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UniCredit's reply to the FSB consultation on Effective Resolution of SIFIs

UniCredit is a major international financial institution with strong roots in 22 European countries and an international network present in approximately 50 markets, with approximately 9.600 branches and more than 161.000 employees. Unicredit is the 2nd largest operator in Italy, the 1st one in Austria and Poland, and one of the most important actors in Germany in particular in Corporate and Investment Banking. In the CEE region, UniCredit operates the largest international banking network with around 4.000 branches. Unicredit Group is a market leader in the CEE region.

Executive Summary

The avoidance of financial instability is a much needed public good. While it is clearly in the common public interest to find solutions to protect it, market discipline has to be preserved and moral hazard avoided. All market participants, including SIFIs, have to be allowed to fail. Failure is an essential tool of "efficient markets": it allows for selection and fosters market discipline. However, systemically important functions (e.g. payment systems, deposits) require resolution tools that ensure their continuity.

Our considerations are based on the following considerations:

1) the economic unity, despite multiplicity of legal entities, of integrated cross-border banking groups;

2) the need for a broad and progressive effective removal of legal cross-border obstacles for an effective recovery plan;

3) the need for a global and regional governance for cross-border resolution regimes;

4) Complexity is not generally a firm choice, but in most cases it is due to exogenous factors.

On this basis we suggest an International Concordat signed by competent authorities based on four main points:

a) recognition of the **Group economic unity**;

b) **mutual recognition of national insolvency proceedings**, so that the entire group can be subject to a single principal insolvency procedure;

c) **cooperation among authorities** in cross-border crisis management and resolution, including, where appropriate, delegation of powers;

d) obligation for a fair and **equitable treatment of foreign stakeholders;**

Statutory bail-in and debt write down should be considered as a tools to be used **in a gone concern phase**, not as going concern measures. Only in exceptional circumstances and only upon resolution should authorities have the power to impose a debt write-down.

UniCredit fully supports the framework for **intra-group financial support** proposed by the EU Commission and call for its extension in the FSB jurisdictions.

Greater convergence in the statutory ranking of creditors would be highly desirable.

Convergence should move towards the creation of a depositor preference. Socially relevant creditors (retail clients and SME depositors and bondholders) shall be granted a "super senior" status and preference over the bank's assets in liquidation. Similar liabilities should be rapidly separated from the ailing bank and transferred to a third party (where possible a private sector purchaser; otherwise a **bridge bank**, whatever is the best solution in the circumstances). **The priority ranking of creditors based on social relevance according to public interest considerations should be clearly stated in law.**

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I Key considerations

We would like to summarize some UniCredit key considerations on Effective Resolution of SIFIs.

There is a **shortage of effective and credible proposals** concerning preventative tools **to reduce the probability of entering the resolution phase employing first market-led solutions and enhanced supervision.** To this end, it is crucial to recognise:

i) the economic unity, despite the multiplicity of legal entities, of integrated cross-border banking groups as well as the role of the parent company within the group, both in normal times and in crisis. The positive stabilization effects of well-functioning internal capital markets within cross-border groups should be exploited during crisis management as far as possible. The ability to transfer assets – subject to the applicable laws and regulations - between group entities has to be rightly recognised as a valuable crisis management tool. "Ring fencing measures" and other legal and regulatory national obstacles to the proper functioning of the "internal capital market" are likely to hamper the transfer of assets when it is mostly needed (namely in pre-crisis and crisis situations), thereby threatening the financial stability of the SIFI and therefore of the financial system at large.

ii) the need for broad and progressive effective removal of legal cross border obstacles for an effective recovery plan. UniCredit favours an intra-group support agreement ensuring the removal of unnecessary obstacles to a smooth the international flow of assets and liquidity within cross-border banks, not only in situations of liquidity shortage, but also in the normal course of business. The removal of the current and significant barriers will be beneficial in terms of financial efficiency as well as economic stability;

iii) **the costs of a fragmented legislative framework and ineffective international supervisory cooperation in the resolution phase cannot and should not be borne by cross-border institutions already before entering the resolution phase. Global and regional SIFIs require global and regional governance for a cross-border resolution regime.** If there are no substantial changes to the current various and different

national regimes a cross-border orderly resolution remains unfeasible. For instance, on orderly resolution requires as precondition a **jointly agreed declaration that refers to the Group consolidated level**. A mechanism to ensure rapid consultation among relevant competent authorities as well as concerned communication and necessary actions are seen as crucial elements for success. Moreover, on the resolvability assessment, we would suggest the FSB to **focus primarily on the institutional, legal and regulatory conditions/impediments (exogenous factors), and then on the firm structure and complexity (endogenous factor).** As far as **resolvability** is concerned, the firm structures are the result also of national exogenous factors which should be adequately addressed by the **G20, FSB and IMF's scrutiny and actions in order to meaningfully improve firms' resolvability.**

iv) **Complexity is usually not a firm choice; on the contrary in most cases it is undesirable and costly for the firm and due to exogenous factors.** The more heterogeneous and fragmented the exogenous factors, the more complex the firm structure. While endogenous factors may be more important as for recovery plans, the **exogenous factors are a dominant variable, when resolvability is assessed during the normal course of business**. The experience in the EU shows that ultimately there are no national solutions – in institutional, legal and regulatory and supervisory terms - that are effective for cross-border resolution challenges. In the foreseeable future, the proposed FSB approach should allow preventing national competent authorities from charging firms' sustainability, organisation and business model, with the faults of a still too fragmented institutional, legal and regulatory international framework. The FSB could play a major role in helping G20 policy makers to cope with the cross-border nature of financial institutions. In the medium term, for the FSB proposal to be credible and sustainable, we would ask the FSB to overcome undesirable forms of protectionism that clash with global markets, infrastructures and players, including investors, while making visible and biting national barriers and ring fencing.

Concerning the key considerations on <u>crisis resolution</u>, we suggest:

i) an **International Concordat signed by individual competent authorities**, in order to facilitate authorities involved in a cross-border crisis to seek true coordination and cooperation with each other. Such Concordat should rely on <u>four main points,</u> namely:

a) recognition of the **Group economic unity, despite the multiplicity of legal entities, of integrated cross-border banking groups**;

b) **mutual recognition of national insolvency proceedings**, so that the entire group can be subject to a single principal insolvency procedure;

c) **cooperation among authorities** in cross-border crisis management and resolution, including, where appropriate, delegation of powers;

d) obligation for a fair and **equitable treatment of foreign stakeholders;**

Non-G20, non-FSB jurisdictions should be encouraged to adopt resolution measures that are consistent with global standards.

ii) the IMF and the FSB to include in their "Implementation progress report" a **section dealing with the Resolvability Assessment** describing:

- which steps have been undertaken by Jurisdictions to remove key legal cross border obstacles for an effective recovery plan; an updated plan of those obstacles that remain to be addressed by Jurisdictions;
- which geographical areas (e.g. the EU or euro area under the new crisis resolution framework) are deemed sufficiently integrated - from an institutional, legal, regulatory and supervisory perspective - so that a cross-border resolution is really supposed to be manageable;
- which conditions have to be fulfilled for a geographical area to be recognised as an "integrated area";
- a road map towards the fulfilment of the above conditions for the G20 and non-G20 jurisdictions that ask for it.

iii) the **resolution plan should also include a section prepared by every single SIFI** describing how the systemically important functions (identified by the regulators) and the essential functions (identified by the firm) can work from a business continuity perspective and whether there are any significant impediments that are out of the firm's control;

iv) **to consider statutory bail-in** and debt write down as a tools to be used **in a gone concern phase**, not as going concern measures. Only in exceptional circumstances and only upon resolution should authorities have the power to impose a debt write-down.

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2 Detailed answers

Part. 1. Effective resolution Regime

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?

We think that the suggested framework provides a first basis for discussion on the content of the regulation, but we realize that limited progress has been made towards a common regulation and particularly with regards to the effective allocation of institutional responsibilities. We are strongly concerned about a number of key aspects that still remain open and therefore threaten, from the outset, the credibility of a proposal aiming to properly resolve a cross-border financial institution.

Besides the popular and sometimes misleading perception that all G-SIFIs are too big to fail, there is the expensive perception that G-SIFIs are too "difficult" to be resolved. In order to overcome this, it is necessary a "quantum leap" at political and institutional level: *a **Global SIFIs requires a global governance for the resolution regime***.

As it stands, the perceived effectiveness and legal enforceability, even in the medium term, are far from being ensured, especially concerning cross-border resolution:

- the legal conditions for cross-border cooperation are still very weak;

- it is not clear who has the authority to promptly take and enforce decisions across borders/jurisdictions. In our view, also minimum accomplishments such as exchange of information among the group of (almost) "equals" in the firm's Crisis Management Group seem to have a doubtful chance of success and limited effectiveness. Instead it should be better clarified who is responsible and what are the key steps of the decision making process (and related mechanisms) for dispute settlement, for instance it would help to achieve a joint agreement for the declaration of the group resolution (no unilateral actions should be allowed);

- the legal status and hierarchy of the "Cross-border cooperation agreements" and the term "key attributes" are still unclear and highly questionable;

- the effectiveness of the IMF/WB Financial Sector Assessment Programme to timely oversee and credibly put into place the necessary framework and any requested changes is highly questionable;

- It should be better clarified that the Recovery and Resolution Plans are defined at Group level with provisions also applicable for the involved subsidiaries;

- it is far from clear what is exactly the real power a resolution authority has about managing assets owned in various jurisdictions or handling contracts with foreign counterparties. Special attention should be paid to internet banking as deposits could be collected through a large number of jurisdictions.

The playing field is far from being levelled to an acceptable extent, also because the right for discretionary national action is still completely in place (see annex I point as 8.3):

- All financial institutions shall be allowed to fail and be resolved, so that market discipline preserved;

- Regulation on resolution should allow the choice of the business model a banking *group* deem most appropriate irrespective of whether it is based on **integrated** or **stand-alone** legal entities. Hence regulation shall provide a framework allowing for the provision to the parent company of powers and responsibilities for the soundness of the group as a whole, based on the chosen business model;

- Recovery and resolution plans should be required for all financial institutions, not only SIFIs. However, the requirements should be applied proportionately. It is very critical that authorities clearly define, in cooperation with financial institutions, the vital functions of the bank to be preserved and transferred to a bridge bank in order to avoid contagion and market disruption, while the residual components would be liquidated. Smaller institutions, with a narrow geographical scope, e.g. Community Banks in US or Volksbanks, could be exempted to avoid unnecessary burdens.

- On the firm side, not only Senior Management should be involved but also the **Board of Directors**, ultimate responsible of the bank management as shareholders' representatives.

- Resolution of a financial institution shall be based on legal certainty at all times. *Ex-ante* statutory rules, predefined triggers as well as contractual terms and conditions shall assist supervisory and resolution authorities in the adoption of relevant actions;

- The **information requirements** for resolution (section 11.4) should be consistent across G-SIFI to ensure a level playing field, while avoiding unnecessary burden on certain jurisdictions.

- The "entry into resolution" definition[1] remains a very vague concept. This inter alia has not yet sorted out the uncertainty on the allocation of responsibilities of all the various involved parties,

***- An adequate framework should properly distinguish early intervention tools,* e.g.** those that are "intrusive" (for instance because they affect shareholders rights and therefore should be based on legal certainty and not upon discretion by the national authorities), from others types of "not intrusive" early intervention tools, where an overly prescriptive approach,

[1] Annex I point 3.1 "…when a firm is no longer viable or likely to be no longer viable and other measures have proved insufficient to prevent failure."

with pre-defined triggers, is probably not necessary and a certain degree of supervisory authorities' discretion would be beneficial.

Concerning "intrusive" actions, ex-ante statutory rules and predefined triggers, shall be properly designed on public interest considerations and shall assist authorities in the adoption of relevant actions. Considering that the new regulatory framework already provides for new requirements addressing a deteriorating situation at an early stage (i.e. conservation buffer and liquidity ratios, which should prevent liquidity shortage), predefined triggers for any circumstances of likely breach should be excluded.

- ***Early intervention measures start*** upon the assessment by the relevant supervisory authorities of a breach (or a likely breach) of regulatory prudential requirements. A similar assessment could possibly take into consideration market-based triggers.
Upon assessment of a crisis, supervisory authorities should have enhanced powers and tools to quickly recover the bank. However the appointment of a **Special Manager** as an Early intervention measure is not a desirable solution and it poses serious questions in terms of the subsequent allocation of responsibilities among the various stakeholders. It should be clarified beforehand who is in charge of appointing the Special Manager of the subsidiaries, i.e. if it is the General Manager of the Holding Company or the host Resolution Authority.

- ***Early interventions shall be based on legal certainty***. *Ex-ante* statutory rules, predefined triggers and contractual terms shall assist supervisory authorities in the adoption of relevant action.

- ***Preparatory and preventative powers need to be applied very carefully at a Group level*** as a result of a broad and qualified consensus within the college of supervisors and only after alternative measures have been duly explored together with the involved institution, and ensuring the required speed of the decision making process, which is a necessary condition for its effectiveness.

- ***The parent company should define*** (with relevant regulators and supervisors) ***ex-ante recovery plans*** under different scenarios. Plans should take into account and prevent any risk of opportunistic behavior (moral hazard). ***The special role of parent companies should be acknowledged,*** especially in integrated banking groups. The parent company is in the best position (in terms incentives and of knowledge of the group as a whole) in order to propose measures in the group interest, taking properly into account a) the potential effects on any legal entities, b) the potential effect within the Group (across borders) of key issues arising in single legal entities and c) is best placed to launch most remedial actions, such as capital increase.

- ***In integrated cross border banking groups intra-group financial support should be a tool to manage the group functioning and to increase its resilience,*** not **only in situations of shortage of liquidity** but also **in normal course of business**. We envisage a framework for intra-group support based on the following features:

i) depending on its business model, structure and strategy, each banking group will be **free to decide whether to adopt the Intra-Group Financial Support Agreement**;

ii) the Agreement has to be **signed by the involved parties** (e.g. the parent company and the legal entities involved).

iii) **internal transfers of assets and liquidity have to take place following the already agreed terms and conditions** specified in the Agreement, with no authorization required on every single transfer of resources during normal course of business.

- Consistency of the preparatory and preventative powers with the above remarks on the intra-group financial support Agreement should be ensured also in **order to remove unnecessary restrictions to intra-group transferability**. Preparatory and preventative measures might be exceptionally applicable to single group entities only following a specific decision within the College of Supervisors.

- ***Financial institutions should be resolved, while avoiding costs to taxpayers.*** The resolution powers of the authorities shall support **private sector solutions** or, if not otherwise possible, be exercised as a last resort in order preserve the common public interest. Where possible, **bridge bank mechanisms** would allow for the continued performance of the firm's essential financial and economic functions in view of a private sector solution. All parties, including management, directors and other stakeholders bearing **responsibility** for the crisis of the financial company shall bear the associated costs proportionally with their proven responsibility.

Part. 2. Bail in Powers

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?

We appreciate the steps forward in defining the statutory framework and the bail-in powers of the authorities. Nevertheless, we have three major concerns:

1. Leaving maximum discretion to the individual authority of the **Triggers' conditions** (as referred to in par. 4.1) **is far too controversial**. While a proper and timely dialogue among the competent authorities and the top managers of the firm is always useful, the consequent uncertainty of "the entry into resolution" step, and unintended consequences is extremely high, especially for cross border financial institutions.

This section should be in our view substantially expanded and included in the International Accord as described in the next section on cross-border cooperation agreements. The analysis and decision making process of different authorities should be part of an integrated framework, following the ongoing debate and achievements in the EU crisis management and resolution framework.

2. **A statutory debt write down as recovery tool before a bank has entered resolution is counterproductive**. Debt write down should aim at making a bank failure properly manageable, and should not be considered as a tool to make bank failure impossible.

While supporting statutory debt write down **in a gone concern phase**, we argue that authorities should be granted the power to write down debt only in exceptional circumstances and only after the declaration of insolvency. Consequently, the "bail in" should be conceived as **a write down, partially or in full, of certain liabilities**, rather than an implausible conversion into equity, which would make no sense, after the insolvency declaration of the bank.

3. **It is highly questionable how "the exercise of bail-in powers within resolution should not constitute an event of default that permits the exercise of early termination and close-out rights in respect of financial contracts."** (as referred to in par. 8.1). We fear there is a contradiction or at least a serious mismatch between the intended objectives and the reality.

We have serious concerns on the effective coordination among national authorities of powers and responsibilities (as described in par. 9.2). The power and the circumstances under which the authority could intervene should be clearly defined under statutory rules designed in a way that adequately reflects the ranking of creditors under insolvency regime and legal privilege to socially relevant creditors. Well defined a priori statutory rules would prevent regulatory arbitrage that would otherwise imply detrimental effects on the price of debt issuance.

This section should be in our view substantially expanded and included in the International Concordat as described in the next section on cross-border cooperation agreements. The involvement of the Crisis Management Group is helpful for information sharing, but the decision making process is inefficient and ineffective until national authorities allocates parts of their responsibilities to a supranational entity (e.g. the European Banking Authority in EU).

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?

Yes, it seems desirable, provided adequate coordination across countries is ensured by a legislative framework and preferably by a supranational entity. Moreover it is recalled that it is not desirable to undermine the key principle that creditors of the same ranking should be treated similarly, also to allow a proper and homogenous pricing of the related financial instruments. Authorities should not exercise any discretionary powers that would allow any discrimination among creditors of the same class.

Finally, under UniCredit suggested approach the debt write down is triggered when resolution is entered into and no compensation mechanism would be required

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

The power to write down debt should take into account the systemic and social relevance of the concerned liabilities. Social relevance implies an ex-ante defined priority ranking of creditors given public interest considerations, based on the impact of the liability on households (deposits of retail clients and SME) and the effective monitoring ability of creditors.

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

In the context of a statutory power to write down debt when the resolution process is activated, socially relevant creditors – e.g. **deposits of retail clients and SME** – as well as secured debt-holders, including holders of covered bonds should be excluded. These creditors should be granted a "super senior status" and preference to the bank's assets in liquidation.

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., (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)?

We are against a targeted approach imposing a fixed amount of bail-inable debt to be issued by credit institutions. This would be perceived as an additional capital requirement, with the resulting in an increase of the overall minimum regulatory capital.

In addition, the proposal to define a fixed minimum of bail-inable debt as a percentage of risk weighted assets is not an adequate choice. In fact, risk weighted assets are not a proper proxy of the likelihood to recourse to public money and of the magnitude of the potential public interventions required in case of a crisis (during the recent crisis some banks incurred losses of relevant magnitude despite their regulatory capital in percentage of risk weighted assets being larger compared to the average of the banking sector).

Also the second suggestion is definitely problematic, especially for the unforeseeable impact on liquidity management and any subsequent impediments increasing the vulnerability of the financial institution.

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?

The introduction of a minimum required amount of bail-inable debt would have the consequences of significantly increase the banks' cost of funding. In fact, it is reasonable to assume that the bail-inable liabilities would be treated by the market as bank capital rather then senior unsecured debt. The significant increase in the banks' cost of funding is also likely to have an impact in terms of more limited and/or more expensive credit supply to the economy.

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Part 3. Cross-border cooperation

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?

We think that the suggested framework is not satisfactory and have major concerns on the FSB proposal to resolve a cross-border financial institution:

The suggested statutory duty to cooperate is insufficient and unsatisfactory:

- the legal **enforceability**, even in the medium term, is far from being ensured;

- the bulk of the proposed **cross-border cooperation agreement does not need to be group specific**, which would also limit the legal status of the agreement and enforceability. Most of the rules could be part of an international framework agreement/template with a recognised international legal status. Annex 3 of the FSB consultation paper argues to draw up firm-specific agreements, which are themselves based on bilateral national agreements. In order to avoid a too high degree of divergence, we ask cross-jurisdictional authorities (such as EBA in EU) to develop a framework for national supervisory authorities. On the basis of such a framework agreement, national authorities may then draw up bilateral agreements that over time should tend to converge by peer reviews.

- the legal nature (binding or not) should not be left to the individual parties for each agreement.

An International Concordat should be signed by individual competent authorities in order to facilitate authorities involved in a cross-border crisis to seek coordination and cooperation with each other.

Such Concordat should rely on four main points,:

a) recognition of the **Group economic unity, despite the multiplicity of legal entities, of integrated cross-border banking groups**;

b) **mutual recognition of national insolvency proceedings**, so that the entire group can be subject to a single principal insolvency procedure;

c) **cooperation among authorities** in cross-border crisis management and resolution, including, where appropriate, delegation of powers;

d) obligation for a fair and **equitable treatment of foreign stakeholders;**

We see no concrete step forward from an institutional and legislative standpoint

o We appreciate that the agreement proposed by FSB should include "the commitment to address the legal and operational impediments to cross-border implementation and specification of framework conditions for resolution strategies and necessary process…" However, this is far from being sufficient in the absence of a supranational authority that is entrusted with the task to agree and deploy the necessary legislative actions to ensure the removal of such obstacles , while guaranteeing a level playing field.

The new Concordat should also include a part on **International coordination and institutional arrangements** with the following recommendations:

- **International and supranational (e.g. EU) Authorities and Bodies should play a key role** in all phases of crisis management, in order to guarantee an effective coordination and level playing field. Such empowerment should include a contribution to the development and coordination of recovery and resolution plans and the power to resolve disagreements between involved national authorities in the application of preparatory and preventative powers.

- For reasons of public interest, **temporary (mid-term) emergency funding and liquidity** should be provided at market conditions and in a coordinated manner. This emergency funding could also be provided by national deposit guarantee schemes or, where already available, by recovery funds or national resolution funds. In our view, **the costs of establishing national resolution funds as tools for financing resolution overcome the limited benefits**, since the national funds are not able to positively interfere with many of the rights at stake (creditors' and shareholders' rights in particular), while they distort competition, foster moral hazard and create a bias towards a national approach to resolution.

- In the event of a cross-border group failure, proper mechanisms to unwind certain relevant intra-group transactions (including *revocation or claw-back actions*) through **international arbitration** should be introduced to assist an orderly and equitable resolution of the parent company and/or failed subsidiaries. The revocation would only be limited to those transactions that occurred within a certain period (the so-called "suspect period") before the beginning of the resolution. This would allow a fairer distribution of assets and other valuable resources within the Group.

- **Resolution costs** (administrative costs, emergency funding) should be shared proportionally among involved national institutions according to fairness and equity principles, to be agreed and defined *ex-ante*.

- Arrangements to resolve a cross-border financial group need to be **coordinated** in a timely and transparent manner among relevant involved authorities in order to ensure fair and (as much as possible) predictable outcomes. National authorities should be committed to the

mutual recognition of national insolvency proceedings, so that the entire group can be subject to a single principal insolvency procedure. Where appropriate, national authorities may delegate authorities of other countries the powers to lead the resolution process;

- all elements of **confidentiality and banking secrecy** must be assured as well, also when different authorities in different countries, e.g. home und host authorities cooperate in a restructuring or resolution.

The playing field is far from being levelled to an acceptable extent: the right for discretionary national action is completely preserved (see annex 3 point as 5.1 iii);

Mutual recognition: the new Concordat could also take into account the following **principles for cross-border financial groups in gone concern:**

- National authorities are committed to a ***mutual recognition*** of national insolvency proceedings, so that the entire group can be subject to a single insolvency procedure;

- Clear ex-ante allocation of responsibilities among relevant authorities: Arrangements to resolve a cross-border financial group need to be **coordinated** in a timely and transparent manner to ensure **fair, equitable and predictable** outcomes. When appropriate, national authorities should be able to delegate supranational authorities (e.g EBA in EU) or authorities of other countries (for example the parent company's authority) the powers to lead the resolution process.

- Treatment of the group entities. In the case of a failure of one or more entities of a cross-border banking group, the **resolution should follow the legal personality** of the entities involved. The parent company may be requested to contribute to the resolution, **in proportion to its proven responsibility for the failure of a certain relevant subsidiary**, with a pre-defined framework for cost allocation in order to minimise any discretionary decisions.

In cross-border integrated banking groups, vital financial and economic functions/operations must be preserved to the greatest feasible extent through the **unity of the group**, provided this corresponds to the common public interest.

- Treatment of the stakeholders. Stakeholders in any jurisdictions must always be treated in a fair and equitable way (thus warding off international discriminations). Stakeholder rights should be preserved and balanced with the common public interest. Stakeholders shall always be entitled to challenge before a judicial Authority any decisions taken by authorities and directly impinging on stakeholders' rights.

Part. 4 Resolvability assessments

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?

UniCredit deems the list of determinants a useful starting point however **we object to the approach used by the FSB that primarily focuses on the firm structure and complexity (endogenous factor) and not on the institutional, legal and regulatory conditions (exogenous factors).** We are of the considered opinion that there must be a paradigm shift when performing "Resolvability assessments" and above all the awareness of potential (and much needed) changes in the current legislative framework.

The firm structures and complexity, from a resolvability viewpoint, are the result of national exogenous factors which must be the object of the G20, FSB and IMF's scrutiny and actions to improve the exogenous factors concerning resolvability. While endogenous factors may be more important as for recovery plans, the **exogenous factors are dominant when resolvability is concerned**. The experience in the EU, shows that ultimately there are no national solutions – in institutional, legal and regulatory and supervisory terms – which are effective for cross-border resolution challenges. The FSB approach is likely to lead national competent authorities to charge on firms' sustainability, organisation, business model, with the faults of a fragmented institutional, legal and regulatory framework, and the failure of G20 policy makers to cope with pros and cons of the cross-border nature of financial institutions. With this regard we would like to remark that the Group structure acted as a kind of first level safety net in avoiding some Legal Entities to default and therefore avoiding contagion effects in some financial systems.

In the medium term, the FSB regulatory approach risks to reverse the globalization process and impinge substantially on the market choices, raising again national barriers and protectionism. We are of the view that the G-SIB resolvability's issues must be addressed by appropriate adaptations to the level of governance with Authorities having a global reach and rules applicable across borders and not the opposite, namely that in order to resolve G-SIB in a national, albeit coordinated, environment, G-SIB must "become" national. In EU, we believe we are on the right track, even if enormous challenges still lie ahead.

- We consider that sections from 4.9 to 4.13 should be completely redrafted along the lines of the replies to Part 3 above.
- We suggest the IMF, the FSB to include in their "Implementation progress report" a **section dealing with the Resolvability Assessment** describing:
  - which steps have been undertaken by jurisdictions to: 1) remove the relevant legal cross border obstacles for an effective recovery plan; and 2) update a plan of those steps that still need to be addressed by such jurisdictions;
  - which geographical areas (e.g. the EU or euro area) are deemed sufficiently integrated - from an institutional, legal, regulatory and supervisory perspective - so that a cross-border resolution is effectively and efficiently manageable;
  - which specific conditions have to be fulfilled to be deemed as an "integrated area";
  - a Road Map towards the fulfilment of the conditions for the G20-jurisdictions that ask for being considered part of an "integrated area".

We would also like to provide some suggestions to better specify some aspects to improve the effectiveness of FSB framework.

Section 2

(ii): it should be underlined that the resolution actions strongly depends on the exogenous factors and to some extent to market conditions. The exogenous factors, including

institutional supranational arrangements, are to be reviewed as structural changes which could have substantial positive implications on the resolvability of cross-border firms, regardless their structure.

Section 3:
The regulators should set out the criteria to define the key host authorities within a cross-border Group.

Section 4:
4.1 Regulators should define what are the systemically important functions as they are not linked to the single group. This is also vital to shape the resolution actions. UniCredit deems of the utmost relevance that the definition of systemically important functions is going to be discussed and shared with the financial industry.
4.3: It would be more appropriate to reword in term of intra-group transactions where the operations quoted, such as guarantees, are examples. Furthermore transactions also includes such actions that could not imply assets or liabilities but services such as payments.
4.5 Within the assessment it is necessary evaluating if spun-off assets could be viable outside the Group.
4.6 In the assessment of Firm structure and operations by the competent authorities, a key element is missing: HR management. In many cases there are exchanges of human resources within the Group such as secondments, expatriates, temporary redeployments.
4.7 The full analysis of the group should not only be focused on the risk profile but also on the revenue and profitability as key elements for better understanding the sustainability of the resolving actions.
4.8 To ensure desired full effectiveness and efficiency, regulators should define what is the relevant required information from any relevant institution.

Section 5:
5.1 UniCredit would deem of the utmost relevance a more detailed analysis of market impacts, that besides the mentioned factors, should also include the following ones, leveraging on the Lehman case/experience:
- stock volume
- weight of the shares in stock indexes, which is the underlying of most derivatives
- OTC exposures
- Outstanding bonds and owners
- Management of credit cards

5.4 an adequate assessment of liquidity impacts should be assessed as well
5.5 It would be beneficial a proper assessment of the impacts on the real economy in term of segments, e.g. corporate, small business, retail
It is totally missing what we deem as a very critical issue, the impacts on sovereign risk, and therefore we would recommend adding a new bullet point, for instance:
5.6 Impact on the functioning of the Sovereign Debt market due to the intermediary' role of the financial institution in managing the public debt in the stages of origination, auction purchase, placement, secondary market making, custody, settlement etc.

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

In the short term, UniCredit deems of the utmost relevance a better definitions of the roles of home and host authorities, because the current proposals seems falling short of a clear role attribution that would prevent an efficient and effective resolution.
It is not clear how a potential disagreement could be settled, i.e. if the Home Supervisors has the same role as foreseen by EU Directive on Capital Requirements (CRD), article 129, or if any agreement is based on a voluntarily base. In this case, we consider that a supranational third party such as EBA would play a vital role and crucially facilitate the decision making process in the College of Supervisors.
On top of an efficient and effective resolution action, which is the main objective, the involvement of supranational parties (e.g. EBA in the EU) could certainly and significantly help to level the playing field on the regime applied for different Cross-border banking groups.
Lastly it should be specified how the countries not part of CMG are dealt with, for instance with bilateral meetings with the home supervisors, consistently with Annex 5.

In the common public interest, the ongoing performance of the firm's essential financial, economic and systemic functions/operations should always be ensured. Essential and systemically important functions/operations would also include uninterrupted access of depositors to their own funds, regardless of their location, and ongoing payment system activities. This is necessary to try to avoid panic and/or a further and potentially devastating destabilization of financial markets[2].

Part. 5 Recovery and resolution plans

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?

UniCredit deems the proposal an important step forward though there are a number serious concerns:

- **who is in charge/responsible among the relevant authorities?** For Global SIFIs it is necessary for most of the proposed tasks to unequivocally specify ex-ante what are the criteria to identify a relevant responsible body or entity (e.g. European Banking Authority, CMG, College of Supervisor, home supervisor?)
- **cross-border coordination proposal for the RSP is unclear and does not appear to be credible.** As stated above in parts 1, 3 and 4, the effectiveness of the Resolution Plan depends on exogenous factors – institutional, legislative, regulatory, supervisory environment – which are well beyond the single firm responsibility and require a road map towards an increased coordination and integration (as in EU) among the authorities
- **the resolution plan** should also include **a section prepared by the firm describing how the systemically important functions** (identified by the regulators) can work within resolution from **a business continuity** standpoint and whether there are any other impediments to the continuity which are out of the firm's control.

Furthermore it could be appropriate to better specify some relevant aspects, in order to improve the effectiveness of the suggested framework:

[2] See Financial Stability Board, "Reducing the moral hazard posed by systemically important financial institutions - FSB Recommendations and Time Lines", 20 October 2010, 3.

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Section 1:

1.4 It has to be carefully thought whether system-wide stress scenarios can be actually tested. UniCredit notes that the assumptions regarding the reactions of governments and central banks are key in changing the market environment and the results of the tests. The recent and ongoing systemic financial crisis has seen for instance the activity of central banks to address systemic funding liquidity risk or of governments to address the systemic credit risk.[3] With this in mind, **UniCredit deems that systemic crisis scenarios should include systemic reactions by relevant public bodies/entities as well**. The firms' idiosyncratic actions could be ineffective in the event systemic reactions by central banks or governments are ruled out, or could even make more severe the market disruptions due to herd effects ;

1.5 it would be necessary to specify what are the criteria to identify the mentioned authorities (home supervisor and the involvement of host authorities, supranational third party such as EBA), and the allocation of roles and responsibilities;

1.9 It is unclear whether the mentioned host authorities are those members of the Crisis Management Group or of the College of Supervisors, or else.

1.16 It is crucial that regulators provide a better understanding on how the consistency across firms would be achieved, in order to actually ensure a level playing field

Section 2

It is vital for authorities to adequately explain how all the legal, regulatory and supervisory impediments to an effective cross-border resolution are going to be addressed.

2.2 We would deem as appropriate that the definition of major operations in the executive summary should be linked with the resolvability criteria as outlined in Annex 4.
It is important that the Group provides an overview of its operations and structure.

Section 3

3.4 It is of the utmost relevance that the analysis of constraints on the transfers of liquidity and assets is performed also by supervisors in order reach a common understanding of what could be done by the firm and what are exogenous responsibilities to be addressed.

Section 4

4.1 It is fundamental the criteria for initiation of official actions are discussed with the financial industry to ensure their full effectiveness, credibility, as defined in Annex 4, and the necessary level playing field. These criteria should serve the purpose of proposing legislative changes in order to remove potential legal obstacles.

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

The proposal does not provide an entirely clear understanding of the role of subsidiaries. In our view, the key principle should be that the RRP is a group effort with an

[3] Liquidity facilities, such as those granted exceptionally provided by FED and ECB; credit lines or guarantees as such provided by some governments during the crisis.

active involvement of the key Legal Entities, where the parent company identifies the key strategic options at a consolidated level.

Subsidiaries are supposed to contribute by assessing the feasibility of the proposed remedial actions, their timeliness, market impact and the constraints, if any, to the transfer of resources such as liquidity, capital and assets. The parent company's RCP should also ensure the business continuity of any of the key legal entities (as minor ones rely on the largest ones) so that they might be sold/transferred if and when appropriate rather than let to default.

The plan should be reviewed as a whole at consolidated level by the College of Supervisors and the Crisis Management Group and not individually by certain authorities. That would also mean the proper engagement by the home supervisors of those authorities out of the CMG, if any.

Part. 6 Improving resolvability

UniCredit deems this section a useful starting point. However, UniCredit suggests to focus more on the institutional, legal and regulatory impediments (exogenous factors).

On a more operational level, the resolvability should be viewed within the context of the overall business model In the recent crisis the integrated UniCredit group structure was effective in reducing the impacts on legal entities that would otherwise have suffered a systemic impact.

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

The proposed measures broadly outline the obstacles even if we would like to point out some remarks.

Section 1
To avoid an undesirable overshooting, the interconnectedness should apply to the main Legal Entities of the Group or at nation level, as minor legal entities by definition rely on the largest ones.
Adequately detailed booking practices would significantly help to efficiently unwind infra-group transactions. Nevertheless, certain alternatives should be considered for certain special transactions such as multilateral securitisations, i.e. securitisations backed by loans booked in different legal entities.
1.1

(ii) It is important to assess any significant constraints to a free information flow, but it would also require a review of the impediments due to the current legislation;
(iii) the proposed time span should be discussed and checked with the financial industry

Section 2
The flows within a group should be properly ruled, even if SLAs could not be the appropriate tool, since they are related to services and do not cover in full certain other key activities such as risk management. On the other hand there are certain works/activities (such as risk policies) that are driven by governance and therefore enforced by internal regulations.

Section 3

UniCredit deems necessary that no constraints are set to ring-fence any intra-group transactions that "trap" value in one legal entity, thus compromising an efficient and effective recovery of the Group.

3.1 We strongly support that intra-group guarantees should be processed according to the normal decision-making and risk management processes.

3.2 (i) To some extent, the quoted actions could be put in place only by changing the current legislation
(ii) The need to limit imbalances should apply also vice versa, i.e. if a crisis of a main subsidiary emerges

Section 4
4.3 (ii) The standardisation should be pursued by the industry as a whole and/or regulators

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

The steps seem to go in the right direction, but unfortunately they are far from being satisfactory.

On an operational level, it would be beneficial foreseeing not only close-out clauses but also novations, in order to facilitate the hand-over to a third party, such as purchasing bank or a bridge one.
Therefore the key point is the willingness to properly modify where required the current legislation in order to remove any relevant obstacles in case of an effective resolution.

A potential area of action to be better specified are hedging or protection instruments where they are related to portfolios in different jurisdictions.

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

We would like to draw the attention to the proposal from the European Commission early this year on bank recovery and resolution. The EU Commission proposes an **intra-group financial support** which represents a crucial attempt to break through some of the currently deadlocked thinking on how to ensure the removal of unnecessary obstacles to the resolvability and to the smooth flow of resources (e.g. capital, securities, and liquidity) within a banking group operating across borders, and in the EU in particular. We therefore **fully support the framework for intra-group financial support proposed by the EU Commission and call for its extension in the FSB jurisdictions**.

We also deem useful to propose some amendments in order to improve its real effectiveness.

An **intra-group support agreement ("Agreement")** should ensure an effective flow of resources within a banking group operating across EU jurisdictions while providing the necessary safeguards and information to key stakeholders, such as minorities, creditors, subsidiaries and local authorities. Intra-group financial support should be a tool to manage the group functioning and to increase its resilience, not **only in situations of shortage of**

liquidity but also **in normal course of business**. In this respect, **it's crucial that the parent company has the necessary powers - in the interest of the group as a whole - in efficiently transferring assets within the Group**. The parent company will be responsible for any decisions taken in the interest of the Group. Moreover, we agree with the EU Commission that such a financial support should not be conceived as a tool to facilitate or manage resolution.

We envisage a framework for intra-group support based on the following features:

- The FSB shall define the minimum content of the Agreement (**minimum common procedures and responsibilities** of the involved parties) and on this basis delegate the drafting of a contractual template to competent supervisors (Basel Committee on Banking Supervision).
- The Agreement must be finalised **in normal course of business** in order to provide an "additional" tool to further improve the management of liquidity problems in an early intervention situation.
- From the perspective of the competent authorities, the Agreement will have the objective to give sufficient **comfort to competent authorities** that the parent company will always act in the interest of the Group within a predefined set of rules safeguarding the stability of legal entities.
- Each banking group will be **free to decide whether to adopt the Agreement**. Presumably, well integrated groups supporting a further removal of current obstacles to a free flow of resources (within a group) would sign such an agreement. Groups based on less integrated business model would be free not to sign such an Agreement. If no Agreement is signed, then the underlying framework for intra group support will be regulated by national corporate and insolvency laws (thus without any changes with respect to the current situation).
- The Agreement will have to be **signed by all the key parties involved** (the parent company and relevant involved legal entities). The competent home and host authorities will certify the conformity of the Agreement to the contractual model as defined by the legislator and specified by the supervisory authority (e.g. EBA in EU).
- Once the Agreement is signed, **internal transfers of assets and liquidity can take place following the terms and conditions** specified in the Agreement. Hence, no authorization is required by the Authority on every single transfer of resources during normal course of business.

Upon the terms and conditions of the Agreement, the group will have to provide regular updates to the authorities on a pre-agreed set of liquidity indicators. **When there is a breach** in the liquidity indicators activated by predefined triggers, then the **competent Authority has the power to impose or forbid any transfer of resources** within the group.

Finally, intra-group transactions, often for risk management purposes, are a key part of the group activity and business model and as such increase its efficiency and sustainability. Therefore should not be banned or unnecessarily constrained.
We deem appropriate that all guarantees are subject to the same controls done with external counterparties.
That should be matched by the assessment, both by the firm and then by Supervisors, that a LE business is viable also without the infra group guarantees

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 measures outlined should be set as a requirement in the recovery and resolution planning by the firm and in any subsequent reviews by Supervisors.

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

Concerning the cross-border cooperation, UniCredit is of the view that much still needs to be done to properly address this aspect and the timetable seems unrealistic but we appreciate the effort as the current institutional architecture and legislative framework negatively affect an effective cross border resolution and therefore negatively impinge on firms' resolvability assessment and recovery plans.

UniCredit would deem as relevant that the all competent supervisors provide by June 2012 a feed back to the first version of the RCP to be delivered by December 2011.

Concerning the RSP and the deadline of June 2012, UniCredit is of the view that it is acceptable even if quite demanding, provided that Supervisors timely indicate the requirements for the firms' contribution.

Part.7. **Creditor hierarchy, depositor preference and depositor protection in resolution**

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?

Differences in creditor ranking impede effective cross-border resolution as they might have the following consequences:

(i) reduce national authorities' (including governments) incentives to cooperate: e.g., jurisdictions with national depositor preference will tend to seek protectionist (non cooperative solutions) during resolution. In such a situation, other involved authorities will likely follow a non-cooperative strategy, too.
In general, creditor ranking reflects political and common interest considerations, which might be an obstacle to the willingness of national authorities to effectively cooperate with each other in a cross-border bank resolution.
Political considerations and (at least in some cases) underlying creditor hierarchy might turn to be an obstacle to creditor ranking harmonization.

(ii) reduce the scope and effectiveness of resolution tools. Partial transfers and bridge bank solutions (in a cross border context) could result in a violation of the principle of equal treatment of creditors if the creditor ranking differs across jurisdictions.

(iii) reduce the scope and effectiveness of bail-ins: whereas contractual bail-in should not pose any particular problems, statutory bail ins at cross-border level (imposing a haircut

to certain categories of bank creditors) could be hindered by differences the legal creditor ranking across jurisdictions.[4]

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 harmonised definition of deposits and insured deposits desirable and feasible?

a) **Greater convergence in the statutory ranking of creditors would be highly desirable**.

b) **Convergence should move towards the creation of a depositor preference.** Depositor preference is already in place in several jurisdiction and is justified on economic, social and public interest reasons. Moreover, it would enable authorities to put in place resolution tools (such as partial transfers and bridge bank) aimed at carving out and protecting bank essential functions/operations (such a deposit taking and payment systems).

Socially relevant creditors (retail clients and SME depositors and bondholders) shall be granted a "super senior" status and preference over the bank's assets in liquidation. Similar liabilities should be rapidly separated from the ailing bank and transferred to a third party (where possible a private sector purchaser; otherwise a **bridge bank**, whatever is the best solution in the circumstances). However, in order to allow for the transfer of socially significant liabilities to a solvent third party, without violating the principle of *par condicio creditorum*, an adequate legal definition of the priority ranking of unsecured liabilities is required.

c) **The priority ranking of creditors based on social relevance according to public interest considerations should be clearly stated in law.** Obviously, the general priority ranking of socially significant unsecured liabilities would not cause any kind of prejudice on secured debt, which would maintain its status over the relevant assets.

d) In order to move towards a uniform treatment across jurisdictions, a harmonized definition of deposits and insured deposits is necessary, also to avoid any undesirable arbitrage/distortions. Moreover, a common definition is a feasible step towards a more comprehensive international solution.

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)?

[4] As an additional piece of information, it may be recalled that according to the German Restructuring Act ("Restrukturierungsgesetz") provisions could be made in the Reorganization Plan for a forced standstill agreement or even a haircut of unsecured creditors (with certain exceptions, e.g. it is not possible to allow a haircut for receivables of the employees or for receivables secured by a public or private protection scheme ("Einlagensicherungsfonds")). In general the creditors involved would have to agree to this provisions in the Reorganization Plan. But even if the relevant class of creditors would not agree – for example to the haircut - , this could be seen as irrelevant and could be overruled by court order whenever it is obvious (to the court's opinion) that this class of creditors would not be treated worse in relation to a situation without Reorganization Plan (so-called "ban of obstruction")."

Depositor protection (e.g. deposit insurance) is justified for several reasons, including: the inability of depositors to exercise an effective monitoring role on the deposit taking institution; the reduced capability of depositors to bear the risk of a sudden and unexpected loss of their deposit; the (irrational) referential behaviour of depositors in a crisis, causing and further fomenting panic. All the mentioned arguments suggest that depositor preference should be limited to deposits of retail clients and SMEs.

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?

Depositor preference protects the systemic functions/operations of banks, allowing a wider and more effective scope of resolution tools and an enhanced cross-border cooperation amongst national authorities. Moreover, depositor preference will reduce deposit insurance costs and increase the ability of deposit insurance funds to play an active role in a resolution.

A possible cost of depositor preference is the increase in the cost of funding by lower ranking (junior and subordinated) creditors. Moreover, the FSB recognizes that "when depositors are given a higher ranking than other creditors, it increases the potential loss exposure of the lower ranking creditors, thereby increasing incentives for them to exercise more market discipline and run than would otherwise be the case". We argue that a similar argument could be considered as a benefit of depositor preference. Indeed, as depositors have admittedly ineffective risk monitoring ability, increasing incentives of lower ranking creditors to exercise more market discipline should be regarded as a positive by-effect, and an effective counterbalance to the bias of deposit insurance and depositor preference.

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?

An internationally harmonized definition of deposits and insured deposits would possibly allow, similarly to uniform depositor preference, cross-border cooperation, resolution tools, such as partial transfers (at least of insured deposits) to private sector purchasers or bridge banks.

Resolution tools should take into account the systemic and social relevance of involved liabilities. Social relevance implies a priority ranking of creditors following public interest considerations, based on the impact of the liability on households (deposits and savings of retail clients and SMEs) and the ability of creditors to monitor risk both effectively and efficiently.

An **international resolution forum**[5] should allow for the aggregation of claims across financial instruments (irrespective of nationality) for voting purposes with due regard to seniority. A super majority[6] of aggregated creditors is deemed to be sufficient to take the key and binding decisions on debt restructuring.

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5 Creditors should pre-authorise a representative who may take binding decisions in a resolution forum on their behalf.

6 A super majority is a qualified (weighted or un-weighted) majority in the range of absolute majority and unanimity.

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Part. 8. Conditions for a temporary stay on early termination rights

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?

A stay on early termination rights should only apply if it can cover all entities within a financial group, while avoiding any arbitrage opportunities. Whilst we see the benefits of a short stay upon termination in theory, there may be practical difficulties that impede its effectiveness (for example, whether a global solution to competing local interests can ever be achieved).

Assuming that a stay would apply to all financial contracts without any cherry picking, it could have a negative impact for both the failing firm (in that it cannot realise any contractual gains owing to it) and for its counterparties (in that they cannot effectively risk manage their positions). In order to mitigate these effects it would advisable to ensure that the parameters and length of such a stay are clearly pre-defined and indeed the length is as short as possible to implement resolution measures.

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?

There should not be any ambiguity around the specific event and it should be linked to a court order, formal notice issued by the failing firm or certain authority filings.

Upon occurrence of an “event”, any stay should apply automatically so that all counterparties are in the same position and an authority cannot then determine whether or not any discretionary stay will apply.

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?

The provisions should relate to all payment and delivery obligations and all rights of termination, close-out and netting or set-off such that counterparties are not disadvantaged amongst each another. Any exemptions should be minimised and apply only to illegality type termination events

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

One week. There should be sufficient warning signs beforehand to indicate a firm is in financial difficulty so that outcomes can be considered before the firm officially is put into resolution, in order to minimise any undesirable delays.

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?

The stay should not be applied to cleared trades or those traded on exchange as this would be extremely difficult to be managed and could have serious knock-on effects in the clearing/exchange systems. Moreover, certain measures are already being discussed in the context of cleared trades regarding "porting" a failing firm's trades to another counterparty to cause the minimum of disruption to the market as whole.

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?

Given recent G20 regulatory developments for derivatives (e.g. the Dodd-Frank Act, EU EMIR Directive etc) and other financial contracts (Basel III etc), it seems unnecessary to add an additional layer of complexity with an automatic stay which, due to cross-border difficulties, may not ever be properly and fully achieved in practice. Given that the substantial changes to the derivatives regulatory framework are still to be finalised (let alone implemented), it would be prudent to wait until these are in place before adding any other additional requirements.

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

In practice it may be too difficult to ensure effective cross-border cooperation across multiple jurisdictions. However a practical incentive would be to offer regulatory benefits (in the form of reduced capital charges) for those financial contracts that contain appropriate stay upon enforcement language.

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.

Limitations may best be achieved in the actual contract itself (and expressly recognised under the relevant governing law).

Contact people name.surname@UniCredit.eu

Main contributors and involved parties

Regulatory Affairs – Contributor and Coordination Team
Sergio Lugaresi, Head of Regulatory Affairs (RA) - Public Affairs (PA)
Marco Laganà, RA (marco.lagana@UniCredit.eu)
Micol Levi, RA
Andrea Mantovani, RA

CIB (Corporate Investment Banking) – Unicredit SpA
Stefano Chiarlone, Head of CIB Division Staff
Enrico Boati, CIB Division Staff

Group Risk Management – Unicredit SpA
Luciano Tuzzi, Group Balance Sheet & Liquidity Risks
Widjojoatmodjo Armin Noorgamal, Head of Liquidity Risk Portfolio

Legal and Compliance – Unicredit SpA
Carlo Kostka, Head of Global Legal in Legal and Compliance
Ifther Ali, Head of Global CIB Legal
Lorenzo Lampiano, Head of Corporate Law
Guido Moscon, Head of Banking Supervisory Relations
Ermanno Bonessi, Head of Corporate Law Advice
Andrea Cremonino, BSR Head of Banking Supervision College and EU
Debbie Ellett, Global CIB Legal
Manlio Nuzzo, Corporate Law Advice

Planning, Finance and Administration – Unicredit SpA
Mirco Bianchi, Head of Group Finance
Maurizio Cravero, Head of Capital Management (CM), in PS&CM
Stefano Porro, Head group ALM and Financial Planning
Philipp Waldstein, Head of Group Strategic Funding and Portfolio
Guglielmo Zadra, Head of Planning, Strategy And Capital Management
Alessandro Barchietto, Head of Capital Planning and Allocation
Federico Ravera, Head of Strategic Portfolio
Davide Stroppa, Capital Planning and Allocation

Public Affairs – Unicredit SpA
Costanza Bufalini, Head of Institutional Relations with EU
Serena Massimi, Head of International Institutional Relations
Pietro Bertè, Head of Relations with Multilateral Organisations in IIR
Mario Di Ciommo, Institutional Relations with EU
Luca Ranieri, Head of International Relations in IIR
Peter Rieger, Head of Liaison Office to the EU, Institutional Relations with EU

UniCredit Bank AG
Achim Oelgarth, country coordinator, Head of Institutional Affairs Germany, PA
Dobrikat Joachim, Accounting,Tax and Shareholding
Schönfelder Matthias, CIB Legal

Bank Austria – Unicredit Group
Roland Berger, Head of Compliance Office
Stella Klepp, country coordinator Compliance Office (Regulatory Issues)

Bank Pekao – Unicredit Group
Jacek Starosciak, country coordinator Compliance

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