INSTITUTE OF INTERNATIONAL FINANCE

gfma GLOBAL FINANCIAL MARKETS ASSOCIATION

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Financial Stability Board
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Guidance on Arrangements to Support Operational Continuity in Resolution

Comments on Consultative Document

Dear Sirs:

The Institute of International Finance and the Global Financial Markets Association (the "Associations") appreciate the opportunity to contribute to the discussion of the captioned Consultative Document and look forward to further exchanges with the Financial Stability Board on this important topic.

General comments

The Consultative Document provides helpful commentary on the issues of operational continuity. The comments developed here are intended to add constructively to an already good discussion. It is especially noteworthy that the Consultative Document reviews impartially the three different models of provision of operational continuity, recognizing that any of them, or a combination, may be appropriate depending on the business model and preferred resolution strategy of a given firm.

The discussion in the Consultative Document largely focuses on the needs of *banks* in resolution. Further consultation should be had with respect to the specific needs of other types of G-SIFIs. The comments below are also written primarily with banks in mind, although there will be broader applicability in some cases.

We note the lack of reference to CMGs or colleges: good and close regulatory coordination will be necessary to create operational continuity measures that are available in the (remote) case of need but do not create undue burdens on banks in business-as-usual (BAU) conditions. This is especially important at a time when very substantial reform has been achieved and firms are working hard to meet capital and liquidity requirements while achieving the necessary level of profitability to provide credit to society on a sustainable basis.

Furthermore, we note the lack of reference to involving firms in ensuring operational continuity in resolution. In order for resolution firms to be workable and credible, the resolution planning process should include iterative communication between the resolution authorities and the firms. This is especially true for the parts of resolution planning that require very specific consideration of details important for operational continuity.

The FSB should take a leading role in obtaining regulators' and resolution authorities' undertakings of cooperation on as strong a basis as possible, even if full legal commitment is found not to be achievable.

It is important to stress that operational continuity planning should focus on each firm's resolution strategy, and reflect insofar as possible its operating model. This is not only the sound approach but is important to the conservation of scarce resources. Each firm should concentrate on assuring that its strategy will work; resources are better employed in developing detailed plans in relation to the strategies or options which are most likely to be adopted and make sense for its business model. Diversion of resources to work on alternatives that are unfeasible or unlikely unnecessarily damages the common objective of making sure a firm is resolvable.

The Associations join the FSB in recognizing the need for sufficient financial resources for service companies to cover their costs during resolution. Planning for such costs should be in line with the needs foreseen in the firm's resolution plan. Such planning should not burden the group with disproportionate costs during BAU.

In particular, financial planning for prudentially regulated entities should take fully into account the fact that additional financial resources will often not be required beyond the capital and liquidity that will be generated through bail-in and the liquidity resources available to a recapitalized, solvent bank after resolution.

While thought should be given to post-stabilization restructuring, it should be recognized that post-stabilization restructuring is not likely to be fully predictable, so highly granular planning for that phase should not be expected; rather, planning should make sure the preferred strategy can be carried out in stabilization, to provide a sound grounding for subsequent restructuring on a basis that is as close to optimal as possible given circumstances at the time. The requirement to allocate sufficient resources should thus be appropriately limited in time. The post-stabilization firm will have different needs and will discontinue some activities or, more importantly, continue activities that will generate cash flows.

The industry notes the criticality of FMI access and looks forward to working with the FSB to develop further considerations on continued access to critical FMI functions, which are stated to be out of scope of the current Consultative Document.

At paragraph 2.10, it is noted that there could be tensions between BAU operational continuity and continuity in resolution. In general, of course, it is for management to decide, subject to supervisory review, the appropriate allocation of the firm's resources. This should extend

insofar as possible to the balancing of resources allocated to BAU and resolution planning objectives.

In particular, the point about "operating discrete IT systems" may run at odds with the imperatives of Basel 239 on Risk Data Aggregation, AML, and other regulatory requirements. The establishment and maintenance of separate MIS would be a substantial operational challenge, which would be likely to result in duplication of existing infrastructures with little practical benefit. Therefore, prescriptive requirements should be avoided.

There is also potential for disagreement between the requirements of conduct supervisors, of prudential supervisors and of resolution authorities, each of whom may have different views as to the structure of IT, control and reporting systems. It is therefore likely to be necessary to provide for a common approach between these different authorities to requirements in respect of IT systems.

Paragraph 2.11 is important. Reasonable time and discussion to reach appropriate balances between conflicting needs will be required to make all these complex requirements work out efficiently and effectively and without unduly impairing the industry's operations or ability to support the real economy in normal times. Adverse impacts on firms' going-concern capabilities need to be taken into account to reach balanced and proportionate resolution solutions. In this regard, it will often be difficult to look at resolution functions in the abstract; the analysis will need to be done in conjunction with analysis of going-concern needs, including operational continuity planning.

Consideration should be given to the current level of granularity of the Guidance. While all the issues raised are worthy of consideration, the real question is whether the firm can explain to its regulators and resolution authorities how, in light of its resolution strategy and planning, the arrangements made will be sufficient to get through the stabilization phase, without having to foresee all conceivable options or make indefinite projections into the future.

To reduce the risk of cross-border firms' having to comply with different requirements having the same operational continuity objectives under a group resolution plan, the final Guidance should provide that host authorities should consider requirements defined by the home resolution authority, and not impose additional or contradictory requirements, except if strictly necessary to achieve important host continuity goals. Home authorities, working with CMGs where relevant, should take due notice of the needs of host authorities.

The following comments refer to the FSB's set questions.

1. **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**?

The three service delivery models described in Section 3 represent the approaches that can currently be observed in the industry. As firms may in fact use a combination or adaptation of the

different models, it is important that the final Guidance should not limit the choice of service delivery model, but remain as neutral as possible as to the solutions that firms may elect.

It is appropriate that paragraph 3.4 stresses the importance of reflecting the firm's resolution strategy and operating model, as discussed in the general comments above. Thus, paragraph 3.2, last sentence, the obligation of additional analysis of resolution strategies, should be refocused on the adopted strategy and related service delivery models; it should not be necessary to explore other resolution scenarios in any kind of detail.

It should be recognized that post-stabilization restructuring is not likely to be fully predictable, so highly granular planning for that phase should not be expected; rather, planning should focus on the preferred strategy in the stabilization phase, to provide a sound grounding for restructuring to be designed to be as close to optimal as possible given circumstances at the time.

In paragraph 3.7 it seems odd that the role of the CMG in assisting removal of obstacles or ambiguities has not been mentioned. None of the difficulties mentioned should be insurmountable just because of acting on a cross-border basis; rather, good planning, cooperation among authorities that are members of the CMG and other relevant host authorities, and appropriate contractual arrangements, should be able to manage most of the types of problems that can be anticipated.

Paragraph 3.10 seems to confuse legal enforceability with prudential oversight. Legal enforceability of continuing SLAs that become binding under resolution circumstances is obviously necessary and will be achievable by normal contractual means in many cases; to the extent the resolution authority steps into the shoes of the firm, it should be able to succeed to enforce the legal rights of the firm. This is different from the question of whether the host country recognizes fundamental resolution actions. With respect to recognition of resolution, the industry hopes that the FSB will continue to pursue clarification of cross-border resolution issues among the major markets and other jurisdictions over time.

Paragraph 3.11 is correct in citing the need for sufficient financial resources for service companies to cover their costs during resolution. As discussed above, planning for such costs should be in line with the needs foreseen in the firm's resolution plan, including downsizing if figured in the plan. Importantly, the obligation to allocate sufficient resources should be appropriately bounded in time. The post-restructuring firm will have different needs and will discontinue activities or, more importantly, continue activities that will generate cash flows. Such planning should not burden the group with disproportionate costs during BAU. See also the comments on paragraphs 4.4(iii) and 4.4(v).

Regarding paragraphs 3.14 and 4.4(iv), it is important to note that, even if the resolution authority has limited or no powers of its own that it can exercise as a matter of legal imperative, it may be able to exercise contractual rights on behalf of the original firm or its successor if SLAs are drawn properly.

Similarly, paragraph 3.15 should recognize that most joint-venture questions should be solvable by appropriate joint-venture documentation in the future, although some time will need to be allowed for the renegotiation of existing joint-venture arrangements.

2. **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?**

In paragraph 4.2, it should be recognized that the two stages of resolution are not the same. Whereas specific planning for the critical stabilization period needs to be detailed and focused, the restructuring period is likely to be much more fluid and open-ended, and unpredictable as to duration; therefore operational continuity planning for the restructuring period should be more flexible and less granular; it should also be proportionate and aim at allowing sufficient time for a good start on the restructuring process, without covering in detail the entire possible length of any possible restructuring process.

Referring to paragraph 4.4(ii): while good and appropriate MIS is clearly essential, the goal should be appropriate outcomes in a resolution; whether a searchable centralized repository is necessary depends on the firm's facts and circumstances and should be determined by the home regulator and resolution authority.

Importantly, sufficiency of financial resources as discussed in paragraph 4.1(iii) (and as already discussed with respect to paragraph 3.11 above) should be determined on the basis of the firm's resolution strategy and plan. It cannot be stressed enough that the stabilization and restructuring periods are different. Paragraph 4.4(iii) should refer *only* to the stabilization phase. If it is judged necessary to refer to the restructuring phase, clear boundaries need to be put around the expectations if the Guidance is to be at all helpful or workable. It is neither reasonable nor feasible to devise an open-ended requirement for foreseeing financial resources in the restructuring phase. Available resources for the restructuring phase will, after the initial stages, depend on how the restructuring proceeds, what choices are made, and what priorities are established. To an increasing extent, resources will be generated out of the entity as it restructures and continues to operate essential functions, especially if the restructuring phase is protracted; thus sufficiency of resources determinations should recognize this fact.

Paragraph 4.4(iv): The requirement that "the cost structure for services should not be directly or indirectly influenced by the financial performance of the service recipient" is too limiting and rigid. Normal contractual negotiation may appropriately relate fees to such factors; moreover negotiations may indicate that additional compensation would be appropriate in resolution circumstances, given the risks and adjustments that are likely to be required of the service provider. The test should therefore be that any such fee arrangements should be proportionate and that financial planning should allow them to be met. There is no benefit to any other restrictions on the contractual arrangements that can be made.

Paragraph 4.4(v): Again, it should not be necessary to plan for an indefinite restructuring phase, but for a sufficient period to allow for restructuring decisions to be taken in an orderly way and

the restructuring to be begun, with retention decisions after that being dictated by the course of restructuring and the needs and resources of the entity in restructuring.

Paragraph 4.4(vi): The requirement of "own governance structures" where services are provided by divisions is vague but if taken literally seems too rigid; normal firm governance and risk management procedures should take cognizance of the need to provide "critical shared services" as part of the function. Adding corporate governance requirements risks complicating BAU governance and generating bureaucratic burdens that should not be necessary.

In paragraph 4.4(vi): it is also not clear why critical shared services should not rely on staff from business lines that may be wound down if planning could involve their transfer to the service-providing entity. It should be sufficient to foresee arrangements for the transfer of such personnel, with continuation of adequately attractive salary and benefits.

Paragraph 4.4(vii): Once again, access to IT and other services during the restructuring period should be reasonably designed to get restructuring under way, but should not be required to cover absolutely any restructuring period, the term of which may not be foreseeable, and should allow for revision and renegotiation in restructuring. Transitional Service Agreements may or may not be required, depending on the circumstances.

Paragraph 4.6(i): should make clearer that arrangements to facilitate post-resolution restructuring should not be expected to foresee specific restructuring approaches in any detail, but should simply be flexible enough not to impede restructuring decisions that may be taken on the basis provided by the firm's resolution strategy and plan.

Paragraph 4.6(ii): See paragraph 4.4(iv).

Paragraph 4.6(v): Firms should be allowed a reasonable period (perhaps two years depending on the facts and circumstances) to renegotiate existing external SLAs to make the provisions required. This should not be a requirement where the law of the contract would not permit early termination for resolution (provided payments continue to be made), as in the EU.

Paragraph 4.8: The provision that "options for divestment should be contemplated under any resolution strategy …" seems to intrude into the definition of such strategies by firms and their resolution authorities. The operational-continuity guidance should be that the authorities should consider whether such options are necessary, not dictate that they always be provided for, given the considerable analysis and legal work that may be required. Furthermore, reference to the SPE model in paragraph 4.8 does not take sufficiently into account the flexibility of SPE strategies and firms' ability to restructure within the overall SPE group structure. Therefore, the SPE reference would better be omitted from this paragraph.

Paragraph 4.9: While there may be additional challenges in cross-border resolutions, this need not and should not be the case. The industry proposes to work with the FSB on improving cross-border resolution understandings, procedures, and provisions to minimize such problems.

3. 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?

The industry agrees with the goal that the final Guidance should be strategy-neutral, and also neutral as to service-delivery models, allowing development of operational continuity plans that would be fully compatible with the preferred strategy and business model of each firm.

We also note with approval the statement in paragraph 1.4 that there is no presumption that firms should adopt one or another service-delivery model. Similarly, paragraph 2.6 should not be prescriptive: facilitation of (further) separation may or may not make sense in light of the resolution strategy of a particular group. There will be many circumstances where there is no need to foresee separation, given the nature of the firm's strategy or the envisioned continuation of essential services; of course, there will also be other circumstances where it will be clear to home regulators and resolution authorities that separation should be planned upon. That determination should be left to the firm and its regulators and resolution authorities.

4. 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?

See the responses to question 2. As described, some of the proposed arrangements may prove challenging and difficult to implement.

There are likely to be particular challenges regarding contractual arrangements with third-party service providers, which usually cannot be changed or amended unilaterally. Contracting parties may not be inclined to change the essentials of contracts if not in their own economic interest; demand compensation for changes; or use the regulatory imperative to obtain changes as an opportunity to renegotiate existing terms.

In considering external-provider issues, it should be noted that banks are in important cases likely to need to resort to greater use of shared service providers, infrastructure entities, or industry utilities (a) to cope with certain regulatory challenges, such as AML-CTF or sanctions compliance, and (b) to use the efficiencies of shared services or utilities to respond to the competitive challenges of rapid technological change and new competitive challenges. While rapid change in the market does not obviate concerns about operational continuity, regulatory flexibility may be necessary to enable banks to respond efficiently and effectively and even, in some cases, for banks to stay relevant to important customer segments.

In any case, a reasonable amount of time will be required to bring third-party arrangements in line with the requirements.

5. **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 discussed above, the complexities of joint ventures should be manageable by appropriate contractual provisions. The main issue will be to allow time for firms to adjust their BAU joint venture agreements for joint venture entities that are material to operational continuity under the firm's strategy to meet these requirements. Non-material joint-ventures of course need not be affected.

6. **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?**

No further measures are required.

7. **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?**

Many of the issues both with respect to foreign service providers and non-regulated service providers can be accommodated, certainly over time, by appropriate contractual provisions.

In order to maintain the flexibility, it is important that the final Guidance does not impose restrictions on the location or domicile of service providers. Any issues should be analyzed specifically and should be addressed by the individual bank's relevant resolution authorities.

8. **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?**

Overall, the categories of information apply to both generic strategies, but in actual practice will need to be adapted to the needs of the firm's specific strategy and resolution planning. Depending on the strategy and planning, it may or may not be necessary to have specific types of information available at the group level.

Certain modifications should be made to the information requirements:

- Paragraph 1 of the Annex implies that the criticality of staff should be identified at the employee level, which would be excessively granular and subject to frequent change. Firms should be able to identify staff needs by roles or functions much more efficiently and effectively.

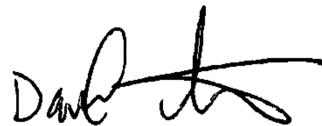
- The requirement in paragraph 2.2(a) of the Annex for *audited* balance sheets, income statements and cash flows would be onerous to impose at the level of service companies. The audit requirement should be omitted. Only a few material entities within a G-SIFI would normally have externally audited financial statements, while the current wording would appear to require audits of financially insignificant service companies.
- The reference to "working capital" in paragraph 2.2(b) of the Annex should be deleted as that is not a defined financial metric. References to liquidity, capital, and cash flows would suffice.
- Paragraph 2.2(b) is also problematic in that it requires analysis of liquidity under severe stress conditions, which seems highly prescriptive and would require analysis beyond preferred resolution strategies. As noted at several points above, the liquidity analysis in service companies should be based on the firm's resolution strategy, not all conceivable options.
- In paragraph 2.2(c) of the Annex, the word "liquidity" should be inserted before "reserves" as the latter term is too generic and imprecisely defined.

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

Guidance and, to assure a level playing field, internationally consistent implementation will be important. As a result, it would be helpful if the FSB would identify principles for relevant authorities to implement the Guidance.

In conclusion, the Associations hope that these comments will contribute constructively to the finalization of the Guidance. They would be pleased to answer any questions, and stand ready with their members to consult further with the FSB if that would be helpful. Please contact David Schraa (dschraa@iif.com) or Oliver Moullin (oliver.moullin@afme.eu).

Very truly yours,



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APPENDIX: Description of the Signatory Associations

GFMA

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit http://www.gfma.org.

IIF

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