks in resolution from Directive 2001/34/EC or national legal requirements for ad hoc publicity of potentially price-sensitive facts for their own securities, as such disclosure could upset the resolution action.

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?**

With reference to Principle 18, as a consequence of a bail-in a former bondholder may inadvertently turn into a major shareholder. In certain jurisdictions, exceeding specific thresholds may require such a shareholder to provide all other shareholders with a mandatory take-over bid. Moreover, trading of bank debt in secondary markets prior to a bail-in is likely to be gamed by players who will form consortia to take legal actions. That means that even if individual bond holders don't breach large shareholding disclosure requirements post bail-in, together they could form powerful shareholder groupings that could potentially disrupt the reorganisation process. Therefore, the respective law should provide for an exemption from such a requirement in the context of a bank resolution

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 enters resolution, a credible communication plan has to be launched as the post-bail-in stage can be expected to be very unstable. A 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 to:

1. strength the market confidence (wholesale markets);

2. provide certainty to retail customers and critical services providers;
3. avoid contagion;
4. reassure employees.

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 lose huge number of clients, if the above goals are not achieved.

Therefore, for those jurisdictions where a liquidity back-stop is part of the resolution infrastructure, public statements mentioning the availability of the back-stop to safeguard against any liquidity problems should be made.

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?

We believe that the bail-in set up should, if possible, include a mechanism enabling a "write up" in case the valuation was too conservative and the bail-in was applied too broadly. This would increase confidence in the fairness of the framework, because investors would to be compensated in case there is a resolution surplus. This write up mechanism should be harmonised across jurisdictions for level playing field reasons.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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