The voice of banking
& financial services

Svein Andresen
Secretary General
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

fsb@bis.org

2 September 2011

Dear Mr Andresen,

**Effective Resolution of Systemically Important Financial Institutions: Recommendations and Timelines**

This is the British Bankers' Association's response to the above consultative document; we welcome the opportunity to comment.

We are firm supporters of the development of resolution regimes, viewing them as an intrinsic part of an effective regulatory framework and a necessary complement to measures underway to strengthen the safety and soundness of individual institutions and the markets in which they operate. We view the Financial Stability Board as the most appropriate vehicle through which to deliver the G20 leaders' recommendations for the development of such regimes and warmly welcome the opportunity to provide our observations before the proposals are deliberated in the autumn.

In considering the recommendations, our starting point is the need to ensure that each jurisdiction develops a resolution regime which incorporates the tools and the powers necessary to ensure that resolution is seen as a credible option in the event of failure. We agree that the definition of an effective resolution regime should be taken to mean that the authorities can intervene to ensure the continued operation of the systemically important functions banks provide while apportioning losses to unsecured and uninsured creditors in a manner that is fair and predictable and which maximises value to creditors in the long-term. This is fundamentally important if we are to minimise the systemic risk and fiscal consequence of a bank failure and to eliminate moral hazard and permit market discipline to operate.

However, given the international nature of modern financial markets and many of the firms which operate within them, it is vitally important for national resolution regimes to be developed in a consistent manner and for there to be tools and mechanisms in place to enable national authorities to work together to supervise and, should it prove necessary, resolve an institution. We therefore welcome the steps taken by the FSB to set out the characteristics which should underpin national resolution regimes and to propose mechanisms through which national authorities should channel their cooperation. Whilst the proposed cooperation agreements represent a good step forward, we fear that in places they demonstrate a lack of ambition and fail to provide the incentives we believe are necessary to engender real cooperation between national authorities. For example, the recommendations do not tackle the fundamental issue of sharing the ex ante costs of resolution between authorities in the event of failure; until this issue is resolved there will always be an incentive for national authorities to act in their own interest. Even if resolution of the burden sharing issue proves impossible in the short-term, there are other measures which could be taken to incentivise national authorities to cooperate and to bind them into the framework, such as making membership of Crisis Management Groups conditional on the adoption of appropriate data security protocols.

Whatever measures are taken to bind jurisdictions into the framework, it will be important for the powers and tools to be introduced in a consistent manner. We are somewhat concerned by the lack of any specific timeline or deadlines by which nations should introduce the legislative changes necessary to implement the new toolkit. This is in sharp contrast to the tough deadlines set for the measures which fall to the industry and the detailed transition schedule under Basel III. We propose that when endorsing the framework at their summit later in the year, the G20 leaders should commit to a firm timeline for the adoption of necessary legislation and commit to an annual peer review process, led by the FSB, to assess the level of convergence and identify any gaps which need closing.

In terms of the specifics of the framework, we welcome the recognition of the important role which should be played by the lead authority (or authorities) in the supervision and resolution of an institution and the endorsement of the use of Crisis Management Groups. Nevertheless, there are parts of the framework which look to us to propose an over expansion of the power of supervisors of branches or subsidiaries (‘local supervisors’) which work against this. We strongly believe that in all but the most exceptional cases group-led consolidated supervision is the most efficient and effective way of supervising and resolving a cross-border group.

We would also urge the FSB to focus on providing as much clarity as possible over the way in which tools and powers are intended to be used. There are numerous examples (identified below) where, whilst we are supportive of the direction of the thinking, insufficient clarity is given around how a power will be used and how an investor might be affected. The provision of clarity and certainty in these areas will be vital to minimise the potentially significant impact the proposals could have on the attractiveness of financial institutions to investors. This is notably the case when it comes to the proposals for bail-in. Although we are broadly supportive of the proposed regime, there are a number of areas where we believe important clarification is required. It is fundamentally important that the new regime is seen to be credible – this means that the market must have faith that the authorities will use the powers available to them in predefined and understood circumstances. National authorities must be cognisant of the expectations on them and the fact that decisions they take will set precedents. Again, we see a role for the FSB to play in driving convergence.

By way of summary, we would draw attention to the following specific recommendations:

- The G20 should set a firm timetable for the adoption of the legislative changes necessary to implement the proposed regime;
- Consistent implementation must be prioritised to avoid superficial alignment;
- This minimum set of standards should be the starting point with an explicit goal set for the convergence of national resolution regimes over time;
- The power of local supervisors in relation to branches operating in their jurisdictions and locally established subsidiaries must not be over-expanded and must not undermine the principle of group-led consolidated supervision;
- There should be a specific expectation that authorities will provide guidance to the market on how they will utilise their tools and powers to provide certainty and promote confidence; and
- Recovery and Resolution Plans need to be developed in a manner which incentivises firm participation and effective outcomes.

We provide our response to the specific questions posed in the consultative document in the attached document. These reflect the views of a wide range of financial institutions operating in the UK and more than 180 jurisdictions worldwide. We would be delighted to provide you or your staff with further details on any of the issues covered in this response.

Yours sincerely,

**Angela Knight CBE**
*Chief Executive*

Direct Line: 020 7216 8869
F +44(0)20 7216 8953
E angela.knight@bba.org.uk

## Effective Resolution of Systemically Important Financial Institutions Recommendations and timelines

### Resolution powers and tools

**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.**

We agree that the objective of an effective resolution regime should be to make feasible the resolution of any financial institution without systemic disruption and without exposing taxpayers. As the question implies, to make cross-border resolution a realistic prospect it will be essential for all jurisdictions to have this type of regime.

The attributes set out in Annex 1 look suitable. In particular, we welcome the statements that an effective resolution regime should provide for as much predictability as possible and embed cooperation, information exchange and coordination amongst national supervisory and resolution authorities before and during a crisis.

The proposed scope for the resolution framework looks broadly appropriate. We agree that it should apply to any financial institution whose failure could have systemic consequences and be extended to include financial holding companies and significant non-regulated entities within a financial group and we look forward to the proposed sector specific guidance. We are concerned, however, at the proposal to include the branches of foreign financial institutions in the manner proposed by 8.4[1]. Whilst we can see a legitimate case for the local supervisor to have an obligation to support resolution actions taken by a lead consolidated supervisor in respect of a local branch, we do not see circumstances in which the host supervisor should have resolution powers in respect of a local branch. We believe this would work against the concept of group supervision and the cooperation provisions proposed elsewhere in the document; moreover, it would give rise to significant practical legal difficulties as branches have no independent legal personality. If nothing else, such a power acts as a major incentive for local supervisors of branches to act precipitously and in their own narrow best interests. It will also provide no incentive for the fundamental discussion on the relative rights and responsibilities of home and local supervisors, including burden sharing, to take place. It should be recalled that the local supervisor retains its normal supervisory powers and as such has powers to sanction the activities of a branch in its jurisdiction should it deem this necessary.

The proposed arrangements for resolution authorities would appear appropriate; we particularly welcome 2.3 and the notion that resolution authorities should have a statutory objective to consider the potential impact of their actions on financial stability in other jurisdictions. Whilst we agree that resolution authorities should have unimpeded access to firms as necessary (2.7), we believe there should be a duty on authorities to coordinate their inquiries and requests for information via the CMG. We note the proposed safe harbour for the resolution authority and its staff proposed in 2.6. It would be interesting to understand what consideration, if any, has been given to the liability faced by a firm's management in a recovery scenario. It is possible to foresee a situation in which a supervisor forces the management of a firm to take an action during the recovery phase – such as the disposal of a major subsidiary in a third country – which significantly damages the franchise value of the group as a whole. Whilst we understand there are protections for the supervisor in this scenario, the directors do not appear to enjoy the same safe harbour.

Much greater clarity needs to be provided over the entry to resolution and the manner in which the choice between the resolution tools will be exercised. In principle, we support the view that the trigger should capture the moment prior to balance sheet insolvency but after all reasonable measures have been exhausted to prevent failure. Given the inherent subjectivity of this trigger, however, we believe it is important for there to be as much clarity as possible over how the relevant

[1] In this regard, the legal difference between branch and a subsidiary must be borne in mind.

authority will interpret this point in time and would encourage the adoption of Codes of Conduct, on similar lines to the one which operates in the UK, developed in conjunction with the industry. We believe that the FSB could play a valuable role both by undertaking thematic reviews in this space but also by acting as a central repository for the Codes of Conduct in force in each jurisdiction. A more ambitious objective would be the development of a single international Code of Conduct. Thought should also be given to how undue supervisory forbearance might be avoided. We set out our thinking on the triggers for resolution in the annex.

The list of resolution powers in part 4 looks to be comprehensive and in keeping with the developing UK and EU regimes (we provide comments on bail-in below). As with the resolution trigger, however, it will be important for resolution authorities to provide clarity to the market on how they plan to use their tools. Not doing so will lead to uncertainty which will feed through into increased costs of funding for banks at a time of major regulatory change. It needs to be explicitly stated that the resolution tools will be used in a manner which respects the creditor hierarchy and treats creditors as pari passu within the same class. In addition to providing greater clarity on how tools might be used, we would suggest that the wording of this section be carefully considered to make clear that these are not arbitrary powers. For example, the suggestion that resolution authorities should have the power to ‘recover monies from responsible parties’ (4.1 (i)) should be clarified to specify that this is in line with bonus claw back powers. The power to require companies within a group to continue to provide essential services to an entity being resolved (v) should specify that this is on commercial terms.

We agree that there should be private sector arrangements to provide for the temporary costs of resolution and to meet any remaining costs after the allocation of losses to shareholders and creditors. We would welcome, however, recognition in 6.3 that if the industry is providing funding to support a resolution then it should have an oversight role in how any legacy costs are managed. We should add that it is of the utmost importance that any temporary funding should be subject to strict conditions that minimise moral hazard. In addition to the points in 6.4, we would suggest that this should include a specific statement that no funding is provided unless the firm has entered resolution – this would not apply to the provision of central bank liquidity facilities if part of a firm had been returned to going concern status following the application of the resolution tools.

We broadly welcome the provisions in parts 8, 9 and 10 to strengthen cross-border cooperation but believe that they could be more ambitious. Our view remains that until the existing tensions between lead and local supervisors are resolved and appropriate burden sharing mechanisms have been agreed there will always be a risk that any agreements entered into will fail when tested. As mentioned in our opening comments, we believe that the resolution of internationally active firms will be facilitated by the convergence of national resolution regimes. We therefore welcome the statement in 8.1 that this is an objective but are disappointed that no timeline is given in which this will be achieved. We also reiterate our concerns relating to the powers intended for local resolution authorities of foreign branches which seem to move away from the principle of group led supervision and give rise to practical legal difficulties as branches have no independent legal personality. Overall, however, we believe the combination of legal conditions for cooperation, institution-specific cooperation agreements and focus on cross-border crisis management groups offers the potential to provide a significant step forward. To be effective, however, it will be essential for national laws to prevent discrimination against creditors based on nationality or location and for appropriate information sharing protocols to be developed, which balance the need for information to be exchanged with the imperative of protecting firms’ data. We suggest that one method to bind national authorities into the international regime would be to make membership of CMGs conditional on the development of sufficiently robust information sharing protocols. Without measures such as this it is difficult to see how national authorities will be incentivised to participate.

We comment on the proposals for recovery and resolution plans in detail below.

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 see Annex 1 as a good compromise between the need to balance the different starting points of jurisdictions with the longer term objective of convergence. That being said, we believe that, the convergence of national resolution regimes should be seen as a priority and that until this is achieved, then we risk a veneer of convergence which could lead to a potentially dangerous level of false confidence. We strongly urge the G20 to agree a deadline by which jurisdictions should converge their regimes and to empower the FSB and IMF to monitor convergence and identify areas of inconsistency. An annual update on the state of convergence should be provided to the G20 leaders and be published. The difference in granularity of the milestones between this framework and the Basel III implementation timetable is marked.

The framework appears to be drafted in such a way as to permit application to banks with different business models and corporate structures. We would question, however, whether it is sufficiently flexible to be used to coordinate the effective resolution of a non-bank financial institution given that the tools are designed in the context of regulated institutions.

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 believe that bail-in could be an important enhancement to the powers available to resolution authorities to manage the failure of a financial institution without recourse to the taxpayer and are therefore supportive of the decision to include the concept within the proposed framework. We note that the FSB has proposed to position bail-in as an alternative resolution tool rather than as a tool to be used in circumstances where it is judged the traditional resolution tools will not be best placed to bring about the effective resolution of a firm and the maintenance of the critical functions it provides.

In our view, it is important to distinguish clearly between the bail-in of junior and subordinated creditors and the bail-in of senior creditors. We believe that to reassure creditors and markets, it is essential for the resolution authority to set out a well defined and understood process around how the bail-in power might be used. There must also be clarity about the interplay between various classes of bail-in paper and the treatment of investors, and a firm understanding that the creditor hierarchy will be respected.

We agree that the bail-in of junior and subordinated debt could be used as an alternative to the traditional resolution tools if it was deemed the most effective manner of preserving the firm's critical functions. However, given the potential consequences, we believe that there should be an understanding that bail-in will only be extended to senior creditors if deemed absolutely necessary to contain systemic risk and maintain the critical functions the firm provides. As such, we believe that any decision to use the bail-in tool in relation to senior creditors should be seen as a last resort option and one which is subject to a secondary authorisation/trigger procedure. A Code of Conduct, agreed with the industry and market participants, should be used for this purpose and set out that:

- no creditor will be left worse off by the use of the bail-in power than they would have been under liquidation or administration;
- the bail-in power should only be used in relation to senior debt if the resolution authority determines that there are no other tools available to resolve the firm in an orderly manner and prevent systemic contagion; and
- the use of the bail-in power in relation to senior creditors will be approved by the home state finance minister, supervisor and resolution authority. All relevant supervisors and the firm's management should be informed of the decision.

In addition to the points above, we also have the following specific observations on Annex 2. There is a need for absolute clarity about how the powers in section 3 will be utilised to provide investors with certainty over how they would be treated, without this we fear the market for bank debt will be shallow and the cost of funding will increase. The need for certainty extends to how the regime will be triggered (section 4). As discussed above, we consider there must be clearly understood safeguards and procedures agreed with market participants over and above those required for the triggering of resolution. We broadly agree with the proposals for the scope of the regime, including respect for the statutory order of priorities, the safeguards and judicial review provisions.

In our opinion, further consideration must be given to the application of bail-in to cross-border and group scenarios. As a general rule, we agree that bail-in should be initiated by the lead authority (although we warn that it is not always the case that debt is located at the parent level) and be coordinated through the CMG. We are concerned, however, by the proposition in 9.2 that local authorities should have the power to exercise bail-in powers at subsidiary level. This may not only have ramifications for the structure of the group but could also prove destabilising if the local supervisor exercised this power before waiting for the lead supervisor to assess the most appropriate group-wide solution. At the very least, we would suggest that the conditions on local authorities to consult the lead supervisor and support a group-wide solution should be placed on a statutory footing. This being said, our favoured method of exercising bail-in in group situations is that outlined in 9.4.

**Bail-in powers**

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?**

We are yet to reach a consensus view on whether bail-in should be implemented under the comprehensive or targeted approach. However, whichever approach is followed, we believe that there is merit in developing largely consistent regimes across countries and that there are certain classes of liabilities which should be excluded from the regime in the interests of financial stability. We would argue that this list should include: swap repo and derivative counterparties and other trade creditors, retail and wholesale deposits and secured debt and collateral. Views differ on whether short-term debt should be included; some take the view that it should be included to mitigate a migration to short-term funding and reduce the prospect of structuring. Others, however, are concerned that doing so would exacerbate funding difficulties during a stress scenario and point to the different use of short-term finance in the funding of the firm (i.e. as liquidity management instruments that might also be used as collateral for derivative transactions).

We accept that exclusions from the regime establish a new creditor hierarchy by definition and therefore believe that consideration should be given to compensation mechanisms to assure that debt is not subordinated to equity. It goes without saying that we believe senior debt should only be subject to bail-in if absolutely needed to protect financial stability, and if so, should always be treated better than subordinated instruments. Subordinated instruments should likewise always receive better treatment than equity. We note with concern the suggestion in 6.1 that there could be circumstances in which the statutory ranking of creditors and the pari passu treatment of creditors might not be respected. We would urge that this must be limited to the most exceptional circumstances and in full knowledge of the consequences that such a precedent would set. Given that all flexibility comes at a price, we believe clear guidelines are needed setting out the circumstances in which it is acceptable to alter the creditor hierarchy.

Whatever approach is chosen, there is a need to develop legal certainty and for investors to understand where they stand in the hierarchy. An international convention on bail-in would be the most effective way of providing this certainty and promoting consistency.

**7. Will it be necessary that authorities monitor whether firms' balance sheet contain at all time as 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 would not support the suggestion that a minimum level of bail-in debt should be explicitly specified. Rather we foresee the combination of resolvability assessments and RRPs as a vehicle through which the supervisor should discuss steps the firm should take to enhance its resolvability, including any target level of bail-in debt. Fundamentally, it needs to be understood that any specific requirements in this area will carry a financial cost, which could be material (and potentially insurmountable) for firms encountering a stress situation.

**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?**

We believe it is too early to quantify the impact the introduction of a bail-in regime would have on senior funding markets. We note that the pricing of bank debt spiked with the publication of the European Commission's consultation paper but it is uncertain whether a move to a bail-in regime has been fully priced in at this stage. Funding costs are evolving due to a number of regulatory changes and the move away from the notion of an implicit state guarantee. It is therefore important to assess the bail-in regime in a 'new world' without any further bail-outs of senior creditors.

The structure of the bail-in regime will have a bearing on the impact on senior debt. If bail-in is only imposed on the basis that creditors will be left no worse off than they would have been under insolvency then bail-in could lead to a slight increase in Probability of Default but a significant decrease in Loss Given Default; hence bail-ins could moderate the effect of the removal of an implicit state guarantee.  Clarity on the type of instruments within scope of the regime and the hierarchy of likely resolution actions should minimise the impact on funding costs.

<u>**Cross-border cooperation**</u>

**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?**

We welcome the desire to strengthen cross-border cooperation arrangements but question whether what is proposed is as ambitious as it might be. Given the focus of G20 leaders on this issue, we find it somewhat surprising that the paper concludes that there is no immediate prospect of a multilateral agreement on the resolution of financial institutions. We urge the FSB to take the opportunity afforded by the current focus on this issue to call for the parts of the paper focused on cross-border resolution to be implemented as quickly as possible.

We believe that a statutory duty on authorities to cooperate will be an important step forward. We agree that this should be framed so that resolution authorities – but also supervisors – have a duty to consider the potential impact of their actions on the financial stability of other jurisdictions and, in applying the resolution tools, the impact on the overall group. Whilst it is hard to disagree with the statement that the statutory duty to cooperate should not be so prescriptive as to deprive jurisdictions of the flexibility to act when necessary to achieve domestic stability in the absence of effective cross-border cooperation, we would argue that a high hurdle should be set for this to apply.

Doing otherwise risks the propagation of uncertainty and gives local supervisors a rationale for moving first. This will undermine financial stability, increase the cost of credit and work against the development of an effective international regime.

We suggest that the strengthening of information sharing protocols is one way in which trust can be engendered between lead and local supervisors via CMGs. As suggested above, we believe that adequate information sharing protocols should be a prerequisite for membership of CMGs. That being said, it is essential that information sharing agreements include sufficient confidentiality agreements to ensure that firms' data is protected. The G20 should set a tight timetable for jurisdictions to adopt the relevant legislation to ensure that such measures are developed and implemented.

**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?**

The proposed agreement looks appropriate, if rather vague. If they are to have any value, however, the agreements must be legally binding.

As explained above, we welcome the proposed information sharing framework in 6 but would urge that this be underpinned by legislation.

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

We believe that the lead authority should determine which authorities should be parties to the agreements, in conjunction with the firm's management. At a minimum we would expect this to include: the consolidating resolution authority and the consolidating supervisory authority, together with the resolution authorities, supervisory authorities and financial ministry officials of key subsidiaries and branches.

**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?**

We view the proposed resolvability assessments as a central part of the framework but stress that they must be used not only to assess the feasibility of applying the resolution tools to firms but also to test authorities' tools, powers and preparedness. It follows therefore that we do not believe it would be appropriate for assessments to be made of firms' business models before jurisdictions have fully implemented the recommendations of this report. Assessments of the credibility and feasibility of firms' resolvability cannot be delinked from the credibility and feasibility of national resolution regimes. The consistency of resolvability assessment – across both jurisdictions and firms – will also be enhanced if any consequential requirement to make legal or structural changes is postponed until after the elements of this framework have been introduced in a consistent manner.

In terms of the specifics of Annex 4, we stress that the guidance must provide a clear definition of what should be considered essential and systemically important functions. We fear that as currently drafted, 4.1 does not provide this clarity. This will lead to inconsistent interpretation between jurisdictions which will diminish the value of the exercise and therefore urge the FSB to develop more detailed guidance on this point.

We note the importance of institutions maintaining adequate management information systems but question whether it is necessary for firms to have this capacity at both group and legal entity level

(4.6), at least in the first instance. Given the different starting points of firms, a pragmatic approach will need to be taken to permit systems to develop to meet the new requirements.

We appreciate that section 5 has been drafted in such a way as to avoid promulgating a list of indicators of systemic impact but nevertheless are concerned that it is drafted at much too high a level to foster any meaningful level of consistency in the way systemic impact is assessed across jurisdictions. We would urge the FSB to conduct further work to develop thinking in this area.

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

The questions posed in 4.9-4.12 appear appropriate to assess whether cross-border resolution is possible. That being said, we stress again the need for jurisdictions to move as quickly as is possible to adopt the FSB framework and urge the G20 to monitor progress towards this goal. This is the best way to ensure that cross-border resolution can take place.

**<u>Recovery and resolution plans</u>**

**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?**

We are firm supporters of the concept of recovery and resolution plans. We believe that the FSB guidance should be taken as the basis for the development of national regimes which currently require differing levels of detail and information. This is an area where we believe the FSB could be most effective in promoting a consistent template for RRPs. This should cover issues such as, how critical economic functions should be identified, what data is required from the firm and how contingency analysis will be approached. If RRPs continue to develop on a national basis then there is a very real risk that the process will be inefficient, will place undue burdens on firms and will result in the provision of contradictory and inconsistent RRPs. We would urge national supervisors not to hard code their own RRP requirements until the FSB proposals are finalised.

In terms of the specifics of Annex 5, we believe more attention should be paid to proportionality, which should be assessed against a firm's inherent resolvability and resilience. The current mosaic of differing national requirements means firms (and their supervisors) will approach the development of RRPs from very different starting points. The RRP development process must be an iterative one, which promotes facilitates the learning process and the development of best practice. We must also underscore our view that the timeline for the implementation of RRPs must be consistent with that for data sharing protocols. As stated elsewhere, the importance of robust arrangements for data sharing and confidentiality requirements cannot be over-emphasised.

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

We agree with the distinction which is drawn between recovery plans, which are the responsibility of the firm, and resolution plans, where responsibility lies with the authorities.

We strongly believe that recovery plans must be developed at the group level. Although there may be elements of recovery plans which are specific to certain systemic subsidiaries, for legal and practical reasons recovery can only be led effectively at the group level. We accept that this means that certain elements of the recovery plan will need to be shared on a need-to-know basis with specific host supervisors, via the CMG, to provide them with an understanding of the steps the group's management would take if it encountered a stress scenario. Local requirements to develop recovery plans for subsidiaries or branches should be avoided. Again, we reiterate the importance of robust arrangements for data sharing and confidentiality requirements.

We believe that the consolidating supervisor should lead the development of the group resolution plan through the CMG but accept that local resolution authorities may wish to take steps to understand the actions they would need to take to resolve the parts of the group entities established in their jurisdiction. That being said, these local resolution plans should be developed and implemented in coordination with the group level resolution plan, led by the lead resolution authority through the CMG. As a matter of principle, we believe that local supervisors should not impose any requirements which can not be justified by prudential requirements – ring fencing undermines the principle of group-led supervision, adds unwarranted complexity and increases costs to the end users of financial services.

When reviewing RRPs, authorities should coordinate their requests for information via the CMG and wherever possible agree a standard list of data requirements.

**Improving resolvability**

16. **Are there other major potential business obstacles to effective resolution that need to be addressed that are not covered by 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 be best incorporated within the overall policy framework? What would be required to put those in place?**

Our first point would be to stress that regulation should respect the structural choices made by firms and should not seek to impose any individual solution. We must also emphasise the importance of the powers in this section being interpreted in a consistent manner by national supervisors so that a level playing field is maintained. Consistent interpretation of the requirements will also have the benefit of enhancing the predictability of the regime, permitting firms to grow their businesses in the knowledge that the supervisor is unlikely to try and unpick changes to enhance resolvability in some hitherto unforeseen manner.

The development of measures to improve the resolvability of firms should also be progressed in a form which fully appreciates changes taking place in other parts of the regulatory framework to reduce the probability of failure and enhance the resolvability of firms. In particular, we would highlight the role that a bail-in regime could play in buying time for resolution authorities to consider the actions they will need to take. If implemented, bail-in will relieve the need for the authorities to find solutions to the failure of a firm which can be implemented over the course of a weekend.

In terms of the specifics of Annex 6, we observe that this shows a prejudice against more integrated approaches to bank management and tools which in many instances actually reduce risk and enhance system stability. In particular, we would note that steps to reduce intra-group guarantees may have the unintended consequence of increasing the complexity of firms' funding structures and increase the cost of doing business. There is also a risk that the forced unwinding of such tools could prove systemically risky. Fundamentally, the issue of intra-group guarantees and risk transfer represents a trade-off between resilience and resolvability which cannot be fully reconciled. Our view is that enhancing day-to-day resilience through the use of such risk-transfer mechanisms has a greater impact on reducing systemic risk than avoiding a marginal increase in the theoretical complexity of a resolution.

**Timelines for implementation**

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

The proposed timelines look challenging, but this is appropriate given the importance of progress in these areas. That being said, deadlines will need to be set in a way which is cognisant of the operational challenge of delivering changes to systems and the overall regulatory change agenda. We would argue that further thought should be given to the interaction of deadlines – for example deadlines for the development of RRPs must be consistent with those for adoption of MoUs on the exchange of information and cognisant of the different national starting points and legislative processes.

However as related elsewhere, it is disappointing that there are no deadlines set in which jurisdictions should implement the legislative changes necessary to underpin the framework. Without a specific timeline, we fear that it will be many years before meaningful levels of convergence in national regimes are delivered which will continue to impede the effective resolution of a cross-border institution. We strongly urge the G20 and FSB to monitor the progress being made by institutions and to conduct regular thematic reviews to identify areas of inconsistency.

As a footnote, we note that the European Union is expected to adopt a proposal on bank recovery and resolution at some point during 2012. This may well have a significant bearing on the requirements imposed on firms based with in its jurisdiction and the timeline over which European Member States are able to implement requirements.

**Creditor hierarchy**

**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 harmonised 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, asset managers and hedge funds, insurers and pension funds; c) the (subrogated) claims of the deposit guarantee schemes (especially in jurisdictions where these 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?**

We are supportive of the decision of the FSB to consider this issue but also welcome the consultative manner in which this is being done. We agree that clarity and predictability over the order of seniority or statutory ranking of claims in insolvency are imperative for the functioning of the market and the allocation of losses. As a matter of principle, we believe a consistent international creditor hierarchy would be beneficial and would strongly support a firm statement of intent in this regard. However, we recognise that it is not essential (or feasible) for such harmonisation to take place in the short-term as there are a number of measures which can be taken in the interim to reduce the impact of existing differences which will support the effective resolution of a cross-border group.

We believe that the starting point should be that the position of existing creditors should be maintained whilst discrepancies remain between national insolvency laws. Altering the rights of existing creditors would not only be inequitable but would also have a significant impact on banks access to funding markets. We further believe that the differing positions of deposit guarantee schemes should be maintained but do not believe that there should be a right for individual national schemes to exercise a priority claim over a disproportionate volume of a global group's assets. If necessary, the national deposit guarantee scheme should be used to meet the cost of paying out to protected depositors. Doing otherwise runs the risk that local authorities will seek to pre-empt any group-wide resolution process in an attempt to ring-fence a specific proportion of assets to meet the claims of local depositors and thus runs against the concept of group-wide supervision/resolution. In principle, we believe that the assets of a failed global group should be available to meet the claims of all its creditors, including international creditors. In our opinion, the lead resolution authority should then have a duty to establish the seniority of claims, without discriminating on the basis of nationality.

**Close-out netting**

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?**

We understand the reasoning for the proposal to introduce a temporary stay on early termination rights and can see that in certain circumstances this could be helpful in facilitating the resolution of a failing institution. That said we note that when the UK authorities introduced the special resolution regime a temporary stay power was not deemed necessary.

In view of the crucial role played by close out netting in risk management the broader impact of a temporary stay power requires careful consideration. In this regard there have been concerns that there could be implications for the commercial and funding costs of banks subject to the regime (BSR) from the outset. Insofar as counterparties to a BSR feared that (should the BSR go into resolution) the bank might be unable to post additional collateral (in response to market movements) it is to be expected that they would require more collateral up front. In addition it is possible that there would be an increase in the cost in wholesale funding for BSR on account of the perception of higher risk. It is noted, however, that the consultative document clarifies that a counterparty's right to call for additional collateral (consequent on market movements) would be unaffected by the stay and that if such collateral was not forthcoming from the failing bank the counterparty could then close out.

It would be helpful to have clarification on whether a counterparty would be able to call for additional collateral simply as a result of an ailing bank going into resolution.

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?**

If the automatic route was taken the stay would obviously come into effect when the bank went into resolution. If the power to impose a stay was discretionary then, presumably, the resolution authorities would impose a stay when they decided that such action would facilitate the resolution of the failing bank and/or make a positive contribution to systemic stability - in these circumstances it is not clear that seeking to identify a more 'specific trigger' would necessarily be appropriate.

As to the choice between automaticity and discretion the latter would have the merit that a stay would only be imposed when the authorities believed this to be necessary. That said as the focus of the proposals is SIFIs it may be that the authorities (in some jurisdictions at least) would be inclined to impose a stay as a matter of course. Also an automatic stay would at least provide an element of certainty.

**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 suspension of rights should only apply to (i) the right to terminate that arises due to the fact that a counterparty is to enter resolution and (ii) the right to withhold payment pursuant to Section 2 a (iii) of the ISDA master agreement. The stay would not extend for example to a situation where an ailing bank failed to meet margin calls. Since banks in resolution would typically be stressed it is noted that this feature could undermine the rationale for the stay in the first place.

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

The need would be to strike a balance between the needs of the authorities in pursuing their resolution objectives and the broader effects on other firms and the market as a whole. It is considered that the length of the stay should not exceed 48 hours.

**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?**

Given their unique role and systemic importance we believe it would be prudent to exempt CCPs and FMIs.

**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?**

It needs to be formally confirmed that a power to call a stay when a bank goes into resolution would not trigger any change in the regulatory capital treatment of their counterparties - in particular that for regulatory capital purposes exposures within a netting agreement would continue to be treated on a net basis. Also the authorities should only be allowed to transfer the contracts within a meeting agreement in their entirety (i.e. no cherry picking).

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

The automatic universality approach has obvious attractions at the level of principle but it is, to say the least, open to doubt whether this would be feasible on a global basis any time soon. The other possible ways forward identified in Annex 8 of the Consultative Document merit further consideration.

**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?**

See comment under Question 32.

**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 mechanisms could be considered to give effect to the stay?**

See comment under Question 32.

British Bankers' Association
2 September 2011

**ANNEX 1: The 'trigger' for the application of resolution tools**

The below note was provided to the European Commission alongside our response to its 2011 consultation on a proposed Directive for Bank Recovery and Resolution. It nevertheless identifies a number of issues we believe are germane to the development of triggers for resolution more generally.

**Background**

The BBA concurs that the application of the proposed resolution tools should occur at a point when there is no realistic prospect that a failing institution will recover but before it is balance sheet insolvent. A balance needs to be struck therefore between the need for an objective standard for the trigger decision to minimise uncertainty for all concerned – not least given that the resolution tools may involve a significant interference in property rights – and the need to allow for the exercise of supervisory judgement.

Below we offer a proposal which seeks to define the trigger and the conditions to be considered before authorising the use of the resolution tools. We also make proposals as to how the trigger could be applied in cross-border circumstances.

**Proposal**

We believe that the trigger should include scenarios where an institution either fails or is likely to fail to meet the minimum conditions and standards required by the Supervisory Authority for authorisation. We suggest that this formation would:

- capture the wide variety of reasons which could lead to an institution's failure;
- avoid the potential for unforeseen consequences which could arise from a trigger linked purely to capital ratios or solvency;
- permit the trigger point to be interpreted consistently across Member States; and
- be consistent with the Basel Committee's proposed non-viability trigger.

Importantly, when assessing whether an institution meets this criteria, we believe that the Competent Authority should have regard to other relevant circumstances and determine that there is no realistic prospect that other measures available will enable the institution to meet its authorisation criteria. Further, we believe that the Competent Authority should be required to satisfy itself that the application of the chosen resolution tool(s) is necessary to protect the public interest. In assessing this, it should have regard to the following conditions and the views of the Competent Authorities in all the Member States in which the institution or its subsidiaries conducts business:

- the stability of the financial system of each Member State in which the institution or its subsidiaries operates;
- the maintenance of public confidence in the stability of the banking systems of each Member State in which the institution or its subsidiaries conducts business; and
- the protection of depositors.

Prior to the application of the resolution tools, the Resolution Authority should notify/consult (or if required under local law, seek approval from) the Ministry of Finance in the Member State. If applicable, the Consolidating Resolution Authority should be notified.

It should be noted, that where the Supervisory Authority and the Resolution Authority are not separate bodies, Member States must ensure that there is functional separation within the body such that individuals involved in the day-to-day supervision of a firm are not involved in the resolution of the firm.

**Holding companies and cross-border situations**

We believe that the proposed Directive should make provision for the home Resolution Authority to apply the resolution tools in respect of a parent financial holding company (established in its Member State) if it is satisfied that the credit institution cannot be resolved without the application on one or more of the resolution tools to the parent financial holding company.

Where the parent financial holding company is established in a different Member State to the relevant credit institution, and the credit institution's home Resolution Authority is satisfied that the credit institution cannot be resolved without the application on one or more of the resolution tools to the parent financial holding company, resolution of that parent financial holding company would need to be effected by the Consolidating Resolution Authority. In these circumstances, we believe that the trigger and the conditions for its use should be the same as those described above but that the Supervisory Authority (if it is not the same as the Consolidating Supervisor) should be required to notify the Consolidating Supervisor, the Consolidating Resolution Authority and the Ministry of Finance in the Member State (or, if required in the Member State, seek approval from the Ministry of Finance). To make this approach workable, the Directive will need to place an obligation on Consolidating Authorities to share information with all Supervisory Authorities, in particular where a decision has been taken to apply a resolution tool on a group-wide basis.

We provide draft legislative text setting out our proposition in the Annex to this note.

British Bankers' Association
July 2011

**Annex: Proposed legislative text**

Below we set out our proposed trigger for the application of the resolution tools.

*Article [X]*

1. A Resolution Authority may exercise a Resolution Tool, or any combination of Resolution Tools, in respect of an EU Credit Institution only if:

   (a) the Supervisory Authority has notified the Resolution Authority that it is satisfied that:

      (i) the EU Credit Institution no longer fulfils the Authorisation Conditions; or

      (ii) there is no reasonable prospect that the credit institution will continue to fulfil the Authorisation Conditions;

   and that, having regard to timing and other relevant circumstances, there are no other measures available to be taken by or in respect of the credit institution that will enable the EU Credit Institution to meet the Authorisation Conditions;

   (b) the Resolution Condition is met; and

   (c) the Resolution Authority has [obtained the approval of / has notified]:

      (i) the Ministry of Finance in its Member State; and

      (ii) the Consolidating Resolution Authority (if applicable).

2. The **Authorisation Conditions** are the minimum conditions and / or standards required by the Supervisory Authority from time to time in order that a credit institution becomes and remains authorised to carry on business as a credit institution, together with its ongoing capital and liquidity requirements pursuant to the (recast) BCD and the (recast) CAD.

3. The **Resolution Condition** is that the relevant Resolution Authority is satisfied that the application of the chosen resolution tool or tools is necessary to protect the public interest.

4. In assessing the Resolution Condition, the Resolution Authority shall have regard to:

   (a) the stability of the financial systems of each Member State in which the EU Credit Institution and any subsidiaries of it conduct business;

   (b) the maintenance of public confidence in the stability of the banking systems of each Member State in which the EU Credit Institution or any of its subsidiaries conducts business; and

   (c) the protection of depositors.

5. The Resolution Authority shall consider the views of Competent Authorities in all Member States in which the EU Credit Institution or any of its subsidiaries of it conduct business.

*Article [X+1]*

6. Article X shall apply *mutatis mutandis* in respect of a parent financial holding company in a Member State provided that the Holding Company Condition is met.

7. A Consolidating Resolution Authority may exercise a Resolution Tool, or any combination of Resolution Tools, in respect of an EU parent financial holding company only if:

   (a) the Supervisory Authority of the relevant EU Credit Institution has notified:

      (A) (if it is not the Consolidating Supervisory Authority) the Consolidating Supervisory Authority; and

      (B) the Consolidating Resolution Authority;

   that it is satisfied that:

      (ii) the EU Credit Institution no longer fulfils the Authorisation Conditions; or

      (iii) there is no reasonable prospect that the EU Credit Institution will continue to fulfil the Authorisation Conditions;

   and that, having regard to timing and other relevant circumstances, there are no other measures available to be taken by or in respect of the EU Credit Institution that will enable the EU Credit Institution to meet the Authorisation Conditions;

   (b) the Resolution Condition is met;

   (c) the Consolidating Resolution Authority has [obtained the approval of / has notified] the Ministry of Finance in its Member State; and

   (d) the Holding Company Condition is met.

8. For the purposes of Article [X+1(b)] and [X+1(d)], the Resolution Authority referred to in the Resolution Condition and in Holding Company Condition respectively shall be the Consolidating Resolution Authority.

9. The **Holding Company Condition** is that the Resolution Authority is satisfied that the EU Credit Institution cannot be resolved without exercising one or more Resolution Tools in respect of the parent financial holding company.

**Drafting Notes:**

1. A separate trigger is likely to be required for investment firms.

2. Provision needs to be made in the Directive for the obligations on Consolidating Authorities to share information with all Supervisory Authorities, in particular where a decision has been taken to apply a Resolution Tool on a Group-wide basis.

3. Where the Supervisory Authority and the Resolution Authority are not separate bodies, Member States shall ensure that there is functional separation within the body such that individuals involved in the day-to-day supervision of a firm are not involved in the resolution of the firm.

4. Definitions required:

- **EU Credit Institution** means a credit institution which has been authorised in a Member State.

- **(recast) BCD** means Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

- **(recast) CAD** means Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast).

- **Consolidating Supervisory Authority** means 'consolidating supervisor', as defined in Article 4 of the (recast) BCD.

- **Consolidating Resolution Authority** means the Resolution Authority empowered to conduct the orderly resolution of an EU parent credit institution or of credit institutions controlled by EU parent financial holding companies.

- **Supervisory Authority** means, in respect of a Credit Institution, the national authority of the Member State in which the Credit Institution is established and which is empowered by law or regulation to supervise credit institutions established in that Member State.

- **Resolution Authority** means, in respect of an EU Credit Institution, the national authority of the Member State in which the EU Credit Institution is established and which is empowered to conduct the orderly resolution of credit institutions established in that Member State.

- '**authorisation**', '**credit institution**', '**parent**', '**subsidiary**', '**parent credit institution in a Member State**', '**parent financial holding company in a Member State**', '**EU parent financial holding company**', '**EU parent credit institution**', '**financial holding company**', '**mixed-activity holding company**' shall each have the meanings given to them in Article 4 of the (recast) BCD.

- '**mixed financial holding company**' and '**financial conglomerate**' shall each have the meanings given to them Article 2 of Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

- **Resolution Tool** means any one of tools provided for in Articles [A, B or C] of this Directive.