

**FSB Consultative Document:
Effective Resolution of Systemically Important Financial Institutions –
Recommendations and Timelines**

Response by RBS Group plc

Executive Summary

Introduction

RBS Group plc ('RBS') welcomes the opportunity to comment on this important consultation.

Our key comments on the consultation are reprinted in this Executive Summary section. Comments to the Annex and its chapters as well as answers to the individual questions posed by the consultation are contained in the sections that follow; these reflect the Consultation Paper's headings.

We would be happy to elaborate further on any of the points made in this response and look forward to engaging with, and supporting, the authorities as they take forward the extensive work that these reforms will require. In the first instance, any questions should be addressed to:

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Key Comments

General Remarks

We support the objectives set out by the FSB with respect to the effective resolution of Systemically Important Financial Institutions (SIFIs). We consider effective resolution regimes, coordination between regulators, and recovery and resolution planning important components of an extensive reform agenda to provide safety and stability within the banking industry. We would stress that the proposals need to be considered in line with wider regulatory initiatives such as strengthened capital and liquidity standards under Basel III and measures to promote greater use of centralised clearing of derivatives to reduce the complexity of resolution.

Single Harmonised Statutory Resolution Regime

To avoid market distortion and regulatory arbitrage, particularly with regard to global SIFIs (G-SIFIs), it is key that the global convention for their resolution be consistently incorporated into national resolution regimes in G20 jurisdictions. Such a global convention should ensure that unsecured creditors of these global firms, whether retail or otherwise, have certainty that they will receive consistent treatment regardless of their domicile, the status of their claim or the jurisdiction in which it is payable.

The FSB appears to be proceeding on the basis that there is no immediate prospect of such a harmonised statutory regime and is looking to proceed with the establishment of robust bi-lateral and multi-lateral agreements between relevant authorities. Whilst we are supportive of such measures as steps which can help embed the principle of harmonisation and as a means to achieve a better cross-border co-operation between home and host resolution authorities for G-SIFIs, we do not consider that these steps, in themselves, would go far enough to realise the important principle of harmonised resolution regimes for such institutions. Harmonisation could be further assisted by additional measures such as robust peer reviews, an initial accord and Recovery and Resolution Plan (RRP) templates.

Timeline for Implementation of Policy and Legislative Changes

Whilst we recognise the need for legislative changes to be made quickly they must be preceded by (a) a much more granular G20 convention on resolutions/ bail-ins and (b) agreement amongst G20 members that the convention will almost entirely be incorporated 'as is' into national law and, consequently, domestic regimes adjusted to fit the convention. Unless such a harmonised approach to the statutory regime is achieved there is a real risk of selective application of the convention/ national interpretation which creates the serious risk of undermining the international harmonisation requirement for a workable resolution regime for G-SIFIs.

The FSB needs to be mindful that some countries are yet to put in place appropriate resolution regimes and will need time to introduce and affect appropriate legislation. Many countries will be unable to introduce RRP without the appropriate legislation being in place, which in turn makes the proposed RRP deadlines unrealistic. International alignment (and deadlines) of the timetable for legislating (and thereafter implementing policy) is critical.

High threshold to entry

A high threshold for triggering resolution is essential given the scope of the powers contemplated in Annex 1 and to avoid resolution being used as a way in which to circumvent contractual and shareholder rights that would otherwise apply. The consultation paper contains limited discussion and guidance in this area. We recommend that analogous provisions to the "threshold conditions" applied by the Banking Act 2009 should be applied across the G20 countries.

Liquidity

The paper makes limited reference to provision of liquidity for the institution being resolved. Any institution that becomes insolvent will also see depositors and investors looking to reduce their exposure well before the insolvency crystallises. It is likely that lack of liquidity will be the actual cause of a bank's inability to continue to trade. Any resolution regime therefore needs detail and clarity on the legal resolution process; and the liquidity support mechanism.

Bail-in

Bail-in can be an important tool in a resolution framework that preserves value and facilitates orderly resolution, without recourse to the taxpayer. Bail-in should only be used after traditional resolution alternatives have been exhausted and a formal bail-in arrangement is considered superior to insolvency proceedings. A bail-in regime should act under a clear code of conduct that is internationally harmonised, enabling authorities to take actions while preserving the creditor hierarchy. A comprehensive approach applied to all qualifying debt issued by an institution.

Resolution of specific assets within a legal entity

The FSB assumes resolution will take place at the legal entity level. It is probable that resolution activity within a G-SIFI will be required to be undertaken at individual asset level (e.g. mortgages) within an entity thus consideration needs to be given to the additional tools and mechanisms required to resolve specific asset and liquidity pools contained within a legal entity.

Asset pooling in resolution

The paper has not addressed the key question of whether assets in all the firm's subsidiaries and the parent should be pooled for the benefit of all creditors or whether the assets of each subsidiary and the parent should be used first for the benefit of the subsidiary's/parent's creditors before then being pooled (if any remain) for the whole group. We have assumed that the latter option will be preferred, and have referenced this in our more detailed response to the FSB proposals, but would suggest that the FSB be asked to specifically confirm this point.

Understanding the full impact of initiatives to improve resolvability

With regard to potential requirements of SIFIs to improve their 'resolvability', it is essential that the full implications of any changes are identified, analysed and understood. Changes to a bank's structure, operating model or legal entities may have major implications for the costs of its products or services, its

ability to lend and thereby wider impacts on economic growth. Any structural changes need careful consideration, with trade offs clearly understood.

Management Information requirements

In order to ensure that the appropriate Management Information (MI) can be provided to the authorities to assist resolution planning and execution, MI systems need to be flexible enough to cater for the different outcomes that would necessitate resolution. The more flexible these need to be, the longer the time required to enhance existing systems. Ideally, a core minimum set of standardised information should be specified in order to prioritise individual G-SIFI institution efforts in enhancing MI systems as part of their mitigating actions required to resolve barriers to resolution.

Confidentiality

The proposals put forward by the FSB raise some serious concerns for financial institutions with regard to protection of institution specific confidential information and we request that the FSB provides further in-depth consideration to the need to ensure that confidential information relating to G-SIFIs is adequately protected. Without robust protection, G-SIFIs will not be prepared to consent to the sharing of information between authorities as currently proposed by the FSB, given the substantial risk that financial institutions face in their day to day operations if confidential information is leaked.

The inherent risk remains for financial institutions that the more information they provide which goes beyond their home regulator, with whom there are agreed confidentiality provisions, the greater the risk of unauthorised disclosure.

1. Effective resolution regimes

Set out below are specific comments on a number of the Chapters set out in Annex 1. These comments take into account both the attributes proposed for an effective resolution regime and the flexibility that the regime affords. If some chapters or sub-chapters are not shown, it means there is no specific comment for those particular sections.

Annex 1:

Chapter 1: Scope

We are supportive of the FSB's proposal for the resolution regime to apply to any financial institution, rather than to apply a size criteria framework to institutions on the basis that the particular circumstances that exist at the time that a financial institution faces difficulties will determine whether a particular failure will prove systemically significant or critical.

We note that the FSB is to undertake further work with CPSS, IAIS and IOSCO to develop sector specific guidance for the application of a resolution framework for non-bank SIFIs and the interaction of the regimes and tools available will be of great interest to financial institutions. We are aware that proposals have been put forward for Clearing Houses to develop a resolution regime which seeks to impose unlimited liability on their members. We share the concern that ISDA has already voiced that such unlimited liability to Clearing Houses could itself lead to increased risk to the stability of the financial system, we do not view unlimited liability as a solution here but rather that it is essential that Clearing Houses ensure that adequate collateral is posted to support their operations.

Chapter 2: Resolution authority

We support the objective set out in paragraph 2.3 for the pursuit of financial stability and the protection of "insured depositors, policy holders and other retail customers". The critical questions to be determined, especially given the desire for cross-border co-operation, are how both "deposits" and "retail customers" are defined. There needs to be certainty over the level of protection available to the different categories of unsecured creditors in the resolution of a financial institution – this is key to market and public confidence.

We consider that clarification is required on paragraph 2.6 in relation to the legal protection that will be made available to the resolution authorities and their staff. Any provision of the regime which suspends what would otherwise be due process will need to have clearly defined parameters and allow for after the fact judicial review to address matters such as any clear abuse of power and errors that have occurred, preventing creditors from receiving the minimum amount to which they were entitled to in resolution.

We are concerned that the proposal in paragraph 2.7, to allow a resolution authority to "have unimpeded access to firms as necessary for the purpose of resolution planning", could result in excessive costs and administrative burdens being imposed on firms. More detail is required as to the parameters that would be in place and the time at which such requests for access may be made.

We also consider that careful consideration must be given to the sharing of confidential information of financial institutions between resolution authorities and this concern is set out in further detail in the comments provided in relation to Chapters 8 and 9 of Annex 1 below.

Chapter 3: Entry into resolution

We support the FSB approach of not looking to have a specific list of triggers for a financial institution to enter into a resolution regime. The recent financial crisis clearly demonstrated that systemic risk is not simply determined by the size of an individual institution but is also context specific and it is key that individual cases are dealt with on the facts at the time the question of entry into resolution is considered. The entry point needs to be high and reasonably clear to provide investors with some certainty.

We recommend that analogous provisions to the "threshold conditions" applied by the UK Banking Act 2009 should be applied across the G20 countries.

We consider it essential that rigorous and consistent controls be put in place across all G20 jurisdictions to avoid resolution being used as a way in which to circumvent contractual and shareholder rights that would otherwise apply. The decision to enter resolution for any financial institution will need to have been considered at the highest level – no lesser equivalent consents should be accepted than those currently required in the UK, namely the consent of each of the Financial Services Authority (FSA), the Bank of England and HM Treasury.

Chapter 4: Resolution powers

We consider this to be a comprehensive list of powers, although further detail on the conditions will be needed to give comfort to investors, e.g. the provision of services on commercial terms.

Further detail will be required on these powers to provide clarity on what decision is reached across the jurisdictions on matters such as stays on termination rights, ability to split up security arrangements for individual customers etc.

The extensive power to override shareholder powers / consents, whilst understood in terms of the need to act with speed and without constraint, provides further rationale for requiring that a high threshold is required for the decision to be made for the authorities to place a SIFI into resolution.

Chapter 5: Netting, collateralisation and segregation

We support the principle set out in Chapter 5 for the legal framework governing netting, collateralisation and segregation of client positions being transparent and enforceable during a crisis or resolution of a financial institution.

We consider that further detail is required on how the resolution authorities propose to deal with netting arrangements within resolution regimes across different jurisdictions. For example, any proposal to allow for the splitting of group netting arrangements (e.g. small companies in a group are moved to bridge bank for protection and larger companies remain in the rump) could raise issues as to unfair treatment if the split itself causes an event of default due to a breach in agreed credit limits which itself brings about the insolvency of the companies left in the rump bank.

Chapter 6: Funding of firms in resolution

The paper makes limited reference to the provision of liquidity for the institution being resolved.

Any resolution regime needs both the legal winding up/resolution process and a liquidity support mechanism. Detail on the liquidity element of the regime is not currently contained in the FSB proposals. It would be useful to see reference to:

- how central banks would coordinate liquidity support;
- how and in what form collateral from the different parts of the group being resolved would be encumbered by central bank support; and
- the need for funding after going into resolution which would have to come from third parties. Such funding will need to be given a higher priority in the waterfall and that needs to be thought through.

We agree that resolution funds (paragraph 6.3) should be held at national level (where fiscal responsibility lies) on an ex post basis (ex ante funds increase moral hazard, act as a “deadweight” cost and are likely to be quickly exhausted).

Chapter 7: Speed, flexibility and adequate safeguards

We are fully supportive and understanding of the need for resolution authorities to be able to act in a coordinated manner and with speed, flexibility and legal certainty subject to adequate safeguards. Key to authorities being able to achieve these aims is the extent to which bi-lateral and multi-lateral agreements are put in place between the authorities.

Clarification is required on the legal protections that will be put in place to protect directors / officers of firms and the resolution authorities as they work to execute the recovery and resolution of SIFIs.

We consider it important for creditors of a financial institution to have confidence that there is a means by which the actions of those involved in the execution of the resolution can be challenged in the event that, for example, there has been an abuse of power which results in a category of creditors being unfairly prejudiced.

Chapter 8: Legal framework conditions for cross-border co-operation

If resolution regimes and co-operation between authorities are to be effective across the G20, the provisions to protect firm specific confidential information are of key importance. Whilst in Europe, the Banking Consolidation Directive ("BCD") already applies to credit institutions in member states and requires the competent authorities to collaborate with each other in the supply of such information as is necessary to carry out their respective supervisory duties, there are also specific protections that member states must adhere to in order to ensure that confidential information is protected. Specific Non Disclosure Agreements or guarantees will be required to the extent that confidential information is to be shared by authorities not covered by the provisions of the BCD.

Consideration will also need to be given to the provisions that will be required to protect confidential information from disclosure by intervening factors such as parliamentary privilege and/or local legislation such as the UK Freedom of Information Act.

A distinction needs to be made between the information that the authorities are looking to share pre and post entry into the resolution regime.

Potential tensions / flexibility issues may arise with home regulators having resolution powers over local branches of foreign institutions to preserve local financial stability. To the extent that such matters are not already addressed by the binding obligations that have been put in place (e.g. within the EU Winding up and Reorganisation Directives) then it will be key for such issues to be addressed in the cross-border agreements between home and host authorities. No local resolution activity should be initiated without the agreement of the home regulator.

Chapter 9: Institution-specific cross-border co-operation agreements

We believe the framework outlined to be broadly appropriate. However, we think there should be an explicit leadership role for the home authority (Annex 3, section 4.1 talks solely in terms of "coordinate...facilitate and chair" with a lead role only articulated for the review of the RRP) and robust security procedures for data sharing and retention, given that sensitive information will be passed around a potentially wide range of authorities (see also comments on Chapter 12).

Furthermore, we do not believe that these institution-specific cross-border cooperation agreements should be made public documents. We see little valid public interest in having these documents published, given their technical, operational nature, and also see potential security and other risks in doing so, given that they would presumably include, inter alia, information such as "out of hours" contact details for key officials.

Rather, these documents (alongside other elements of resolution frameworks), should be regularly reviewed for their quality and consistency through robust peer review mechanisms. Authorities should also publicly confirm that all such agreements are in place and be held to account where they are not.

Chapter 12: Access to Information & Information Sharing

We have already commented on the importance of robust security procedures (see Chapter 8 and 9 above) in connection with information sharing and we feel the wording of 12.1 (iii) is too general in nature. There should be clear protocols for the level at which particular information can be shared and the firm should have some input into this.

Information and data requirements should, as far as possible, be consistent in all jurisdictions. This will facilitate quick decisions based on clearly understood data. Global authorities should work with the industry to achieve this (as is currently occurring with legal entity identifiers).

Response to Specific Questions

Response to Questions 1 & 2:

We agree that the proposals outlined in Annex 1 form the basis of an appropriate resolution regime. However, it will be key to avoid market distortion and regulatory arbitrage, particularly with regard to G-SIFIs, that the global convention for the resolution of such institutions should be consistently incorporated into national resolution regimes in G20 jurisdictions, such that unsecured creditors of these global firms, whether retail or otherwise, have certainty that they will receive the consistent treatment regardless of their domicile, the status of their claim or the jurisdiction in which it is payable.

The FSB appears to be proceeding on the basis that there is no immediate prospect of such a harmonised regime and is looking to proceed with the establishment of robust bi-lateral and multi-lateral agreements between relevant authorities. Whilst we are supportive of such measures as steps which can help embed the principle of harmonisation and as a means to achieve a better cross-border co-operation between home and host resolution authorities for G-SIFIs, we do not consider that these steps, in themselves, would go far enough to realise the important principle of harmonised resolution regimes for such institutions.

The FSB proposals regarding the sharing of information between authorities raises some serious concerns for financial institutions with regard to protection of institution specific confidential information and we request that the FSB provides further in-depth consideration to the need to ensure the confidentiality of sensitive information relating to SIFIs. Specific protections, including contractually binding undertakings on recipients of the information not to disclose information outside of a defined list of individuals, will need to be put in place ahead of information being shared on the basis that the FSB has proposed.

2. Bail-in powers

Set out below are specific comments on the Chapters set out in Annex 2 and the response to Question 3. If some chapters or sub-chapters are not shown, it means there is no comment for those particular sections.

Annex 2:

Chapter 1: Objectives

We agree with this chapter but would like to include the following clause as an addition to the chapter:

Bail-in can be an important tool in a resolution framework that preserves value and facilitates orderly resolution, without recourse to the taxpayer. However it should only be used after traditional resolution alternatives have been exhausted and a formal bail-in arrangement is considered superior to insolvency proceedings. Bail-in should apply at the point of non-viability once an entity has reached gone concern enabling authorities to rapidly capitalise relevant entities

A bail-in regime should act under a clear code of conduct that is internationally harmonised, enabling authorities to take actions while preserving the creditor hierarchy.

The option of bail-in as an additional resolution tool should not be limited to SIFIs. It should in principle be applicable to all financial institutions. A limitation to SIFIs would lead to a distortion of competition between SIFIs which are defined in advance and banks that could also be characterised as national or international SIFIs in the current situation of their imminent failure (e.g. HRE, IKB, DüsselHyp).

Chapter 2: Statutory Framework

2.2 (i) Reference needs to be made to the 'Resolution Authority' in the resolution regime.

2.2 (ii) There is a need for the FSB paper to specify the following:

- How bail-in facilitates loss-absorption at the point of non-viability when gone-concern is reached, with the bank thereafter continuing to operate in a special going concern status, allowing authorities to assume control and apply an orderly resolution process that precedes any possible liquidation.
- That bail-in should only be used after traditional resolution alternatives have been exhausted and a formal bail-in arrangement is considered superior to insolvency proceedings.
- That the threshold conditions applicable to the exercise of resolution powers should also apply to bail-in so that the bar is high and is related to the point of non-viability (i.e. to give confidence to the bank funding market that the authorities could not trigger bail-in before the point of non-viability is reached and all resolution options available have been considered).
- How bail-in would operate within existing corporate approval regimes (i.e. expedited approval framework as provided for in Chapter 3 Bail-in powers).
- The level of capital post bail-in "deemed adequate" to preserve financial stability and restore market confidence, i.e. will it be precisely to the point of meeting regulatory minima, or will there be some cushion beyond that? To allow pricing and risk management of bail-in debt instruments, the extent to which they can be bailed-in to recapitalise the distressed entity should be known with certainty. (See Chapter 5, Chapter 10 Quantum of bail-in debt; definitions per questions 5 and 6).

2.2 (iii) The following would be required:

- Confirmation that bail-in applies only within a legal entity to losses incurred by that entity – not to a loss making entity's parent, subsidiary or sister entities.
- Definition on what is capable of being bailed in, including equity, debt and other creditors (see question 5 and 6).
- Specification of matters found in similar 'convertible' contracts (conversion ratio, trigger, requirement (or not)) and to deal pro rata and pari passu with all relevant debt.
- Provide for the hierarchy of creditors to be preserved.
- Internationally harmonised regulatory standards and substantive rules, so that there is no creditor prejudice resulting from investor base jurisdictions, should be included within the bail-in definition and bailed in at the same time e.g. Euro and USD debt holders should be treated in the same way.

2.2 (iv) The resolution regime and legal framework for bail-in should also provide clarity and certainty in the process for entering resolutions as well as the process for triggering a bail-in with explicit triggers.

2.2 (v) We submit that bail-in must always preserve the hierarchy of creditors. Clarification is required on how write-down or bail-in would affect ownership of a loss-making subsidiary or ring-fenced group entity. Definition is also required on how residual bailed-in debt would be applied for recapitalisation or redistribution. Specification is also required on how the shares of a bailed-in subsidiary bank would be valued (if not publicly traded or if publicly traded and the market has collapsed), i.e. how will the number of shares a holder gets per £1,000 of residual outstanding debt be calculated?

Chapter 3: Bail-in powers

We agree with this chapter but would like to include the following clause as an addition to the chapter:

Bail-in powers should be implemented with the aim of creating internationally harmonised regulatory standards and substantive rules.

Chapter 4: Triggers

We agree with this chapter but would like to include the following clause as an addition to the chapter:

Bail-in of a stressed entity should not result in the trigger of bail-in in its affiliate entities. Preservation of non-loss making entities is important (broader ring-fencing)'.

Chapter 5: Scope

5.1 The scope of a statutory bail-in regime should NOT be as wide as possible. The scope should be comprehensive across defined bail-inable classes of liabilities (see definitions per question 5 and 6) and apply to such debt issued by all financial institutions to avoid creditor prejudice as mentioned in 2.2 (iii) and therefore level the playing fields. We suggest that following the cancellation of equity, bail-in would include all unsecured debt securities of a term greater than 12 months at issue. All other forms of liability should not be applied within a resolution framework. Other measures such as NSFR (Net Stable Funding Ratio) will capture whether a banks funding profile risk is deteriorating.

Chapter 6: Respect for statutory order of priorities

6.1 Any change to treatment of creditors during resolution will need to be set out in statute.

Chapter 8: Impact on financial contracts

The legal framework will need to be very solid and possibly accompanied by changes in ISDA standards to the same effect, that a bail-in phase is not a termination trigger for derivative contracts. (Also see response to Q8 on consequences for bank's funding and credit supply to the economy.)

Chapter 9: Group and cross-border issues

9.2 We would like to include the following clause as an addition to this sub-chapter:

Bail-in regimes should include flexibility to avoid de-linking (through transfer of shares in listed parents) in addition to other options (e.g. transfer of entity into a bridge bank) at the discretion of the home authority – delinking should not be inevitable.

Chapter 10: Quantum of bail-in debt

We do not agree with 10.1 and put forward that there should be no minimum amount of bail-inable debt. Having the ability to draw upon any amount of outstanding unsecured long term debt for bail-in as defined, will ensure that the quantum of bail-in debt available will almost in any case exceed requirements, given banks'

balance sheet profiles. Different bank funding profiles (i.e. retail deposits vs. wholesale term debt) can lead to different perceptions of risk and banks will be able to manage this through their combination of capital and bail-inable debt. Authorities should address this through resolvability assessments.

Chapter 11: Liquidity needs

11.1 In theory a “super-senior” status of such funding would be required to ensure funding during the bail-in phase, otherwise liquidity will dry up. In practice, it may still not be sufficient (any liquidity suppliers other than the government will want to check that there is sufficient recovery value at the end of the bail-in phase to make the super-seniority of these funds meaningful).

Chapter 12: Transitional period

12.1 We agree that a transitional period should be considered before bail-in powers are exercisable and recommend that this period be as long as possible.

Response to Specific Questions

Response to Question 3:

This has been covered above in the comments for Annex 2.

Response to Question 4:

5.2 The scope of liabilities covered by statutory bail-in powers should NOT be as wide as possible. The scope should be comprehensive across defined bail-inable classes of liabilities. We suggest that bail-in would include all subordinated and unsecured debt securities of a term greater than 12 months at issue. All other forms of liability should not be applied within a resolution framework.

A comprehensive scope will reduce chances of gaming and allow any losses to be allocated across this entire pool of investors, reducing the loss rate given bail-in. The securities covered by bail-in should also be largely similarly defined across countries, time zones and currencies.

Response to Question 5:

The classes of debt or liabilities to be included within the scope of statutory bail-in powers should be: unsecured debt securities with a tenor of greater than 12 months at issuance; subordinated debt and hybrid debt.

Response to Question 6:

The classes of debt or liabilities outside the scope of statutory bail-in powers should be:

- Secured debt, e.g. covered bonds
- Debt resulting from:
 - Transaction payments;
 - Repos;
 - Derivatives;
 - Trading;
 - Fiduciary business etc;
 - Certificates of deposit (CD);
 - European commercial paper (ECP);
 - Interbank money market transactions;
 - Senior unsecured bonds less than 1 year;
 - Promissory notes; and
 - Deposits.

Carving out classes of liabilities gives rise to incentives for structures to be created outside of the bail-in framework. Regulators should allow flexibility on this point and revisit the list if required.

Response to Question 7:

There should be no minimum quantum of bail-in debt. If a comprehensive-based approach is used to capture all subordinated and unsecured debt securities greater than 12 months at issue, the quantum of bail-in debt available should in practice always exceed bail-in level requirements, given banks' balance sheet profiles.

Different bank funding profiles (i.e. retail deposits vs. wholesale term debt) can lead to different perceptions of risk and banks will be able to manage this through a combination of capital and bail-inable debt.

The correct amount of bail-in debt necessary will depend on the institution, the financial environment and the macroeconomic circumstances.

Authorities and investors should be able to identify the level of outstanding bail-inable debt to assist with their assessment of the riskiness of the entity.

Response to Question 8:

It is highly likely that fewer investors will be able and willing to buy securities that carry the risk of bail-in on a 'de jure' basis as opposed to a 'de facto' basis and the ratings changes would impact access to markets. So the investor universe is likely to shrink and as funding supply reduces, the credit supply to the economy would suffer. Of those investors still prepared to buy such securities, the vast majority are expected to require a significant risk premium for the bail-in feature over existing prices, which will be passed on to consumers as all banks are likely to be impacted.

Recently in Denmark, the introduction and application of bail-in has led to increasing banks' cost of funding and challenges to their capacity to obtain funding from the market.

The impact of a minimum requirement more specifically would depend on the quantum and timeframe of implementation, which will drive the extent to which specific issuance will be required. Achieving issuance of bail-in debt would be more straight-forward under a broad-based comprehensive approach as it would be carried out for all debt issued in the normal course of business.

3. Cross-border co-operations

Set out below are specific comments and response to the Chapters set out in Annex 3 and Questions 9-11. If some chapters or sub-chapters are not shown, it means there is no comment for those particular sections.

Annex 3:

Chapter 1: Objectives, nature & scope of the agreement

There should be flexibility to allow for revisions when the firm makes structural or other relevant changes, without the need to renew the entire document. Please refer to the response to Question 10 for more details.

Chapter 4: Home authority's commitments

We recommend a more overt leadership role for the home authority. Please refer to the response to Question 10 below for more details.

Chapter 6: Co-operation mechanisms and information sharing framework

We stress the importance of robust security protocols; confidentiality provisions will be a key area. Please refer to our response to Question 10 below for more details.

Chapter 7: Cross-border implementation of resolution measures

We agree that there is a need for the identification of legal and operational impediments to allow for the successful resolution of a firm. Such impediments are factors that the firms themselves should be identifying as not only are they key to the resolution regime but they impact on the ongoing performance of a firm.

The extent to which the authorities are looking to share such information ahead of resolution is another area of concern for firms as there are potentially seriously damaging consequences for firms if such information becomes known beyond the relevant authorities.

Response to Specific Questions

Response to Question 9:

The key point is to maintain flexibility as the process develops over time and, as the FSB states (on page 14) "cooperation and trust among resolution authorities should be built up". As G-SIFIs are by nature complex organisations each with their own unique features we believe that institution specific agreements are an appropriate starting point, as work is undertaken to achieve the harmonised statutory resolution regime. However, whilst the institution specific agreements will set out the understanding between the authorities of their responsibilities in the event of the resolution of a firm the reality is that in times of crisis the authorities are likely to take sovereign focused views and, in the absence of binding legislation across the authorities, will be able to act in ways contrary to the agreements that the authorities had put in place with market participants and firms having no recourse as they will not have been party to the agreement between the authorities.

Response to Question 10:

The agreement should include scope for revisions to accommodate structural and other relevant changes within the firm, without the need to renegotiate the whole document.

As stated in section 9, we think a more overt leadership role for the home authority should be articulated as they will be in the best position to drive decisive action in a crisis situation.

There should be scope to include ongoing consultation with the relevant G-SIFI as a fundamental part of the agreement. An appeals process should also feature.

In our comments on Annex 1, Chapters 8 and 9, we have already commented on security considerations and we emphasise that there should be detailed protocols for sharing information at an appropriate level and on a "need-to-know" basis.

Response to Question 11:

The resolution and, if different, the supervisory authorities are the key parties with the central bank, depositor compensation scheme and finance ministry having a close interest in systemic impacts.

4. Resolvability assessments

Set out below are specific comments on the Chapters set out in Annex 4 and incorporates our response to Question 12. If some chapters or sub-chapters are not shown, it means there is no comment for those particular sections.

Annex 4:

In summary:

- Resolvability is most likely to be required at legal entity or sub-legal entity level rather than by individual economic function.
- The Assessments need to consider the feasibility of the creation of the resolution capability of the bank (for the authorities to exercise).
- The Assessment process needs also to review the scenarios from which the resolution strategies resulted, to ensure the continued appropriateness of these strategies given the prevailing environment.
- Where SIFIs supply services to other banks, it is unclear (in this section) how the associated dependencies will be handled.
- We agree in principle with the MI requirements statements. However, without specifics on the type of data and periodicity, it is difficult to assess the feasibility of providing this data
- There are a number of legal impediments that would currently provide obstacles to resolution (e.g. in the UK the Data Protection Act) and these issues will need to be addressed in the legislation that is drawn up for a harmonised resolution regime.

Chapter 1: Defining resolvability

This chapter makes reference to “functions critical to the economy”. These functions are generally not “stand-alone” and thus the practicality of resolution will often require to be at a higher/aggregated level. This could be at legal entity or some other sub-entity level.

There will need to be a definition of what ‘severe’ means in context of systemic disruption.

Chapter 2: Objectives of resolvability assessments

These objectives seem satisfactory, but (iii) should also make some reference to the economic feasibility, within the suggested regulatory timescale, of the specific actions required by the bank to create the capability for the authority.

Chapter 3: Process for assessing resolvability

We believe there is an additional, fourth, preliminary stage – identification and maintenance of the range of scenarios mentioned in Annex 1, Chapter 11 and Section 11.3, which will result in the latest view of the stress situations to be addressed by the resolution strategies.

Chapter 4: Assessing the feasibility of resolution strategies

This chapter makes reference to “critical economic and financial functions”. In many banks’ IT and operations models, these functions are unlikely to be capable of existing as “stand-alone functions”. Thus resolution will often require these functions to be grouped at legal entity or sub-entity level.

4.1 - 4.8 There are a number of external legal constraints that may prove to be obstacles to resolution including for example (from a UK perspective) the Data Protection Act, Banking Secrecy Legislation, Competition Law, Contract Law and any limitations in FSMA Part VII (e.g. extension to non-banking assets).

4.3 – 4.4 We agree that it is the financial (4.3) and operational (4.4) dependencies that will be critical to determining the obstacles to resolution and the work required to separate systemically important business from the rest of the group for resolution.

4.6 - 4.8 We agree in principle with these requirements. However, without specifics on type of data and periodicity, it is difficult to assess the “do-ability” of what is implied by these statements. Also need to include MI on operational performance and capability, particularly as this could be affected in crisis periods.

4.9 - 4.13 We agree with the questions identified. Cross-border cooperation and consistency is obviously critical in this context. Whilst recognising the political obstacles to going further in this respect, for instance with respect to harmonising insolvency law, we believe more can be done to support cooperation and consistency, e.g. through developing robust peer review mechanisms, and standardising templates for RRP.

Chapter 5: Assessing the systemic impact

We agree with the criteria listed but some quantitative assessment could be added by incorporating the primary and secondary indicators proposed by the Basel Committee on Banking Supervision in their consultation document, 'Globally Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement'.

Response to Other Specific Questions

Response to Question 13:

The overall process seems appropriate, albeit it is described only in high-level terms and will be critically dependent on cooperation between home and host authorities. We support the leadership role proposed for home authorities, and the qualitative (non-binary) nature of such assessments. While it is essential that the host state authorities have the necessary legal powers to implement a resolution plan, these powers will have no legal effect in foreign jurisdictions and international cooperation is essential if the resolution of a SIFI is to have any chance of succeeding.

In assessing actions to improve resolvability, we would not want to see firms be made to compensate for weaknesses in official sector frameworks.

On the basis that bail-in regimes are put in place, we believe that these should be a major consideration in assessments of the adequacy of firms' resolution arrangements, and take away the need for costly and likely redundant ex-ante changes to firms' existing configurations (since bailing in debt holders buys time for the authorities in a crisis and the possibility of an orderly wind-down/resolution of a firm, over an extended, less stressed, time-scale).

5. Recovery and Resolution Plans

Set out below are specific comments on the Chapters set out in Annex 5 and Questions 14 and 15. If some chapters or sub-chapters are not shown, it means there is no comment for those particular sections.

Annex 5:

Chapter 3: Essential elements of a Recovery Plan

While the most significant elements of a Recovery Plan will actually be requirements (i.e. counter-cyclical capital buffers and large liquidity buffers), a clearly defined and embedded risk tolerance framework, linked to a firm's vulnerabilities, will help demonstrate what scale of events will trigger the use of all, or part, of a Recovery Plan. The options for increasing liquidity and capital once a stress event has occurred are extremely limited. The most successful firms will be those that can navigate through economic cycles adjusting business and risk types as required. The most effective recovery tools are actually now BAU requirements; the Recovery Plan becomes a roadmap that can help de-risk a bank quickly as opposed to being a list of contingent sources of capital or liquidity.

3.5 The development of a Recovery Plan will necessarily require the bank to consider in advance some tough strategic and organisational choices. To survive, the bank may be forced to do things that it would prefer not to do in normal times, such as issuing new equity capital, selling/running down certain businesses or even selling the firm itself.

Chapter 4: Essential elements of a Resolution Plan

4.1 As stated in the response to Annex 1 Chapter 3, we support the approach of not having a specific list of triggers for rigid adherence but nevertheless consider that legal and regulatory grounds must be established before resolution can be initiated. In the case of the UK, these are set out in the Banking Act 2009. We support the proposal that the Authorities must retain some discretion to prevent them from being obliged to initiate resolution when other options may still be available.

4.2 This can be divided into Strategies and Pre-Conditions:

(a) Strategies

The focus seems to be on resolving whole legal entities, whereas experience suggests that splitting 'ongoing' from 'wind-down' assets within a legal entity is a key option that will be available (Section 4 of Key Attributes). This does not mean that this split should take place in course of normal activity, but would be available as resolution (and possibly recovery) events. Achieving this is a significant challenge.

It is recognised that there is a need for flexibility in the strategies that can be deployed as the specific circumstance at point of resolution will require specific actions. This will drive a 'pick & mix' approach (as in recovery planning) where the specific actions will be determined as circumstances require.

(b) Pre-Conditions

The pre-conditions could fall into two categories: those required to immediately facilitate the resolution activities; and, the internal and external scenarios that could give rise to the need for resolution

1. While it is recognised that the preconditions must be in place to facilitate resolution, it is important that these should not have material adverse impacts on the normal course of business. In particular, they should not create an anti-competition situation for specific institutions that cannot be justified as part of normal business.
2. It will not be possible to identify all potential scenarios that could give rise to resolution. However, it is important that key potential outcomes are identified and agreed as valid outcomes for assessment and planning. This agreement could be at global or local jurisdiction levels as well as being institution specific. These scenarios and outcomes can be amended/created/removed on a suitable periodic basis, possibly annually.

4.3(i) It is important to recognise the inter-legal entity dependencies, but also important to understand some key interdependencies within the legal entity to facilitate partial-legal entity resolutions. There is a need to specifically understand interdependencies to/from other FI's. There is also a need to understand how the interdependencies are affected by cross-jurisdictional agreements (e.g. off-shoring and offshore outsourcing).

4.3(ii) Intra-group transactions are an important part of managing a complex group but it is appreciated that they need to be carefully recorded and managed, particularly where they cross jurisdictional boundaries. For example:

- it makes sense to operate a hub and spoke arrangement through a Group's central treasury when managing funds flows. The alternative would see subsidiaries long of funds placing such funds into the market - incurring credit risk and subsidiaries short of funds borrowing from the market increasing liquidity risk; and
- it also makes sense to route derivative transactions through a central point so that operational risk is kept to a minimum when dealing with external hedging of those derivative transactions.

Such transactions must, of course, be recorded in the same way as any third party transaction would be and be subject to arms-length pricing arrangements and contracts. That makes them straight-forward to unwind if the central hub entity runs into trouble. It is accepted that certain other intra-group transactions may result in more complex transactions.

4.3(iii) This assumes an uninterrupted level of access to payments, but Section 4 of Key Attributes allows for brief suspension of activities – we suggest that brief interruption is probably correct (and likely to give rise to greater complexity – e.g. how are payments made during 'suspension' treated).

4.3(v) We are not sure on how communications can ensure cross-border co-operation.

Chapter 5: Information requirements for Recovery and Resolution planning

There is a need to agree the scope and the timeliness of the information – this is likely to be a challenging area.

5.1 We agree that both operational and financial linkages are documented. This should also include linkages to third parties (to/from).

5.2-3 We will need to include banking operational data (not just Treasury data).

5.5 Each jurisdiction will be able to put in place its own legal and regulatory framework. The objective must be to ensure, so far as possible, that the individual country specific frameworks are as consistent as possible. Failure to achieve consistency is likely to result in the creditors of a SIFI receiving different treatment depending on their domicile or the governing law of the contract. For any Resolution Plan to be successful liquidity will be essential and the central bank of the home state is the obvious and perhaps the only possible provider.

Response to Specific Questions

Response to Question 14:

Recovery and Resolution Plans will need to be flexible and cover multiple recovery or resolution strategies. In particular they should be able to incorporate the appropriate grouping of Critical Economic Functions to address the particular characteristics of the recovery or resolution situation.

Please refer to the individual chapter comments for more information.

Response to Question 15:

Although not specifically stated, Annex 5 can equally be applied to subsidiaries. The need to develop RRP's independently will depend on the nature of the subsidiary and in the relationship and dependencies with the Parent. Where there is a tight integration of the activities of the subsidiary with the Parent, we would expect the Parent's RRP to encompass the resolution of the subsidiary activities.

6. Improving resolvability

Set out below are specific comments on the Chapters set out in Annex 6 and Questions 16-19. If some chapters or sub-chapters are not shown, it would mean there is no comment for those particular sections.

Annex 6:

Chapter 1: Information Systems

The complexity/difficulty in providing the level of interconnectedness information required for resolution is difficult to assess without specific detail, or additions to already provided monitoring information:

- It is agreed that inventory information at the appropriate level is necessary for resolution. The difficulty is assessing the appropriate level.
- Addressing exogenous legal constraints may not be within the power of the firm.
- Timeliness is again dependent of the appropriate level of information and pre-existence of the details.

Chapter 2: Service Level Agreement (SLA)

SLAs encompass internal service agreement as well as external third-party agreements. The recommendation is for legally enforceable SLAs. This could prove unwieldy for internal agreements.

- It is agreed that any external third-part agreements should be in place.
- Inclusion of provision for transferability and continuity of service in times of resolution would be better provided by some statutory mechanism rather than being left to the wording of individual contracts with a firm.

Chapter 4: Global payment operations

The second paragraph of Chapter 4 refers to the safeguards put in place to protect Schemes, and their members, from the disruption caused by the weakening, and potential default, of a member. Whilst it might be the case that the triggering of more stringent requirements (e.g. in terms of higher collateral) of a weakening member might put that member under additional pressure, the need to protect the Scheme is likely to be viewed by regulators as being of paramount importance. There is, however, potentially an issue for all Schemes in terms of ensuring that measures put in place to protect them from member failure do not inadvertently hamper the subsequent resolution process.

4.1 The FSB paper suggests that firms should assess the additional requirements which may be needed to maintain their FMI memberships in times of crisis - this is a sensible suggestion and likely to be part of its RRP. It also suggests that firms should develop a range of options for addressing those additional requirements (e.g. by sourcing additional collateral, or assessing potential constraints on payments flows) - which is again sensible, but there is a need to recognise the challenges in implementing these options in the event of a firm facing a crisis situation.

4.2 (ii) Standardising documentation for payment services - it is unclear whether this refers to the documentation between Schemes/members, or between members/customers (including agency bank customers). In either case, this could prove a significant challenge for banks operating in numerous geographies.

4.2 (iii) Establishing a draft TSA as part of RRP requirements does not seem unreasonable, but the new purchaser should have the final say in any TSA.

4.2 (iv) Developing a "purchaser's pack" to include key information on payments, does not seem unreasonable, but we assume that data provision for due diligence would be wider than just payments operations.

4.3 This section discusses alternative access to payment infrastructures for agency banks. This issue is already under discussion in the UK with the Bank of England. We would hope to be able to avoid a situation where every agency bank has to have two sponsorship arrangements for every clearing, resulting in significant duplication. For G-SIFIs, the position of bank subsidiaries needs to be determined.

Response to Specific Questions

Response to Question 16:

Another obstacle may be the ability to rapidly identify 'ongoing assets' from 'wind-down assets' if it is deemed appropriate to resolve a SIFI on a sub-entity basis.

Response to Question 17:

Our view is that splitting banks' activities into separate legal entities squeezes the risk balloon in one area (namely for resolution purposes) but expands it elsewhere - in the credit risk between entities. This creates an issue of more intra-group exposures. We are unclear on whether the FSB is proposing this kind of legal split of activities or is it proposing that activities are in distinct businesses within the same legal entity. The latter approach still leaves problems for anyone resolving the company as the business units have to be sold out of the legal entity rather than being a clean sale of a legal entity.

We are supportive of the activities currently in train in the UK to better protect depositors of financial institutions which include (i) the adoption of bail-ins as workable solution for SIFIs; and (ii) financial institutions having a clear focus on the financial needs of consumers.

There will be a need to provide MI at sub-entity level (or at any other agreed 'unit of resolvability' level). The FSB paper should also consider how 'operational resolvability' will practically be achieved, particularly for cross-border and cross-entity structures.

Response to Question 18:

The obvious solution is to re-structure transactions in a way that does not require a parental guarantee or risk transfer arrangement. That, however, is dependent on the financial standing of the contracting party and where a subsidiary of a SIFI has no credit rating or whose net asset base is insufficient in relation to the value of the transaction, the counterparty is likely to seek security or a parental guarantee. To avoid a guarantee the parent entity could enter into the transaction as principal, in which case the liability would convert from a contingent liability to an actual. In those circumstances the obligation would remain as on its balance sheet.

Apart from restricting the provision of guarantees / internal risk-transfer structures so far as possible, another solution would be to increase the capital base of the subsidiaries of a SIFI in order to allay the concerns of counterparties of those subsidiaries. As that would be an extremely costly exercise the continued issue of guarantees and risk sharing arrangements is likely to continue.

Response to Question 19:

With respect to SLA Agreements, in resolution third party vendors will need to be compelled to provide services to the entity in resolution under existing contracts that would otherwise have been terminated.

7. Timelines for implementation of G-SIFI related recommendations

Question 20

It is imperative that the timelines for implementing recommendations must be practical and realistic.

Legislating Policy: Whilst we recognise the need for legislative changes to be made quickly they must be consistent, preceded by a much more granular G20 convention on resolutions/ bail-ins and agreement amongst the G20 that the convention will almost entirely be incorporated 'as is' into national law. Domestic regimes should be adjusted to fit the convention rather than the other way around. Otherwise, the situation will be ripe for selective application of the convention/ national interpretation which creates the serious risk of undermining the international harmonisation requirement for a workable G-SIFI resolution/ bail-in regime and, consequently, the availability of regulatory arbitrage.

International alignment of the timetable for legislating policy is also critical. Jurisdictions are starting from very different starting points, some with established resolution regimes and tools and others that have yet to establish the necessary powers. Sufficient time needs to be provided to allow local legislative processes to be completed; statute to be enacted; and, policy established in each jurisdiction. There are currently timetable conflicts across national law and domestic regimes which may cause material legislative conflicts at a later date, for instance Resolution Plans in the United States may have to be completed shortly, ahead of FSB proposals.

Implementing Industry Firm Specific Changes required to meet Recovery and Resolution Planning policy: Given the complex nature of G-SIFIs, structural/ technical changes required to facilitate recovery and resolution planning legislation are potentially significant and will require considerable investment at both industry and firm specific level. Lead-times required to implement these changes needs to be realistic and investment needs to be proportionate to the problems being addressed.

Linked to the above, the speed at which firms are required to develop finalised resolution plans will limit the options available in the event of resolution due to the time required to resolve granular resolution barriers. With regard to potential requirements of SIFIs to improve their 'resolvability', it is essential that the full implications of any changes are identified, analysed and understood. Changes to a bank's structure, operating model or legal entities may have major implications for the costs of its products or services, its ability to lend and thereby wider impacts on economic growth. Any structural changes need careful consideration, with trade offs clearly understood.

In addition, solutions developed to resolve barriers to resolution need to take into account, and harmonise with, other linked regulatory initiatives. For instance, the EU Crisis Management Directive is unlikely to be finalised until the end of 2012, i.e. after RRP deadlines proposed by the FSB.

8. ANNEX 7: Discussion note on creditor hierarchy, depositor preference and depositor protection in resolution

Set out below are specific comments on the chapters set out in Annex 7 and Questions 21-25. If some chapters or sub-chapters are not shown, it would mean there is no comment for those particular sections.

Annex 7:

As mentioned in Annex 7, it is essential that there is clarity and predictability in the event of insolvency. All creditors must be able to ascertain where their claim will stand in the order of ranking if a particular entity fails. The generally accepted order of ranking is:

- secured creditors (in respect of the assets charged to them);
- claims arising in say an administration or equivalent such as the Administrator's fees and outlays;
- preferential creditors (could be employees, government departments);
- floating charge holders (where that form of security is recognised);
- unsecured ordinary creditors;
- unsecured subordinated creditors; and
- shareholders.

Where creditors have rights of set-off these will be exercised and a claim submitted for any outstanding residual debt.

Chapter 2: Depositor Preference

- Clarity and certainty around the seniority or statutory ranking of claims in insolvency are essential for the functioning of the market.
- Harmonised insolvency provisions are unlikely in the near future, it is therefore key that all unsecured creditors are treated equally. Individual states will independently determine the local deposit protection limit.
- What is important is that parties are aware of the protection and insolvency arrangements that will apply.

Background

In the UK, the claims of all depositors rank equally as unsecured ordinary creditors. The deposit guarantee scheme (the FSCS) would compensate depositors promptly upon the failure of a bank, up to the compensation limit of £85k. The FSCS would then stand in the shoes of depositors as creditor in the subsequent liquidation process¹. Eligible depositors are retail customers (individuals), clubs, charities, partnerships and also "small companies" as defined by the Companies Act 2006.

If all depositor claims were elevated to preferential status without limit as to amount then they would probably be paid in full but to the detriment of all other unsecured ordinary creditors such as suppliers / service providers, funders and counterparties generally. Such an order of priority would probably result in less likelihood of a claim being made on the FSCS and therefore less reliance on funding from the participant banks. If that regime were to be introduced to the UK it could result in increased deposits for all the UK banks. It could also increase the cost of external funding as funders would be postponed creditors in the event of the liquidation of the bank.

National depositor preference applies in the US, i.e. deposits payable by a US chartered bank in its US based branches. There is no cap on the amount of the claim. Deposits payable at a foreign branch of a US bank are not preferred claims. If a similar arrangement applied globally it would simply enhance the position of all home state depositors if one of their banks were to fail.

Public policy in the UK would probably dictate that depositor protection must exist for personal customers and SMEs and the current limit of £85k per depositor is probably about right and is likely to protect the vast majority of personal depositors. The cap is based on the EU requirement for deposit protection schemes to provide cover to the extent of €100k. Unlimited cover from the FSCS would be costly and probably could not be replicated in some member states.

¹ Individual depositors with balances above £85k would be included with other unsecured ordinary creditors in the insolvency process.

It should be borne in mind that foreign banks can open for business in the UK, if properly authorised by their home state and accept deposits from UK residents. That could result in those depositors being protected by the deposit protection scheme of the foreign bank's home state rather than by the FSCS. The level of protection could therefore be lower than £85k.

Clarity and predictability

The crucial question is, what law will apply when a bank is wound up? It should be the law of the country of its incorporation with the administrator/liquidator gathering in the realisations from all the assets of the bank worldwide and then distributing the proceeds in accordance with the home state's insolvency rules. That however may still result in the administrator being foiled by a foreign state which freezes the assets of the failed bank in its own country for the benefit of local creditors. If a global agreement cannot be achieved that self protection should not apply, then it is essential that everyone knows what insolvency arrangements will apply in the G20 countries as a minimum. Assuming no change it would mean that if a US bank fails then US depositors of US branches of that bank will rank as preferential creditors while depositors of overseas branches would rank along with all other unsecured ordinary creditors both in the US and abroad.

The existence of different creditor hierarchy and depositor protection rules in different countries should not impede the winding up of a multi-national banking group but they will affect the size of the dividends paid to creditors falling into the same class e.g. depositors.

Response to Specific Questions

Response to Question 21:

As a general rule a financial institution will be wound up in accordance with the laws of its country of incorporation. That could result in different classes of creditors being preferred depending on the country in which the SIFI is incorporated. While that will obviously affect the actual distributions of dividends to creditors, the order in which these will be paid will be a matter of public record. Consequently, counterparties dealing with SIFIs incorporated in a foreign jurisdiction should make enquiry as to the insolvency laws of the country of incorporation of the SIFI before entering into any material transactions with it.

Whilst the existence of differing statutory creditor rankings in different jurisdictions should not prevent effective cross border resolutions, resolution will be further complicated to the extent that assets held by the SIFI in another jurisdiction are subject to local laws which provide for these assets to be ring fenced to satisfy the claims of local creditors in the first instance. In that event, such arrangements are likely to prejudice the general body of unsecured creditors of the SIFI and would only ultimately be resolved if insolvency laws are harmonised across the globe.

Response to Question 22:

Consistency in the treatment of creditors' claims irrespective of the jurisdictions in which they arise would lead to a more certain outcome for all creditors. That presumably would require the realisations from all free assets to be gathered in by the authorities in the home state for distribution in accordance with the internationally agreed arrangements.

Political and economic reality strongly suggests that harmonisation of cross-border insolvency provisions is unlikely in the near future, if at all, but in any event all unsecured creditors should be treated equally.

If the claims of all unsecured creditors, including depositors, are treated equally it will then be a matter for individual states to determine if all depositors or certain classes of depositors are to enjoy the benefits of deposit protection schemes and what limits will apply to such schemes.

Response to Question 23:

Any move to prefer all depositors could bring with it the risk of arbitrage (and funding arrangements would be structured as deposits). Even if all depositors were to enjoy preferential status in the event of the liquidation of the deposit taker, would claims be capped in any way at least to allow for a potential dividend to other classes of unsecured creditors? Any distinctions made within the same class of creditor e.g. retail depositors and corporate depositors, as is the current position in the UK, will result in large corporate depositors placing their funds with the most financially stable banks.

To provide all classes of depositors with unlimited preferential claims would prejudice the position of suppliers of goods and services to financial institutions and any counterparties dealing with a financial institution. This is likely to result in a call for security over the assets of a financial institution where it has large external obligations and / or whose credit rating is poor.

The simplest solution is for the claims of all depositors to rank pari passu with the claims of all other unsecured non preferential creditors even where retail depositors can claim on deposit guarantee schemes financed by the banking industry.

Response to Question 24:

We are not aware of any cost / benefit analysis exercise having been conducted.

Response to Question 25:

If different ranking arrangements are likely to impede effective cross-border resolution, a universally agreed ranking of creditor claims would be required. Local laws could possibly remain unchanged where a bank's activities are restricted solely to its country of incorporation. Doubtless considerable debate would immediately ensue as to what is the ideal creditor hierarchy but sophisticated counterparties will always be able to ascertain the laws of each jurisdiction in which they operate in order to evaluate their potential risk profile.

Even where cross-border ranking arrangements are agreed, the fact that the legal processes will differ and are unlikely to operate to the same timetables, will inevitably result in some impediment to effective resolution.

9. ANNEX 8: Discussion note on conditions for a temporary stay on early termination rights

Response to Specific Questions

Response to Question 26:

We understand that the desire to introduce a stay on early termination rights is to avoid contagion with the main advantage of the stay being to provide some additional time to effect a resolution, without a rush on funding following an early termination triggered by the authorities instigating their right to step-in and resolve. Whilst practically the stay (assuming circa 24 or 48 hours) is likely to be too short to provide a SIFI (or any of its counterparties) with an opportunity to achieve anything internally to prepare itself for a default, such as reconciling and consolidating portfolios or restructuring any imminent large payments, such a brief suspension might be long enough to prevent the start of a chain reaction with adverse contagion effects spreading from an insolvent firm to its otherwise solvent counterparties. Please also see the comments at Question 33 below in relation to alternative solutions.

Potential adverse impacts of the stay relate to the uncertainty that is created by any stay on termination rights. We consider it likely that despite a suspension of termination rights, the market will continue to speculate on the impact of a default and such uncertainty of whether or not the transactions will survive post-moratorium would not be welcome in the market. Counterparties may try to take pre-emptive action, once the stay looks likely, and begin the process of re-hedging any positions that they have with the SIFI. Whilst banks should be able to re-hedge, smaller counterparties may struggle to find any dealer willing to offer replacement hedges whilst the security offered by the small counterparties is tied up with the SIFI.

We also note that trading books are dynamically hedged and require new trading to be conducted constantly. Where the hedging is on-exchange this should not be a problem (although this could cause credit concerns for the exchanges themselves) but OTC hedging could simply dry up as you cannot force counterparties to take on new trades. This provides further support for any proposed stay to be kept very brief in time as its existence may well have a very negative effect on management of risk on a trading book.

The introduction of uncertainty may lead to counterparties charging additional margins to SIFIs, which may lead to SIFIs becoming less competitive in the market. This uncertainty on whether or not counterparties are entitled to accelerate financial contracts (such as bonds) might cause credit default swap spreads to widen, which, in turn, may adversely impact on the cost of funds for SIFIs. This concern will be significantly mitigated if the provisions for the stay on early termination are adopted across all G20 SIFIs.

Counterparties to SIFIs may face concerns where there is a restriction on their right to terminate the contract as the legal netting opinions regarding the effectiveness of close-out netting may need to be qualified. This could result in the counterparty having to report exposure under a derivative contract on a gross basis instead of a net basis. Possible mitigation to this concern may be to state in primary legislation that all master netting agreements are safeguarded (as is currently the case for Financial Collateral Arrangements under the FCD). It is noted that the right of the US FDIC to impose a stay on banks that it regulates has not prevented supervised institutions from obtaining clean legal opinions – consideration would need to be given as to whether the same position can be achieved in all jurisdictions.

Response to Question 27:

In order to avoid the creation of unnecessary distortion and uncertainty in the market it is essential that the trigger for the stay is linked to robust controls that govern the point of a financial institution's entry into resolution. We respectfully refer the FSB to the comments made on Chapter 3 of Annex 1 earlier in this paper.

We consider that the better option would be for any power to impose a stay on termination to be a discretionary tool available to the authorities. However, further consideration is required as to how the authorities would together agree whether to utilise this power and how such a decision would be communicated to the market given the need for a prompt decision to be made between the authorities that would be recognised globally. The practicalities around such a stay require further detailed consideration before any final decision is taken on whether this power to stay should be included as a tool for the authorities within resolution regimes.

Response to Question 28:

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 2a(iii) of the ISDA Master Agreement.

Consistent with the view set out in the answer to Question 26, as to the need for the continuation of funding, is the proposal that the stay will not apply in situations where parties are not able to post collateral when requested for additional collateral by counterparties. However, we would note that there is some tension between this and the effectiveness of the stay given that in a resolution scenario, unless additional sources of funding have been secured, it is likely that parties will be stressed and will not be able to post additional collateral thereby undermining the objective of the stay.

Response to Question 29:

Given the risks created by market uncertainty it is essential that the period of the stay is brief, extending no longer than 48 hours.

Response to Question 30:

To the extent that a temporary stay is to be utilised, and is restricted to the rights referred to in Question 28 above, such a stay would need to be applied in a uniform way with all counterparties and in relation to all contractual rights. To do otherwise increases the risk of market uncertainty and financial uncertainty for counterparties.

Response to Question 31:

Whilst the proposed conditions for any stay are acceptable, it will be key to ensure that they are applied in a harmonised way in the different jurisdictions.

Response to Question 32:

It is essential that a solution is capable of being imposed across all jurisdictions in the context of cross border insolvency law. There must be certainty across the jurisdictions that the courts will recognise the validity of any temporary stay.

Response to Question 33:

An alternative approach, which we consider sensible, would be to rely on provisions such as those already contained in the UK Banking Act 2009 which prevent creditors from exercising termination rights where claims are being transferred to a bridge bank or a private sector purchaser. Whilst the proposed suspension of rights would prevent such creditors from exercising termination rights before such transfer were implemented, this would only be a relevant concern if such creditors knew that a termination right had arisen and wanted to exit from their contractual arrangements, rather than being transferred to a counterparty which, it is assumed, would be able to satisfy the creditor's claims. In the absence of any announcement that resolution procedures had been implemented, it is not clear that such creditors would, in practice, know that a termination right had arisen. It is therefore open to question whether the stay would actually solve a real issue, or whether, given its link to publicising possible reorganisation measures, it could ironically produce the destabilising effect that it was intended to prevent.

Please see Question 27 with regard to the need for clarity on how a decision to impose the stay would be communicated to the market.

Response to Question 34:

The law of the contract must prevail and once again the key factors will be harmonised statutory application of any stay which has full cross border recognition.

--End--