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FSB Consultation Paper

Credit Suisse Response to the FSB's Consultative Document, Recovery and Resolution Planning: Making the Key Attributes Requirements Operational

Credit Suisse Consolidated answers

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1) Introduction

Credit Suisse welcomes the opportunity to comment on the FSB consultation draft "Making the Key Attributes Requirements Operational", launched on November 2, 2012.

We agree fully with the goal of improving the international standards for Recovery and Resolution Planning which are essential for enhancing responsiveness in crisis, and ensuring resolvability if necessary. Credit Suisse therefore generally supports the alignment of recovery and resolution practices as well as jurisdiction specific institutional frameworks with the *"Key Attributes"* as the international standard for resolution regimes. We also welcome the recommendation that a greater consistency in the implementation of the *"Key Attributes"* is extended beyond the recovery and resolution planning for financial institutions defined as G-SIFI by the FSB, but to other financial institutions which have a potentially systemic impact.

Before turning to detailed answers and comments to the questions raised in the consultative document, we would like to emphasize a few key concerns upfront (according the annexes in the consultation document):

- Recovery Triggers and Stress Scenarios: Recovery triggers should be "soft", i.e. they should trigger a predetermined escalation and information process up to senior management. They should avoid triggering automatic, compulsory recovery actions.

- Developing Resolution Strategies and Operational Resolution Plans. Two aspects are essential:

  - Firstly, these strategies and plans need to be visible to investors. We believe that a Preferred Resolution Strategy – also sometimes called a "Presumptive Path[1]" - that sets out the most likely outcomes and procedures under some baseline assumptions is helpful to simplify an otherwise complex process, and clarify actions. We understand and acknowledge the importance of regulatory flexibility to adapt to unforeseen circumstances, but still believe that a baseline strategy can be effective in a large portion of scenarios. We believe that public disclosure of the essential elements of the presumptive path, at an appropriate and coordinated time, will help investors understand the risk inherent in their commitments. We also believe communication can improve the reliability of legal, political and cross border procedures and ensure that any difficulties are addressed prior to actual invocation.

  - Secondly, the resolution authorities should make a clear commitment to maximize creditor value. The commitment should ideally be framed as a hard coded requirement in order to avoid uncertainty over the pursuit and allocation of overall firms surplus value. This requirement must be predicated on no taxpayer losses, and the maintenance of systemic stability. But once these threshold conditions are reached, the authorities should have a duty to maximize outcomes for the investors who are funding the new regime. (We believe loss minimization will also help support the goal of stability, and may also provide an useful guidepost to supervisors who are evaluating different options in a crisis situation.)

- Identification of Critical Functions and Critical Shared Services: The assessment of critical functions and critical shared services needs to be based on a set of quantitative criteria.

Overall, Credit Suisse supports the general guidance set out in the document and considers it helpful and supportive.

[1] "Presumptive Path" is an emerging term for a baseline Preferred Resolution Strategy that also incorporates certain elements of the Operational Resolution Plan. It would include the critical elements that a reasonable external investor and home country supervisors would need to know in a base case resolution event. Some have mischaracterized this term as suggesting an inflexible, fully predetermined or contractual requirements that would deny supervisors sufficient flexibility in crisis. We reject extreme forms of this approach, but believe that a strong degree of predictability and transparency is essential for a robust resolution regime. Indeed we believe that part of the reason the financial system became so paralyzed in the 2008-9 crisis was not just the losses being recognized at that time, but the deep uncertainty about the system and confusion over what rules would apply.

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2) Recovery Triggers and Stress Scenarios (Annex 1)

1 *Does Annex 1 appropriately identify key emerging practices regarding recovery triggers and stress scenarios? What additional triggers of an institution-specific or general nature may be useful?*
Yes, we agree with these key emerging practices regarding recovery triggers and stress scenarios. For liquidity a recovery trigger based on NSFR and/or LCR (or similar liquidity measure) may be useful. It would be important to avoid setting the triggers close to normal ratios; instead triggers should be based on severe deviations from normal ratios (otherwise, these ratios lose their ability to protect a firm, and become "concrete" requirements not "cushions" that protect a firm through a crisis).

2 *Are there certain quantitative recovery triggers that are likely to be more effective than others across different types of financial institutions?*
In our view it is most important that the set of recovery triggers is well-balanced, including forward as well as retrospective triggers.

3 *What kind of qualitative recovery triggers are likely to be most helpful to decision makers within the banking group?*
No feedback.

4 *How can financial institutions achieve the goal of early and effective internal triggers, while avoiding negative market reaction to recovery actions taken?*
It is essential that triggers are viewed as 'soft' triggers, i.e. trigger breaches lead to predetermined escalation and information process up to senior management level within the firm. Recovery triggers should not lead to automatic, compulsory reactions as this may jeopardize flexibility to develop a discretionary response in accordance with the specifics of the situation and is counter- productive in a stress scenario. We also agree that this can also help avoid awkward situations where an ill-timed public disclosure might be forced by the existence of hard triggers, which could exacerbate distress.

5 *Are there certain triggers that are more suitable as early warning indicators for pre-emptive recovery actions versus trigger events that are more suitable for particular recovery actions?*
To keep flexibility and to ensure that a future, uncertain situation can be addressed in the most efficient manner, there should be no pre-defined recovery actions, but rather a broad menu of possible recovery options.

6 *Are there any other issues in relation to the implementation of the Key Attributes requirements for recovery planning that it would be helpful for the FSB to clarify in further guidance?*
No feedback.

3) Developing Resolution Strategies and Operational Resolution Plans

8 *Does Annex 2 adequately capture the key elements of a resolution strategy and operational resolution plan? If not, what aspects are missing or need to be changed?*

Annex 2 captures most of the key elements of a resolution, but we believe there is a need to go further.

We believe that authorities should commit clearly to maximizing creditor value, once the gating conditions of systemic stability and no taxpayer support are achieved. While the principle of No Creditor Worse Off can provide an important safeguard, in many cases it is a weak quantitative requirement and there can be wide uncertainty over the pursuit and allocation of overall firm surplus value. We believe it would be useful to make a clear commitment - or even better, a hard coded requirement - for resolution authorities to maximize creditor value for the entire group and not only parts of it.

It is also important to develop a "presumptive path" to provide guidance to firms and supervisors. The RRP process should be re-focused on the elements most important to executing the Presumptive Path – the most likely baseline approach to a successful resolution. Current RRP requirements often have an implicit bias towards a breakup of a firm, and can produce results that are incompatible with a constructive Presumptive Path.

Paragraph 4.14 states that parts of the resolution strategy would have to be communicated to external parties "during the early stages of resolution." We believe that the CMG, in consultation with the institution in question, should develop a presumptive path based on the Operational Resolution Strategy and disclose it in the normal course of business i.e. before the institution has entered resolution. Whilst due care must be taken to ensure that the presumptive path would not legally bind resolution authorities and deny then the flexibility to react to unforeseen events, there are manifold benefits to controlled ex ante transparency, including:

i. increasing market stability via a concrete procedures showing resolvability;
ii. Providing broad economic and political clarity that TBTF has been ended in a credible way.
iii. providing the clarity necessary on bank resolution mechanics to enable bank investors to make risk aware decisions and accurately price bank funding instruments (and reduce the risk of runs);
iv. facilitating the removal of obstacles to resolvability - ensuring the Presumptive Path is kept clear.
v. improving the market's ability to exert influence on a bank in pre-resolution.
vi. improving home-host cooperation by demonstrating how a privately funded resolution should work without producing government support requirements in host jurisdictions, and what expectations are on various resolution parties in the official sector

9 *What are potential obstacles to the effective implementation of either the 'multiple point of entry' (MPE) or 'single point of entry' (SPE) approaches that could arise from national legal frameworks (e.g., insolvency law)? How could they be addressed?*

Potential obstacles are a) cross border enforceability of actions which affect creditors of foreign branches, b) legal challenges to resolution actions which might affect speed and finality / certainty of outcome, c) insufficient cross-border cooperation among regulators, d) effective stay of termination and close out rights under contractual documentation and e) lack of liquidity support during resolution.

10 *What are the implications of the MPE and SPE approaches for the way financial institutions are structured, and what are the likely benefits and costs of any consequential changes in structure?*

Both approaches have their merits for certain organizational structures. Centrally organized and managed institutions typically benefit from a SPE approach, whereas fully subsidiarised structures might be better

resolved using a MPE strategy. The choice of SPE or MPE should not drive the bank structure, but rather be agreed in line with the banks legal entity structure.

11 *Does the Guidance adequately draw out the key commonalities and differences between the MPE and SPE approaches to resolution?*

Yes, however further clarity and a stronger mandate should be given to regulators to preserve and maximize creditor value during resolution.

12 *Does the Guidance adequately accommodate the needs and perspectives of host authorities that are not members of the CMGs for G-SIFIs, especially in those jurisdictions where a G-SIFI may be systemic?*

The COAGs should be disclosed to all host authorities that are not members of the CMG. They have a genuine interest that resolution is approached on an entire group basis and coordinated among the main regulators which are represented in the CMG.

13 *Are there any additional issues in relation to the development of resolution strategies and plans that it would be helpful for the FSB to clarify in further guidance?*

One element that is not discussed sufficiently in Annex 2 is the allocation of the value waterfall to be allocated to different classes of investors. This can be a complex topic, with considerations of legal entity structure, severity, and uncertainty of valuation. Regardless of complexity, we believe that the issue needs to be addressed if we are to have a credible and fair system for investors.

It is important to acknowledge that valuations are likely to be uncertain in some markets if a major SiFi is at the point of failure. In light of this, we believe that a system of relative priority is likely to produce more stable results than a system of absolute priority (defined here as a "hard requirement" to protect the most senior creditors at all costs). Junior investors should, to the degree practical, be wiped out if they have no plausible legitimate claim on book value, but this may be difficult to assess in the midst of a market meltdown. It may be better to give warrants in such cases, to provide a more balanced outcome in the presence of uncertainty. In addition, the needs of recapitalization are different than the needs of liquidation, and should respect the capital contribution of various classes.[2] The capital element should therefore be based on a well – formulated system of relative priority.

[2] For example, consider a case where sudden losses depleted old equity holders to near zero, and forced resolution. Further, assume that the new capital for resolution was created via $26bn of coco conversion plus another $4bn of subordinated debt conversion, in order to achieve the new target capitalization. In a system of strict priority, the sub debt holders would receive all the new equity shares, potentially achieving a dramatic windfall gain. The coco holders – despite providing most of the fresh equity – would lose everything. Such cliff effects are not helpful to the market place and can put difficult pressures on resolution authorities. We believe that junior investors (e.g. coco investors) should receive a reasonable share allocation in proportion to their equity contribution, and not be wiped out to provide a windfall to a more senior class. The principles of such a relative priority system need to be set out, and should be disclosed in advance.

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4) Identification of Critical Functions and Critical Shared Services

14 Is the two-part definition of 'critical' and the distinction between 'critical functions' and 'critical shared services' a useful taxonomy?

Yes, we regard the definition as a useful one.

15 Is the framework for determining 'critical functions' appropriate? If not, what aspects are missing or need to be changed?

Quantitative aspects are missing which would help to assess the critical functions and critical shared services. Criteria for centrally cleared or exchange traded functions under Substitutability would be helpful.

16 Do the five broad categories of activities outlined in the Appendix - that is, deposit taking, lending, payments, clearing and settlement, wholesale activities and capital market activities - cover all relevant and potentially critical G-SIFI activities? What additional categories of activities should be added?

As COs we would add safekeeping and related Services (custody services).

17 Is the framework flexible enough to cover the different types of business undertaken by G-SIFIs?

Yes, the framework is flexible enough.

18 Is the framework flexible enough to take account of the external environment in which failure is occurring, for example, an idiosyncratic event or in the context of more severe distress in the financial system?

We are not sure that environmental factors are relevant. The definition of a critical function or critical shared service will always need to follow the worst case as it is not possible to add new critical functions or critical shared services at short notice.

19 Is the definition and framework for determining 'critical shared services' appropriate? If not, what aspects are missing or need to be changed?

The text refers to a dependency of functions rather than a function. Is it intended that a shared service could only be critical if multiple functions have a dependency? We would view any shared service function that supports a critical function as critical.

20 Are there any other issues in relation to the identification of critical functions and critical shared services that it would be helpful for the FSB to clarify in further guidance?

The assessment of critical functions and critical shared services needs to be based on a set of quantitative criteria. A materiality threshold would be useful. Additionally it would be helpful to have standards governing the level of description or service quality which might differ in resolution. Service quality would need to be defined and agreed, as it might differ from a BAU service quality.

We would be interested in clarification on quantitative thresholds. Also weighting of different criteria may potentially be helpful (based on impact to the financial system from previous experiences and importance to the regulators).