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Introductory Remarks

Santander strongly welcomes the FSB proposals on the **Effective Resolution of Systemically Important Financial Institutions.** This is clearly a very challenging issue which requires careful consideration and we are pleased to have the opportunity to contribute to the FSB's consultation process. **Santander strongly supports the establishment of effective resolution arrangements, which will help to restore market discipline, reduce moral hazard arising from the "too systemic to fail" problem and would avoid putting taxpayers' money at risk when dealing with crises.**

Effective Resolution Regimes

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.

Santander strongly supports the establishment of resolution regimes and therefore welcomes the FSB's efforts to identify the key attributes that should form part of an effective resolution regime. Resolution regimes must be credible if they are to stand any chance of success[1].

We **welcome the reinforcement of supervision and prevention measures envisaged in the framework**. We agree that prevention is better than cure. Particularly relevant will be the introduction of recovery and resolution plans.

We also approve of the strong emphasis on the importance of **effective cross-border implementation**. It is vital that national authorities work closely together and have in place effective communication structures in advance of any possible problems.

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?

It is very important that the **overarching framework is capable of being applied to all types of institutions and infrastructures** that could imply a systemic risk. Any financial institution could potentially pose a risk to the financial system and thus its exclusion could imply future systemic risks and a current distortion to the level playing field. That said, we believe that measures should be applied proportionately in accordance with the level of systemic risk of the institution in question.

It is appropriate for there to be **some flexibility in the overarching framework** to reflect the differing nature of financial institutions that might pose systemic risk. In particular, for global banks with a significant presence in third countries it is essential to develop effective coordination tools to identify and understand potential divergences and to ensure effective communication between authorities.

[1] Such a credible framework could also increase the incentives for creditors to enter into voluntary agreements (e.g. restructuring of debt) well before resolution commences. Facilitating these agreements and developing clear protocols and improving the governance of creditor associations could merit further effort.

We would emphasise that there **should be no expectation of group support for a failing affiliate, if providing such support would have a detrimental effect on other entities in the group**.

We also think that the framework should take account of different jurisdictions' traditions in terms of the assignment of responsibilities of supervision and resolution. In our experience, there are advantages of having both roles within one entity. A deep knowledge of the institution's financial position – such as that acquired by a supervisor – is very important when choosing the most appropriate resolution measures. This is made much easier when the required knowledge is already in the same institution, otherwise an effective cooperation agreement between responsible authorities should be put in place. Mechanisms should also be in place to prevent any potential conflict of interest between supervisory and resolution objectives.

Finally, there are many specific points which will require further careful defining and explanation beyond what it is possible to express in a high level summary of key attributes. For example, the exact circumstances under which it will be permissible to override shareholder rights and the appropriate ex-post compensation mechanisms, or the extent and limitations to which a moratorium on payments to unsecured creditors and customers will apply.

Bail-in Powers

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

We welcome the objective of developing greater transparency and effectiveness in the availability and application of bail-in powers across jurisdictions.

We support the FSB's general assertion that *"the exercise of **statutory write-off or conversion powers within resolution should respect the pari passu treatment of creditors and the statutory ranking** and order of priorities of the affected debt that would otherwise exist in insolvency"* (Annex 2, 6.1). **It is vital that loss absorbency ranking reflects the existing ranking of creditors in each jurisdiction** which is justified by their weight in decision making and ability to exert market discipline. We agree that **senior secured creditors should be outside the scope of statutory bail-in powers.**

To this extent we are concerned **about the suggestion that exemptions may be possible** *"to the extent necessary to achieve the objectives of the resolution regime set out in the statute."*

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?

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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)?

We think it is appropriate for authorities to consider the potential quantity of liabilities available for bail-in **as part of the overall process of effective prudential oversight and monitoring of resolvability**.

In order to be able to do this effectively it is **imperative to undertake empirical analysis to help identify the likely scale of any future bail-in.** Reviewing historical examples of previous financial institution failures should prove illustrative in identifying in broad terms the likely scale of a possible write-down/haircut and how this would be affected by the range and composition of liabilities available. Such analysis will need to take account of the new capital requirements and the forthcoming changes in the resolution framework.

However, we do not agree with the proposal to impose a minimum amount requirement, which would essentially constitute an additional layer of tier 2/3 capital and we have strong reasons to doubt that it would be the best approach:

- **Firstly, it is likely to be extremely expensive to emit debt that would meet the characteristics of the minimum requirement in the first place**. The mere possibility of potentially being bailed-in implies significantly increased risks for the holders of these types of debt (all the more so if they are in the minority) and suggests that they will demand a significant risk premium in return. As a result, such a minimum amount of bail-inable debt would impose very significant funding costs.

- **Secondly, applying a minimum limit would also imply imposing a limit on the amount of secured senior funding, such as covered bonds, which, would be excluded from the bail-in.** This could have a very profound effect on the funding strategies of some banks, especially in those countries where the covered bond market is well developed, and might have the perverse effect of making banks more vulnerable

We are convinced that a statutory bail-in, which is as wide as possible in scope would be more effective. It would:

- **reduce the risk of significant disruption in funding markets**, which could exacerbate rather than improve financial stability. The potential impact would be spread across a wider range of creditors; the amount of losses to be absorbed by each creditor would therefore likely be small and thus reduce the likelihood of significant disruption in the funding market. A bail-in mechanism, which is designed in a way that makes it very likely that once an instrument is affected it assumes a 100% loss (binary application) would almost certainly create significant disruption for such instruments and could,

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in fact, imply the disappearance of these funding tools. This could lead to a lack of diversification of funding sources, which is detrimental to financial stability.

- **provide a large pool of creditors for bail in**, which would limit the excess costs that would need to be picked up by the taxpayer.

This in turn would lead us to suggest that uninsured deposits should be able to absorb losses *pari passu* with unsecured senior debt, as is the case in many current insolvency regimes. As our illustrative analysis shows in APPENDIX A, treating senior debt and non-insured deposits on a *pari passu* basis reduces the impact on key funding elements and introduces the best incentives among different creditors, without increasing the potential need for public support. (See response to question 21)

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?

All things being equal we would anticipate this to increase the cost of our funding. **A transparent and objective framework for bail-in which maintains the current creditor status and is wide in scope would help to avoid this and limit implications for the amount of credit we would be able to supply**. Holders of bail-inable debt are likely to demand a premium for the additional risk that they will encounter. Enforced changes are likely to increase the costs of our funding.

In this sense, it is important to emphasise that the banking sector cannot be viewed in isolation but as a sector that has to compete with other sectors in order to attract investors. The special nature of the banking sector justifies some differences in the resolution approach to the extent necessary to avoid moral hazard. However, care should be taken to avoid unnecessarily penalising the banking sector in contrast to the other financial and non-financial sectors.

Cross Border Cooperation

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

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

It is vital that there is clear leadership to take forward resolution of cross-border entities and coordinate amongst various authorities involved. **We strongly believe that the home authority should be clearly established as the lead for cross-border resolution**.

We believe that the FSB should make it clear that the home is the lead not just in crisis but also in the elaboration of pre-crisis measures, and clearly define its legal responsibilities in this regard.

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In particular, home leadership could further be reinforced by:

- o Making clear that the home should lead the development of the RRP and, where applicable, be responsible for coordinating any possible RRPs for local SIFIs. If the intention is to have an effective, coordinated approach to resolution in the event of a cross-border crisis, then an uncoordinated preparation would not be very helpful. In this respect it would be advisable to avoid each different local authority demanding independent plans of the institutions (branches and subsidiaries) of which they are hosts.
- o Establishing (in Annex 3, section 4) that the home authority should be regarded as the main channel through which host authorities can raise issues concerning particular entities (for example, raise alarms about their position, make suggestions to improve resolvability or requests to implement RRP measures).

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

Santander strongly supports the focus in the consultation document on making cross-border cooperation more effective. The framework needs to be straightforward and predictable.

The role of each authority involved in the process should be clearly specified in their mandates in order to avoid gaps and overlaps. The outcome from this process must be that authorities in different countries develop a better understanding of each other's regulatory frameworks and increased trust.

In particular, it will be important to ensure that membership of the Crisis Management Group is sufficiently broad while keeping being operative. The governance of the Crisis Management Group must carefully balance the need to be operative and effective, whilst also reflecting the legitimate interests of countries where the institution could constitute a strategic risk and also all countries of strategic importance to the institution. We would encourage the FSB to explore ways to make sure this balance is struck.

As above, we think it is of the **upmost importance that the leading role in resolution of cross-border groups is assigned to the home authority and that they take the lead role, for example, in reviewing Recovery and Resolution Plans**. This will **increase the emphasis on the effective implementation of resolution powers in those countries home to large cross-border banking groups**, so as to be able to effectively execute their increased responsibilities.

Resolvability Systems

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

We agree that resolvability assessments should be qualitative, non-binary and led by the home supervisor.

Given the nature of such qualitative assessments, there are inevitably a wide range of factors that could impact on a firm's resolvability. **It is crucial to avoid making too**

broad or too crude assumptions about an individual firm's position. For example, just because a financial institution has cross-border operations, does not necessarily mean it will be less resolvable than others. Likewise, just because a group is organised through independent legal entities, does not necessarily mean it will be less resolvable than others as the paper seems to imply in different parts. For this reason, we welcome the attention on important characteristics such as legal structure or the extent of use of intra-group guarantees.

Santander approaches this debate from the perspective of a banking group organised by stand-alone subsidiaries autonomous in capital and liquidity. **This standalone approach avoids excessive intra-group complications and makes it feasible for each jurisdiction to take responsibility for its relevant entity.** This avoids intra-group contagion and can even make the international coordination required for the resolution of an international group more feasible as it provides ex ante mapping of the different entities in the group.

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

We agree that home authorities should lead the overall assessment of resolvability. However, as Annex 4 makes clear, an important element of this assessment will be for home and host authorities to carefully evaluate the effectiveness of their own information sharing and coordination procedures.

Recovery and Resolution Plans

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

Santander considers the development and maintenance of recovery and resolutions plans to be a crucial element of an effective resolution regime. Prevention is better than cure and effective planning can go a long way to avoiding the need to use other resolution powers.

Overall, we consider the elements identified to be broadly appropriate. An important element will be **consistent application of RRPs across jurisdictions**. In this respect, there are several areas where we think previous identification and establishment of comparable international definitions by authorities will be required:

- In order for firms to be able to effectively identify "essential…[and] systemically important functions", it will be important for the authorities to first define what they understand this term to mean (Annex 5, section 2.3);
- The specific information requirements that authorities require firms to provide (Annex 5, section 1.11) should also be defined consistently across jurisdictions;
- Finally, we agree – with the somewhat tentative suggestion – to aim for consistency in the severity of stress tests used by different firms in their recovery plans, in order to ensure a level-playing field. It may be worth considering to what extent these stress tests should be consistent with those already in operation.

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We believe authorities should share the contents of the resolution plan with the firm in question as this will ensure that the firm is aware of the potential problems around resolvability and contribute to an environment of trust and communication. Likewise, in a cross-border context we believe it is desirable for the firm under consideration to be involved in all discussions concerning its viability.

Finally, we do not believe that the triggers for implementation of recovery and resolution measures (Annex 5, section 2.1) should be based only on rigid thresholds, applied automatically. Given the complex nature of different possible situations, we believe such triggers should instead act as alarm bells requiring firms and authorities to reach a formal decision about whether to implement the existing plan or not.

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

We understand there is no information on this aspect in Annex 5. However, we believe that RRPs should only be prepared at subsidiary level when the subsidiary is a local SIFI. As highlighted in our response to question 10, we believe that the home authority should have overall responsibility for coordinating RRPs conducted by host authorities, where the entity in question constitutes a local SIFI in the host jurisdiction.

Improving Resolvability

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

We agree that the four obstacles identified in Annex 6 (fragmented information, reliance on service providers, intra-group transactions and global payment operations) could, depending on the circumstances, constitute possible constraints on effective resolution.

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

The proposed steps seem to be appropriate.

Santander's model is organized in such a way that the services provided by the group's factories (business / group entities providing a specific market function or service) are appropriately identified and documented, making it possible to differentiate between each factory and where applicable, separate them.

The services that take place between each unit and each corporate factory are documented in the respective Service Level Agreement, which describes the services to be provided, the level of quality of services, economic considerations and termination procedures, amongst other matters.

Each group's entity (factories) appoints a client manager for each bank and creates local subsidiaries when service requirements are relevant. By doing that – and always as part of the SLA – when part of the group fails, the functions and services provided

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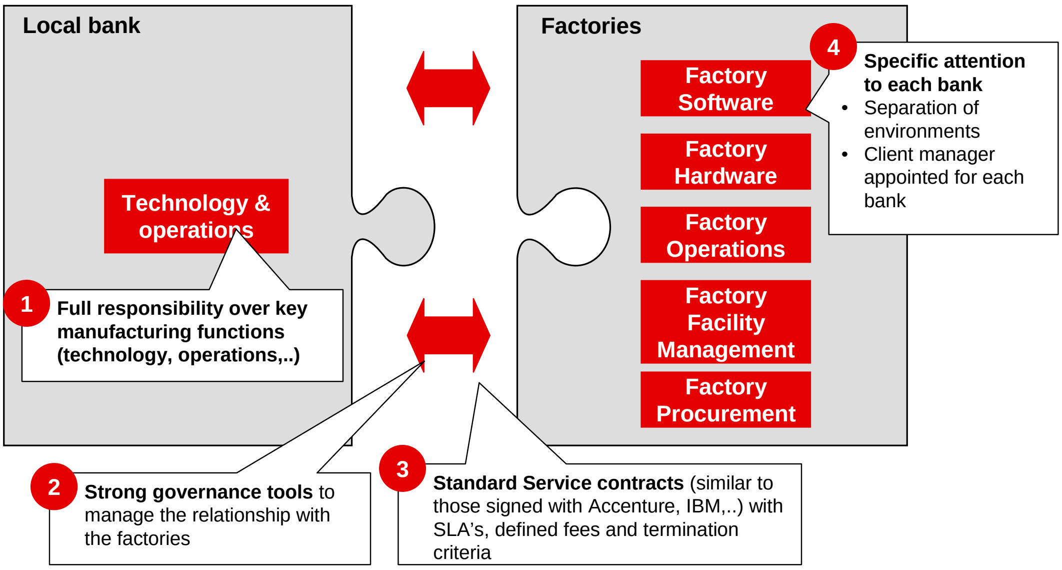
by each factory remain unaffected by what is happening elsewhere in the group and can continue to be provided without creating market disruption.

Moreover the factories also are independent subsidiaries. This means they are self-funded from the revenues of the services they provide and not in any way reliant on financial support from the rest of the group.

The following exhibit depicts the segregation procedure available for IT factories.



As previously mentioned we would also emphasise that there should be no expectation to group support – even in the form of continuation of these services beyond what is established in the service level agreement – for a failing affiliate, if providing such support would have a detrimental effect on other entities in the group.

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

Under normal (i.e. non-resolution) conditions, intra-group operations and transactions form an important tool in day-to-day business. We agree that such transactions should be conducted transparently, conducted at market prices and in adherence with established accounting practices. We therefore believe the FSB's proposals in this regard are sensible.

However, it is important that these business-as-normal operations are clearly distinguished from the decision of whether to provide intra-group support in the case of a crisis in one or more constituent parts of a group. In this case, we think that a model which allows the institution's management to decide on case-by-case basis whether or not to support a troubled unit contributes to the soundness of the group and to financial stability. The group could decide not to provide support to a unit when it is detrimental for the whole group. In fact, today in the absence of such a framework, financial groups have the option to support a unit in trouble when it is beneficial for the group and does not put the rest of the group at risk. **Santander** has examples of both situations and considers that the freedom to decide on a case-by-case basis gives the group valuable flexibility, and also provides certainty to the financial systems where the group operates

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that a problem in one part of the group will not put the rest of the group at stake. This respects the legal status of each unit, allocates responsibilities accordingly and allows market discipline to be exerted.

To avoid situations where, due to the existence of legal constraints, certain measures that otherwise can solve a problem are not feasible, we may distinguish between the following measures:

- Financial support or asset transfer that, in accordance with the relevant law, may be decided by the transferor (or the management of the provider of the support) without further conditions.
- Financial support or asset transfer that, in accordance with the relevant law, needs the approval granted by any other company body (i.e. shareholders meeting).
- Financial support or asset transfer that, in accordance with the relevant law, needs administrative or judicial authorization.

The first group should not be subject to requirements other than the voluntary management decision and the authorization of the home supervisor. Such an authorization shall be granted provided the support does not jeopardize the solvency, liquidity and compliance with regulatory requirements of the transferor.

For the second and third group, a special procedure should be set up by the CMG in order to acquire the relevant approvals promptly, including the approval of the home supervisor.

Amendments could be introduced to make the process:

1) Quicker (e.g. a special procedure that allows for expeditious decisions),

2) Safer for the management (e.g. if the prospects at the time when the decision is taken are that the support could be beneficial for the transferor as well as for the transferee the subsequent insolvency of the transferee should not question the legality of the provision of support),

3) Safer for the transferor (e.g. priority claim in case of transferee insolvency).

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?

We think that corporate bodies have to have the responsibility on a case-by-case basis for approving credits, guarantees or provision of intra-group services as well as for deciding whether the conditions of the agreement are met.

However, payment systems should appear in the RRP and the Crisis Management Group should be engaged in all these processes.

Timelines for implementation of G-SIFI related recommendations

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

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The proposed calendar seems appropriate. However, it will be important to make sure that the calendar takes account of developments at the supra-national level, for example, deliberations at the EU level.

Likewise, the FSB should also ensure that developments at a national level are compatible with the proposed international calendar. Certain authorities (US and UK) are already requiring RRPs within their national jurisdictions with timelines that do not appear to fit with those set out by the FSB. It will be important to make sure that such local developments are made consistent with the international process being set out by the FSB.

One approach that could be taken would to proceed more rapidly with those elements that are clearly understood and for which there is consensus (recovery and resolutions plans, early intervention tools, etc.). Meanwhile for those elements that are still in need of further analysis and are more controversial, a longer run-in may be more desirable (e.g. details of bail-in, temporary stays, depositor preference, etc.).

<u>Discussion note on creditor hierarchy, depositor preference and depositor preference in resolution</u>

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

Differences in statutory credit rankings could indeed complicate a coordinated process of cross-border resolution but we do not believe that harmonization is necessarily achievable or indeed required. Rather the key is to ensure mutual recognition of the different regimes in place in counterpart jurisdictions and a genuine willingness to cooperate.

Moreover, we think it is very important that overall statutory creditor rankings are respected. Loss absorbency ranking should reflect the ability to influence an institution's risk strategy directly (i.e. shareholders) and ability to exert market discipline (i.e. more sophisticated investors). Informational asymmetry justifies this ranking. Thus shareholders should bear losses before junior creditors and they in turn before senior creditors. **This ranking is typical across most jurisdictions and should be respected.**

As the Discussion Note makes clear, the main differences across jurisdictions occur with respect to the treatment of depositors, where jurisdictions provide varying degrees of depositor preference.

Santander's view is that **depositors (not covered by the relevant Deposit Guarantee Scheme) and senior unsecured creditors should be treated *pari passu*** as is already the case in many jurisdictions. Excluding certain creditors from the bail-in could exacerbate moral hazard and reduce their incentives to exert market discipline. In addition, as illustrated in APPENDIX A, ensuring that depositors are treated *pari passu* increases the potential scope of bail-in able funds, reducing the size of the overall haircut on senior debt and other creditors, minimising the need for public funding. In addition, as the potential impact would be spread across a wider range of creditors the amount of losses to be absorbed by each creditor would likely be small and thus reduce the likelihood of significant disruption in the funding market.

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Nevertheless, a thorough analysis of the need for bail-inable debt and possible impacts would be essential so as to identify any potential risks for depositor and funding markets. If required, a range of mitigating solutions could also then be explored. Especially important will be clear communication to avoid significant negative reactions by depositors and other creditors at a time of market volatility.

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

Whilst we recognise that greater convergence of depositor preference schemes could be helpful in the context of cross-border resolution, **attempting to aim for a single “gold” standard for depositor preference would have relevant implications in jurisdictions where changes would be imposed.** As the Discussion Note rightly observes, any change in the statutory hierarchy would “require strong political support and its benefits would need to clearly outweigh its costs”.

In particular, we emphasise the **importance of avoiding an overly simplistic characterisation of existing systems of depositor preference across countries.** It is important not only to consider the scale of potential coverage, but also the **extent to which authorities are credibly capable of delivering on their commitments**. For example, in Spain, we have an insured depositor preference scheme. The Deposit Guarantee Fund is pre-funded through annual contributions from member credit institutions meaning that there are pre-existing funds available at the point of resolution and insured depositors can have full confidence that their insured amounts will be covered. Furthermore, the deposit guarantee scheme funds can also be made available to fund resolution (provided depositors would be no worse off). On this basis we think it is **very important that the FSB takes into consideration the extent to which depositors are credibly protected.**

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

It is important to distinguish between eligible deposits which are covered up to the amount insured by the Deposit Guarantee Scheme – mainly retail deposits up to a certain amount, and all other deposits.

As set out above, we believe the latter group should be treated *pari passu* with senior unsecured creditors. The risk of arbitrage will also be limited by the lack of available alternatives given that all the liabilities will be affected in the same way.

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?

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The Discussion Note sets out a number of salient costs and benefits associated with depositor preference. We would particularly emphasise the risks of reduced incentives for depositors to exert market discipline. Depositors' behaviour should be driven not only by price but also by solvency of the institutions they choose to deposit with. This could also risk provoking a deposit war that increases the instability of this funding source. Furthermore, we agree that there is a danger that increasing the costs of senior debt would lead to increased use of short-term funding.

We believe that **the risks and costs of depositor preference for unprotected deposits are greater than the benefits.** In particular, we draw attention – as we have done so above – to the implications of depositor preference for the effectiveness of the bail-in resolution tool. Treating depositors *pari passu* with senior, unsecured creditors significantly increases the range of liabilities available for bail-in, reducing the size of the overall haircut and increasing the potency of the bail-in tool.

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

We consider that further work would be useful on the application of bail-in powers in the case of cross-border resolution under a group structure.

Discussion note on conditions for a temporary stay on early termination rights

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

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

28. What specific provisions in financial contracts should the suspension apply to? Are there any early terminations rights that 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?

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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?

We believe the idea of a short temporary stay of between 24 to 48 hours is broadly sensible and provided it is kept to a limited time frame should not have undue negative market impact.

However, **we believe it is very important to clearly define which arrangements will be affected by the temporary stay and the purpose for which the administrator is applying the stay**.

In particular, we would emphasise that the approval of temporary stay should:

- Function automatically and should not be discretionary;
- Only be applicable in situations where resolution measures will be applied and not under any other circumstances;
- Apply to all transactions with counterparty and its group (including branches, holding company, etc.). This is vital not only to preserve the netting (all the transactions under the same master agreement) but also to permit the cross affiliate set off;
- Ensure that the value of the transactions subject to a stay do not impact on a firm's capital consumption.

Furthermore, it is important to emphasise that in the case where authorities decide to transfer transactions subject to a stay (with the counterparty and the group) to another entity or to a bridge entity, that the receiving assignee should have sufficient credit quality or be backed by sufficient guarantees respectively, to be able to cover the transactions so assigned.

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APPENDIX A: Debt bail-in

It is important that the new framework minimizes moral hazard enhancing market discipline. A framework that ensures the effective loss absorption of capital instruments and a credible bail in mechanism are both crucial elements in this regard. Basel III has already addressed the first issue and thus we should expect in the future a re-pricing of capital hybrid instruments that reflects the higher probability of these instruments to absorb losses. Much more difficult is the question of bail in as holders of senior debt, depositors and other creditors are in general less sophisticated investors that cannot exert by themselves the market discipline that ensures a fair pricing of a loss absorbing instrument. To the extent possible the ranking established within insolvency law should be respected and not distorted through exceptions.

Before deciding on the bail in mechanism design (e.g. which creditors should be affected and when) and on the establishment of a resolution fund (amount, etc) it could be worth to make an exercise to determine whether a solution that completely rules out some form of public support is the best option from a social interest point of view.

A useful exercise would be to make a counterfactual analysis based on recent crisis examples. We acknowledge the evident drawbacks of this approach as it is impossible to know ex post how the agents would have reacted in a different scenario. Besides, as the public support in the recent crisis has been provided not only directly to the institutions but through a number of monetary and fiscal policies, whose cost is more difficult to precisely allocate, the counterfactual analysis could only be taken as a first approach but at least would serve to identify pros and cons of the different options and set up the logic behind each decision.

The analysis which follows is based on the following assumptions: minimum common equity tier 1 of 7%; effective loss absorption of hybrid capital instruments; an amount of generic provision of 1%; pre-funded guarantee schemes amounting to 1.5% of deposits

This analysis begins by asking the following questions.

1. Which banks would have survived without public support if the **Basel III requirements** on the level and definition of capital instruments and subordinated debt would have effectively absorbed losses?

   We estimate that in the majority of the cases no public support would have been needed, as is the case of the two examples below.

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(STG mill.)	Northern Rock 2007	Northern Rock New Proposal - Scenario
Loans 2007	98.835	98.835
RWA 2007	20.768	20.768
CT1	608	1.450
Ratio CT1	2,9%	7,0%
Total Losses 2008-2010E	-2.330	-2.330
CT1	-1.722	-880
CT1	**-8,3%**	**-4,2%**
Capital generation		
Generic Provision after tax (1%)		642
Convertible preferred		908
Convertible subordinated		1.841
CT1		2.511
CT1 Ratio		**12,1%**
Cocos (2%)		415

(GBP mill)	RBS 2007	RBS New Proposal - Scenario
Loans 2007	829.250	829.250
RWA 2007	609.000	609.000
CT1	27.324	42.630
Ratio CT1	4,5%	7,0%
Total Losses 2008-1H'10	-38.102	-38.102
CT1	-10.778	4.528
CT1	**-1,8%**	**0,7%**
Capital generation		
Generic Provision after tax (1%)		5.390
Convertible preferred		6.919
Convertible subordinated		37.979
CT1		54.816
CT1 Ratio		**9,0%**

2. For the remaining cases, which banks would have survived without public support if **haircuts were applied on other creditors (senior debt and deposits)**?

   a. Which would have been the haircut in case the **senior debt** were put in a subordinated order with respect other creditors (deposits)? If markets would reproduce a similar analysis to price senior debt, what would then be the amount of senior debt given the likely banks reaction (i.e. replacement of senior debt for cheaper funding such as deposits or covered bonds)?

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Taking Anglo Irish as an example, in a scenario where the new capital ratios were in place, to cover the remaining losses a haircut of 50% on senior debt would have been necessary. With potential haircuts of 50% the price to issue senior debt would dramatically increase.

	Anglo Irish	
(EUR mill)	2007	New Proposal - Scenario
Loans 2007	66,244	66,244
RWA 2007	78,677	78,677
CT1	4,721	5,500
Ratio CT1	6.0%	7.0%
Total Losses 2008-2010E	-23,445	-23,445
CT1	-18,724	-17,945
CT1	**-23.8%**	**-22.8%**
Capital generation		
Generic Provision after tax (1%)		431
Convertible preferred		2,056
Convertible subordinated		2,715
Haircut on rest of bond holders 50%		18,779
CT1		6,035
CT1 Ratio		**10.9%**

Irish goverment has injected nearly 23 billion euros into Anglo

This effect would be much more pronounced in the case of a typical retail bank with a broad base of deposits and covered debt. Taking the balance sheet of Bradford & Bingley at June 2008 as an example, it could be seen that the haircut of the senior debt under different scenarios of losses is significantly much higher when senior debt does not absorb losses *pari passu* with other creditors.

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	jun-08	% of loans + debt securities
Loans and advances to customers	42.197	
Debt securities	4.629	
Assets- rest	5.425	
Total assets = total liabilities	52.250	
Total attributable equity	1.144	2%
Subordinated liabilities + other capital instruments	1.357	3%
Customer accounts	**24.463**	**52%**
Non collateralised debt	**6.033**	**13%**
Secured funding (securitisations + covered bonds)	16.502	35%
Secured funding- rest + other obligations higher in the pecking order (estimated)	2.750	6%

Hypothetical scenarios

Total loss (as % of loans + securities)	Haircut- non collateralised debt only	Haircut- non collateralised debt + deposits
6%	0%	0%
10%	31%	6%
15%	70%	14%
18%	93%	18%
20%	**> 100%**	21%
25%	**> 100%**	29%
30%	**> 100%**	37%

Notes:
Non collateralised debt represented just 13% of loans outstanding + debt securities (estimatec
Total losses in excess of 20% of loans + securities cannot be absorbed by non-collateralised c
In crisis situations (e.g., 2008), the % of the balance sheet financed with non-collateralised del

We guess that, most likely, senior debt would practically have disappeared and replaced by collateralised debt and depositors, with negative consequences in terms of diversification of funding sources and market discipline. Therefore, limiting the bail in to the senior debt would have a negligible effect in reducing the probability of winding down of an institution without public support.

b. Which would have been the haircut in case other creditors (e.g. **deposits**) would have absorbed losses *pari passu* with the senior debt?

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We estimate that in general a modest haircut for senior debt and deposits would have been sufficient.

Taking again the Anglo Irish example, if other creditors, of an amount of 46,700 million EUR, were able to absorb losses the haircut would have been much lower: 20%.

	Anglo Irish	
(EUR mill)	2007	New Proposal - Scenario
Loans 2007	66,244	66,244
RWA 2007	78,677	78,677
CT1	4,721	5,500
Ratio CT1	6.0%	7.0%
Total Losses 2008-2010E	-23,445	-23,445
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Capital generation		
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Haircut on rest of bond holders 50%		18,779
CT1		6,035
CT1 Ratio		**10.9%**

Irish goverment has injected nearly 23 billion euros into Anglo

It is difficult to know the impact of applying such a haircut both on the market (new issuances) and on depositors. However, we think that the impact would depend on the confidence in the restructuring process. If the haircut is perceived as an effective tool to avoid the bank collapse then a modest haircut could even calm debt markets. It should be taken into account that at the time a bail in is decided, the institutions should be intervened since the shareholders should have already been wiped out.

In addition, if the haircut is modest the majority of the currently prefunded DGS would have been able to absorb the corresponding losses with their current levels of prefunding in the recent financial crisis.

If the DGS covers directly the losses the covered depositors would not suffer losses not even transitorily. In this way the risk of a sudden run of deposits driven by panic would be minimised. The risk of a run of deposits in the segment of non covered depositors should be less given its different nature and the absence of alternatives given that all liabilities will be affected.

In the Irish case if DGS were prefunded at a 1.5% of deposits an amount of 3,000 million Euros would have been available to cover these losses. Assuming that two thirds of deposits were covered by the Fund this amount would have not been enough to cover the 6,200 million Euros of depositor's losses. There are three alternatives to cover this gap:

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1. Double the level of prefunding with consequences in terms of credit and real growth – which would be an expensive way to cover a very unlikely event,
2. The public sector finances transitorily the DGS, and the DGS repay the debt through ex post contributions of its members,
3. The public sector assumes the remaining losses attending to the social character of the covered deposits.

Although the third solution implies a cost for the tax payer, it is much more moderate than it would have been under the framework in place during the crisis and it would only protect deposits, not bond holders.

It is therefore essential that the bail in is linked with a credible restructuring process led by the resolution authority in close dialogue with the financial sector. Equally important is that the non covered depositors absorb losses and the DGS was able to bear losses in the event of a depositor's haircut up to the covered amount instead of in the event of judiciary liquidation. Besides, contributions to the DGS should be risk sensitive in order to avoid banks moral hazard.

If in order to avoid contagion or keeping alive vital functions it is decided that other creditors need to be protected then schemes similar to the DGS should be put in place that could absorb losses instead of these creditors if needed.

In any case, we think that the possibility to bail in all the creditors would substantially reduce the need for public support.

	Anglo Irish	
(EUR mill)	**2007**	**New Proposal - Scenario**
Loans 2007	66.244	66.244
RWA 2007	78.677	78.677
CT1	4.721	6.294
Ratio CT1	6,0%	8,0%
Total Losses 2008-2010E	-23.445	-23.445
CT1	-18.724	-17.151
CT1	**-23,8%**	**-21,8%**
Capital generation		
Generic Provision after tax (1%)		431
Convertible preferred		2.056
Convertible subordinated		2.715
Haircut on rest of bond holders		**6.619**
-Non- collateralized bond holders		33.093
Haircut 20%		***6.619***
-Collateralized bond holders		4.474
Haircut 0%		-
Haircut on customer accounts		**4.010**
Customer Accounts		46.700
Haircut 20%		***9.340***
CT1		4.010
CT1 Ratio		**7,3%**

3. Which additional funds in the **DGS or in a resolution fund would have been necessary to avoid public support in the 100% of the situations we can imagine**?

We think that the cost in terms of real growth of reducing the need for public support in scenarios even worse than the recent crisis by increasing the amount of ex ante funds is disproportionate and increases exponentially. Each extra point in safety implies increasing the amount of prefunding exponentially. A cost benefit analysis should be performed to determine the optimum level of risk from a social point of view. Reducing to 0% the need for public support would imply funds of such a magnitude that the banking function would be seriously impaired and thus affecting real growth. Only once the trade off between level of prefunding and real growth is determined could this level be set up appropriately.

To sum up, we think that with the new requirements and the strengthening of the capital definition, in addition the possibility of bail in which prefunded DGS could assume the corresponding depositors haircut, the need for public support would be substantially reduced. Going beyond this level of safety could imply disproportionate cost in terms of real growth.

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