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Mr Svein Andresen
Secretary General
Financial Stability Board
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Dear Mr Andresen,

Re: FSB Consultation on Effective Resolution of Systemically Important Financial Institutions

The IBFED appreciates the opportunity to comment on FSB Consultation on Effective Resolution of Systemically Important Financial Institutions. It wishes to offer the following comments:

General

The IBFED supports the creation of special resolution regimes for financial institutions that minimises the systemic and fiscal consequences of bank failures and eliminates moral hazard, thereby allowing market forces to exert greater market discipline and a fair allocation of losses. The primary goal of any resolution regime should be to protect society (i.e. states and tax payers) from the costs of failure and to limit the effects of contagion to the financial system as a whole.

We agree with the need to allow for a firm's continued performance of systemically important functions and services when going concern values are higher than their liquidation values. We urge that among the many attributes of such a regime, the need for the preservation and maximisation of value for the benefit of creditors should be a priority.

The resolution tools under consultation are effective and coherent with the best practices under discussion at the international level. The proposals to strengthen the cross-border cooperation in the case of a crisis represent a good step forward. We strongly support the underlying conclusion of the report that internationally coordinated reforms of domestic resolution regimes and tools, and of frameworks for cross-border enforcement of resolution actions, need to be accelerated.

Scope

The Key Attributes recognise the need for a resolution framework which applies to all financial institutions that could be systemically significant. Restricting such a framework to credit institutions and investment firms would be too short-sighted an approach to effectively address systemic risk and exceptions to the scope of the regime might encourage regulatory arbitrage. The level playing field between all financial institutions should be kept in mind, globally, regionally and nationally.

Timeline

The timeline proposed by the FSB appears to be challenging given that the final recommendations will not be published until November. The timeline does not sufficiently allow jurisdictions to seek convergence of their resolution regimes through the legislative changes needed to incorporate the tools and powers set out in the Key Attributes into their national regimes. Moreover, it is disappointing that there are no deadlines set in which jurisdictions should implement the legislative changes necessary to underpin the framework.

We view the various recommendations as interconnected, and urge regulators and national authorities to proceed with their implementation in light of this interconnectedness. So, for example, the resolvability assessments will depend in part on the progress of institution-specific cross-border cooperation agreements, and the timeline should reflect such dependencies, especially where it is dependent on the provision of a resolution framework in another country's host jurisdiction.

Resolution authority

The FSB recommends that the resolution authority be protected against lawsuits for actions taken and/or omissions made in good faith (Annex 1, paragraph 2.6). This protection should be limited so that time-tested due process protections are not eviscerated unnecessarily. At a minimum, there needs to be robust after-the-fact judicial review, to enforce, among other things, the minimum recovery right, resolve valuation disputes and address any manifest abuses of authority. There needs to be legal certainty with regard to the accountability and liability of the institutions and authorities involved in crisis management.

Entry into Resolution

While the entry into resolution should be timely and earlier than balance sheet insolvency (Annex 1, paragraph 3.1), there should be a high hurdle for putting an entity under the resolution authority to prevent it from becoming a means to circumvent shareholder and other protections that would otherwise apply (see, e.g., Annex 1, paragraph 4.1.vi). Entry into resolution should certainly not take place until it is clear that the recovery measures contained in the Recovery Plan have failed to be effective.

One of the key elements of an effective resolution framework is that the entry point is well defined in advance by law. We support the definition suggested by the FSB of non-viability or impending non-viability. The definition of non-viability should be as transparent, objective and predicable as possible, however without being solely automatic based on numerical thresholds, i.e. by requiring some supervisory discretion in dialogue with the firm. There is a real risk that with advanced thresholds firms could effectively go earlier and unnecessarily into a winding-up procedure, i.e. that bankruptcy is triggered by the regulatory mechanism prematurely.

It is advisable that the FSB provides additional guidelines or a definition of "systemically critical financial services and functions" to help firms identify critical functions that should be either kept or transferred in the event of failure.

Resolution Powers

We agree that the definition of an effective resolution regime should be taken to mean that the authorities can intervene to ensure the continued operation of the systemically important functions of banks. The IBFED supports the effort to articulate alternatives to resolving SIFIs by selling them to third parties. In particular, we believe that a useful alternative is to resolve SIFIs by recapitalising their systemically important and other viable operations by exchanging certain types of debt for equity in the SIFI or in a bridge institution. However, it should be made clear that bail-in should not be used as a means to rescue and relaunch an institution without prior profound restructuring. The assurance that no creditors are worse off than they would be in liquidation is an important protection that will also contribute to the market stabilising goal of such resolution regimes.

Resolution Funding

The cost of a bank failure should be borne primarily by shareholders, and secondly by holders of other loss absorbing instruments. The remaining creditors should suffer losses only after the previous ones have fully absorbed their losses. This implies that the remaining creditors should absorb losses only in exceptional circumstances and once all other alternative measures have been explored and exhausted, as they would be in a situation of liquidation. This way, the creditor rankings in the financial institution's debt structure will be respected. Only subsequently should the wider industry be called to absorb the remaining costs.

Bail-in

We note that the FSB proposes the introduction of a statutory bail-in mechanism as a tool to be used by resolution authorities within a resolution. This proposal, as stated by the FSB, is not incompatible with the issuance of convertible debt securities or hybrids by financial institutions which might include bail-in clauses with specific and predefined triggers.

Debt-write down or bail-in mechanisms must be further analysed and a thorough impact analysis, including the changes in the nature of funding and implied costs, must be done before it is introduced.

If introduced, it should be a last recourse action where other tools are assessed as unlikely to achieve an orderly resolution or protect creditors' interests, and only in situations which are transparent (i.e. predictable and observable). Following the resolution trigger, when a financial institution is at a point of resolution, supervisory authorities should have the discretionary decision to select bail-in as one possible measure. Bail in should respect the natural ranking of creditors when being applied and leave the holders of the ”bailed-in” instruments in no worse a position than had the bank become insolvent and liquidated in an orderly fashion.

A statutory bail-in measure as proposed by the FSB should follow a transparent and predictable process for discretionary decisions taken by the authorities, potentially applicable to all liabilities. Conversion of bail-in instruments into equity takes place as a final proceeding of the resolution process that must be monitored by supervisors.

Additionally, no limits or conversion ratios or certain liabilities should be pre-defined in statutory bail-ins, in order to increase flexibility and the effectiveness of the measure, while also discouraging arbitrage in the financial markets at times of stress;

A broader scope of liabilities covered by statutory powers will imply several advantages:

The authorities will have higher flexibility when applying a bail-in solution;

The impact in the cost of funding will probably be diminished, since the statutory bail-in regime will be equivalent to a new regulatory framework under resolution (almost bankruptcy), applicable to the whole financial sector, and potentially to all liabilities; hence, the potential increase in the cost of funding will be diluted amongst all liabilities;

Both the risk of arbitrage between asset classes and the risk of financial engineering that could endanger the application of a bail-in will be a minimised.

The IBFED stresses again that the ranking of the creditors and the order of priorities must be maintained. The treatment of creditors belonging to the same credit class should be pari passu. Incentives should not be distorted. Loss absorbency ranking should reflect the weight in the decision power and ability to exert market discipline (informational asymmetry justifies this ranking). Thus, shareholders should bear full losses before all other creditors, and all junior creditors before senior creditors. The initial focus of bail-in should be subordinated debt, which could be expected, in a majority of cases, to be enough to achieve the objectives. Use of bail-in powers on unsecured senior debt should be strictly limited to special situations, last resort alternatives to winding-down or liquidation.

We believe that the relationship between the various classes of loss-absorbing debt needs to leave sufficient flexibility for the market to develop appropriate instruments. The FSB should not be prescriptive as to the features of not yet defined instruments as there is a need for further reflection about the relationship between bail-in and contingent capital. Further, analysis is needed on the interplay between bail-in debt and contingent capital.

The IBFED supports a bail-in mechanism which is at the broad discretion of the authorities during resolution. Therefore, there would be no need in setting additional requirements to add bail-in terms in contracts or a minimum requirement level of bail-in debt. We are thus strongly opposed to introducing a minimum level of bail-in debt.

Finally, it is important to stress that at the current juncture, with the price and availability of bank funding under significant pressure and significant changes to capital and liquidity requirements in process, there is a risk that the introduction of bail-in could have particularly pronounced impacts on bank funding. It may therefore be prudent for the regulators to allow a phasing period of such other measures before the introduction of a debt bail-in regime. This is particularly important as access to liquidity has been one of the largest issues during the recent crisis and a key objective must be to find a regime which avoids unnecessary pressure on the liquidity of banks.

Cross-Border Cooperation

We agree that home and host country authorities should establish arrangements in advance of how they will coordinate in the event of a cross-border resolution of a SIFI, the home authority having the lead in the coordination and implementation of such agreements. Cross-border cooperation is necessary in every situation (subsidiary or branch) and disagreements can be resolved within the context of colleges of supervisors.

However, the intended strengthening of the supervision or resolution authority with respect to local branches of foreign institutions is likely to foster ring fencing measures in a crisis of the respective firm which could hamper effective cross-border resolution due to a so caused increase of questions of conflicts (e.g. scope of local measures in relation to home authority measures). The leading role of the home supervisor within a college of supervisors needs to be maintained in order to guarantee the implementation of the previously reached agreements, while providing clear definition of tasks for both home and host supervision authorities.

We are strongly opposed to publicly disclose the institution-specific cross-border cooperation agreement (Annex 1, paragraph. 9.2). Even in the event that disclosure is to take place, the meaning of “broad structure” must be rigidly defined.

Moreover, while we urge that cooperation agreements should ideally be multilateral agreements, we do recognise the difficulties of attempting to have full multilateral agreements in place in the first instance. In the short term, we encourage bilateral agreements with the long-term objective to achieve multilateral agreements that reflect the multinational coverage of a global financial firm. It is the responsibility of the FSB and G20 to foster an ambitious international programme to harmonise resolution regimes internationally.

Much of the work that is suggested to be conducted to assist with these agreements, including identification and evaluation of legal impediments to resolution (Annex 3, Section 7) is likely to be underway by the institution. Without information sharing and discussion, the firm's plan and the cooperation agreements may make differing assumptions or come to differing conclusions, which will be confusing in a crisis.

Recovery and Resolution Planning

A Recovery Plan should be regarded as a flexible instrument, consisting of a detailed set of mechanisms available for use by the management of a financial institution. The Resolution Plan should also be led by resolution authorities, with a fluent dialogue and close coordination with the firm. Thus, we do not agree with the FSB recommendation which proposes that authorities may discuss Resolution Plans with firms only to the extent they believe is useful (Annex 5, 1.14). Resolution Plans are dependent on the valuable input of the firm and should be openly discussed between an authority and the concerning firm. Otherwise there is the risk that the Plan contains misinterpretations or even mistakes which could hamper any resolution process.

Further, just as the report recommends a lead authority to coordinate the resolution process of a group with multiple entities in the jurisdiction, we recommend a home country regulator to lead and coordinate the Recovery and Resolution Plans at the parent company level, and the resolution process of a business, in multiple jurisdictions. Any efforts to address deficiencies (Annex 1, paragraph 11.10) should be implemented through the home country resolution authority. In parallel the IBFED strongly believes that RRPs are more effective for cross-border recovery and resolution when prepared at the parent company level.

Finally, the requirement for Management Information Systems (MIS) in RRP should reflect national practical differences and various business models of financial institutions. As such each authority should have the discretion to set out the MIS requirement for the whole of a group.

Information requirements for recovery and resolution planning" of Annex 5, financial institutions are required to have the capacity to provide the essential information needed to implement the RRPs on a timely basis. We fully understand that such requirement is imperative for the authorities in case of executing RSP. However, taking it into consideration that G-SIFIs are globally active bodies with more than a hundred branches or subsidiaries overseas, it is unrealistic that G-SIFIs should provide data covering all of their group entities within such a short period. Thus, we seek the limitation of timely provision of RSP information to important materials only. Objective criteria, such as certain thresholds should be established from the viewpoint of materiality.

Resolvability Assessments

We support the review and assessment of resolvability of institutions, but stress that they must be used not only to assess the feasibility of applying the resolution tools to firms but also to test authorities' tools, powers and preparedness. We further believe that the degree of resolvability of an institution should inform the level of G-SIFI surcharge that applies to a particular institution to provide an incentive to pursue resolvability, i.e. by supervisors evaluating an institution's Resolution Plan.

We do not think that impediments to resolvability beyond an institution's power to control should be used as a justification for ordering institutions to change their business or legal structures or practices, or be factored into the resolvability assessment for purposes of the G-SIFI surcharge, unless they are also beyond the power of national supervisors and resolution authorities to control. Instead, such impediments should ordinarily be addressed in a timely way by national supervisors and resolution authorities. Authorities should give banks advance notice and allow for sufficient time for consultation and implementation regarding possible measures for improving resolvability.

Measures to Improve Resolvability

We agree with the efforts to identify in advance and address those operational complexities that can create practical obstacles to resolution, but we urge that implementation take into account going concern priorities such as maximising value for shareholders. However, we respectfully request that measures to improve resolvability (Annex 1, paragraph 11.11) be reasonable, and should not result in a conflict between managing for failure at the expense of managing for success.

In particular, Recovery and Resolution Plans or other preventative measures should not be used for supervisory intervention in the structure or operation of healthy financial institutions without restructuring or resolution having become necessary. These measures must be a very last resort when orderly resolution seems otherwise impossible. This decision should take place in close dialogue with the institution in a Pillar II context in order to be sure that resolvability obstacles could not be overcome by other means. Regarding proposed measures for improving resolvability, supervisors should give sufficient notice to allow time for comprehensive consultation and opportunities for the firm to implement improvements.

Also, there should be no unduly burdensome restrictions on intra-group guarantees (or cross-default provisions). Intra-group guarantees (or cross-default provisions) are a prudentially recognised risk management tool within those banking groups that voluntarily decide to rely on them. Any restrictions, which ultimately constitute interference in contractual autonomy, could create considerable risks – e.g. significantly higher default risk – for the counterparty/group member of the distressed institution and make adjustment of the entire risk management policy necessary. We do not agree with the assessment in Annex 6, Section 3 that the existence of intra-group guarantees makes it more difficult to transfer positions due to the necessary client consent. Client consent is anyway necessary (or not necessary) according to the applicable law. The existence, or lack of existence, of the guarantee does not change this situation, nor the overall likelihood of failure. Likewise, we do not agree either with the FSB statement that the existence of intra-group guarantees necessarily has a contagion effect in a group. Even in resolution, intra-group guarantees do not cause problems if they are adequately documented. The decision to use intra-group support has to remain a strategic choice of the banking group.

We agree with the FSB draft that, as a rule, ordinary intra-group operations (i.e. provision of loans, guarantees, collaterals) should be executed on an arm's length basis. Whether intra-group guarantees increase or decrease the likelihood of failure will depend significantly on the particular model of the entity in question. The provision of intra-group financial support should remain a voluntary management decision of the entities concerned, since it depends crucially on the legal structure and business model of the group. It is the responsibility of the authorities to assess the resolvability implications of these business models.

Confidentiality and Transparency

There is a need for delicate balance between transparent and acceptable legislation for investors while maintaining necessary confidentiality especially for some components such as Recovery and Resolution Plans.

Specifically, we are concerned with the recommendation that the institution-specific cross-border cooperation agreements, even in their broad structures, be made public (Annex 1, paragraph 9.2). Our view is that the Recovery and Resolution Plans should be kept confidential. We are concerned that, as this is likely to be a process that will develop in discussions over time, any public statement about the cooperation agreements will be misleading as to the existence and extent of any gaps in resolvability.

Moreover, we believe that the Recovery and Resolution Plans themselves should be highly confidential supervisory information, and that no attempt should be made to make public even a portion of the Plan.

Ranking of Claims

The framework should ensure equal treatment of creditors across home and host countries and maintain financial stability in all countries concerned. We agree with the comment that differences in ranking of claims across jurisdictions will affect the willingness of national authorities to cooperate and achieve coordinated cross-border solutions (Annex 7, paragraph 11). Therefore, we suggest that the issues raised in this note be carefully studied and concrete recommendations in this area be considered as part of the cross-border resolution review.

There is ambiguity in the discussion as to whether all deposits would be given favoured treatment in a bank resolution, or whether priority or special treatment would apply only to insured deposits. This may be a serious issue for purposes of recovery and resolution planning; for market analysis of exposures faced by holders of other forms of junior and even senior unsecured debt; and for market discipline, as the FSB discussion note recognises.

Gathering more information via an impact assessment would presumably be useful to the FSB and the industry in consideration of the issues of depositor preference.

Temporary Stay on Netting

Netting arrangements are an essential instrument for effective risk mitigation. A suspension of the close-out netting mechanism should therefore only be considered subject to an impact assessment. If implemented, a suspension of close-out netting mechanism should only occur once resolution has been triggered and the supervisor has deemed a temporary stay as essential for the resolution process. Further, the mechanism should be subject to strict time limitations and only in connection with the transfer of assets and liabilities as part of a resolution measure as well as safeguards preventing the separation of assets, rights and liabilities covered by a netting arrangement. Further, a counterparty should still be allowed to closeout upon other events of default (other than a default triggered by the transfer of assets and liabilities as part of a resolution measure). In the interest of legal certainty, the provision of any exemptions to these safeguards should not be considered. Also, adequate assurance of payment should be provided.

Finally, efforts on the statutory level need not only be internationally coordinated, but also need to be tackled on a contractual level by the industry bodies that set out the international standards (master agreements). Regulators should therefore seek cooperation with those standard setters.

Interconnectedness

As a final point, we encourage the FSB to submit proposals regarding the introduction of an international large exposures regime, as requested by the G-20 Leaders in their Summit in Seoul. The underlying idea is to use the ongoing supervision tools as crisis-prevention tools; therefore any proposal that is able to reduce excessive risks-taking, incentivises the adoption of traditional banking business models and creates robust core financial market infrastructure to reduce contagion risk from individual failures should be welcomed.

Yours sincerely,

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