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2 September, 2011

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel

By email to: fsb@bis.org

Re: Comments on the Consultative Document on Effective Resolution of Systemically Important Financial Institutions

Dear Sir / Madam,

Credit Suisse welcomes the opportunity to comment on the FSB consultation draft regarding the Effective Resolution of Systemically Important Financial Institutions ("SIFIs") dated 19 July, 2011.

The proposals set out in the consultation comprise a detailed and constructive framework for bank resolution. We agree fully with the goals set out in the paper: no bank should be too big to fail. It is essential that we build a system that ensures continuity of essential financial services and minimizes contagion risk, while protecting public funds and avoiding the need for bail-outs. With careful design, we believe these goals are achievable. The consultation draft does much to advance this discussion. If properly implemented, it would give supervisors a critical new capability that will make the financial system much more resilient in a future crisis.

Credit Suisse has worked to contribute constructively to this discussion, specifically with its work on Bail-In and through its participation in various industry groups working on resolution reform. In addition, Credit Suisse has been active in related areas, such as the development of contingent capital instruments, and earlier this year helped to demonstrate the viability of this market at scale by placing $8bn of these securities for our own institution.

Our attached response first summarizes the main points that we would like to contribute into the consultation, including comments on: underlying principles; economic objectives; cross-border elements; and resolvability assessments and RRP's. We are in agreement with the large majority of this consultation; however, our comments will focus primarily on areas where we believe refinements should be made. This section is then followed by responses to the specific questions raised in the consultation document.

Overall Credit Suisse supports the direction of the consultation paper. We urge the committee to maintain a strong focus on establishing a clear, predictable, simple tool that maximizes value and can be effective in crisis. Implementation will require considerable resources, but if implemented correctly, effective bank resolution through tools such as Bail-in can provide a durable and potentially revolutionary contribution to a more robust financial system.

We are at your disposal if you have any questions regarding this material.

Yours sincerely,

David Mathers	Wilson Ervin
Chief Financial Officer	Senior Advisor to the Chief Executive Officer

Zurich, 2 September, 2011
Credit Suisse AG

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Comments on the Consultative Document:

Effective Resolution of Systemically Important Financial Institutions

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Summary of Main Points

I) Underlying Principles

1. Practicality of Bail-in: We believe that "Bail-in Within Resolution" is the best practical way to solve the issue of too-big-to-fail. It could provide an effective alternative to the ad hoc, emergency interventions of 2008, and could be sustainable across time and address a wide variety of circumstances. It mimics to a large extent the going concern recapitalizations that are used for large enterprises outside the banking sector, but adapts these techniques to the particular considerations of banking. While this approach is perhaps most useful to address the particular challenges of large bank resolution, it should be available for use on institutions of all sizes where it provides the most value preserving approach.

2. Advantages Over Other Tools: Bail-in provides some significant advantages over other resolution tools currently under discussion. It avoids liquidation or forced sales, which can destroy value, especially in crisis. It also avoids the need to separate assets, critical functions, or businesses in a crisis. This separation is normally required under bridge bank or asset separation tools, and can be operationally challenging as well as value destroying. It avoids the need to tap resolution funds, reducing the subsequent strain on other banks in a crisis and allowing them to focus on restoring their own health and supporting their customers.

   Bail-in also eliminates the need to deal with multiple parties to effect resolution, which provides important benefits over traditional merger-type solutions. The task of a supervisor is simper if he or she can focus directly on a single institution in distress, without having to interact with potential third-party acquirers and their supervisors. We would note that the pool of potential acquirers diminishes rapidly as the size of the troubled bank increases, and can lead to concentration concerns. Moreover, a number of the resolutions that were addressed via acquisition in the crisis have led to a degree of stress for the purchasers, and in many cases, regret by the new owners.

   The relative simplicity of Bail-in compared to other resolution strategies can provide a critical advantage in a fast moving crisis, especially if multiple institutions are under threat.

3. <u>Enhancing Financial Stability</u>: In addition to the relative simplicity it can provide, Bail-in techniques also have important consequences for financial stability. Many of the other resolution approaches are predicated on the liquidation of assets or the sale of businesses, which transfer risk to other institutions. That works fine in an idiosyncratic situation -- when other participants are healthy -- but it can be dangerous in a broad crisis. The purchase of substantial assets or a large business raises the leverage of acquirers, and can add to management challenges with a difficult integration project. The recent crisis provides several examples where acquisitions proved dangerous, and changed an otherwise healthy institution into a damaged one.

   Moreover, when large positions are sold through the asset markets, they can exacerbate already difficult trading conditions and force prices down. At the peak of the recent crisis, this lead to a self-reinforcing deleveraging cycle in many markets through price declines, collateral calls, forced sales and related processes.

   In contrast, Bail-in focuses on the liability side of the balance sheet. It recapitalizes the bank in question by converting debt into equity, increasing the loss absorbency of the system at the point of stress. This puts the financing of existing risk assets onto a sustainable basis, without requiring a forced sale into a stressed market and without passing the risk to another potentially vulnerable institution in a crisis. Bail-in refinances the system automatically and sustainably, without the drawbacks of liquidation-oriented or merger-oriented approaches.

II. Economic Objectives

4. <u>Strong Duty to Maximize Creditor Value</u>: The resolution regime should have a clear duty to maximize value for the benefit of creditors that are subject to haircut or conversion. In several places, the document seems to divert from this objective, and adopts vague and difficult-to-interpret objectives. For example, on p27, the consultation asks for the "authority to wind down for those operations that . . . are judged by the authorities not to be critical to the economy". Liquidation will rarely maximize value or minimize systemic stress, and macro judgments on economic relevance should not be the relevant criterion for action in a crisis. A clear focus on value maximization is the most direct and measurable way to reduce contagion to other market participants and lower systemic risk impact.

5. <u>Non-Discrimination</u>: Creditors with similar holdings should not be discriminated against on the basis of national origin or type of investor, but solely with respect to the nature of their investment. Bail-in does involve some discrimination between creditors of the same standing in liquidation, but based only on the nature of their investment. This discrimination is to ensure systemic safety and to maximize the value of the institution as a whole, in line with principles typically used in a consensual corporate restructuring.

6. Predictability: An effective resolution regime should be predictable. Having more "options in the toolkit" is necessary - but not sufficient - to ensure stability. If counterparties are uncertain about which tool will be used, a wide range of tools can actually lead to unnecessary stress and runs. For example, if a counterparty or customer believed that some plausible resolution options might inflict loss on them, they would be incentivized to run, even if the ultimate method chosen by the supervisor would not affect them. The decision rules that determine the choice of resolution method should be clear to the market.

7. Transparency: The resolution regime should be transparent, subject to appropriate safeguards for confidential business matters. Information about the overall risks and rewards of different investments should be publicly available, so that counterparties and investors understand the nature of their investments. Without a clear knowledge of likely outcomes, it is difficult for investors to establish proper market discipline and eliminate moral hazard.

   A predictable, transparent regime will also help avoid surprises that can undermine market confidence. It can also help expose poorly designed mechanisms to external criticism before a crisis, and thereby help to upgrade any weaknesses prior to their use.

   One helpful tool might be to publish the results of a set of standardized scenarios for a range of banks, which showed how instruments of different seniorities and legal entities could be affected in a Bail-in event of a given severity (this is perhaps more difficult to do with other strategies such as "good bank / bad bank" bridge approaches, since it is difficult to know ex ante what will be in the good bank). Another useful tool would be disclosure of the key principles that the supervisor would employ in making certain key decisions (such as the choice of resolution method). Such table top scenarios and decision checklists could also provide useful practical aids to supervisors in executing a future Bail-in.

8. Respect for Creditor Priority: Bail-in creates equity by imposing write-downs or equity conversion on the longer term capital stack, in order of creditor priority. Write-down or conversion should occur to the minimum extent necessary to create a robust, going concern outcome. Supervisors should take particular care when assessing the need to convert senior unsecured obligations, but these obligations should be in scope if additional equity resourcing is necessary.

9. Depositor Preference and Short Term Funding: Depositor preference should be instituted on a global basis and avoid national preference. It should apply to all demand style deposits (i.e. not term CDs), all saving / retail type instruments and apply to both insured and uninsured depositors.

   In addition, we believe that it would be useful – though not essential – to exempt short term funding (including short term deposits) from bail-in as a means to slow down liquidity crises at the margin. A cut-off threshold of 1 month might best accommodate the goals of stabilizing short term funding without reducing capacity or burden sharing unduly.

This approach would reduce incentives for runs, assuming that this policy was made transparent on an ex ante basis. It would transfer market discipline and oversight responsibilities to long term credit investors, who are better placed for this role. Due to the nature of their investment, long term investors cannot create funding problems for the institution by "running" (i.e. demanding their money back, as in a demand deposit). Long term credit investors assess credit risk as an intrinsic part of their mandate, and are familiar with distinguishing between different credits, and charging for those differences.

10. Post Resolution Liquidity Support: The paper would benefit from a more elaborate discussion of liquidity support for going concern recapitalization strategies. A well planned liquidity program that addresses near and medium term constraints in a substantive way will be essential in restoring the confidence of counterparties and clients. An ability to provide new, post-resolution funding on a super-senior basis could provide an important tool to establish a strong liquidity profile in short order from the private sector. In addition, central banking authority to accept investor positions secured by such positions could provide additional support in a crisis.

11. Transition Issues: The transition from current regime to a Bail-In regime (whether statutory and contractual) will need to be sequenced carefully. In order to be effective, Bail-In needs to have certain legal preconditions implemented in the major financial markets. If some banks are forced to become early adopters - before these legal preconditions are in place – and before other banks, they could suffer higher costs or liquidity stress as counterparties shift exposures to other banks.

III) Cross Border Elements

12. Home-Host Coordination and Supporting Incentives: Effective coordination between home and host regulators, supported by clear rules and agreements, is critical to effective resolution. A well coordinated approach would also reduce the incentives for ring-fencing and forced subsidiarization.

This could also be usefully supported by an incentive-compatible framework that allowed home country supervisors to allocate equity or liquidity created in a recapitalization to a host jurisdiction that that had appropriate concerns for the viability of entities subject its remit. That would help to translate better global outcomes into better local outcomes, and encourage participation in a better global solution.

We recommend that international coordination should be stronger than outlined in the consultation paper, with substantial deference to the home country. In particular, the right for host countries to implement resolution measures which are not agreed with the home regulator should be a last resort.

IV) Resolvability Assessments and RRPs

13. Acceptability of Whole Bank Solutions: The consultation document appears to take a negative view of integrated approaches in some areas. Compartmentalization is not appropriate for many banks and can destroy value in many cases. It can be difficult to implement at the moment of crisis, and make a difficult job more challenging for the resolution authorities. It is not necessary for successful resolution or to satisfy other legitimate government interests in most cases. Indeed, compartmentalization – especially if associated with national ring fencing – could be the greatest threat to the successful stabilization or resolution of a SIFI.

    We support the use of bridge banks where this is a useful tool to accomplish outcomes similar to whole bank recapitalization. But we oppose the use of bridge tools where they impair franchise value, leak value to 3rd parties through forced sales or liquidation, or add needless complexity.

    Too much focus in the document is placed on internal simplification - removing guarantees, etc and on subsidiarization, as a means to improve resolvability. Many such internal transactions act to reduce risk, enable efficiencies and are beneficial to the stability of the banking system.

14. Top Down Approach to Assessment and RRP: To pursue the ultimate goal of effective cross border resolution, the resolution assessment should be done top down, for the group as a whole. By doing so, the best resolution strategy can be identified and the necessary cooperation agreements can be reached within national legal boundaries. Maximizing the total value improves the systemic consequences of a resolution tremendously, and host country concerns can be dealt with more easily if they are supported by a more valuable home (or group) enterprise.

    Conversely, RRPs which focus on local, country by country or legal entity-oriented solutions will lead to a fragmented, inconsistent approach. Such approaches have a much higher risk of failure and are likely to destroy value needlessly. Furthermore, by keeping a group wide focus, unregulated entities which are part of a regulated banking group are also adequately considered.

15. One RRP: The Recovery and Resolution Plans (RRPs) need to be jointly developed between the bank and its primary regulators. There should be only one RRP for a banking group. National requirements from host supervisors should be coordinated through the home regulator, to ensure that the bank is not subject to conflicting demands.

16. Clear RRP Criteria: The criteria for success in an RRP should be clearly established, and not mutate into an ill-defined, potentially endless power that allows supervisors to alter bank structures for non-essential objectives. Any right by the resolution authority to require the firm to change its business structure or organization should be based on clear, unambiguous definitions, and implemented only when it is truly essential for a successful resolution. The focus of the RRP should be to identify the essential elements needed for a successful and efficient resolution, and not form a presumption for liquidation or compartmentalization.

    As success is achieved in establishing a successful resolution regime and an implementable RRP, the justification for additional burdens on SIFIs – such as additional measures to "improve" resolvability or extra capital requirements - is eliminated. Clear milestones should be established to measure success in this regard. As these are achieved, there should be a corresponding reduction and/or elimination of such burdens.

17. Timelines: The envisaged timelines for RRPs are aggressive, and would benefit from a more considered approach that gives time for banks to respond the new legislation that is needed as a precondition.

Overall Credit Suisse supports the direction of the consultation paper. We urge the committee to maintain a strong focus on establishing a clear, predictable, simple tool that maximizes value and can be effective in crisis.   Implementation will require considerable resources, but if implemented correctly, effective bank resolution through tools such as Bail-in can provide a durable and potentially revolutionary contribution to a more robust financial system.

Zurich, 2 September, 2011

Credit Suisse AG

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Questions for public consultation

> 1. *Comment is invited on whether* ***Annex 1: Key Attributes of Effective Resolution Regimes*** *appropriately covers the attributes that all jurisdictions' resolution regimes and the tools available under those regimes should have.*
>
> 2. *Is the overarching framework provided by* ***Annex 1: Key Attributes of Effective Resolution*** *specific enough, yet flexible enough to cover the differing circumstances of different types of jurisdictions and financial institutions?*

1. We broadly agree with the key attributes set out in Annex I, although we have some specific concerns:

    a. <u>Strong value maximization principle</u>: There should be a clear focus on maximizing value for creditors (and shareholders if there is any residual value for equity holders). While the preamble mentions "avoiding unnecessary destruction of value", it chooses a relatively weak formulation for such an important principle. Maximizing value for creditors is perhaps the most direct way that a resolution regime can reduce systemic damage from contagion. For example, if creditor recoveries had been higher in the case of Lehman Brothers, as we believe would be possible in an orderly recapitalization, The Reserve Fund would have avoided "breaking of the buck" later that week. That would have directly reduced contagion into money market funds, which was an important pathway of stress in 2008.

       Maximizing value also provides a clear, direct guide to supervisory action in resolution. However, in some areas of Annex I, the document strays from this principle. For example in section 4.3 the document recommends granting authorities the power to wind down those operations that are "judged by the authorities to be not critical to the economy", which is an incorrect and vague principle.

    b. <u>Avoiding a presumption for wind-down</u>: Some elements of the key attributes seem to assume wind-down or exit-oriented resolution outcomes, and might preclude strategies based on whole bank recapitalization. For example, in the preamble, one objective is to "ensure the rapid return of segregated client assets", which seems to assume that this function should be terminated. A better formulation would be to "protect or return" such assets. Similarly, it suggests that we should "ensure that non-viable financial institution can exit the market in an orderly way" which raises similar concerns. The priority should not be on "exit" or forcing an institution out of certain businesses, unless that would help to maximize value for creditors by eliminating a value-destroying activity.

If taxpayer capital is not needed, there is no legitimate government purpose in forcing a wind-down of specific activities unless that can be shown to improve recoveries for creditors or avoid unacceptable systemic stress.

c. Avoiding a presumption for segregation/ subsidiarization. Section 11.11, recommends that authorities have "powers to require . . . changes to a firm's business practices, structure or organization to reduce the complexity and costliness of resolution. . . ". This appears to be predicated on adopting a strategy that is based on breaking up the firm in resolution, rather than a whole bank oriented strategy, which we believe is likely to be more effective. If a firm can show that it is resolvable under a whole bank recapitalization, it should not be liable to forced changes that could have detrimental impact on its current business and risk management practice, in order to improve the efficacy of a superfluous resolution option.

d. Liquidity Program: We think that an additional attribute for an effective resolution regime is a strong set of programs to ensure access to liquidity to support the other objectives. This is particularly true in re-capitalization oriented strategies (this is noted in Annex II, Section 11.11, but should be included as a general attribute). While a restoration of solvency through recapitalization should, in theory, provide a firm basis to restore liquidity, liquidity is often subject to its own local dynamics. A strong liquidity program that addresses near and medium term constraints in a substantive way will be essential in restoring the confidence of counterparties and clients. An ability to provide new, post-resolution funding on a super-senior basis could provide an important tool to create a strong liquidity profile in short order from the private sector. In addition, central banking authority to accept investor positions secured by such positions could provide additional support in a crisis where liquidity is likely to be at a premium for any banks or investors involved in such a syndicate. We think this is a much more practical solution to the issue than – for example – the resolution funds mentioned in section 6.3, which can carry dangerous moral hazard consequences. It could provide an elegant solution to the issues mentioned in Section 6.2.

e. Home and Host Resource Allocation: Home regulators should have the power to downstream equity or liquidity created at the holding company where needed to support subsidiaries or branches in host jurisdictions and assure their safety. This would provide a mechanism by which a value maximizing global recapitalization strategy could also assure improved stability for local operations. Host jurisdictions should have a duty to keep their demands proportionate in any such rebalancing, and consistent with the condition of other firms operating in their jurisdiction. (This would be a useful augmentation of section 4.4).

f. <u>Technical Challenges</u>: A very comprehensive list of key attributes is provided in the consultation paper, but will put significant challenges to lawmakers and regulators
   i. Highly specialized units with sufficient experience need to be created within regulator (see 2.5)
   ii. Resolution powers (para.4) are very broad, however it is very challenging and demanding for a resolution authority to operate and resolve the firm (4.1(iii)) The Lehman case illustrates the importance of interaction with bankers, technicians etc., which should be reflected in the final proposal
   iii. Cross-border cooperation is essential prerequisite for resolution of internationally operative SIFI but (per Paras. 8.4 et. seq.) a more specific focus on the avoidance of ringfencing should be put in place.
   iv. Para. 8.7: Should consider the sharing of only such information between home regulator and host regulator that host regulator needs to know in relation to cooperation relevant for the establishment in the host country
   v. Para 9.1: A definition of "relevant host authorities" should be considered, if the meaning is that there should be two groups of host authorities, "relevant" and "others"
   vi. Whether CMGs should be established (para. 11) should be reevaluated. There is a danger is that yet another body is created for the oversight of SIFIs, resulting in additional bureaucratic requirements but not necessarily fostering efficiency in oversight
   vii. Paras. 11.6/11.10 provide that in case RRPs are not sufficient, the resolution authority may require the firm to change its business structure or organization. Such a mechanism would require (i) a very clear basis in the national laws and (ii) a very clear and unambiguous definition of what the requirements for an RRP are against which it could be measured whether an actual RRP is not sufficient.
   viii. Para. 12: Should consider data safety issues in connection with exchange and storage of all relevant information.

2. We think the framework generally strikes a reasonable balance, albeit with two concerns.

   a. <u>Predictability</u>: While flexibility is desirable, it can lead to confusion and instability if not properly constrained. An effective resolution regime should be clear and predictable. Having more “options in the toolkit” is could lead to uncertainty about which tool will be used, and potentially to unnecessary stress and runs. For example, if a counterparty or customer believed that some plausible resolution options might inflict loss on them, they would be incentivized to run, even if the ultimate method chosen by the supervisor would not affect them. Market discipline is best achieved when the market and the banks management both understand how the mechanism would work for a given bank, and what decision rules will govern.

b. "Early entry" trigger: In section 3.1 we are concerned about the phrase "early entry into resolution", as it does not seem to treat crossing the threshold from recovery into resolution with the appropriate restraint and diligence. The second sentence of this paragraph seems more precise and better crafted for an event of this importance.

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

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

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

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

7. Will it be necessary that authorities monitor whether firms' balance sheet contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring minimum level of bail-in debt ? If so, how should the minimum amount be calibrated and what form should such a requirement take, e.g.: (i) a certain percentage of risk-weighted assets in bail-inable liabilities, or (ii) a limit on the degree of asset encumbrance (e.g., through use as collateral)?

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

3. We think the elements described in the Bail-in Annex are generally set out very well in the document, with a few additional comments below:

   a. Predictability: We believe that the effectiveness of this regime would be substantially strengthened if resolution outcomes were highly predictable for market participants (see also our previous answer (2a)). This includes both the choice of what overall resolution regime to be employed (i.e. whether Bail-in would be used as the primary strategy) as well as the consequences for owners and creditors (as mentioned section 2.2 (v)). The impact on other customers and counterparties should also be clear, and there should be a communication plan to support this.

   b. Clarity of approach: In this regard, we also have concern about the language on p12 that notes that bail-in "most likely would be used in combination with other resolution tools". The reasoning behind this and its implications are unclear to us. In the absence of any clarifying comments, we would disagree with this assertion.

c. Asset Valuation Procedures: The document overall would benefit from additional focus on asset valuation. Concern over correct asset pricing and/or insufficient reserves is often the underlying cause of distress for a large bank; it is essential to address this directly in a resolution. While crises often are associated with a high degree of valuation uncertainty, a rough approximation of updated asset values is an essential precondition for determining the needed capitalization changes.

   There are also procedures that can be used to manage the challenges of valuation uncertainty, if they are unusually large for some reason. For example, a conservative initial estimate that could be used to establish initial conversion ratios and create a relatively generous amount of equity. These ratios could be reduced if subsequent, more refined valuations showed that the institution was well capitalized without the full initial amount of conversion.

d. Degree of Conversion: Some have suggested that a full conversion of all bail-inable liabilities to equity would be the safest default approach for supervisors. While that would assure the maximum safety for the pro forma institution, it could also be unnecessarily disruptive for markets and for investors, possibly exacerbating stress on investors. We think it is better to aim for balance in this regard, and to convert only the liabilities that are truly necessary and to preserve other liabilities in their initial state.

   Others have suggested that it would be important for the authorities to provide immediate liquidity for debt investors after a resolution, so that investors who were not converted could redeem their investments for immediate cash. We do not think this is necessary, and this could also put unnecessary strain on governments – in an extreme case, it could even put the government in a risk position (e.g. if all liabilities were repaid in this manner, government funding would become the first dollar of risk beyond equity). Moreover, it would dramatically shorten the funding structure of the recapitalized bank and make it more reliant on ongoing government support, and less able to move back to an independent status.

4. It is desirable (subject to the considerations laid out for questions 5 and 6) that the scope of liabilities should be broad and defined similarly across countries. The former will help assure the efficacy of the regime across a range of event severities. The latter will act to promote a level playing field and reduce jurisdictional arbitrage. The consistency is particularly important, as it will be hard to maintain discipline in one country if a government protected a particular set of products in another country. In such a case, customers are likely to run from the more disciplined jurisdiction in a crisis to the more protected jurisdiction, potentially destabilizing both nations.

5. We believe that regulators should have a statutory power to write down and convert a broad range of unsecured capital and funding instruments, from equity to subordinated debt up to and including senior unsecured debt if necessary. These instruments are inherently credit risk investments, and these investors are the most capable in analyzing the risk that their assets may not be fully covered by assets or

cash flow. Resolution authorities should convert classes in order of priority, and should not convert incremental classes unless that is necessary for a successful resolution.

Specifying Priority: In some jurisdictions, "strict priority" can be interpreted to mean that junior tranches have to be wiped out entirely before the next more senior tranche suffers any writedowns or conversion to equity. We believe that this may be too harsh in a regulator-imposed recapitalization, as it could disenfranchise junior investors with a legitimate claim on book value, with no recourse to protect themselves. One approach could be to introduce a mechanism whereby junior creditors would have the option to re-establish their position by "buying out" the conversion of the senior investors and restoring them to their ex ante position. If that proved cumbersome in practice, it would be reasonable to establish more graduated rules – "balanced priority" that allocated claims against asset values in a less binary fashion. Such an approach would wipe out investors with no credible claim to net asset value (once assets and reserves had been properly adjusted to current market conditions). However it would also ensure that junior investors with a legitimate claim on book value were given some equity, even if some more senior investors were also converted. More senior creditors should always treated significantly better than junior investors. There are a variety of formulations that could be adopted to specify precise rules that met these constraints; if adopted these rules should be made public. We also believe that this issue – how best to operationalize creditor priority in Bail-in – would benefit from further public discussion, alongside the issue of depositor preference.

Contractual Language and Guarantees: A statutory power in the home jurisdiction could be supplemented by contractual language that would govern debt issued in other jurisdictions so that they respond in a similar way. It may also be useful to capture funding guarantees by bail-in language (e.g. a guarantee of a bond issued by a subsidiary given by the holding company); otherwise there can be circumstances where unsecured obligations issued by the subsidiary might lose any loss-absorbent qualities.

Maturity Considerations: There is an important issue regarding the maturity profile of what instruments should be included in a Bail-in – in particular, whether Bail in should be applied to very short term liabilities. We believe that it is possible to design a stable regime that applies to all unsecured debt, as well as one that applies only to unsecured debt with a term longer than a defined cut off maturity. These regimes have different properties, but both could be effective.

Assume a starting point where all unsecured obligations are subject to bail-in regardless of maturity: This maximizes the total stock of debt, available for recapitalization, and will mean that haircuts are therefore smaller. However, short term investors can "run" simply by not renewing their investment, with the extreme case being overnight liabilities. If short term liabilities are protected (and if investors believe that bail-in is the procedure that will be applied), then there will be a strong incentive for investors to buy debt with a short maturity. While this debt will therefore be more stable, it could frustrate some of the other liquidity management objectives currently contemplated in the reform effort - however, this effect could be controlled by those other rules being established as well as by the anti-arbitrage rules raised by question #7).

The choice made about a maturity cut-off will affect the speed at which the resolution trigger is likely to be reached. If short-term obligations are subject to bail-in, it is likely that the loss of rollover capability could become the practical trigger for resolution in many cases. This will mean that the resolution trigger could be reached more quickly, when short term creditors judged that the likelihood of some write-down or conversion was outweighing the (relatively small) coupon they are earning. This approach also is likely to shorten the amount of advance warning for supervisors to plan for the event. If only longer term debt was subject to potential conversion, then the practical trigger for bail-in would likely become the inability to issue term debt, which is a process that would become clear over a somewhat longer period.

On balance, we would support the exclusion of unsecured senior liabilities with a maturity of less than 30 days for these reasons.

6. We would exclude two main categories of liabilities from the write down power: those that relate to “customer activities” and certain “protected liability classes”. These classes are populated by counterparties who are engaging with the bank primarily for transactional purposes, and the extension of credit is often incidental to the transactions. These counterparties often do not have the incentive or wherewithal to assess credit in normal conditions, and tend to run if credit begins to be called into question. Many of these types of positions are also highly interconnected, with the potential for chain reaction disruption if (e.g.) settlement procedures are disturbed.

   We would define customer activities as those activities that are inherent to the “business of banking” rather than the funding of the balance sheet. These activities are crucial to the bank’s customer base and the value of its business franchise. Specifically we would exclude the following elements from conversion: transaction payments, settlements, prime banking, and normal derivatives, among others. Protected liabilities would include covered bonds and repo transactions, assuming that these are well structured and secured by adequate collateral.

   While purists might argue that any unsecured amounts in a repo or a derivative should also be subject to bail-in, in line with senior creditors, we believe that such an exercise would have a poor cost-benefit, be difficult to implement practically, and likely would be damaging to the franchise value of the firm. We would therefore approach this solely as an anti-arbitrage issue, to address any cases where these instruments were misused to a significant extent to evade the overall intent of the rules. But we would be careful to minimize these exceptions, and recommend that safe harbors be established to additional protection for normal instruments. This would help to minimize the run pressures in these liability classes, and mitigate some of the severe problems faced in the Bear Stearns and Lehman Brother situations.

(It may be easier, as a practical matter, to designate what liabilities are included in the power, as opposed to listing the liabilities that are excluded from the power.)

The separation between bail-in-able claims and other protected classes implies that it is unfortunate – but necessary - to distinguish between creditors of the same ranking in liquidation for this tool to be effective. Protecting certain classes will have direct and important benefits for financial stability for those counterparties and customers. Equally as important, Bail-in aims to produce greater value for senior debt investors, by maximizing the franchise value of the firm. Similar tactics are often used in industrial reorganizations, where "trade creditors" are given favoured treatment in order to keep the business going and preserve franchise value for the investor classes. We think this is a productive analogy here and suggest that it can provide a useful guide to these decisions when future idiosyncratic liability cases are considered.

7. We believe this it will likely be necessary to monitor the composition of a firm's balance sheet and ensure it includes a minimum amount of bail-inable debt. Without such a tool, banks that either employed "optimization techniques" or simply those funded with non-bail-inable classes would enjoy an advantage over banks that operated with a safer capital structure.

   We would suggest the amount of bail-in-able debt be tested regularly in resolution plans, as one direct method to ensure that sufficient liabilities subject to bail-in are maintained. This will be particularly important in crisis, when arbitrage pressures are likely to be greatest.

   Various measures could be developed to provide auxiliary support, such as establishing a guideline on the amount of asset encumbrance. But the primary tool should be based on a minimum level of bail-in debt, as this addresses the issue directly.

   The easiest way to dimension this requirement would be similar to the sizing of other capital figures, but to a much higher degree of confidence. We would suggest that a measure that compared historic losses as a % of RWA, appropriately adjusted for Basel III considerations, would be a good starting point. The amount of existing capital, plus the amount of bail-in-able claims should be able to absorb this loss to a high degree of confidence, as well as to re-establish a strong capital position. We would suggest that a strong capital position for a newly-recapitalized firm would likely be in excess of the normal standard (e.g. 7% core equity tier 1 ratio) by some margin, when consideration is given to the challenging circumstances under which this event might take place. We would suggest 10% as a practical initial approximation.

8. There are general consequences for funding and credit supply in moving to a resolution system that eschews the use of government bail-outs. Much of this is currently visible in the market, as bank spreads have widened in many jurisdictions. Some of this widening also reflects uncertainty over the exact rules of the new

system. A system that is clear, predictable, and designed to maximize creditor values could help reduce the pressure on spreads.

Based on a review of major banks operating in Europe and the US, we believe that most major institutions would already meet a practical requirement of this type, and therefore that such a transition would likely be manageable.

There will likely be additional market pressure on weaker banks to raise capital in such a regime. We view this as unavoidable in a system that attempts to avoid government bail-outs, and is a necessary part of a transition to a more robust regime.

Section 8.1: For clarity, we would also note that a "brief stay" on close out termination may not be sufficient or appropriate for a bail-in resolution where the bank is recapitalized directly. In such a case, the stay would need to be permanent to the extent of the bail-in event where the result was a creditworthy entity (though subject to normal ongoing performance requirements under the terms of the contract).

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?*

9. There should be a duty for authorities to consider the overall systemic risk impacts of their decision, as well as the impact on local conditions. While there may be political pressure to focus on maximizing local-oriented outcomes, it should be noted that offshore distress will often have large adverse impacts on local conditions, albeit indirect, and that these effects should be considered in local decision making.

   We believe that an approach that maximizes the overall value of the franchise post resolution is the best starting point, and also provides a clear guide to supervisory action. By establishing the maximum store of overall value, there is more to share for supervisors in each jurisdiction. This would need to be supported by a framework that allowed home country supervisors to downstream equity and/or liquidity created in a recapitalization to host jurisdictions that that had appropriate local concerns. With this type of approach, the ability for supervisors to work together to maximize overall value would be supported by the allocation of resources to support local safety. At a minimum, host supervisors should be empowered to participate in such an approach and not required to pursue short-sighted locally-motivated actions, such as immediate ring-fencing, that could destroy significant overall value.

The deference to home country supervisors should be strengthened. A host country should have, at a minimum, a duty to consult with the home supervisor prior to instigating resolution in their jurisdiction.

10. International coordination and clear guidance and agreements between home and host regulators to coordinate actions are a key component to effective resolution. A well coordinated approach would also reduce the incentives for ring-fencing and forced subsidiarization.

    We recommend that international coordination should be stronger than outlined in the consultation paper with substantial deference to home country. In particular the right for host countries to implement resolution measures which are not agreed with the home regulator should be a last resort. For Bail-In we also suggest that no host regulator should have the power to enact a bail-in over debt issued by a subsidiary or branch in its country without a) prior home regulator notification, and b) for the affected bank to be given an opportunity to avoid de-consolidation (e.g. by exchanging holding company equity of equal value).

    As noted above, we believe these elements should also include a strong duty to maximize value for creditors, without national discrimination.

    We agree that table top planning is a useful and practical tool that can help ensure that a clear path to resolution is created and maintained over time. We believe that firms should be involved in this process, which will help make it more practical. We also believe that certain standardized results should be made public on a broad, cross-industry, and regular basis (e.g. perhaps as part of Pillar 3 disclosures). These could show how various instruments issued by different legal entities and with various seniority would be affected by a recapitalization events of predefined magnitude under standardized procedures.

11. The home supervisors, as well as supervisors who cover subsidiaries in major host jurisdiction should be party to this agreement. It is not necessary for supervisors in all jurisdictions to be involved.

    An initial list of major host jurisdictions would probably include jurisdictions which house entities covering at least 10% of an institution's RWA or 10% of its unsecured liabilities. It may also be useful to include supervisors for major market centers if the firm has significant trading activities in that center. We would suggest that the exact delineation of which supervisors are critical can be refined through the use of the table top planning exercises noted above.

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

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

12. The focus of a Resolvability Assessment should be to determine the practicality of a clear path to resolve a distressed institution. We are concerned that the broad, qualitative language in Annex 4 could result in an endless upgrade program, determined by qualitative regulatory judgment without clear standards and enforced by compulsion. In addition, Section 3 appears to suggest the consideration of multiple resolution approaches in this regard. No institution is likely to be easily resolvable using every possible approach. Once a single, clear path is established which satisfies the primary specific attributes for a successful resolution and addresses a range of plausible distress triggers, the power for a supervisor to require further actions to improve resolvability should cease.

13. We find the language in Section 5 (pp50-51) to be quite vague and unhelpful. We are concerned that this could provide a pretext for inconsistent application and for unchecked and unwarranted intrusion into a firm' structure. For example, attempting to assess "confidence or uncertainty" effects is not likely to provide any practical, quantifiable benefit to future supervisors. We think that the resolvability should be linked to a) the demonstration of the existence of a clear path to resolution, and b) the depth of assurance provided by such a path in financial terms, including whether it would be sufficient to protect systemic functions like deposit taking, settlements, and similar activities.

    The MIS requirements suggested here would benefit from a Basel-style harmonization process, so that requirements are consistent across jurisdictions. This would avoid the unnecessary expense of building multiple parallel systems to generate data that is inconsistent. That would also aid regulators by establishing a common language that could be easily ported across jurisdictions and legal entities, and allow direct consolidation.

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

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

14. Given the experience of the last crisis, it is clearly necessary to include far more firms than simply G-SIFI's. Institutions like Northern Rock, Bear Stearns and even perhaps even Lehman Brothers would not have been included on a G-SIFI list from that time, but their distress was sufficient to roil markets. If a firm of that scale was found to be unresolvable in a future crisis, the potential for global damage could be just as significant. Markets would be quick to draw adverse implications from a small firm failure and doubt the resolvability of other firms. An RRP for smaller firms can be simpler if the structure of the firm is less complex, but a clear strategy for resolution needs to be in place for many more firms than the G-SIFI list.

    Banks should have significant input into resolution plans, to ensure that they are appropriate for their structure, and to consider how changes required for better resolvability might affect the business plan and risk controls of the firm in normal times.

    The RSP should be disclosed to the firm. We see no reason why this should not be transparent, and believe that management commentary on the RSP could provide valuable insights to supervisors.

    Much of the information requested in the RRP is market-sensitive and needs to be kept confidential. For example, if an RCP scenario included likely divestitures or "bad-bank" strategies, public disclosure could have an adverse impact on employee retention and client behavior, and potentially accelerate problems in a crisis. However, the broad implications of an RRP should be sufficiently clear and transparent so that outcomes are predictable for investors

    Section 3.1 appears to frame a recovery plan as a mechanistic process, to be triggered by management based on certain criteria. We see the primary benefit of a recovery plans as providing an inventory of possible actions that can be chosen at the time of crisis. Their benefit is to enable managers to address a deteriorating situation more quickly and clearly, not as a mechanistic program to be triggered in sequence.

    Section 4.2 emphasizes the flexibility given to authorities to choose a variety of strategies. While we understand the desire of authorities to have maximum freedom in a future crisis, we stress that predictability and clarity will be critical to the market and to minimizing systemic contagion. This inherently implies a reduction of flexibility. That may be done in a structural way, or - at a minimum - through a statement of intent on how they would expect to resolve the major instructions operating in their jurisdiction. Public decision rules and specific scenarios can be very helpful in this regard. We believe it will be in the interest of the authorities to explain their intentions and that any criticism of such intentions is better debated in "peacetime" than in the actual event of a crisis.

    The set of essential and systemically important functions should be defined at a global level by a body like the FSB, and not be left to different analysis in each jurisdiction. This could lead to difficult and incompatible requirements for global firms. We would recommend the IIF report from May 2011 in this regard. We would also note that a whole bank bail-in strategy can eliminate the need to wrestle with this issue entirely, as all functions are inherently preserved

15. RRP's should be prepared for major subsidiaries, but they should be prepared "top down" (i.e. consistent with the agreed RRP of the home country). Supervisors should be required to identify and resolve any discrepancy, with significant deference given to the home regulator in this exercise.

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

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

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

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

16. The main obstacles appear to be well covered, and we believe the list actually includes more elements than necessary. Several are not true impediments. For example, it states that the "ability to quickly transfer assets from one entity to another is necessary for preserving the value of the good assets and the franchise value of the group as a whole." That might be true in certain highly specific situations which could be covered in an RRP, but we doubt the importance of legal entity transfer as a general matter, especially in whole-bank bail-in.

Any right of resolution authority to require the firm to change its business structure or organization would require (i) a very clear basis in the national laws and (ii) a very clear and unambiguous definition of what the requirements for an RRP are against which it could be measured whether an actual RRP is not sufficient. Too much focus is placed on internal simplification - removing guarantees, etc and on subsidiarization - as a means to improve resolvability. Many of the internal transactions are in fact reducing risk in the system and are beneficial to the overall stability of the banking system. Complex structure arise more than often from inefficiencies in legislation (be it tax laws, regulations or other legal impediments).

Bank structures are largely optimized to fit the business strategy within the legal and regulatory framework. Therefore, the measures to improve resolvability should also analyze the legal and regulatory framework and make suggestions, how it can be changed

17. In general we believe that Annex 6 places far too much focus on internal organization and simplification - removing guarantees, etc and on subsidiarization - as a means to improve resolvability. Many internal transactions act to reduce risk for the firm and its counterparties and are beneficial to the overall stability of the banking system. For firms which operate in a relatively integrated fashion, it is likely that whole bank recapitalization strategies will be the primary practical approach, and the challenges of internal organization raised by the FSB are likely to be superfluous. The paper places too much emphasis on a breakup strategy.

    Improved resolvability is not driven fundamentally by the ability to separate legal entities, but rather by the ability to restore key businesses to a sound solvency and liquidity footing, and by minimizing losses to investors and counterparties. We believe that whole bank resolution meets these objectives in an efficient and effective way.

18. Complex structures frequently arise from inefficiencies in legislation (such as tax laws, regulations or other legal impediments). Bank structures are largely designed to fit a business strategy within a variety of legal and regulatory frameworks in an efficient manner, and adapting those over time. Therefore, any broad initiatives to measures to simplify banking with the objective of improving resolvability should first analyze the legal and regulatory framework and look for opportunities where it can be simplified.

19. We believe these proposals should be reconsidered along the lines suggested above in questions 16 through 18, and substantially simplified before implementation.

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

20. The timetable seems quite aggressive given the high degree of change in national law and regulation surrounding bank resolution. We think that these foundational elements should be completed first, with appropriate industry involvement, and that detailed, bank specific plans should follow at a speedy but more deliberate interval. Developing a sensible RRP is difficult and potentially impossible before the underlying laws and regulations are established. A twelve month delay would seem appropriate and would shift the focus of the exercise much more towards the quality of the exercise. It would also enable regulators to systematize their expectations, establish more consistent protocol for this exercise, and simplify the nature of the task for both banks and supervisors.

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

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

23. *Is there a risk of arbitrage in giving a preference to all depositors or should a possible reference 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 banks, insurers and pension funds; (c) the (subrogated) claims of the deposit guarantee schemes (especially in jurisdictions where these schemes are financed by the banking industry)?*

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

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

21. Yes. Different treatment of depositor rankings and preferences can invite ring-fencing and create pressure for national authorities to protect local investors regardless of the best overall outcome. It can also create arbitrage pressure in a crisis where various investors seek the best jurisdiction for their particular investment. This can be destabilizing.

Depositor preference would be helpful as a general matter, especially in allowing institutions to be resolved in a way that meets the no creditor worse off requirement more easily. If deposits have to be protected to preserve franchise value and assure systemic stability, then the weight of conversion is transferred onto long term debt investors. But if the minimum recovery right analysis treats the debt and deposits as pari passu in liquidation, then there will be cases where the minimum recovery right test may not be met, even in cases where a bail-in recapitalization would preserve substantial value overall. This could also impose significant cost on governments or DGS schemes as a consequence.

22. Yes. We would support increased convergence, in particular in the relation between head office and branches. As noted above, we believe that convergence would be best if it was in the direction of depositor preference, but without preference being applied on a national or ring-fenced basis.

23. We believe that a general preference for all demand style deposits, including both insured, and uninsured, and including the deposit guarantee scheme, would be the most efficient and effective. We also think that this preference would reduce the pressure on bank runs by a highly run-able class of investors (though it is unlikely to eliminate this pressure entirely). We would not protect term deposits, as these are more in the nature of a long term, non-runable credit investment and are highly analogous to senior unsecured debt.

24. We see four primary benefits from depositor preference:

    a. Depositor preference may provide some protection against bank runs and may provide better funding basis for bank.
    b. Depositor preference will make the no-creditor-worse-off calculation a more achievable target in many situations
    c. Deposits often form a substantial part of the franchise value of a bank, and preserving them can reduce the cost of resolution.
    d. Deposits are often used as a key store of value and liquidity for many depositors, and losing immediate access to them as a par asset may be destabilizing for these entities. For example, if a corporate payroll account were converted into equity, the ability for that company to meet payroll would become difficult, which could lead to substantial challenges in the non-financial sector.

    The arguments against depositor preference are partly based on historical continuity and precedent. Perhaps the main economic argument for including them is that they would provide greater depth of assurance that a recapitalization could be made to work, even in highly extreme situations. Including deposits could also be seen to enable better burden sharing by sharing asset losses over a broader base of liabilities.

    However, we think that the benefit of this burden sharing is illusory in most scenarios, due to the destruction of franchise value, and the increased likelihood of runs. Including deposits in a recapitalization should only be considered in extreme cases where a full bail-in of all unsecured capital would insufficient to recapitalize the institution.

    Overall, we believe that depositor preference would be strongly desirable if it were done on a non-discriminatory basis (i.e. not on the basis of national preference)

25. Because preferences are usually set forth in mandatory provisions of national law, ultimately the rapid harmonization of these national laws may be the only realistic process.

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

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

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

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

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

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

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

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

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

26. CS supports a short dated stay on early termination rights in cases where the intent of the resolution is to re-establish the creditworthiness of the distressed bank and continue to perform under the terms of the contract. In this case, close out is unnecessary, and potentially very expensive.

In the case of a large dealer, a mass early termination could impose costs that are substantial enough to frustrate an otherwise successful resolution. For example, in the Lehman case, the cost of early termination created a deadweight loss of roughly $40 billion (based roughly on the midpoint between recent court filings by two sides). An additional loss of this magnitude can increase the difficulty of recapitalization and increase the risk that senior creditors could be put at risk. A mass unwind of this type also provides no benefit to counterparties if the health of the dealer can be re-established. Finally, an unnecessary unwind would also add to systemic stress by forcing a large number of counter parties to re-hedge their positions. Assuming that the entity was successfully recapitalized – whether by transfer to a bridge, by sale to a creditworthy entity, or directly through a bail-in recapitalization – then the early termination right related to this event should cease, and the contracts should revert to normal.

There are some costs associated with a stay, such as the uncertainty over the net risk position faced by counterparties going forward if the decision to close out cannot be taken for a short period. But these costs are vastly outweighed by the benefits of avoiding a large deadweight loss to the estate noted above, and the unnecessary systemic stress generated by a mass close-out.

In cases where termination is the planned outcome, then counterparties would benefit from being allowed to determine the size of their claim and to re-establish their hedging positions immediately.

27. We suggest that the trigger should apply automatically in resolutions where the intent of the regulator is a going concern style outcome – whether facilitated through a bridge or directly through creditor conversion. This will be especially important for firms who act as dealers and market makers. The starting point of the stay should be the initiation of resolution proceedings.

    The stay should not be imposed in a situation where the entity is intended to be liquidated; in this case there is no benefit from deferral and counterparties should be allowed to crystallize their positions immediately, establish their claim, and seek new counterparties for their risk management needs.

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28. Any automatic and optional termination rights as well as cross-default acceleration rights should be suspended where the termination is related to the credit of the affected counterparty. For example the stay should apply to downgrade provisions, as well as any analogy to a "credit event upon merger" clause.

    It should not apply to termination rights that are linked to broad market references, such as interest rate option contracts where the contract may be terminated if interest rates rally below a certain threshold.

    The stay should not apply to normal cash flows and collateral procedures. It is probably better for market stability if these continue uninterrupted.

29. The stay should be long enough for the newly capitalized entity to be established. With proper preparation, this should not require more than 48 hours from the initiation of resolution.

    The stay should also be long enough to identify derivatives that themselves led to major distress for the troubled bank. Although an isolated case, the AIG example demonstrates a need to capture certain derivatives in a bail-in, and subject them to conversion or being left behind in a bridge solution. AIG had a huge amount of speculative, mostly uncollateralized swaps that became a sudden, large cash flow claim on the company. In this case, they became a large portion of AIG's liabilities and too large to be repaid on normal terms. A credible resolution reform should address this situation, but in a carefully circumscribed way so that it does not impinge on normal derivatives relationships and increase the pressure for counterparties to run – as they did in the Bear Stearns and Lehman crises – and exacerbate the challenges of maintaining stability. One approach to this could be to establish a broad safe harbor for most contracts, but to also specify that unsecured derivative claims above a certain percentage of a bank's capital could be subject to bail-in or left behind in a bridge solution.

30. CCPs and FMIs should be treated similarly to other counterparties. Allowing them to close out when other contacts remain outstanding could be destabilizing and force large re-hedging activities into the market. It is potentially very costly (see our answer to Q26). It is also unnecessary, assuming that proper collateral is maintained.

31. The list of conditions looks reasonable. We believe that it is intended (but unclear in the text) that a direct bail-in should be included as a procedure that should be treated identically to a situation in which derivatives were transferred to a healthy third party (as in III 5 (v) in Annex 8).

32. An ISDA protocol, supported by clear regulatory intentions, could be a useful mechanism to ensure that contracts are moved to a new standard. This could be done in a manner similar to the CDS "clean up" exercise that was initiated by regulators in advance of the recent crisis, and which proved highly effective.

    A typical SIFI enters into financial contracts governed by the laws of home and non-home countries (especially New York and English laws) and raises the issue of enforceability of such a statute beyond the borders of the home country regulator. Due to this uncertainty, an industry protocol by which the bankruptcy-related early termination clauses in ISDA's and other financial contracts are overridden in the event of a bail-in is probably the most efficient means to achieve the amendment of a critical mass of the contracts. (We would also note that it is unlikely that such an industry protocol will occur in the absence of a bail-in statute in a major jurisdiction.)

    Assuming the master agreements are amended by statute or by industry protocol, the schedules and confirms would be covered since they are typically subject to the terms of the master agreements. To guard against isolated wayward confirms, the statute or protocol can be more broadly framed to override such deviations, or via a regular supervisory test (perhaps as part of the RRP testing process). There is no reason why frustration of an important policy aim should be permitted for something that does not provide a meaningful economic benefit to a customer.

33. Please refer to our comments for question #32

34. Please refer to our comments for question #32