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September 2, 2011

The Honorable Mario Draghi
Chairman of the *Financial Stability Board*

Governor of *Banca d'Italia*
Via Nazionale, 91
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By electronic submission to: fsb@bis.org

IIF comments on the FSB Consultative Document: "Effective Resolution of Systemically Important Financial Institutions"

Dear Governor Draghi:

The Institute of International Finance (IIF) is pleased to respond to the Consultative Document on "*Effective Resolution of Systemically Important Financial Institutions*" published by the Financial Stability Board (FSB) on July 19, 2011. The Institute appreciates the opportunity to provide its comments and hopes that they will form a useful input to the deliberations of the Financial Stability Board. The response has been prepared by the IIF's Working Group on Cross Border Resolution, which I chair.

The global financial industry fully supports the objectives and appreciates the overall direction of the recommendations of the consultative document. As the Institute has consistently advocated[1], effective resolution is essential to achieving financial stability and addressing moral hazard: major, cross-border institutions that fail should be capable of being resolved without systemic disruption, without unnecessary loss of value, and with absorption of losses by equity holders and unsecured debt holders, while precluding imposition of losses on the state.

We believe that, building on the work to date by the FSB, the G20, national authorities, and the industry, an international framework for the resolution of cross-border financial institutions is well on the way to achievement. Convergence toward credible national regimes, strong coordination among resolution authorities, good institution-specific cooperation agreements, and equitable cross-border outcomes on a non-discriminatory basis, are all significantly advanced by the FSB's work reflected in the consultative document. The industry stands ready to participate in further work and dialogue in order to leverage the insights and solutions of all parties.

[1] The IIF has published the following reports and papers focusing on resolution issues: "*A Global Approach to Resolving Failing Financial Firms: An Industry Perspective*" (May 2010); "*Preserving Value in Failing Firms*" (September 2010); "*Addressing Priority Issues in Cross-Border Resolution*" (May 2011).

As work toward international standards is carried forward, the Institute would like to stress the following points, which are discussed more in detail in attached General Comments and Appendix:

- **Home-host**. The Institute applauds but suggests strengthening the recommendations on the leading role of home authorities. Focusing both pre-crisis processes and in-crisis decision-making in the home authority will be crucial to the ability to act quickly and without systemic disruption.

- **Cross-border Issues.** The Institute endorses the recommendations on international mandates and international coordination and supports institution-specific cooperation agreements. The Institute encourages the G20 to galvanize legislative and regulatory changes to maximize cooperation among jurisdictions, to set milestones for countries to meet as rapidly as possible, and to work toward multilateral agreement that could remove residual vulnerabilities in the international framework.

- **Group focus.** Recovery and resolution planning, cross-border cooperation, and resolution itself should, insofar as possible, be organized on a group basis, with exceptions only on well-defined conditions where structures have been designed for good business reasons for stand-alone funding or substantially solo operation. Ring-fencing of assets, particularly within national boundaries, should be avoided.

- **Bail-in**. The IIF favors the objectives of the FSB's concept of statutory bail-in within resolution and the other options proposed to minimize destruction of value and preserve critical functions.

- **Creditor Hierarchy and Depositor Preference:** Respect for creditor hierarchies is fundamental not only to a credible regime but also to the industry's ability to fund itself.

- However, ***national*** **depositor preference should be avoided** as it complicates equitable cross-border resolution.

- **Maximizing value *for creditors,*** as much as avoiding contagion in the system, should be a principal objective. While shareholders and creditors should shoulder the losses from the failure of any financial institution, the dramatic loss of value that is likely in the liquidation of a financial firm, particularly during a financial crisis, needs to be averted. Clarity about this objective will be a tangible guide for supervisors, and contribute in a direct way to avoid contagion, as well as providing investors the reassurances required for them to continue to provide stable bank funding. It is thus important for the objective of financial stability to be very clear about this objective.

- **RRPs and Assessing Resolvability.** The IIF is in favor of a robust, globally consistent recovery and resolution planning process. It is important for the FSB to clarify the criteria and procedures for assessing systemic impact and the "credibility" of resolvability, in order to ensure confidence, predictability, consistency and the level playing field. Such criteria and procedures should recognize and respect different group structures and business models.

- **Improving Resolvability.** The process of deciding whether a firm's resolvability needs to be improved, and the potential remedies, needs more development, aimed at predictability and international consistency. Where "exogenous" factors are the issue, firms should not be penalized for jurisdictions' failure to make necessary legal or regulatory changes. Decision on "endogenous" issues that may need to be addressed to improve resolvability of specific firms should be decided on the basis of objective criteria and clear procedures with decision taken by home authorities.

- **Firms' participation.** It is important to make clearer provision for the participation of each firm in dialogue with its college and CMG to make sure that issues are fully understood on both sides and decisions are well informed, regarding resolution and recovery plans, identification of systemically important functions, resolvability assessments, and measures to improve resolvability.

- **Third countries.** The G20 and FSB should work with non-G20, non-FSB jurisdictions to encourage them to adopt resolution measures that are consistent with global standards. Non-harmonized regimes add complexity to recovery and resolution planning. Incompatible local laws or ring-fencing of assets may impede resolution and add to systemic risk.

- **Intra-group exposures**. Intra-group credit extensions, guarantees, and transactions may, depending on the firm's business model, be critical not only to the efficient management of cross-border firms, but to risk management. Standards eventually established should recognize the legitimacy of both integrated groups and groups with more independent affiliate structures, and should assess the resolvability implications of each case, without creating prejudices in favor of one or the other.

- **Management information systems (MIS)**. Ambitious goals are set for MIS. Colleges and CMGs should work in a harmonized fashion to make sure that data definitions and requirements are as consistent and coherent as possible**.** There needs to be realism about required investment and build times for risk IT.

- **Stays and termination rights:** While the FSB's discussion builds usefully on past national developments, the fundamental nature of the issues raised needs further international debate; some basic principles are suggested for consideration.

- **Confidentiality.** The consultative documents raise serious issues of confidentiality of recovery and resolution plans and resolution assessments: as discussed in detail, these processes need all the confidentiality protection traditionally allotted to firms' discussions with supervisors. Moreover, clear legal protection of the confidentiality of information shared is essential to meaningful international cooperation among authorities.

- **Insurance industry:** Resolution and other regulatory processes need to be tailored to sectoral differences, reflecting the exposures and liabilities of different sorts of business activities; possible ambiguity on this point should be corrected to avoid any suggestion that the specific proposals of the consultative document should apply to insurance firms, which could obscure the need for sector-specific consideration.

- **Timeline:** The G20 should set a realistic but ambitious timeline, with specific milestones, for needed legislative and regulatory changes**.** Some aspects (e.g. RRPs) of the timeline as it applies to firms are ambitious, especially in those jurisdictions where legislative and regulatory changes have started recently.

In conclusion, the publication of the consultative document is a significant development in achieving the G20's goals; it clarifies many issues, appropriately focuses the discussion and establishes an ambitious roadmap for progress. The Institute and its members are pleased to provide this industry perspective on the many and complex issues involved and stand ready to participate in that discussion in the coming months.

Should you have any questions about these comments, or wish to pursue any issues, please contact David Schraa (dschraa@iif.com; +1 202 857 3312) or Stefano Mazzocchi (smazzocchi@iif.com; + 1 202 857 3309).

Very truly yours,

Urs Rohner

Chairman of *IIF Working Group on Cross-Border Resolution*

Chairman of the Board of Directors, *Credit Suisse Group AG*

cc.

M. François Baroin, Ministre de l'Économie, des Finances et de l'Industrie - French G20 Presidency
M. Hervé de Villeroche, Assistant Secretary – Financial Sector Department, French Treasury
Mr. Timothy F. Geithner, Secretary of the Treasury, U.S. Department of the Treasury
Mr. Paul Tucker, Deputy Governor, Financial Stability, Bank of England
Mr. Stefan Walter, Secretary General, Basel Committee on Banking Supervision
Mr. Andrea Enria, Chairman of the European Banking Authority
Mr. Mario Nava, Acting Director, DG MARKT Financial Institutions, European Commission
Mr. Mauro Grande, Director General Directorate General Financial Stability, ECB
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Mr. Andrew Bailey, Deputy Head of the Prudential Business Unit, UK FSA
Mr. Yoshihiro Kawai, Secretary General, International Association of Insurance Supervisors
Mr. Greg Tanzer, Secretary General, International Organization of Securities Commissions
Mr. José Viñals, Financial Counsellor and Director, Monetary and Capital Markets Department, IMF

Attachment:

General IIF comments on the FSB Consultative Document: "*Effective Resolution of Systemically Important Financial Institutions*"

September 2, 2011

By electronic submission to
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General IIF comments on the FSB Consultative Document: "Effective Resolution of Systemically Important Financial Institutions"

Introduction and Overview

The Institute of International Finance[1] (IIF) **strongly endorses the goals of the consultative document** and welcomes the opportunity to provide comments. As the Institute has argued since it first addressed resolution issues, and as the FSB intends, it is essential that a major, cross-border institution that fails should be capable of being resolved without systemic disruption, without unnecessary loss of value, and with absorption of losses by equity holders and unsecured debt holders, while precluding imposition of losses on the state.

In **previous IIF Reports on cross-border resolution[2], the Institute argued for an international cross-border framework** including: (a) convergence of national regimes to incorporate agreed-upon key features of effective resolution frameworks; (b) enhanced coordination among resolution authorities, including a lead authority approach, based on modified universalism; and (c) equitable cross-border outcomes. **In many ways, this private-sector vision of cross-border cooperation is consistent with the approach that is being recommended by the FSB.**

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[1] The Institute of International Finance, Inc. (IIF) is a global association created in 1983 in response to the international debt crisis. The IIF has evolved to meet the changing needs of the international financial community. The IIF's purpose is to support the financial industry in prudently managing risks, including sovereign risk; in disseminating sound practices and standards; and in advocating regulatory, financial, and economic policies in the broad interest of members and foster global financial stability. Members include most of the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms. Among the IIF's Associate members are multinational corporations, consultancies and law firms, trading companies, export credit agencies, and multilateral agencies. All of the major markets are represented and participation from the leading financial institutions in emerging market countries is also increasing steadily. Today the IIF has more than 400 members headquartered in more than 70 countries.

[2] The IIF has published the following reports and papers focusing on resolution issues: "*Addressing Priority Issues in Cross-Border Resolution*", May 2011 (http://www.iif.com/download.php?id=615ZrRHRb+E=); "*Preserving Value in Failing Firms*", September 2010 (http://www.iif.com/download.php?id=ryVjoux4FSs=); "*A Global Approach to Resolving Failing Financial Firms: An Industry Perspective*", May 2010 (http://www.iif.com/download.php?id=Oq+9y23X4Us=);

A **credible resolution regime in each major market, with robust procedures to assure fairness to claimants in all jurisdictions on a non-discriminatory basis, is essential to the stability and resilience of open, productive global markets.** It is also an indispensable component of an integrated and coherent global regulatory structure as envisioned by the G20, one that appropriately balances safety and soundness with the financial capacity to sustain growth in the global economic system[3]. Successful achievement of these goals will assure the full restoration of market discipline.

The Institute strongly supports **institution-specific cooperation agreements** between relevant home and host authorities, which allow taking into account fully the complexity of specific circumstances of individual groups. Importantly, such agreements clarify the roles and responsibilities of all parties involved, both in the planning and in the resolution phases, and ensure an adequate level of information sharing. Well-designed, institution-specific cooperation agreements, which may initially be on a bilateral basis, can be the means of achieving many of the FSB's goals for resolution while other issues identified in the consultative document are being resolved.

Significant Issues for the Global Industry

The Institute welcomes the recommendations of the consultative document. Overall, the proposals are entirely appropriate and point toward a credible, robust resolution regime for Systemically Important Financial Institutions (SIFIs), and indeed *any* significant financial institutions. The proposals build constructively on progress that has already been made in various countries.

While the overall approach is sound, and much can already be effected via firm-specific bilateral or multilateral agreements among relevant authorities, certain of the points raised need **refinement and development**. Others, such as questions about creditor hierarchies, general depositor preferences, intra-group exposures, cross-defaults, and the like are essentially new issues at the international level, having far-reaching implications that cannot be explored fully in a brief consultative period.

It is, however already clear in considering these new issues that "**national depositor preference"** (as the term is used in the consultative document) **should be avoided as it makes cross-border cooperation and equitable treatment of creditors more difficult.** Therefore, (i) national depositor preference should be eliminated in those jurisdictions where it currently exists, and (ii) should be excluded from further adoption by clear FSB standards.

Therefore, the progress already achieved on national and bilateral bases should be continued, and, in addition, the IIF suggests that the FSB adopt an **iterative approach** on the newer topics, and include in its planning an intensive round of study and debate, colloquia and consultations among public-sector bodies, industry, legal experts, and other stakeholders, before issuing refined

[3] In this respect, please see also the IIF response to the Basel Committee's Consultative Document on "*Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement*", where the IIF argues that credit should be given to banks operating in jurisdictions (or groups of jurisdictions) that have in place laws that establish clear recovery and resolution frameworks and require banks to have sound and adequate recovery and resolution plans. The IIF response is available here: http://www.iif.com/download.php?id=82XdpBP6pBY=

recommendations on the open issues. Perhaps the best approach to assure adequate ventilation of the issues while avoiding undue delay would be for the FSB to agree the broad outlines of the resolution regime, reserving the remaining points to be completed within that framework by appropriate working groups, in consultation with the industry and other stakeholders.

The following summarizes some of the points that still need attention and debate, within the very sound overall structure that the FSB has suggested. More discussion of these points, with reference to specific parts of the consultative document may be found in the Appendix[4].

- **Home-host issues**. The Institute applauds the recommendations on the **leading role of home authorities**. Focusing both pre-crisis processes and in-crisis decision-making in the home authority will be crucial to the ability to act quickly and without systemic disruption. However, some parts of the document would require a clarification of this home country leading role. For example, clearer guidelines are necessary to define in which cases host resolution authorities may maintain their own, detailed resolution plans for parts of the firm that are active in their jurisdictions.

- **Cross-border Issues.** The Institute endorses the recommendations on international mandates and international coordination. It particularly welcomes the recognition that it will be **possible to proceed expeditiously and effectively with firm-specific agreements,** which can achieve a great deal, especially for jurisdictions that have already begun adjusting their regimes. However, the recommendations do not go far enough to recognize the need for the **G20 to galvanize international action** (a) to set milestones for countries to enact as rapidly as possible the legislative and regulatory changes necessary to maximize cooperation among jurisdictions, and (b) to take advantage of the current focus on resolution issues to proceed expeditiously toward a formal multilateral agreement to remove remaining ambiguities and potential conflicts. The challenges are considerable but they should not be thought insurmountable. The remarkable progress promoted by the G20 and the FSB since the crisis demonstrates that strong leadership, global coordination and political can bring about fundamental change.

- **Group focus.** Recovery and resolution planning, cross-border cooperation, and resolution itself should, insofar as possible, be **organized on a group basis**, for efficiency for both firms and authorities in the pre-crisis phases, and to maximize conservation of value, assurance of critical functions, and non-disruption of markets in case of an actual resolution. Exceptions to the general group focus should be made only on well-defined conditions where structures have been designed for good business reasons for stand-alone funding or substantially solo operation. **Ring-fencing of assets, particularly within national boundaries,** that is not strictly necessary within such exceptions **should be avoided**.

[4] In addition to the comments set out here and in the appendix, the Institute has joined in developing high-level comments submitted jointly with The Global Financial Markets Association, The Clearing House Association, the American Bankers Association, the Financial Services Roundtable, and the Institute of International Bankers. While the comments here give the Institute's international, cross-sectoral perspective in somewhat more detail, the thematic comments of the joint submission are fully supported by the IIF and should be useful to the FSB in taking this central issue to the next stages.

- **Bail-in**. The IIF favors the FSB's concept of statutory bail-in within resolution and other options proposed to minimize the destruction of value and to preserve systemically important functions and businesses. Bail-in should extend across the entire capital structure, including existing debt. The IIF welcomes the fact that the proposal envisions bail-in of senior debt on a basis similar to that proposed in the most recent IIF report on resolution, with clearly established respect for the creditor hierarchy and the principle that no creditor should be worse off than it would have been in liquidation.[5] This will help ensure that the credit hierarchy is respected. Clear provisions for expedited judicial review of bail-in decisions will help to create confidence, but must be designed to permit resolution on the very rapid basis envisioned by the FSB.

- **Creditor Hierarchy and Depositor Preference: Respect for creditor hierarchies is fundamental** not only to a credible regime but also to the industry's ability to fund itself. These are issues on which the debate on the need for international convergence has barely begun. Clearly, more than the brief consultative period allowed for the present document is required.

- **"National depositor preference" is not helpful and should be excluded**: Some firms are strongly opposed to the principle of *general* depositor preference, while others are more supportive or are still formulating positions on that issue; hence the importance of further debate. All agree, however, that *national* depositor preference is unfair and complicates needed solutions.

- **Avoiding Unnecessary Loss of Value: Maximizing value for creditors** should be a principal objective as defined by the FSB. While shareholders and creditors should shoulder the losses from the failure of any financial institution, not the state, a well-crafted international resolution regime with a strong bail-in option should not only focus on preserving essential functions and avoiding systemic disruption but should also emphasize the closely linked objective of avoiding the dramatic destruction of value that is likely in the liquidation of a financial firm.[6] The FSB should stress explicitly that one of the goals of orderly resolution is maximization of value for creditors. Avoiding contagion requires a clear and predictable resolution process that maximizes value for a firm's counterparties and creditors and is part of avoiding contagion. Creditors of financial institutions are generally institutional investors such as insurance companies and pension funds. They have a duty to help impose market discipline, but clarity about the intent to avoid unnecessary loss of value to such investors would provide the reassurance required for a stable and deep market for bank funding in the future. It would also help mitigate political pressures for bail-out that could arise.

- **Avoiding Unnecessary Loss of Value: Keeping Options Open.** The consultative document appears to recognize (e.g. in discussing resolution tools at page 9) that optimal, value-maximizing outcomes may be achieved by **resolution of the institution as a whole**, but other portions of the document suggest presumption of break-up solutions. Whole-

[5] "*Addressing Priority Issues in Cross-Border Resolution*" (May 2011), IIF; par. 103-105.
[6] For a discussion on what might account for the precipitous loss of value occurring when a firm crosses the liquidation threshold, please see: IIF, "*Preserving Value in Failing Firms*", September 2010, pages 9-11 (http://www.iif.com/download.php?id=ryVjoux4FSs=);

firm recapitalizations should clearly be an option available to the resolution authorities and may in some crisis situations be the most effective way to avoid fire-sale liquidation and damage to markets. Consistent balance in presenting solutions, including whole-firm solutions, would be helpful.

- **RRPs and Assessing Resolvability.** The Institute is in favor of a robust, globally consistent recovery and resolution planning process; however the proposed criteria for assessing systemic impact and the "credibility" of resolvability are vague, raising concerns about confidence, predictability, consistency and the level playing field. **Objective criteria and clear procedures are essential**. Such criteria and procedures should be designed to recognize and respect different group structures and business models. It should be clear that it is sufficient for a firm to establish the credibility of **one plan** among the various options for resolution (and recovery) and that it would be highly inefficient to require firms to develop multiple scenarios. Further guidance on the definition of "**systemically critical financial services and functions**" is also needed, along the lines previously suggested by the IIF. The identification of critical functions should be based on clear, objective and consistent criteria, and analyzed jointly by a firm and its CMG. Robust protection of the confidentiality of RRPs will be an essential prerequisite to making them meaningful and useful. Finally, the final FSB document should give clear recognition to the fact that prevention is better than cure and that to reduce the probability of entering the resolution phase, **enhanced going-concern supervision and market-led solutions will always be the preferred route** in case of any issues with a given firm, rather than allowing resolution issues to drive solutions.

- **"Improving Resolvability".** The process of deciding whether a firm's resolvability needs to be improved, and the potential remedies, need considerably more development, aimed at **predictability and international consistency**. Where "exogenous" resolvability seems to be deficient, firms should not be penalized for jurisdictions' failure to make necessary legal or regulatory changes. Decision on "endogenous" issues that may need to be addressed to improve resolvability of specific firms should be decided in careful dialogue on the basis of **objective criteria and clear procedures** between the firm and its crisis management group (CMG) and college of supervisors, with decision taken by home authorities.

- **Firms' participation.** It is important to make clearer provision for the participation of each firm in dialogue with its college and CMG to make sure that issues are fully understood on both sides and decisions are well informed, regarding resolution and recovery plans, resolvability assessments, and decisions on measures to improve resolvability.

- **Third countries.** The G20 and FSB should make simultaneous efforts to encourage **non-G20, non-FSB jurisdictions** to adopt resolution measures that are consistent with global standards. Non-harmonized regimes would add complexity to recovery and resolution planning and incompatible local laws or ring-fencing of assets may in fact impede resolution of a global group and add to systemic risk.

- **Intra-group exposures**. Depending on the business model, intra-group credit extensions, guarantees, and transactions are critical not only to the efficient management of cross-border firms, but to risk management. Restricting management decisions on appropriate group exposures, given a group's business model, may reduce going-concern resilience and in some cases outweigh the theoretical benefit of reduced complexity of resolution, therefore increasing net systemic risk. It could also hinder group resolution, or create resolution problems in specific units of a group. On the other hand, where the legal structure and business model of the group provide for substantial financial autonomy of a subsidiary, provision of intra-group financial support should not be mandatory. Standards eventually established should recognize the **legitimacy of both integrated groups and groups with more independent affiliate structures**, and should not create prejudices in favor of one or the other. This is one of the areas where much more work and dialogue is needed before reasonable standards that limit risk without unduly abridging the efficiency international groups bring to the global financial system can be defined. There is a **danger of doing damage to useful business-as-usual techniques without commensurate benefits**.

- **Management information systems (MIS)**. Ambitious goals are set for MIS and information provision; these need to be made consistent with the requirements of supervisors and the recommendations of the Senior Supervisors Group. MIS is an area where it is important that colleges and CMGs work in a harmonized fashion to make sure that **data definitions and requirements are as consistent and coherent as possible.** Lack of consistent regulatory requirements complicates the task of building coherent, effective, reliable MIS, and inconsistencies add cost and risk. There needs to be **realism about required investment and build times** for risk IT, as discussed in the recent IIF report on that topic.[7]

- **Stays and termination rights:** While the international debate builds usefully on past national debates the fundamental nature of the issues raised again needs to be fleshed out in the next phase of a constructive iterative process.

- **Confidentiality.** The consultative documents raise serious issues of confidentiality of resolution and recovery plans and resolution assessments: as discussed in detail, these processes need all the confidentiality protection traditionally allotted to firms' discussions with supervisors. Moreover, clear legal protection of the confidentiality of information shared is essential to meaningful international cooperation among authorities.

- **Timeline:** The G20 should set an ambitious but realistic **timeline with specific milestones for needed legislative and regulatory changes.** The timeline **as it applies to firms,** especially the December 2011 target for recovery plans, **seems particularly ambitious** in those jurisdictions that have started the process recently. At the least it should be modified to avoid penalizing firms in instances where legislative and regulatory changes are not made as promptly as urgency of the FSB's recommendations would require, and to recognize the exigencies of adapting MIS, as noted above.

[7] IIF and McKinsey & Company, "*Risk IT and Operations: Strengthening Capabilities*", June 2011.

Important points for clarification

The consultative document focuses on planning for resolution and events that would take place in resolution; however, it largely **overlooks the vital "next day" issues** of getting back to normal, post-resolution. It does note that "super-senior" post-resolution funding to an institution in resolution may often be appropriate (*paragraph 11.1 of Annex 2)*, but does so only in a tentative way. Similarly, it acknowledges, at *paragraph 6.5 of Annex 1* that a post-resolution going concern may appropriately be eligible for normal central-bank liquidity facilities. While these concepts are well-established in some countries, they may need more attention in others. The FSB calls for additional study of super-senior post-resolution financing, with some sense of discomfort about existing hierarchies. While study and discussion are certainly important, the FSB would be doing a great service if it would acknowledge and provide guidance on these techniques, which are essential for avoidance of damage to the system, as well as for the orderly recovery of continued operations or entities.

While in principle the consultative document covers all SIFIs, it recognizes that the **application of bank-type tools to insurers would generally be inappropriate**. The FSB is understood to be working with CPSS, IAIS, and IOSCO to develop sector-specific guidance for non-bank SIFIS. The reference to insurance resolution at *paragraph 4.1(iv) of Annex 1* is too brief to be meaningful. It could be misinterpreted as setting final standards on the issue. A much preferable approach would be to delete such reference and allow for insurance-specific guidance to be developed by the FSB taking into account the specificities of the insurance business model and specific resolution issues of insurance businesses.

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In **conclusion,** the consultative document is a significant development in achieving the G20's goals; it clarifies many issues and appropriately focuses the discussion. The Institute and its members stand ready to participate in that discussion in the coming months.

Appendix

This appendix provides further observations by the IIF Cross Border Resolution Working Group on the FSB's Consultative Document: "Effective Resolution of Systemically Important Financial Institutions", supplementing the general IIF comments to which it is attached.

I. Proposed Policy Recommendations and Annex 1—Key Attributes of Effective Resolution Regimes

Questions for public consultation

1. Comment is invited on whether Annex 1: Key Attributes of Effective Resolution Regimes appropriately covers the attributes that all jurisdictions' resolution regimes and the tools available under those regimes should have.

2. Is the overarching framework provided by Annex 1: Key Attributes of Effective Resolution specific enough, yet flexible enough to cover the differing circumstances of different types of jurisdictions and financial institutions?

The **IIF concurs with the analysis and welcomes the overall policy recommendations** on special national regimes for resolution of financial institutions, with special attention to the issues of institutions active in multiple jurisdictions.[8] It is particularly important to focus on the relevant authorities' having a sound legal basis for using the recommended powers and tools with the necessary speed to prevent financial crisis from spreading. One of the most significant achievements of the G20 would be to establish a clear, credible, well-grounded and workable international standard on resolution. This is essential to address the lack of mutual recognition properly recognized as one of the major impediments to effective resolution today. Given the importance of resolution as a component of the future regulatory regime, global consistency and coordination will also be essential to maintaining a level playing field both in terms of regulatory requirements on firms and in terms of their positioning in the market

As the FSB recognizes, it is **vitally important to give relevant authorities legal mandates or statutory objectives necessary to make possible cross-border cooperation** and effective pre-resolution planning, as well as the legal capacity to cooperate and coordinate effectively with foreign authorities in a crisis. As will be reiterated with respect to other provisions below, it will be especially important for authorities to have clear powers to share confidential information and protect its confidentiality.

The **industry is in favor of a group approach to resolution** insofar as possible, and therefore endorses identifying the home as the "group resolution authority" to coordinate resolutions, not only within specific jurisdictions but across the group.

It should be made clearer that the principles of the consultative document apply to **holding companies,** subject to the comments in the separate box on insurance issues.

[8] These recommendations are broadly consistent with prior IIF publications; please see footnote 2 for more details on previous IIF work.

As discussed further with respect to cross-border cooperation below, **the industry urges the G20 and the FSB to set clear milestones to make sure that all relevant jurisdictions deliver the necessary legislative and regulatory changes as rapidly as possible**. Rapid change is essential to minimize burdens on the credit-generation capacity of the industry from the resolution measures envisioned here, and to foster market discipline on the basis of clear understandings of risks and exposures.

While resolution of cross-border firms may often be effected on the basis of sound bilateral and multilateral firm-specific agreements, the G20 should also take advantage of the current focus on resolution issues to **proceed expeditiously toward a formal multilateral agreement to remove remaining ambiguities and potential conflicts** and assure that such agreements are possible in each instance. Many have noted that, without such strong leadership by the G20, the ambiguities and tensions that remain apparent in the consultative document are not likely to be resolved.

Box 1 - Group approach: Many of the Institute's comments are informed by the belief that a group approach will yield the best overall results for the "pre-crisis" conduct of business, for claimants on a failing firm's assets, for stability, and for the avoidance of moral hazard. Integrated cross-border banking groups function in the majority of cases as integrated economic units, with positive stabilization effects of internal capital markets within such groups. More decentralized groups are managed somewhat differently using more unit-focused finance, but with centralized standards and controls that contribute to stability. For planning purposes, a group approach is essential to manageability and efficiency for firms, supervisors and CMGs alike. The group approach needs to take into account the business and financial design of the group. For many good reasons, group structures vary from wholly integrated structures to those built around substantially stand-alone entities that operate on a coordinated but partially independent basis. While resolution planning and execution must always be designed around the group, differences in structure will indicate different approaches to resolution issues.

As the resolution stage is approached, businesses, branches, or subsidiaries may be disposed of in accordance with the group's recovery plans, but once the stage of "bail-in within resolution" is reached, the group should insofar as possible be treated as a whole, except where the group's structure and planning indicate otherwise. Branches should be treated entirely on the group basis, managed by the home authorities, with procedures established to provide assurances to host regulators that their constituents' interests will be protected on a non-discriminatory basis, compared to other global claimants, consistently with the overall scheme contemplated by the FSB.

Wholly owned subsidiaries, especially those functionally integrated into the operations of the group as a whole, should insofar as possible be managed as part of the group for resolution purposes, and thus primarily under the purview of the home authority. The direct claims of creditors on such subsidiaries must of course be respected in accordance with the principle of existing hierarchies, and the legitimate financial-stability concerns of host regulators need to be well-accommodated in the resolution process. A primary goal of group-focused resolution would be avoiding ring-fencing of assets except as strictly necessary to protect direct creditors, especially secured creditors. As a general matter, this would apply to non-bank financial firms that are integrated subsidiaries, except as stated below. Similarly, substantive consolidation or asset pooling for subsidiaries may or may not be appropriate under the circumstances of a given resolution and applicable law, and raise issues that need careful consideration both in the resolution-planning process and in time of resolution itself. Nonetheless, the resolution of subsidiaries should generally be organized and managed as part of the group process under the auspices of the group's home authority. It should be made possible to organize integrated group resolution around the concept of "group interest".[9] To complete the picture, FSB's recommendations should include guidance on additional techniques appropriate to resolution of many integrated subsidiaries, such as exchanges via swaps into parent equity.[10] See the discussion of *Annex 2* below.

For groups with subsidiaries that are partially owned or operated on a stand-alone basis, especially those that are publicly listed, other, specific approaches may be more appropriate. Insurance subsidiaries of financial groups, if insolvent, would need to be subject to the special insolvency measures appropriate to insurance undertakings (see the separate box on insurance). Although such subsidiaries may be subject to resolution separately from resolution of the group, any resolution of such subsidiaries by a host authority should be closely coordinated with the home authority, especially if simultaneous resolution processes are going on. Subsidiaries operated on a stand-alone basis by the group may either be resolved if they fail while the group as a whole continues as a going concern, or they may continue as going concerns without resolution if they remain viable and continue to be able to fund themselves despite the wide failure of the group. For this reason, and as discussed further with respect to intra-group exposures, there should be no a-priori presumption of group support for such subsidiaries, where management has designed the group structure accordingly, in accordance with the complex array of business, financial, operational and regulatory considerations that drive such planning.

In resolution, one option will be a sale or transfer to a bridge of significant subsidiaries or businesses (or even branches), or of the firm as a whole, presumably once bail-in has been accomplished, as the FSB envisions. A group approach in no way precludes such an option, but would require focus on the group as whole in taking decisions on the disposition of any unit of a group, however organized.

Finally, it is important to emphasize that group structures reflect many different financial, management and risk-management considerations and strategic decisions. As discussed further in parts IV and VI of this discussion, resolution issues should not purport to dictate going-concern structures.

Specific Points on Annex 1

The "Key attributes" identified in Annex 1 are generally quite comprehensive, but set a challenging standard for lawmakers and regulators, as well as (implicitly) for the industry. Once again, meeting this standard will require a clear mandate and strong impetus from the G20 and concerted, ongoing attention by the FSB.

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[9] For a fuller discussion, see paragraphs 131ff of the IIF's report, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011.
[10] See IIF, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011, par. 109.

The stated **objectives of an effective resolution regime are appropriate** and coincide with industry thinking. It is of critical importance that non-viable firms be in a position to exit the market in an orderly way, that there be means to ensure continuity of critical services and functions, that incentives for market discipline and market-bases solutions be created, and that there be a clear basis for international cooperation.

Two points of general import are in order, however.

First, one of the most important features of a strong, internationally coordinated resolution regime is to avoid unnecessary destruction of value. But it is important to stress that this is not only to minimize the costs of resolution in any country and to avoid "fire-sale" destruction of asset values in the market, important though those goals may be. Subject to the basic principle that shareholders and unsecured creditors should bear ultimate losses, it should also be stated by the FSB that an important goal is to **maximize recovery of value for the benefit of creditors**, as part of avoiding contagion in the system, consistently with the objective of avoiding the need for state resources and of averting systemic disruption. Clarity about this objective is important to provide a clear principle on which resolution authorities should act. Creditors of financial institutions - generally institutional investors such as insurance companies and pension funds - have a duty to help impose market discipline, but clear and predictable resolution process that maximizes value for a firm's counterparties and creditors would provide the reassurances required for a stable and deep market for bank funding in the future, which is essential for recovery and financial stability.

In short, stating in the mandates of resolution authorities a duty to maximize value for creditors, as well as to foster stability and remove moral hazard, would be helpful to creating confidence and reducing incentives of creditors throughout the system to run when difficulties threaten.

Second, it would be useful to have a **definition of "resolution" as used by the FSB**, because the terminology used may be unfamiliar or difficult to translate in some systems (especially, but not only, where the language of the law is not English), and such terms as "bail-in" are both new to all and have been shown to be susceptible to different understandings and interpretations in the debates since the crisis. The resolution tools and goals stated at pp. 9-10 of the document provide a sound basis for such a definition, but it should be clear that it means regulator-implemented restructuring or other measures outside of the traditional bankruptcy and resolution regimes, at the point of non-viability.

Although it seems clear at pp. 9-10 that, under certain appropriate circumstances, bail-in and **resolution of the entire firm** may be the best means of optimizing preservation of value, other parts of the consultative document sometimes could be read to indicate a preference for resolution that would continue only essential functions, whether by bail-in, sale, or transfer to a bridge bank. Thus, it would be helpful if the FSB could review the language to make clear that there is no assumption of preference for or against one or another resolution options, including whole-firm options, and in each case the resolution authority should have the necessary tools to undertake a successful resolution. It is important that the process for choosing which technique be made clear by the resolution authority, so that investors and counterparties can make informed judgments about their position. A clear statement about specific decision rules in this regard would be helpful, with the overarching principles being: avoidance of systemic disruption and maximization of value for creditors, subject to the provision that no government risk capital should be required.

Paragraph 2.5. The "expertise, resources and operational capacity to implement resolution measures" will clearly be challenging in almost all cases. The industry endorses providing supervision authorities with the means to meet the needs of the post-crisis environment[11] and the same logic extends to giving resolution authorities (where different) the **resources** necessary to meet the standards recommended here. It may be questionable whether smaller jurisdictions will always be able to meet such standards, which is another reason for as much as possible of both pre-crisis and in-crisis resolution work to be carried out under the leadership of the home supervisor and on the basis of good cooperation with colleges and CMGs.

Paragraph 2.6. As suggested by the consultative document, the resolution authority should be protected from frivolous litigation and its staff protected from personal liability that may arise out of the exercise of resolution powers during a financial emergency. Similarly, firms' directors and officers should be protected in law when taking actions to comply with the decisions of supervisory authorities within the "recovery phase", in the same manner as they are when complying with the decisions of resolution authorities during resolution.

Paragraph 2.7. While resolution authorities need "unimpeded access", in group situations, multiple authorities should **coordinate inquiries and avoid duplication** or variations on the same requests, at least during the pre-insolvency period. This will be essential for efficient use of authorities' resources, as well as to keep the process proportionate and manageable for firms. It will be necessary to bolster legal protections of confidential information shared among regulators for this to work, as discussed further below.

Paragraph 3.1. The **trigger point** for entry into resolution is clearly essential. While it may not be advisable at the FSB level to set a specific standard, the present language is difficult to parse and may lead to confusion: what is "early" in relation to "timely", and in relation to the rest of this paragraph? The stated test of "no longer viable or likely to be no longer viable" is appropriate as the operative principle. This guidance should be clarified after careful study and comparison with existing national standards to assure that the **international standards are based on common, clear understandings of the conditions of triggering resolution at the point of non-viability** that would be comprehended by and reasonably predictable to the market.

Paragraph 6.3. This paragraph seems to mix the roles of deposit insurance and resolution funds, which are not fully substitutes for each other, and which vary from country to country. Deposit insurance schemes may of course provide bridge financing under circumstances intended to minimize their losses. Except where specifically designed to carry the resolution-funding function as well, deposit insurance funds, however, should as a rule be managed for purposes of paying out insured deposits. In previous statements, the IIF has taken the view that that ***ex-post*** **recovery from the industry of residual costs of resolution** would be appropriate; however, the Institute argues strongly against *ex-ante* resolution funds, which can be an unnecessary deadweight cost that reduces availability of credit. (This point is of course analytically separate from the question whether deposit guarantee schemes are funded ex-ante, as many are.)

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[11] IIF, "*Achieving Effective Supervision: An Industry Perspective*", July 2011 (http://www.iif.com/download.php?id=wulnswGYbyc=).

Paragraph 7.1. The standards for **minimum recovery rights** suggested in the consultative document are similar to those already adopted in some places and generally appropriate: the minimum standard that **no creditor should be left worse off as a result of resolution than it would have been in the case of liquidation** provides a solid grounding for prompt and decisive action in resolution; however, because the standard of compensation at least equivalent to what would be received in an ordinary liquidation or bankruptcy is a new one to many practitioners and because of the many practical and procedural questions it raises, it would be appropriate for this standard to be one of the topics to be debated and refined in a second round of consultations, as discussed above.

Paragraph 7.4. It would be useful to have more clarity about the balance between the need to ensure **judicial review** and the need to deploy the resolution tools rapidly. It is clearly appropriate to set clear rules for *post-facto* redress, as has been done in certain jurisdictions, to promote fairness while not undercutting the ability of the authorities to take decisive action to achieve the goals of conserving value and maintaining stability. Such judicial review should not interfere with the power to transfer assets and liabilities to a bridge or to bail-in eligible obligations, but should permit review of claims between and among parties, enforcement of the minimum recovery right and resolve valuation disputes. In addition, consideration should be given to immediate and (where possible) strictly private judicial review of the decision to initiate the resolution, at least where the board of directors of the firm concerned does not concur with the decision, limited to its legality and non-arbitrariness. Adding such a review option, even on a much-expedited basis, would help address some of the remaining reservations about the implications of restricting judicial review.

Paragraph 8.2. As already indicated in the introduction to this section, a **statutory mandate** to cooperative solutions is indeed essential and the IIF supports it emphatically; one of the most important contributions the G20 can make is to be sure such mandates are enacted as widely as possible and as quickly as possible.

The concept of the statutory mandate should be specific that **creditors should be treated fairly on a group-wide basis** and not just at the national level, consistently with the recommendation stated at page 15 of the consultative document, but without the possible exceptions.

Although the FSB makes an important contribution by stressing cross-border cooperation and home-authority leadership, the recommendations of the consultative document need to be sharpened up: some of the provisions seem to cut back from the principles of cooperation and of home-country leadership.

The IIF urges the FSB and G20 to adopt a strong policy of **maximizing home-country control** of recovery and resolution planning, recovery actions and group insolvencies[12].
Insofar as possible, both pre-crisis planning and in-crisis action should be led by the home authority. The existing ambiguities about the roles of home and host authorities should be resolved in favor of a strong leadership role for the home authority.

[12] While this may require an agreement on how to share the burden among jurisdictions in the event of a crisis, the difficulty of dealing with this issue might be considerably reduced by the various resolution tools considered in the FSB paper (e.g. bail-in, provision for assessment of losses against the industry).

These issues are discussed further with respect to cross-border cooperation and Annex 3.

Paragraphs 8.3, 8.4, 11.6, etc. generally leave **too much discretion to host authorities** to intervene in the group resolution process, especially with respect to local branches. Within a principle of home-country leadership, clearer standards for own-initiative host country intervention should be stated, aiming to make sure it is truly extraordinary and for emergency situations only. Specific issues regarding inclusion of subsidiaries in group insolvencies are discussed further in other sections of these comments.

It is important to have a general principle for the **avoidance of ring fencing** in local jurisdictions, subject where necessary to clearly stated and explained exceptions, as discussed elsewhere in these comments. Ring fencing not only impedes efficient resolution of a failing group, but is likely to result in unfair or less-than-optimal outcomes for the globality of a firm's creditors, so there should at the least be a strong presumption against it. Avoidance of such outcomes is, for example, one of the principal reasons for opposing "national depositor preference".

Paragraphs 8.5 **Non-discrimination amongst creditors across jurisdictions** is the foundation of an appropriate international regime, but this paragraph appears to contradict itself by saying that national laws should not discriminate against other creditors, but then saying that where such provisions exist, they should be disclosed. It would be highly desirable for the **G20 to state a clear directive** for member states to remove such provisions and to set norms for such disclosure where necessary until that directive is fulfilled. The consultative document says it well at page 15: "National laws and regulations should not discriminate against creditors based on nationality or location of their claim, or the jurisdiction where it is possible."

Paragraph 8.6. It should be made clear as a matter of law that there would not be prejudice to local creditors if they are **treated equally with all creditors similarly situated in an international (group) bankruptcy;** local creditors should not be considered prejudiced if their recovery is less measured against assets in the jurisdiction than it would have been if such assets were made available only to claimants in that jurisdiction (as may now be the case).

Paragraph 8.7. As confidentiality concerns have historically been a major impediment to **information sharing among supervisors** and resolution authorities in the past, it is essential to remove impediments (legal or otherwise) to information sharing, and creating the necessary legal basis for information sharing in international cooperation should be a G20 priority. This is necessary to creating the "cooperation and trust among resolution authorities" that the FSB wishes to build up. See the further comment on *Section 6.6 of Annex 3*.

Because of the volumes of information likely to be required, and the sensitivity of much of it in the planning phases, it would make sense to define a standard that **information should be shared on a need-to-know basis, giving assurances to hosts** that the home authority would have to take hosts' needs into account in sharing information, and similar assurances amongst hosts. Modularizing the level of detail needed by each authority would help the efficiency of the process. Information sharing on a need-to-know basis that makes host regulators comfortable that their interests are protected is also essential for there to be efficient, coherent group-level

RRPs: the efficiency issues here will be at least as important to authorities as to firms (cf. the comments on *paragraph 2.5* regarding the necessary resources for authorities).

Paragraph 9.2 (and paragraph 1.5 of Annex 3). As to the **information disclosed to the public**, the Institute is concerned that disclosure of the "broad structure" of institution-specific cross-border cooperation arrangements would almost certainly imply the disclosure of confidential information. There is ambiguity on how a "broad structure" can be defined; in any case **at most only the existence of the agreement should be publicly disclosed**. While issues specific to given firms are sensitive and should not be disclosed, it would generally be useful to market credibility to have public disclosure of the authorities' process for choosing the resolution technique and of general resolution policies, including on cross-border cooperation, so that market participants can make informed judgments about their position. A clear statement about specific decision rules in this regard would be helpful.

Paragraph 10. **CMGs** are important for orderly cross-border crisis management, and *Section 11* sets out some important considerations and makes good provision for ongoing review of the process. However, the industry is concerned about the potential for duplication or inefficiency with other oversight groups working with each firm and, in particular, would like to see included in these recommendations **guidance for how the relationship between colleges of supervisors and CMGs should be managed.** Given that the present proposal brings recovery and resolution assessment and planning much closer to the traditional functions of supervisors, and as it is stated at page 7 that the resolution regime requires "a reorientation of the supervision of SIFIs", it is important for all concerned – CMGs, supervisors, and firms – to have clarity about roles and responsibilities and to **avoid confusion or inefficiency** to the detriment of any of the parties.

Paragraph 11.1. **Recovery and Resolution planning**: Much sharper focus is needed on recovery and resolution planning as primarily a *group-level exercise*, to be undertaken in close collaboration of the firm with the home authority, as leader of a cooperative process with host authorities through the CMG. Recovery plans should, as is recognized, be flexible instruments allowing management to address emerging difficulties by differing available mechanisms depending on the circumstances. Resolution plans, devised primarily by the home authorities on the basis of a continuous dialogue with the firm, nonetheless require close dialogue and coordination with the firm itself.

Paragraph 10.11 requires "consultation" by home and host authorities if **a resolution plan is unsatisfactory**. It should instead provide for (i) clear and objective standards for resolvability assessments, as stressed in these comments; (ii) clear and specific procedures for reaching any such determination, and (iii) determination by the home country authorities, as further discussed with respect to *Annex 5*.

Paragraph 11.11. This paragraph raises a number of complex issues, some of which are addressed in greater detail later in these comments; however it is worth underscoring a few particularly salient points:

- Decisions on the need to "**improve a firm's resolvability**": as just said, there should be a clear norm for home-country leadership and control.

- No indication is given of what **objective criteria** would be used as the basis for a decision that "resolvability needs improving." Moreover, much greater clarity is required to create confidence in the market that these significant assessments, which may have very substantial business and financial impacts, will be taken consistently and with some degree of predictability across jurisdictions. Objective criteria are essential for the success of the scheme insofar as they are needed for firms to understand what is expected, and to manage to such expectations. In addition, as discussed with respect to *paragraph 4.1 of Annex 4*, it is important to have a clear and objective definition of "essential functions and systemically important functions".
- Suggested measures to be taken include changes in business practices, structure or organization, to reduce the complexity and costliness of resolution. As discussed with respect to *Annex 6*, there should be **no simplistic, a priori assumptions about what measures may be needed**, even when there are serious endogenous resolvability issues. Going-concern as well as resolution issues should be considered and care should be taken to avoid measures that might in fact increase complexity or systemic issues.
- There are many appropriate business models that groups may adopt; for some firms a highly integrated structure is appropriate, whereas others may opt for more decentralized, modular structure. Contrary to the implication here, there should be **no assumption that systemically important functions should be required to be placed "legally and operationally independent entities** that are shielded from group problems." Requiring such separate entities, where separate entities have not been put in place by the group for good business reasons, may result in trapped pools of capital and liquidity or otherwise reduce the efficiency of the firm, creating substantial burdens in normal operating times without appreciable gains in case of resolution, and could increase rather than decrease systemic risk.[13]

Paragraph 12.2. This paragraph sets **ambitious goals for MIS** at both group and legal entity levels. Risk IT is discussed at length in the Recent IIF report, *Risk IT and Operations: Strengthening Capabilities*[14], which addresses similar requirements raised by the Senior Supervisors' Group and stresses, among other things, the substantial lead times that will be required to achieve such goals. See also part IV below.

Box 2: Implications for Insurance Firms

While in principle the consultative document covers all SIFIs, it also rightly recognizes that the application of bank-type tools to insurers as a whole or core traditional insurance business would generally be inappropriate. The FSB is understood to be working with CPSS, IAIS, and IOSCO to develop sector-specific guidance for the application of the framework to non-bank SIFIs, including insurance companies (and financial infrastructure and other financial institutions), while the framework might be applied to the banking business of an insurance group, as discussed at page 11 of the consultative document. For this reason, the brief mention of insurance resolution at page 25 (*paragraph 4.1(iv) of Annex 1*) is inappropriate: it is much too brief and conclusory to be meaningful. Such brief mention will likely create unintended consequences and could be

[13] See IIF, "*A Global Approach to Resolving Failing Financial Firms: An Industry Perspective*", May 2010, par. 114-119.
[14] The Report is available here: http://www.iif.com/download.php?id=uFCCVkX0UF0=

interpreted as setting final standards on the issue. A much preferable approach would be to delete such mention and allow for insurance-specific guidance to be developed by the FSB.

Local insurance resolution regimes are generally believed to be adequate for national purposes, but improvements in cross-border cooperation are required; to the extent international standards are required, much more focused discussion than this is necessary for them to be useful and avoid unanticipated consequences. The IAIS ComFrame, which includes improvements in crisis management, should fill these needs; in the mean time, the RRP process, like other aspects of the resolution regime described in the consultative paper, would be disproportionate and difficult to apply to insurance firms, and the need for further consideration in this area should be acknowledged.

The insurance industry has long argued for the need to tailor resolution and other regulatory processes to sectoral differences and the exposures and liabilities of different sorts of business activities. As a general matter, traditional insurance activities are not a source of systemic risk and the failure of an insurance company would not be expected to trigger disorderly market reactions, among other things because of the long time periods that would generally be feasible to resolve an insurance business.[15]

The insurance industry does, however, have a great interest in participating in debates about resolution of banks and other financial institutions because, as investors, they are critically interested in financial stability and the orderly, predictable resolution of the firms in which they invest. Insurance members have stated they support he designation of a single lead resolution authority and as much global coordination of resolution as possible, along the general lines of the consultative document.

II: Bail-in within resolution: Elements for inclusion in the Key Attributes, Annex 2

Questions for public consultation

3. Are the elements identified in Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?

4. Is it desirable that the scope of liabilities covered by statutory bail-in powers is as broad as possible, and that this scope is largely similarly defined across countries?

5. What classes of debt or liabilities should be within the scope of statutory bail-in powers?

6. What classes of debt or liabilities should be outside the scope of statutory bail-in powers?

7. Will it be necessary that authorities monitor whether firms' balance sheet contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring minimum level of bail-in debt? If so, how should the minimum amount be calibrated and what form should such a requirement take, e.g.,:

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15 See discussion of this issue in the IIF Report *"Implications of Regulatory Reform for the Insurance Industry",* August 2010.

(i) a certain percentage of risk-weighted assets in bail-inable liabilities, or

(ii) a limit on the degree of asset encumbrance (e.g., through use as collateral)?

8. What consequences for banks' funding and credit supply to the economy would you expect from the introduction of any such required minimum amount of bail-inable liabilities?

As further explained in the IIF report "*Addressing Priority Issues in Cross-border Resolution*" (May 2011), the Institute **supports the use of bail-in** techniques as an effective resolution tool to (i) preserve systemically important functions and businesses, (ii) avoid destruction of value in a crisis, and (iii) preserve maximum value for creditors while achieving effective resolution. The IIF welcomes the significant convergence on the general objectives, governing principles and other basic aspects (institutions potentially covered, tools and powers, triggers, maintenance of the statutory order of priorities, safeguards for creditors and judicial review, non-effect of default) of the proposed tool with the industry perspective set out in the above-mentioned Report.

Also welcome is the focus on the specific concept of **"bail-in within resolution",** which is a useful conceptual clarification to reduce concerns linked to prior discussions of pre-insolvency use of statutory bail-in.

By recapitalizing the firm at the point of non-viability through a regulatory resolution proceeding, in whole or in part, and allowing it to be restructured, a bail-in (or bridge-bank technique in certain cases) can be an effective means of **avoiding the disorderly liquidation** of systemically important firms, with the attendant instability that would result from such an event.

A fundamental issue is the **scope** of liabilities that should be subject to a bail-in power. The consultative document seems clear that "the scope of a statutory bail-in regime, in terms of the range of liabilities covered, should be as wide as possible,"[16] but it also seeks comments on what classes of debt and liabilities should be within or outside the scope of statutory bail-in powers, as well as on a possible minimum requirement for bail-in debt. This has created confusion in some minds about what in fact should be the intended scope of bail-in.

The decision to execute one of the resolution options should be permissible only after a reasonable determination that **other measures that could have prevented a firm from becoming non-viable have been exhausted**, including conversion of early-trigger contingent capital instruments, execution of recovery plans, and conversion of subordinated debt and junior capital instruments where legally permissible.

The consultative document appropriately recognizes that it may be necessary*, after use of all lower-ranked financing instruments*, to bail-in **unsecured senior debt** of a firm. Bail-in should extend across the entire capital structure, including existing debt. Nevertheless, given the market sensitivity of exposing senior debt to bail-in, the different traditions in different countries, and the need for clarity in order to inform future capital planning and market expectations, it is important that it be made abundantly clear in the final standards when issued by the FSB that resolution procedures should explicitly require that existing debt hierarchies would be respected, and that **senior debt would be exposed only *after* exhaustion of resources subordinate to**

[16] Annex 2, paragraph 5.1.

senior debt. Senior debt should only be bailed-in to the extent necessary to recapitalize the firm or the portions transferred to a bridge entity, depending on the chosen approach in a particular case, at a reasonable level.

The "**no creditor worse-off than in liquidation**" principle, rightly adopted by the FSB in *Section 6 of Annex 2* is equally important and requires complete clarity, to provide bailed-in creditors assurances they can expect in many cases to receive more than fire sale in liquidation would yield.

While ultimately all creditors should be exposed to the failure of the firm, the ability of the industry to raise senior unsecured funding will remain critical, and indeed becomes more important with the advent of Basel III. Thus, it is vitally important to be completely **clear about protections as well as the exposures of senior debt** (and, as stated elsewhere in the IIF's comments, to be clear that an important goal of resolution should be to conserve value for creditors insofar as possible).[17]

The consultative document focuses on planning for resolution and on events that would take place in case of bail-out or other actions in resolution; however, it largely overlooks the vital "next day" issues of **getting a bailed-in entity back to normal business operation post-resolution**.

"Super-senior" funding of an institution in resolution may often be appropriate, as is acknowledged, but the discussion (*paragraph 11.1 of Annex 2)* is at most tentative. While it is appropriate to be careful about (pre-resolution) credit hierarchies, which seems to be the focus of the text of the consultative document, it is also important to make provision for funding in resolution (analogous to debtor-in-possession funding in restructuring bankruptcy), which can be a powerful means of putting a bailed-in firm or parts thereof back on a going-concern basis, reducing cost and risk to the relevant insurance or resolution fund. Properly handled, such funding may benefit other creditors of the entity, though of course any such funding should be designed to be proportionate to the needs of the entity and take into account the interests of other claimants.

Similarly, the document acknowledges, at *paragraph 6.5 of Annex 1* that a post-resolution going concern may appropriately be eligible for normal **central-bank liquidity facilities** (but it anomalously states that this may be the case only with respect to "parts of" a firm reconstituted on a going-concern basis: surely there was no intent to exclude whole-firm resolutions).

While the concepts of priority for new funding in resolution and access to central-bank liquidity (on normal terms) are well-established in some countries, they may need more attention in others. While study and discussion, as called for by the FSB, are certainly important, the FSB would be doing a great service if it would more emphatically acknowledge the power of, and provide guidance on, these techniques, which are essential for avoidance of damage to the system, as well as for the orderly recovery of continued operations or entities.

Specific Points on Annex 2

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[17] See IIF, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011, pages 22-23.

The Institute is supportive of the elements identified in Annex 2. In particular, *paragraph 1.1* correctly identifies the key objectives of a statutory tool, subject to the need to add clarity about the goal to recover value for creditors where possible. As stated above, it will be important for the G20 to put a priority on securing the necessary statutory changes, where they have not already occurred.

Section 2 is particularly important as it stresses the need to achieve **clarity and certainty on a number of key aspects of the legal framework**. The Institute has not taken a view as to which home authority should have the power to determine that a firm should be resolved (whether the regulator, a special resolution authority, or other designated authority), including the power to trigger a bail-in, as different approaches are possible, but it should be made clear that it is the home authority (however designated) that will have control.

As to *Section 4,* it is crucial that the relevant trigger for bail-in powers be carefully drawn, focused on the point of non-viability, in order **to avoid undue uncertainty or the potential "bringing forward" of insolvency.** See the comment on *paragraph 3.1 of Annex 1*.

The **scope of liabilities** covered by statutory bail-in powers *(Section 5),* should extend, as appears to be the intent, across the entire capital structure in order to maximize the likelihood of preserving systemically important functions and achieving the goals of resolution, restore confidence during a crisis, and avoid arbitrage between alternative funding instruments. It is also important that **strong convergence across jurisdictions** be achieved on scope to ensure cross-border effectiveness and avoid distortions in the market for bank funding.

While such scope should extend across the entire capital structure, to capture differences in the funding mix of different firms and to preserve the franchise businesses of the firm insofar as possible, a **number of categories of obligations should be protected** from the scope of bail-in, either directly or by means such as transfer to a creditworthy bridge or successor institution and paid in full in order to preserve value (in particular, secured or insured creditors; certain deposits; 'runable' (trading and short-term) obligations; transaction payments; and inter-company liabilities should be so protected).[18]

Discussion of scope cannot be complete without resolution of the **depositor-preference** issues raised in *Annex 7*. Certain members feel strongly that deposits (both insured and insured, the deposit guarantee scheme being subrogated to the rights of the latter, insofar as it has paid out, depositors) should be available to absorb losses on a *pari-passu* basis with senior debt, and hence all depositor preference should be excluded.

For these purposes, it is sufficient to note that all agree that **"national depositor preference" should be excluded from the FSB standards**. Whether any form of depositor preference should be permitted at the very least requires a good deal more discussion.

Section 6 appropriately stresses **respect for the statutory order of priorities** and the "**no creditor worse-off than in liquidation"** principle. Although the Institute agrees with these

[18] The industry has reached the view that trading obligations should not be subject to bail-in to preserve the franchise business of the firm by maintaining confidence of trading counterparties. See IIF, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011, par. 104.

points and the related point in *Section 8* about financial contracts, these issues are so fundamental that they should be stressed very prominently in the final FSB recommendations.

As to *Section 7*, as already stated in Section II ("Specific points on Annex I"), it is important to provide for clear provisions for judicial review of bail-in decisions, while still permitting expedited action. Clear understanding will help create investor confidence.

Minimum level of bail-in debt

The reasons for the concern about the **quantum** of bail-inable debt are not clear in the consultative document, and there seem to be tensions between language suggesting a comprehensive approach and suggestions that not all funding obligations would be subject to bail-in. A clearer discussion of the issues and concerns would be helpful. If the scope of bail-in liabilities is broad enough, it is questionable whether the monitoring of a minimum level of bail-in debt would be necessary, given that firms would in any case have to meet the Basel capital requirements. If the concern is that there should be a minimum amount of "gone-concern capital", then that should be clearly stated so that the relationship between any such requirement and the existing Basel requirements could be understood and analyzed. If the concern is that, even with a comprehensive approach, the appropriate exclusions that are contemplated (secured creditors, "runable" creditors, trading counterparties as advocated by the Institute, insured depositors) might reduce the level of bail-inable capital to an inappropriate degree, then that concern should be stated and analyzed.

Further discussion on these points is essential, in order to reach appropriate conclusions about the issue of **whether the "quantum" needs to be monitored** actively and, if so, how that monitoring would fit in with the already-complex capital requirements that banks will face in the new environment.

Consequences for banks' funding and credit supply

Paragraphs 2.3, 9.4, 12. of Annex 2 indicate that the FSB would extend bail-in powers within resolution to "all **existing and new** non-exempted liabilities".[19] Bail-in should extend across the entire capital structure. This is important to maximizing the likelihood of preserving systemically important functions and achieving the overall goals of effective resolution. Moreover, if existing debt were not subject to bail-in, the pricing of new or refunding debt could become prohibitive, as new issues would have to bear a disproportionate share of the risk; if such were the case, it would distort banks' funding decisions, create incentives to reduce assets to avoid costly funding, or induce greater issuance of secured funding than would otherwise be the case. Such pressures would of course be all the more acute for weaker firms or firms that are still recovering from the crisis.

[19] Although, hitherto, members of the Institute have had reservations about subjecting existing debt to a new power of bail-in, and those reservations require further discussion from legal and finance viewpoints, the conclusion of the Working Group on Cross-Border Resolution was that, in the specific context of "bail-in within resolution" effected by statutory power, it would be appropriate and important to spread the net as widely as possible among the eligible classes of obligations. Nevertheless, it is recognized that further analysis may be required to assess whether in certain jurisdictions the legal challenges of subjecting existing debt to a new power of bail-in may create uncertainty or provide incentives for litigation.

Bail-in will need to be **implemented simultaneously and consistently** in the major markets to be effective and to avoid negative implications for funding raised in specific markets. If bail-in implementation is not coordinated, or not convincing, it has the potential to cut off or disproportionately increase the cost of funding for specific institutions. Announcement of a framework for bail-in in resolution where exposure of certain debt classes in resolution has not clearly been understood up to now, is likely to affect the market for both existing debt and new obligations well before any measures take effect legally. *Paragraph 12.2* of Annex 2 says that "jurisdictions may consider the introduction of an appropriate transitional period before bail-in powers are exercisable in order to ensure that firms can adequately adjust to the statutory bail-in regime." Given that all affected firms are active users of the global funding markets, the FSB should plan to make **any transition period uniform across all markets**.

The Institute will publish shortly a further analysis of the **macroeconomic effects** of the overall suite of capital, liquidity, and national reforms. This analysis makes some assumptions about the effect of exposing banks' obligations, especially senior debt, to bail-in, and generally raises the concern that overall effects on funding, and thus on banks' credit-creation capacities, have been under-estimated. The *final* shape of "bail-in within resolution" may have further effects on banks' funding capacities and thus on the economy.

Group and cross-border issues

The FSB's discussion of bail-in is incomplete as to group issues, in particular because it does not provide for the possibility of swaps between the equity interests received by the creditors of a subsidiary for the equity of the parent, in order to preserve the parent-subsidiary legal relationship and thus to facilitate the group approach to recovery and resolution planning and a globally coordinated approach to group resolutions, especially with respect to integrated subsidiaries.[20]

Paragraph 4.1. **Triggers**. Triggers are discussed above with respect to Annex 1.

Paragraphs 9.1 (also top of page 13), 9.2. The IIF agrees that the **home authority should initiate bail-in**. As argued in the discussion of group issues (above at Box 1), it needs to be made clear that resolution should be under the control of the home authority, but well coordinated with concerned hosts, with well-defined exceptions for certain stand-alone and partially owned subsidiaries.

Section 9 unfortunately creates some ambiguities about home and host roles that need to be sorted out. It is appropriate to state that prior to exercising bail-in powers the host authorities should have satisfied themselves in consultation with the home and the CMG that "(i) the subsidiary is not viable and should enter into resolution and that (ii) the group would not support the subsidiary" and that there is no alternative group-wide solution. However, the test of whether a group-wide solution would be appropriate should be "**a favorable outcome for all creditors of the group and from a cross-border financial stability perspective**", not just a more favorable outcome "from a host country perspective", which invites ring-fencing that may be to the

[20] For a fuller discussion see IIF, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011,, paragraph 109 and Section 3.

detriment of creditors generally. As noted above, additional attention is required to the need for swaps or other mechanisms to maintain group structures in appropriate cases.

III. Cross-border cooperation and Annex 3

Questions for public consultation

9. *How should a statutory duty to cooperate with home and host authorities be framed? What criteria should be relevant to the duty to cooperate?*

10. *Does Annex 3: Institution-specific Cross-border Cooperation Agreements cover all the critical elements of institution-specific cross-border agreements and, if implemented, will the proposed agreements be sufficiently reliable to ensure effective cross-border cooperation? How can their effectiveness be enhanced?*

11. *Who (i.e., which authorities) will need to be parties to these agreements for them to be most effective?*

The Institute is pleased at the importance attached to overcoming obstacles to cross-border cooperation. There is a strong industry view that **enhancement of cross-border cooperation among authorities** is essential for the overall credibility of the resolution regime, and also to reflect the role of cross-border banks in the international financial system. In many ways the approach to cross-border cooperation recommended here is consistent with the Institute's previous work on resolution, which has endorsed the concept of institution-specific cross-border cooperation agreements.[21]

The recognition of **institution-specific cross-border cooperation agreements** is highly important for achieving much greater certainty about cross-border resolution as soon as possible. Such agreements are likely to evolve and become stronger over time, perhaps beginning with bilateral agreements and evolving to multilateral agreements over time.

Given the strong case for cross-border cooperation, it is disheartening that the FSB concludes there is "no immediate prospect" of a formal multilateral agreement on resolution of financial institutions. The IIF urges the FSB to engage the G20 (a) **to act as quickly as possible on the recommendations of the consultative report intended to maximize international cooperation** among resolution authorities (including establishing milestones for passing legislation as needed), and also (b) to take advantage of the current focus on resolution issues to **proceed expeditiously toward a formal multilateral agreement**. **A simple "presumption in favor of cooperation" is not enough.**

The strong encouragement of statutory **mandates** for cross-border cooperation is consistent with prior IIF requests to the FSB and G20. It is especially important that such mandates explicitly make it possible to manage the impact on a group as a whole. This should be more than a matter of best efforts: authorities should not only have the obligation to avoid triggering instability elsewhere, but to aim for the **best feasible global outcome** in terms of conservation of value, continuance of essential functions, and minimizing market impacts. At a minimum, local authorities should be obliged to avoid focusing on narrow calculations of local interests and

[21] See IIF, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011, paragraphs 136-138.

consider the destructive impact that a non-cooperative, ring-fenced solution would have on global markets, which can also have major effects on local conditions.

At a number of points in the document, however, there is **considerable ambiguity between the roles of home and host authorities:** such ambiguities should be removed insofar as possible. It should be a priority of the G20 to mandate the legislative changes to make such resort to uncoordinated local action completely unnecessary. Clearly, multiple, uncoordinated actions can be a threat not only to the effective resolution of a firm without undue disruption, but also to the *ex-ante* credibility of the resolution regime that must be built in the market.

While the introduction to *Annex 3* talks about "key host jurisdictions" it is also important that provision be made for involvement of and engagement with **peripheral host** jurisdictions. While it is of course necessary to focus on the firm's most material exposures and activities, the ability of even peripheral hosts to understand and rely on the process would be helpful to minimizing complications and inefficiencies in the pre-crisis period, and minimizing needless disruption in an actual crisis.

The IIF supports the **explicit inclusion of each firm's college of supervisors** in crisis management planning and welcomes the reference to the "relationship with existing cooperative structures" in *paragraph 6.1*. Supervisory colleges have a key role to play not only in ensuring that the group as a whole is strongly supervised in a well-coordinated manner, but also in making the appropriate preparations so that if the group gets into difficulties, strongly coordinated and effective actions can be taken to assist in the group's recovery or to bring about its resolution. Therefore, while the Crisis Management Group and the supervisory college are said to be "distinct but complementary", it is very important that they at the least be well coordinated and that their decisions be completely aligned, especially given that, as the consultative document says, the attention to resolution planning implies a new approach to regulation of SIFIs. Inefficiencies, duplications and potential confusions need to be avoided, both for the sake of firms and for the sake of supervisors and other authorities. Thus, more guidance regarding the operating relationship between colleges and CMGs, and in particular on the interaction between the "pre-crisis" planning and the day-to-day supervision of institutions should be provided by the FSB and the Basel Standards Implementation Group.

The **authorities that will need to be parties** to these agreements will be the home authority (or supervisor), which should unambiguously have the lead. All authorities or supervisors with respect to material operating subsidiaries should also be active parties. Ideally, agreements should include protection of the interests of peripheral supervisors as well, to avoid creating incentives for them to go their own ways. While it is important to decide what authorities should be parties to the agreements, the more important issue is to plan for effective, confidence-building, on-going cooperation among the CMG, the college, and any host supervisors and authorities that are not active members of those groups.

Specific Points on Annex 3.

Annex 3 sets out "essential elements of **institution-specific cross-border cooperation agreements.**" It is important for the FSB to establish this outline of necessary points of agreement; however, the impression is that this first draft is **quite general and vague** on some points and that it should be more ambitious and will need practical refinement over time.

As argued elsewhere, it is very important that the stated objectives of each such agreement be as clear as possible and that those objectives include avoiding unnecessary loss of value for unsecured creditors of the institution.[22]

One "essential element" of guidance that is missing is the **involvement of the firm**. With respect to resolution plans as well as recovery plans, resolvability assessments, and decisions on measures to improve resolvability, it is important to make clearer provision for the participation of each firm in dialogue with its college and CMG to make sure that issues are fully understood on both sides and decisions are well informed.

Provision should also be made for promptly **informing the firm of material issues** raised by the CMG or otherwise in the process described in the "essential elements", and generally of any decisions taken (with possible exceptions for issues of special sensitivity where there are objective reasons not to inform the firm).

It would also be useful for a refined version of the "essential elements" to include **more focus on the group,** and to make explicit how group issues would be dealt with at each stage of the process. This would not, of course, pre-judge decisions that might have to be taken in a crisis on disposal of businesses or subsidiaries, for example, but there should be more guidance on a strong group focus of all pre-crisis processes. In particular, a group focus, with adequate understandings among authorities, should aim to preclude ring-fencing of assets in one jurisdiction to the detriment of others, or of group claimants as a whole.

Paragraph 1.4. Given the goal to set G20-mandated standards for resolution, it seems anomalous to suggest that any such agreement could be other than **legally binding** among the parties; while obtaining legally binding agreements may be unattainable today, there would not seem to be any reason why establishing the basis for authorities to enter into binding, predictable agreements should not be part of the G20 goals.

Paragraph 3.8. As a part of a general review intended to make clear the relationship of the firm to the process, the principle of **prompt notice to the firm** of decisions affecting it should be stated subject, of course, to recognizing that certain understandings and decisions among authorities may not be appropriate for disclosure to the firm.

Sections 4 and 5. The home-host ambiguities found elsewhere in the consultative document are repeated here. It would be highly desirable for better stability and conservation-of-value outcomes to have a much **stronger role for home authorities**.

The principle of resolution of a group as a whole, in the **interest of all claimants in all relevant jurisdictions** should be well established and not be left to a vague "where possible and feasible" standard, as in *paragraph 4.1(v)*.

[22] A number of points made with respect to *Annex 1* are relevant to the refinement of the "essential elements" but will not be repeated here.

Section 6.6. This section contemplates in a vague way that there could be sufficient confidentiality agreements among supervisors to allow them **to share highly sensitive information**, either pre-crisis or in crisis. Confidentiality issues have been an obstacle to effective information sharing among supervisors, resolution authorities, and administrators in the past. Without a strong legislative basis, the language here is not likely to be credible. **Without removal of impediments (legal or otherwise) to information sharing and solid legal protections for the confidentiality of shared information, authorities are likely to be unwilling or unable to reach fully cooperative and integrated solutions** in the best interests of the global system and of creditors generally. As stressed in part I, appropriate legislation to protect confidentiality and information sharing should be a G20 priority.

Once established on a solid foundation for confidentiality, a high degree of confidence among authorities in each other's cooperation and information sharing should be possible. However - considering the volume and sensitivity of the information required, and the fact that there may be certain elements of information that are needed during a crisis (which is likely to be the most sensitive information, e.g. counterparty exposures) but that are not needed on an ongoing basis – **cooperation should be on the basis of a number of criteria and standards for information sharing**, including that: (a) information should be shared on a "need to know" basis (as already suggested in discussing *paragraph 8.7 of Annex 1*, while assuring that authorities take each other's needs into account in sharing information; and (b) home and key host authorities should have access to the whole set of information concerning the RRP or the resolution of the firm but it will be efficient to define different modules or levels of details and some optionality of what information is needed should be introduced.

IV. Resolvability Assessments, Annex 4

Questions for public consultation

12. Does Annex 4: Resolvability Assessments appropriately cover the determinants of a firm's resolvability? Are there any additional factors to be considered in determining the resolvability of a firm?

13. Does Annex 4 identify the appropriate process to be followed by home and host authorities?

Resolvability assessment is one of the most important but also one of the newest aspects of the recommendations. The assessment process is critical for firms and could have extensive macroeconomic consequences as well, given the possible fallout of a determination that a firm needs to improve its resolvability. The assessment will necessarily entail a good deal of judgment but, given the high stakes, **more international guidance will be needed** to get it right and to assure a reasonable degree of consistency across jurisdictions. Resolvability assessment should be (i) based on clear and objective standards; (ii) organized through clear and specific procedures; and (iii) decided by home-country authorities, after appropriate consultation with hosts where needed.

Member firms and the IIF would be pleased to assist further development of the factors of resolvability and the means of their assessment.

It is important that any assessment methodology consider the "exogenous" factors (i.e. institutional, legal and regulatory), that are necessary to cross-border coordination and alignment of resolution tools. But the target of that part of the assessment should be **rapid change where necessary to assure that all relevant markets meet the G20/FSB standards.** For this reason, these comments urge that the G20 should put a high priority on getting necessary legislative changes.[23]

While it is important to understand the potential impact of exogenous factors on the resolution of a given group, it is important that **such exogenous factors should generally not be the basis for decisions on measures to "improve resolvability"** per *Annex 6*. Firms' structures and business models should not be forced to change for reasons beyond their control.

Furthermore, members are concerned that a **"bottom-up" approach** whereby resolvability is assessed country by country and national authorities are required to make their assessment on the basis of their national regimes, would lead to an excessive emphasis on the national perspective, therefore encouraging ring-fencing solutions out of excess of caution or to maximize theoretical protections of local claimants in case of failure, to the detriment of the broader economic system or of other countries. This approach is likely to lead to excessively negative conclusions and damage the ability of fundamentally sound groups to perform as well as possible for the global economy.

A **"top-down" approach, fully incorporating the FSB's recommendations** for a cooperative and globally coordinated approach, is necessary. As argued elsewhere in these comments, a group-focused process for development of RRPs and for assessment of resolvability is the only approach that can be at all efficient either for firms or for the authorities.

However at this stage, **the major issue is a lack of clarity or lack of full development of the criteria** for "credible" resolution. It needs to be emphasized that these criteria require further work to address definitional and methodological issues in a next phase of consultations.

Finally, in assessing resolvability, it should be made clear that it is sufficient for a group credibly to show **resolvability under one of the available resolution methods**. It would not be reasonable to require demonstration of resolvability under all options, both as a matter of efficiency in use of firm and CMG resources and because exogenous factors may make some methods more feasible than others.

The criticism is sometimes made that the implication of the type of resolvability assessment contemplated here is "**supervising for failure rather than supervising for success**". While this critique can perhaps be overstated, the danger is especially apparent in *Annex 4*, given the subjectivity and the lack of methodological development of the criteria stated.

Specific Comments on Annex 4

Paragraphs 1 – 3. Note that the definition says that a SIFI is "resolvable" if it is feasible and credible to resolve it without systemic disruption and without taxpayer exposures, while

[23] The IIF suggests there should be in the joint assessment process ("Implementation Progress Report") carried out by the FSB with the IMF an additional section dealing with resolvability issues and improvements to the cross-border resolution framework (this assessment could also take into account the higher level of integration in some regions, which could result in a more credible cross-border resolution).

protecting systemically important functions. *Paragraph 2(ii)* seems to weight endogenous, firm-specific, exogenous (regime and international framework), and preparedness questions (RRPs) equally. And "feasibility" depends on the authorities' legal powers and capacity to use them (*Stage 1 of the assessment*). As stated above, **"exogenous" factors should not count against a firm as a basis for taking measure to improve resolvability where the endogenous factors are satisfactory**, yet a firm's "resolvability assessment" apparently could depend on whether its jurisdictions have made the necessary legal changes. The dangers of damaging productive, efficient going concerns because of questions based on exogenous factors should not be underestimated.

Paragraph 5. "**Credibility**" is to be established by "capturing the **likely impact of the SIFI's failure and resolution on global and national financial systems and real economies**." This is obviously very challenging as a matter of macroprudential, microprudential, and macroeconomic analysis. What can realistically be expected? Here again, the IIF sees the need for considerably more deliberation and debate, and stresses that the industry stands ready to contribute to the process of thinking through how to come up with meaningful, manageable criteria on this point.

Paragraph 5 basically sets out what might be called **"things to look at in assessing the systemic impacts"** of a firm's failure, but it provides nothing like a methodology. The criteria suggested are clearly relevant, but are they defined at too high a level to be useful or to be applied consistently across jurisdictions.

Given the importance of this assessment, and the dramatic consequences a negative assessment may have for firms, for their employees and stakeholders, and for their ability to contribute to the global economy, this state of affairs is clearly unsatisfactory and there should be **an international commitment to a public-private sector joint effort to refine thinking** on these as well as the other resolvability-assessment issues. In the mean time, caution would be in order in using these factors: traditional supervisory guidance and cautions to firms may well be in order, but that is not the same thing as "assessing resolvability".

Firm structure and operations

Paragraph 4.1. The questions about principal businesses and "franchise value" should be separated from the questions about a firm's functions for the global and national financial systems.

A business's **franchise value and its systemically important functions are analytically separate** issues. Franchise value will be especially important in recovery planning and in the recovery phase, where the board of directors aims to save the firm's best-established businesses and franchise value as a base for rebuilding resilience. Systemically important functions are of course important in that phase, but not the only consideration. In the resolution phase, preserving systemically important functions becomes a more central consideration for the resolution authorities, but, as part of the general goal of preserving value for the system and for creditors, they should also look at what franchise value remains and could be recovered in a well-designed resolution. Focusing only on systemically important functions, important though they are, may lead to overlooking opportunities to conserve franchise value.

The IIF's *Addressing Priority Functions* report provides an extensive discussion on the **meaning of "critical functions"**, which should be used as the basis of much more developed guidance to the official sector in assessing such functions.[24] More attention needs to be given to what may be different national and international assessments of what constitute critical functions. The identification of critical functions should be based on clear objective and consistent criteria, and analyzed and discussed between a firm and its CMG. This analysis should be a pre-condition and inform detailed resolution planning, to make it more focused and resource effective, as well as provide a solid base for the complex discussions within the CMG and with the firm on the terms of an institution-specific cross-border cooperation agreement.

It is not being overly critical to state that almost complete absence of such guidance in the FSB consultation paper leaves the process completely dependent on the subjective assessment of various authorities. While such assessment will necessarily be qualitative in large part, it would be possible to have much more useful guidance to **assure more authoritative, more consistent, and more predictable assessments across firms and across jurisdictions**.

Paragaph 4.3 (and paragraph 12.3 of Appendix 1, paragraph 3 of Appendix 6). The discussion of **intra-group exposures** compresses in summary discussions a very complex topic. Intra-group exposures are treated briefly and conclusorily, yet intra-group credit extensions, guarantees, and other transactions are critical not only to the efficient management of cross-border firms, but to risk management. Restricting management decisions on appropriate group exposures, given a group's business model, may reduce going-concern resilience and in many cases outweigh the theoretical benefit of reduced complexity in resolution, therefore increasing net systemic risk.

While the questions posed generally seem appropriate, they are not sufficient, noting the implications for intra-group transactions generally, nor is it clear what implications to draw from them. There is a **danger of doing damage to useful business-as-usual** techniques without commensurate benefits.

Much more work is needed **before reasonable means to limit risk without unduly abridging the efficiency international groups bring to the global financial system** can be designed.

This is a topic on which the active participation of the industry in analysis and debate is especially important, given different group structures and different strategies in organizing intergroup transactions and guarantees. There may in fact be value to establishing principles and perhaps standards on these issues, but the discussion in the consultative document is only a point of departure and there has certainly not been enough time allotted for thinking about these issues from an international perspective. See the further discussion under *Annex 6*.

Management Information Systems (MIS)

See also comments on *paragraph 12.2 of Annex 1*, and on *Annex 6*.

Paragraph 4.6-4.8. The standards for "**adequacy of MIS**" and "prompt provision of necessary information to relevant authorities" are high if the language is taken literally: "a complete and accurate view of [the firm's] risk profile under rapidly changing conditions", with "key

[24] See IIF, "*Addressing Priority Issues in Cross-Border Resolution*", May 2011, Section 1.

information on risk exposures" on a daily basis. It seems to require "necessary MIS" at the legal-entity level as well as the group level, including on intra-group transactions and collateral.

Given the cost of making IT changes both in terms of money and in terms of use of scarce resources, the significance of IT requirements should not be underestimated.

MIS requirements for resolvability purposes should be carefully coordinated with MIS and IT requirements made for other supervisory purposes, pursuant to the recommendations of the Senior Supervisors' Group (SSG). The issues involved in meeting risk IT and MIS upgrades that firms agree are necessary and that the SSG is seeking are considered in a detailed, recent IIF report.[25] One of the most important conclusions thereof is that, while firms are at different points of IT development, for many firms, it must be recognized that **fully upgrading risk IT will be a lengthy process**, although the survey on which the report is based found a clear commitment to making the necessary investment of money and resources. It also identified certain expedients that can meet supervisory (or resolution) needs without necessarily requiring massive immediate investments. For example, for many purposes short-term, indicative reports on the basis of reasonable estimations or aggregate data will be sufficient, with full granularity to be provided later.

Paragraph 4.7. It would make sense to set out **official-sector impediments to data sharing** as a separate analytical paragraph.

With respect to firms' data, perhaps it should be stated that requirements on "rapid identification of depositors and amounts protected by a deposit insurance scheme" should be defined by the requirements of the national schemes, which many firms will of course already be meeting.

Assessing Systemic Impact

See the comments on *paragraph 5* above.

V. Recovery and Resolution Plans, Annex 5

Questions for public consultation

14. *Does Annex 5: Recovery and Resolution Plans cover all critical elements of a recovery and resolution plan? What additional elements should be included? Are there elements that should not be included?*

15. *Does Annex 5 appropriately cover the conditions under which RRPs should be prepared at subsidiary level?*

The industry **reaffirms its strong support of recovery and resolution planning** as a key component of an effective resolution regime. But RRPs should be a process and RRPs should not be seen as some form of static blueprint or rigid plan for dealing with hypothetical scenarios,

[25] See IIF and McKinsey & Company, "*Risk IT and Operations: Strengthening Capabilities*", June 2011

but rather as dynamic tools aimed at ensuring that authorities have a full understanding of a firm, its business, operations, and structures for resolution purposes[26].

It is important that recovery and resolution planning be done on a **group basis**: as has been argued throughout these comments, the entire resolution process should be focused on and channeled through the group, especially the "pre-crisis" phases. Thus the **home country authority should take the lead in working with the firm on RRPs**, and generally coordinate through the CMG with the hosts, as the consultative document helpfully recommends at *paragraph 11.6 of Annex 1*. This is important to avoid duplication of work, ensure consistency of plans, and foster close cooperation and consensus among relevant authorities.

The IIF welcomes the fact that the FSB is aiming at an approach to recovery and resolution planning that is to be **fully coordinated internationally**. This is important both to avoid competitive distortions and to ensure robust arrangements for effective resolution of cross-border financial firms. Currently firms are at various stages of discussing RRPs with their supervisors; in some cases, the process of international coordination of RRPs has also begun, although that seems less advanced.

It is important that financial groups continue to be able to choose the mode of organization and degree of integration of the management of their group that most conforms to the nature of their business model and the needs of their business. **RRPs should not force changes to organizational structure** as this might create a significant mismatch between a firm's organizational structure and its overall business model, therefore stifle economic performance and lead to increased ring-fencing of countries and fragmentation of the international marketplace.[27]

The overall process should be designed to make sure that host-specific plans would only be imposed, if at all, in extreme circumstances. This is essential to assure some basic efficiency of the process for the group and for the CMG, and to avoid the risk of incoherent, duplicative, or conflicting requirements. As discussed elsewhere with respect to group issues, where subsidiaries are run on a stand-alone basis, especially if systemic in the host country, the host country role would naturally be larger; still, issues of such subsidiaries should be carefully coordinated through plans under the auspices of the home authority.

Specific Comments on Annex 5

The basic elements of *paragraphs 1.1 and 1.2* are appropriate as to the objectives of RRPs, but greater emphasis should be given to the **objective of preserving value of the operation for counterparties, creditors, and the system as a whole**; therefore, there should not be any implied presumption of liquidation, but provision should be made for the various possible forms of resolution, including reorganization as well as bridge, bail-in, and liquidation.

Clarity about responsibility for developing and maintaining RRPs is crucial. *Recovery* planning is primarily the responsibility of the firm. It involves effective and high-quality planning as to how the firm would achieve recovery in the event of a prolonged period of stress. This implies an

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[26] See IIF "*A Global Approach to Resolving Failing Financial Firms: An Industry Perspective*", May 2010, Section 2.
[27] See IIF "*A Global Approach to Resolving Failing Financial Firms: An Industry Perspective*", May 2010, par. 62-67.

ongoing dialogue between the firm and its supervisor (coordinated to inform its CMG on important matters) as part of the supervisory review process, to assess the quality and effectiveness of such planning, and the appropriateness of the scenarios used.

Annex 5 does not give sufficient attention to the confidentiality and disclosure of RRPs. Without adequate rules of **confidentiality**, unjustified perceptions of vulnerability could be created. Moreover, the RRPs would include key proprietary information concerning the firm's strategy and organization that need to be protected. As explained in previous sections, the IIF supports a high degree of cooperation and information sharing among authorities. However, information should be shared on a "need to know" basis and different modules or levels of details should be introduced when granting access to RRPs to host authorities.

RRPs should not be made public. RRPs should be considered highly confidential supervisory information and protected from disclosure under all circumstances. At the same time, disclosure concerning how regulators expect to manage the resolution process and exercise their powers and responsibilities would provide creditors and counterparties important knowledge about how they would be affected therefore enhancing market stability.

As explained above, RRPs should not be seen as blueprints. This implies RRPs should refrain from encouraging procedures based on rigid triggers and automated reactions. In order to avoid undue rigidity and the risk that interventions are not made or are made at the wrong time, **intervention triggers should only be "alarm bells"**, and trigger not automatic action but intensive discussion among the firm and its CMG and college.

It is especially welcome that the consultative document highlights (*paragraph 1.21*) that the **home resolution authority should lead the group resolution plan**. The objective needs to be the development of one global cohesive plan, developed in consultation with the firm, and not a plethora of local plans. This global plan should then be developed into subcomponents in all major jurisdictions where the group has relevant operations.

Paragraphs 1.18, 1.20-22. The summary description of the role of **home and host** jurisdictions within colleges and CMGs is not adequate. Once again, a good deal more attention could be paid to elucidating these relationships, within the general principles of group focus and home-authority control.

Paragraph 2.3. The reference to **essential functions and systemically important functions** require much fuller definition, as discussed in *section IV* above, with respect to *paragraph 4.1 of Annex 4* of the consultative document.

Paragraph 2.3(viii). It should be recognized that valuation can be difficult in conditions of stress, and that appropriate preparations should be taken to manage this issue. Such measures can include preparation in the recovery phase, including cross-industry valuation reviews of distressed sectors, to establish a broad context of value, while protecting of the identity of the most vulnerable firms.

Paragraph 3.4. This paragraph appears to duplicate the requirements of the **Basel III liquidity** proposals in ways that may be confusing. These matters should be left to Basel III.

Paragraph 5. The **information requirements** for RRP are extensive. While it seems difficult to quarrel with any of the specific requests, it is important to make these requirements more manageable, to avoid duplication of other supervisory requests for the same or similar information, and to define IT needs in a manageable way, as discussed in section IV above.

VI. Improving Resolvability and Annex 6

Questions for public consultation

16. Are there other major potential business obstacles to effective resolution that need to be addressed that are not covered in Annex 6?

17. Are the proposed steps to address the obstacles to effective resolution appropriate? What other alternative actions could be taken?

18. What are the alternatives to existing guarantee / internal risk-transfer structures?

19. How should the proposals set out in Annex 6 in these areas best be incorporated within the overall policy framework? What would be required to put those in place?

The high-level discussion of improving resolvability in *Annex 6*, which relates directly to *Annex 4* of course, lays out useful issues about endogenous issues for firms, supervisors, and resolution authorities to consider both as a matter of preparing for potential resolution and for operations and risk management, as stated at page 61. While the points raised are sensible to think about, once again the issue arises of **overlap with regular supervision and going-concern risk management,** and the concern arises whether addressing these issues in this context is in fact helpful, except perhaps in egregious cases.

The industry is concerned that, for completely understandable reasons, the official sector has been heavily influenced by the example of the Lehman bankruptcy. Given the circumstances of that firm and given all the supervisory and risk-management progress since the crisis[28], there is a distinct danger that "bad cases make bad law", unless considerably more guidance is provided and these issues are handled with caution and intent to avoid harm. There is further concern that, based on the statements of certain individual regulators and authorities, there may be a **predisposition to use the very general factors set out in Annex 4 to demand radical "remedies"** under *Annex 6* that may well not be justified by actual risks on the ground, or may be disproportionate to the value the firm may be able to add in more or less its present structure, with incremental improvements rather than the threat of radical changes.

It cannot be stressed enough, and should be emphasized in the final FSB document, that prevention is better than cure and that **enhanced going-concern supervision should always be the preferred route** in case of any issues with a given firm, rather than allowing resolution issues to drive solutions.[29]

[28] See IIF and Ernst & Young, "Making strides in financial services risk management", April 2011.
[29] IIF, "*Achieving Effective Supervision: An Industry Perspective*", July 2011

The IIF report *Addressing Priority Issues in Cross-Border Resolution* puts considerable stress on **respecting the structural choices made by cross-border groups** and argues against any forced adoption of specific structures. It also stresses the importance of the value created by group structures, much of which may be lost if the needs of **group efficiencies** are not respected.[30]

It is also important to stress that decisions on "improving resolvability" raise important issues for the level playing field: there should be general **consistency across jurisdictions** about the types of measures required of SIFIs or other firms in all jurisdictions.

Further, the considerations for "improving resolvability" should **be reasonably objective and predictable** so firms can apply them in ways that seem to them to be appropriate, without waiting for supervisory judgment, and minimizing the risks of failing to anticipate supervisory judgment correctly. See the comments on *Annex 4* above.

Specific Comments on Annex 6

Paragraph 1. See the comments regarding MIS and information systems under the discussion of *Annex 4* above. **Assessments for resolution purposes should be meshed with those made for normal supervision purposes** and reasonable development plans should be accepted, recognizing that what may be significant IT developments cannot be rushed, especially given the shortage of risk and IT human resources for these purposes, and the often extensive regulatory work requirements that already exist.

It may be useful to have further guidance, perhaps developed jointly by the industry and the official sector on **how to plan to make MIS available** to incoming purchasers, bridge entities, and remaining entities if a group is in resolution.

Paragraph 3. The use of **intra-group guarantees, back-to-back booking, and intra-group loans and funding** has also been discussed with respect to *Annex 4*. However, the IIF is concerned that these issues should not be looked at only or primarily from the point of view of whether they increase "interconnectedness" and "may impede separability of firms' transactions and legal entities." While there is some truth to the statements about the difficulties of unwinding a complex of intra-group guarantees and exposures, the discussion is quite one-sided and **needs to be balanced with further analysis and discussion of the benefits of intra-group structures** and techniques for going concerns so that proportionate and reasonably balanced conclusions may be drawn.

Centralized risk, liquidity, and treasury management are beneficial to strengthening the firm's controls and to maximizing its ability to hedge risks. In addition, the ability of global groups to do internal transactions and hedging will often both increase its ability to contribute to global liquidity and in fact may reduce the group's interconnectedness with other market participants. Provided there is transparency and good internal risk management, intra-group relationships should generally not be restricted beyond generally applicable regulatory requirements. Therefore, forced subsidiarization (as implied by the language of this paragraph)

[30] See IIF "*A Global Approach to Resolving Failing Financial Firms: An Industry Perspective*", May 2010, par. 62-67.

actually may limit the effectiveness of the risk-management techniques utilized in integrated groups to manage counterparty risk and may reduce the ability to take advantage of diversification across counterparties, markets, and funding sources. Groups with significant stand-alone subsidiaries also benefit from intra-group services and transactions, subject to tailored forms of risk management and, of course, supervision.

Equally, it is clear that where the legal structure, risk management, funding and business model of the group provide and plan for substantial financial autonomy of a subsidiary (as may be the case for a number of business, financial, and regulatory reasons), provision of intra-group financial support should not be mandatory.

Much more analysis is required than has been possible in the allotted time as to whether the FSB's recommendations on intra-group exposures are necessary, complete, or appropriate even from a *resolution* perspective, let alone whether they are proportionate, balanced, or manageable from a *going-concern* viewpoint. Part of the further discussion necessary will need to focus on the different requirements, strengths, and issues of different business models. While the Lehman case showed the vulnerabilities that could be established by the disorderly liquidation of a sprawling complex of entities, too much should not be extrapolated from that specific experience without looking at the actual structures and controls of cross-border firms in the post-crisis environment.

Paragraph 3.1. While there are national requirements of arms' length dealing in some places, is the blanket statement that **intra-group transactions should be at arms' length** appropriate? Should there be exceptions or, for example, materiality thresholds? A good deal of legal analysis is required to get a sense of what should be the international standards on this point

Paragraph 3.2. The stated requirements of ability to **reconstitute separate legs of a transaction booked in separate intra-group entities** are not clear enough to provide an adequate response. There is, however, concern that this may refer to breaking apart master trades, which could risk destabilizing large, complex trades involving multiple transactions or booking entities, or breaking apart different legs of deals in different jurisdictions.

Once again, this is a topic where a **serious discussion among specialists** is needed to understand the perceived problem, provide an industry perspective on it, and perhaps suggest workable solutions that will not needlessly affect market liquidity or destabilize groups. It may be noted that in some cases the complexity of such transactions may be dictated by regulatory concerns, but that need not affect how well controlled they are from a risk-management perspective.

Further, it seems likely that some of these same concerns either have been addressed in Basel 2.5 or are being addressed in the Basel Committee's "fundamental review" of the trading book, so duplication or working at cross-purposes must be avoided.

Paragraph 3.3. The issue of "**reducing unnecessary complexity in group structure, intra-group transactions and exposures**" is evoked in a very conclusory and prejudicial manner. While certainly firms should work on understanding their group structures and intra-group transactions, and will be doing that in any case to fulfill their RRP obligations, and while supervisors are already looking at these issues, this section makes no contribution to either the process or the debate. It does not help achieve any consistency of thinking on this, and so does nothing for the **predictability or cross-border consistency** of the process, both of which are of the greatest importance.

Whereas complexity may look "unnecessary" from some points of view, complex structures may have good explanations, they may be involuntary (and often considered costly and undesirable by the firm) if resulting from regulatory requirements, and they **may be complex but not harmful**. Yet no guidance is given on any of these points of analysis.

Further, even complexity that is "unnecessary" in some sense may be **disproportionately costly to unwind**. Firms are often stuck with historical structures that they would like to eliminate but which cannot be wound up without equally "unnecessary" cost or disruption for tax or other reasons. There needs to be some sense of **balancing of potential harm and actual cost or disruption in any decision on "unnecessary" structures or transactions**. It is especially important, of course, at a time when firms are building capital to meet the more-stringent Basel III standards to avoid tax or other costs that would be truly useless for any purposes other than facilitating a (hypothetical) resolution.

Perhaps it would make sense for the industry and the authorities to get together after September 2 to discuss good practices **to identify "unnecessary complexity" or distinguish appropriate and useful transactions from those that "unnecessarily complicate resolution"**; such discussions would also help elucidate the obstacles that firms face, and perhaps be the basis for some guidance as to how to do the balancing just discussed.

Paragraph 3.4. **Cross-defaults** are a deeply engrained, long-standing feature of corporate finance. While the consultative document is quite right that consideration should be given to their implications and to possible alternatives, this cannot be a short-term project. From the point of view of the debtor firm, the concern expressed in the document is understandable, but going-concern financial institutions in the normal course of events are also creditors and it needs to be asked whether they would suffer a net detriment as creditors from the kinds of changes proposed here. How would elimination or alternatives to cross-default clauses affect the market? This is not an easy question.[31]

We refer to ISDA the question about standard valuation methodologies.

Paragraph 4. **Global payment operations** are likely to be "critical functions" of global banks. They are also one of the most tangible contributions that global banks make on a day-to-day basis to the international economy. Care must therefore be taken about any requirements enunciated here. At the very least, any requirements should be well articulated with the recommendations being developed by CPSS and IOSCO on financial-market infrastructure.

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[31] Note: Under the Dodd-Frank Orderly Liquidation Authority, the receiver can enforce any contract of a subsidiary or affiliate of the covered financial company that is guaranteed by the covered financial company notwithstanding any provision therein permitting the non-defaulting party to terminate such contract based on the insolvency, receivership or financial condition of the guarantor; provided that such guaranty is transferred to a solvent third party or adequate assurances are otherwise provided. Should such an approach of optional nullification be the preferred international approach as well? This is yet another question that needs serious study and debate and cannot be answered at this point in time.

VII. Discussion Note on Creditor Hierarchy, Depositor Preference, and Depositor Protection in Resolution: Annex 7.

Questions for public consultation

21. Does the existence of differences in statutory creditor rankings impede effective cross-border resolutions? If so, which differences, in particular, impede effective cross-border resolutions?

22. Is a greater convergence of the statutory ranking of creditors across jurisdictions desirable and feasible? Should convergence be in the direction of depositor preference or should it be in the direction of an elimination of preferences? Is a harmonized definition of deposits and insured deposits desirable and feasible?

23. Is there a risk of arbitrage in giving a preference to all depositors or should a possible preference be restricted to certain categories of depositors, e.g., retail deposits? What should be the treatment of (a) deposits from large corporates; (b) deposits from other financial firms, including banks, assets managers and hedge banks, insurers and pension funds; (c) the (subrogated) claims of the deposit guarantee schemes (especially in jurisdictions where these schemes are financed by the banking industry)?

24. What are the costs and benefits that emerge from the depositor preference? Do the benefits outweigh the costs? Or are risks and costs greater?

25. What other measures could be contemplated to mitigate the impediments to effective cross-border resolution if such impediments arise from differences in ranking across jurisdictions? How could the transparency and predictability of the treatment of creditor claims in a cross-border context be improved?

The FSB poses challenging questions of whether or not differences in statutory credit ranking represent an impediment to effective cross-border resolution and convergence. The industry recognizes the importance of these questions. The **discussion note is a very useful starting point for the necessary debate on these issues**, but there is a need for a second round of discussion and debate, probably including colloquia or other exchanges with the industry and other stakeholders, before an international consensus can be reached on these matters.

There are in effect three questions here (somewhat reformulated from the discussion):

- To what extent do differences in the hierarchy of claims **impede convergence or practical cross-border resolution**?[32]
- What are the **effects of depositor preference** (i.e. putting depositors ahead of other unsecured creditors) **on international cooperation in resolution**?[33]
- What are the effects of **national depositor preference** (i.e. putting claims on the insured domestic offices of a firm ahead of claimants in other countries)?

In discussing depositor protections, it is important to have **clear analytical distinctions between the concepts of deposit-guarantee schemes, depositor preference, and national**

[32] A useful comparison of the different hierarchies in different countries may be found in appendix VIII of the US General Accountability Office report: *Bankruptcy Complex Financial Institutions and International Coordination Pose Challenges*, July 19, 2011

[33] In practice, the deposit insurance scheme is subrogated to the claims of depositors who are paid out, becoming a major creditor in most bank failures.

depositor preference. Differences of design and coverage of deposit guarantees do not necessarily imply depositor preference nor would the scope of guarantees necessarily be the same as the scope of depositor preference, if any. Most importantly, while depositor preference as a general matter can be debated (and, as discussed below, the industry does not have a consensus view on its advisability), it is clear to the Cross-Border Resolution Working Group that *national* depositor preference is at odds with the FSB's goals for effective resolution.

While it is not possible to reach definitive conclusions, it may be useful to think of the issues along the following lines. The attempt here is to recognize the inevitability, at least for the time being, of different hierarchies, different deposit-guarantee schemes, and possibly different depositor-preference rules while minimizing the effects of such differences on the overall goal of fair, consistent, and credible resolution on a cross-border basis.

- Creditor hierarchies on which investors have relied in providing funding to firms must be respected in a way that will be seen as fully fair and equitable.
- Deposit insurance schemes would of course be subrogated to the claims of depositors to the extent paid out by such schemes.
- While local deposit protection arrangements may differ, the differing obligations of different schemes to their depositors do not justify national arrangements that resolution authorities should preempt disproportionate amounts of global group assets to pay out national depositors (or investors).
- Deposit insurance schemes would pay whatever and whomever they are required to pay by local law but this should not give them priority claims over specific sets of assets in their jurisdictions.
- Expectation of national preemption of assets within national bounds creates incentives to defensive, non-cooperative behavior on the part of authorities and administrators of insolvency estates.
- The resulting inability to count on cooperation and lack of trust gets in the way of putting in place meaningful cross border arrangements *ex ante*.
- So the objective should be to **eliminate provisions in national insolvency or resolution arrangements, especially national depositor preference and ring-fencing**, that create obligations on national authorities to act preemptively.[34]
- The G20 rule on global resolution should be **that assets of a global firm (or group, subject to the discussion of group issues in these comments) should be made available for the fair resolution of all claims on the failed firm globally**, respecting the established hierarchy (possibly including depositor preference as a ranking but not national depositor preference as a super-priority over claims in other countries) **without discrimination by nationality** (as already stated in the consultative document).
- Where there are **technical differences in the description of hierarchies across jurisdictions affected by a given resolution, it should often be feasible for the lead resolution authority to establish tranches of corresponding seniority** in order to create a manageable basis for resolution on a basis that is fair to claimants in all jurisdictions.
- There would be a good case in principle for seeking to harmonize depositor protection globally, though that must be recognized as a distant prospect.

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[34] As argued in these comments, the FSB goal should be to eliminate *national* depositor preference, regardless of what determination might be made about depositor preference more generally.

- Similarly, convergence of statutory ranking of creditors across jurisdictions would be desirable in the long run, but, if resolution makes it possible for resolution authorities to group equivalent levels of seniority on a reasonable basis, it should be possible to manage around technical differences in rakings until convergence is achieved.

Specific Comments on Annex 7

It has **not been possible in the short time available to do a full ventilation** of all the challenging questions posed in the consultation, some of which are raised for the first time on an international level and require discussion with investors and rating agencies as well as firms.

The Institute would, however, be keenly interested **in contributing to a full discussion of these issues** over the coming months in hopes of reaching much greater international understanding and consensus on these questions.

The Institute would also urge that these discussions consider a broader discussion of whether substantive convergence of hierarchies is necessary, or **whether primarily procedural coordination provisions, such as those of the UNCITRAL convention for non-financial cross-border bankruptcies would provide a way** to avoid such differences' becoming serious obstacles to quick and effective resolution of cross-border groups.

The following comments are therefore very tentative and subject to such further debate.

On the one hand, some firms feel strongly that deposits (insured and uninsured, with the relevant depositor guarantee scheme being subrogated to the rights of depositors insofar as paid out) should not have preferential treatment but should absorb deposits in event of a bail-in *pari-passu* with unsecured senior debt. **Firms that have built their capital structures in legal systems that do not include depositor preference are uneasy about the implications of depositor preference**, though not all firms have as yet firmly decided upon their positions.

The scope of any depositor preference eventually decided upon could have far-reaching consequences. Including all types of deposits would of course have much greater market impact, especially on the **market for and pricing of senior debt** than would a more circumscribed version of such a preference.

Depending on the capital structure (including junior debt), senior creditors of a bank with large amounts of preferred deposits would take significantly higher risks than senior creditors of banks with lower deposit balances, thus creating an incentive for investors and under some circumstances for banks to prefer wholesale non-deposit funding that looks anomalous given the intent of Basel III to induce more reliance on deposits and less on wholesale funding.

As noted in *paragraph 9* of Annex 7, it seems reasonable to anticipate that extending preferences might increase risk for financial stability because **non-deposit creditors would be given incentives to take other measures to protect themselves, such as collateralizing claims, shortening maturities, shifting from non-deposit instruments to deposits,** etc. They might also demand more stringent covenants, reducing flexibility for a firm that is weakening, or that is reaching the stage where its recovery plan might have to be applied. Senior unsecured funding might become difficult to come by, especially for retail-focused banks and for weaker banks. Moreover, some firms contend that depositor preference reduces market discipline by limiting the exposure to loss of uninsured large or commercial depositors with weaker firms, perhaps enabling them to attract such deposits at rates not reflecting actual risk.

On the other hand, other firms are attracted by the argument that **depositor preference in favor of deposit-guarantee schemes would have the virtue of limiting claims on deposit-guarantee funds and thus reduce non-defaulting banks' exposures** to such funds and to the risks created by less-well-managed firms. Arguably from this point of view, depositor preference should somewhat increase market discipline by non-deposit creditors, focusing exposures on equity and non-preferred creditors, and reducing the exposures of insured or mutualized deposit guarantee schemes.

All agree that ***national*** **depositor preference is at odds with the principles of group-wide resolution on a basis that is fair to all creditors**. It may have very anomalous effects, such as extending a preference to large institutional depositors at the home office over SME or retail depositors at foreign branches. It also tends to be associated with **attempts to ring-fence local assets** to the detriment of international creditors.

Depositor preference, which is almost by definition bank-specific, may also complicate group resolution by **creating a matrix of preferred claims within the group**, especially if deposits are in integrated, wholly owned subsidiaries.

It is stated in *paragraph 8* that if a resolution authority **transferred deposits to a bridge bank** or third party to preserve the continued operation of the deposit-taking function, there could be legal challenges from general creditors that are otherwise *pari-passu* with depositors on ground of unequal treatment. This comment, though significant of course, seems unduly defeatist in an FSB document: if, as suggested in the FSB consultation, the test of fair treatment is what a claimant would have received in liquidation is adopted legally, this problem should go away. In any case, the legislative changes that the FSB acknowledges are needed in many countries should include provisions to mitigate this problem, where necessary.

VIII. Discussion Note on Conditions for a Temporary Stay on Early Termination Rights: Annex 8

Questions for public consultation

26. Please give your views on the suggested stay on early termination rights. What could be the potential adverse outcomes on the failing firm and its counterparties of such a short stay? What measures could be implemented to mitigate these adverse outcomes? How is this affected by the length of the stay?

27. What specific event would be an appropriate starting point for the period of suspension? Should the stay apply automatically upon entry into resolution? Or should resolution authorities have the discretionary right to impose a stay?

28. What specific provisions in financial contracts should the suspension apply to? Are there any early terminations rights that the suspension should not apply to?

29. What should be an appropriate period of time during which the authorities could delay the immediate operation of contractual early termination rights?

30. What should be the scope of the temporary stay? Should it apply to all counterparties or should certain counterparties, e.g., Central Counterparties (CCPs) and FMIs, be exempted?

31. Do you agree with the proposed conditions for a stay on early termination rights? What additional safeguards or assurances would be necessary, if any?

32. With respect to the cross-border issues for the stay and transfer, what are the most appropriate mechanisms for ensuring cross-border effectiveness?

33. In relation to the contractual approach to cross-border issues, are there additional or alternative considerations other than those described above that should be covered by the contractual provision in order to ensure its effectiveness?

34. Where there is no physical presence of a financial institution in question in a jurisdiction but there are contracts that are subject to the law of that jurisdiction as the governing law, what kind of mechanism could be considered to give effect to the stay?

As with *Annex 7*, this open-ended discussion would appropriately be the beginning of a longer conversation in the industry and the market on the issues raised. It is especially important to achieve full clarity and legal certainty about the operation of any stays.

Among the many issues requiring further study and discussion would be the treatment of **CCPs and FMIs** and whether the stay should affect payments and collateral, or be restricted to the rights of early termination and close-out**.**

As with respect to other problems discussed in the consultative document, perhaps the most pressing need to arrive at an **effective cross-border means of assuring a generally consistent result** (*de facto* if not *de jure* universality) in the event of a cross-border firm's failure. The uncertainties identified in *paragraph 6* are clearly unsatisfactory.

If a temporary stay on early termination of qualified financial contracts (QFC) were to be included in the international standard, GFMA, the Clearing House Association, and other associations argue that the following **conditions should be applied to the exercise of any stay** (which conditions seem generally in line with the FSB's discussion, subject to further discussion and debate, especially by parties outside the US and the EU):

- The stay should be brief (e.g. one business day);
- The counterparty should be allowed to suspend its performance on the QFC during the pendency of the stay based on the contractual provisions in the contract; including an *ipso facto* clause tied to the resolution proceeding;
- The counterparty should be allowed to exercise its remedies upon a non-*ipso-facto* default by the receiver or resolution authority during the pendency of the stay;
- The counterparty should be allowed to close out upon a performance or other default on the QFC by the transferee entity after the transfer has been effected, but not an *ipso facto* default under the terms of the contract tied to the transfer or the initiation of resolution proceedings;

- A transfer of any QFCs between the firm in resolution and a particular counterparty and its affiliates should require the transfer of (1) all QFCs between the firm in resolution and that counterparty and its affiliates, and (2) any related collateral arrangement; and
- A transfer should only be allowed to a creditworthy third party or, with appropriate assurances of performance from the resolution authority and its government, to a bridge institution established by the resolution authority and, in either case, the third party or bridge institution should be subject to the same or a substantially similar legal and fiscal regime so that the economic and tax position of the counterparty (apart from the issue of creditworthiness) is not materially affected by the transfer[35].

In the event of a direct recapitalization of a failed firm in resolution, similar conditions should apply, and the assumption of the QFCs should only be allowed if the bail-in results in a creditworthy recapitalized entity.

VIII. Timelines for implementation of G-SIFI Related Recommendations

Questions for public consultation

20. Comment is invited on the proposed milestones for G-SIFIs.

The consultative document says that "the gap between the arrangements necessary for effective resolutions of firms and the arrangements that are currently in place is wide." Yet the timelines are silent on **the most significant of such gaps: the legislative and regulatory changes** that are identified in the consultative document and in these comments as necessary to achieve effective, credible cross-border resolution. Critical needs include mandates for authorities, clarification of powers along the lines envisioned here, and strong confidentiality protections. Rapid progress to fill these gaps is essential not only to create assurances that appropriate resolution can be achieved, but to avoid the distortions, costs, and inefficiencies that would result if structural or business-model changes were imposed on firms as a result of exogenous obstacles to resolution.[36] It would be most helpful for the G20 to establish milestones to be met by jurisdictions that need to make regulatory or legislative changes.

The G20 should also establish a process, through the FSB, to monitor and report upon the progress of jurisdictions in attaining such milestones.

Aside from the fundamental problem of needed exogenous changes, **the timelines stated are found by many firms to be overly ambitious**, in particular with respect to the December 2011 deadline for recovery plans. To some extent, this is because different firms and countries may be

[35] Indeed, a transfer of *any* liabilities should only be allowed to a creditworthy third party or, with appropriate assurances of performance from the resolution authority and its government, in a recapitalization or to a bridge institution established by the resolution authority.

[36] A firm's "resolvability assessment" should not be penalized because of the authorities' failure to make the necessary changes to their legal powers and capacity to use them (*per Stage 1 of the Resolvability Assessment in Annex 4).* Either such part of the assessment should be suspended until the needed legal changes are made, or, at the least, there should be a substantial transition period before any action is taken against a firm on measures "to achieve greater resolvability" that depend on the lack of legal or regulatory changes that are outside of the control of firms.

starting from quite different points in the process. Firms that are farther along find the timelines generally reasonable, subject to the following paragraph, but note that it will be important to align the timeline envisioned by the FSB with timelines being developed by the EU and other jurisdictions.

One specific aspect of the recovery and resolution planning process and of the measures to improve resolvability that will certainly need **phasing in** (even if the timelines proposed are otherwise met) is the **extent of changes of MIS** that may be required, depending somewhat on the business model and structure of each firm. As already stated, the MIS implications of *Annexes 5 and 6* are very challenging, especially when considered in conjunction with MIS changes required to implement other aspects of Basel II, Basel II ½ and Basel III, and other regulatory changes, plus the challenging expectations from a purely supervisory point of view as enunciated by the Senior Supervisors Group, not to mention idiosyncratic national requirements. It is of course important that all these requirements be well coordinated to avoid duplication, waste, or the inefficiencies and risk of error that can be engendered by different data definitions and overlapping or similar but not identical data requirements. Further, the extensive changes required will need substantial investments, will draw upon scarce IT and risk resources, and will need time to be done right[37].

There should also be some indication of the timeline for consideration of the difficult matters raised by the two discussion notes, on **creditor hierarchies and a temporary stay**.

[37] See IIF and McKinsey & Company, "*Risk IT and Operations: Strengthening Capabilities*", June 2011