SANTANDER RESPONSE TO FSB CONSULTATIVE REPORT ON RECOVERY AND RESOLUTION PLANNING

Santander welcomes the opportunity to constructively comment on the FSB's Consultative Report, *Recovery and Resolution Planning*: *Making the* Key Attributes *Requirements Operational*, published on November 2, 2012.

Santander strongly supports the FSB's Consultative Report in the establishment of a harmonized framework of standards for cross-border resolution and its guidance to attain a greater degree of consistency in the implementation of the Key Attributes.

GENERAL COMMENTS

The FSB Consultative Report offers a comprehensive and well-balanced view on general guidelines that cover three important themes: *Recovery Triggers and Stress Scenarios*; *Developing Resolution Strategies and Operational Resolution Plans*; *Identification of Critical Functions and Critical Shared Services*. While the report does address these three in an extensive and sensible manner, broadly viewed witin the prism of a preparatory and preventive phase, it is necessary to underline the need **to develop similar guidelines for the remaining *Attributes* that would constitute an effective resolution regime.**

For instance, on **Crisis Management Groups (CMGs)**, **Santander** would like to highlight the necessity of advancing in the establishment of harmonized governance protocols covering decision-making processes and the adoption of actions by home and host authorities. These governance protocols should ensure effective coordination between members of a CMG and provide for swift dispute settlement mechanisms. They should also be sufficiently comprehensive to cover coordination between different CMGs on the basis of the systemic implications that the resolution of a group could entail.

Along these lines, governance protocols should strike the right balance between legitimacy (i.e. through the proper involvement of all members in strategic decision-making) and operativeness (i.e. through adequate delegation on executive committees). Similarly, governance protocols should ensure that confidentiality requisites uphold, regardless of the circumstances.

Equally within the scope of content, although the report acknowledges that firm-specific **Cross-Border Cooperation Agreements (COAGs)** are a critical element for ensuring viable cross-border resolution, more clarity is needed on how these agreements will be effective in the short term in light of temporary asymmetrical implementation of the *Key Attributes* across jurisdictions, and the absence of clear binding commitments for cooperation by home and host authorities. In the medium term it is vital to ensure a consistent implementation of the Key Atrributtes through in-depth peer reviews.

As a final general comment, **we also strongly sustain that if a G-SIFI is satisfactorily progressing in the implementation of its resolvability, this should be properly recognized when assessing the need for a systemic risk capital surcharge.**

SPECIFIC COMMENTS ON GUIDELINES

Moving forward on the specific content of the report,

Annex 1 focuses on the design and nature of recovery triggers and stress scenarios.

Santander is a strong supporter of recovery and resolution planning, and in fact was one of the first to hand in a recovery plan and resolution information to authorities.

While the Guidelines provide a comprehensive view on the range of quantity and quality triggers, **more emphasis is needed on the governing decision processes that lead an entity to respond to a trigger rather than on the automatism "trigger-re*action*."** The focus should not narrowly hinge on these two, instead it should holistically gravitate on the necessity of clear, straightforward entity governance protocols that lay down the escalation processes of decision-making by management.

Triggers convey cliff-edge situations ultimately occurring when a threshold is breached, warranting in those cases an immediate action (implementation of specific recovery measures envisaged in the Recovery Plan). However, prior to breaching an indicator threshold, an entity's management should adopt decisions aligned with a "*business as usual*" governance protocol to counter the first signs of deterioration of an indicator. Therefore, the focus of attention should shift from what decisions should be made, to providing some general guidance on the decision-making processes (though without dictating specific decisions).

Escalation and decision-making must be interpreted as a continuum, instead of as a discrete process. The breach of a trigger should not entail an authomatic reaction but a thorough review of the pre-emptive measures taken so far and why they have proven ineffective. As a result, and if justified, new measures should be implemented to overcome any inadequacies or insufficiencies.

A balance should be attained between proper analysis and the timing of actions. Triggers provide the catalyst to avoid action-paralysis by management, while envisaging the process as a continuum can avoid sudden reactions.

Similarly, as an integral part of these processes, **there should be fluid, ongoing communication with supervisors** so that they are updated on the developments taking place within the entity and well informed *in advance* of when a trigger would effectively be breached resulting in immediate action.

In this sense, it is worthwhile clarifying the interrelation between recovery actions adopted by institutions and early intervention tools implemented by supervisors. Both the institution's management and the supervisors should be actively engaged when the first signs of significant deterioration emerge. However, the balance of the engagement should gradually tilt as further deterioration occurs and the resolution point becomes visible. At the beginning of the recovery process, the institution's management should adopt the necessary decisions while the supervisor is actively informed, and refrains from imposing any measure. At the end of the process, the roles should shift and the supervisor will have the upper hand. This change in roles should not occur overnight, it should happen smoothly as part of the continuum already described. This logic applies not just to supervisory authorities, but also to resolution authorities given the involvement the latter have on the definition of resolution plans and the role of central banks as lenders of last resort (i.e. in the provision of emergency liquidity).

On stress scenarios, the report states that "*the general emerging practice, particularly for G-SIFIs, is for firms to be required to develop their own stress scenarios*" (as well as their own parameters of stress). Nonetheless, **Santander sustains that in order to ensure a minimum level of consistency and baseline continuity within national jurisdictions there needs to be a set of high-level principles and harmonization criteria on the setting of scenarios** (i.e. established by EBA in the European Union). In this respect, the report does not indicate whether stress scenarios would be applied consistently across jurisdictions.

In particular, minimum harmonization is sought on the parameters that determine the likelihood of occurrence of scenarios and on the definition of severe stress.

Finally, regarding reverse stress testing, the report correctly points out that "*reverse stress tests should only be seen as a starting point for developing scenarios to test the effectiveness of a firm's menu of recovery options*." In this respect, reverse stress testing should be viewed as complementary to normal stress testing but only as a means to analyze the impact of specific risks.

Annex 2 provides guidelines on Developing Resolution Strategies and Operational Resolution Plans.

Santander acknowledges the existence of a natural tension between resolution authority discretion and predictability demanded by investors in the development and implementation of resolution strategies. Striving to strike the right balance between the two is one of the most challenging aspects of resolution configuration.

The report states that "*resolution strategies and plans set out the approach to resolution that is likely to be adopted should the need arise, but they do not prescribe the course of action that the authorities will pursue*."

We agree that the resolution authority should define ex ante the resolution strategy, and the potential resolution paths compatible with this avenue, in order to identify in advance the conditions that must be met for each path to be viable. An indispensable prerequisite for any path to be viable (and thus credible) is that the resolution authorities conduct a thorough assessment to identify the potential obstacles for an orderly resolution that could emerge in each path and work toghether to remove them in advance.

While it is understood that the exact procedures in resolution cannot be necessarily prescribed in advance, the basic components that are the building blocks of those procedures, and the central assumptions that would give way to their activation, should be adequately defined.

Santander acknowledges that a presumptive path may be useful in dissipating ex ante investor uncertainty, though the key focus should be on harmonizing the "landmarks" of that path. In this regard, **in any given resolution strategy there should be concise written definitions (amongst others) of when an entity enters into resolution, of the resolution tools that each resolution authority (home and hosts) could apply, and of coordination between home and host authorities**.

In pursuit of greater conciseness on each of the aforementioned points, the **resolution trigger should kick-in at the point of non-viability (PONV)**, though it is evident that a certain degree of flexibility is warranted depending on the idiosyncratic elements of deterioration for each entity. The trigger should be activated after all alternatives have been exhausted to keep the bank in going concern. Likewise, it should not be automatic (though objective as possible) and harmonized internationally on its determinants.

Concerning resolution tools, if a resolution authority chooses to apply bail-in, provided this tool was envisaged ex ante as part of the available toolkit, all of its elements should be well-defined and disclosed to the market: general principles, scope, creditor hierarchy, cases that would result in exceptions to the general principles with recognized rights of due appeal and judiciary review for creditors, suspension of termination rights, stays,..etc.

In this respect, **more conceptual precision is requested on bail-inable liabilities in order to strike the right balance between market demand and the solicited discretion by authorities**. The FSB's approach in drawing a distinction between "*capital liabilities*" (those that would be subject to bail-in) and "*operational liabilities*" (those excluded given their systemic implications) is clearly correct and the way forward.

However, greater conciseness is requested on the basis that specific categories of "*operational liabilities*," (i.e. sight deposits) which although excluded directly from bail-in, could indirectly share a part of the burden if the deposit guarantee

scheme to which an institution is affiliated is bound to absorb losses up to the covered amount of sight deposits. This clarification has crucial implications not just for deposit-rich banks, which would experience its scope of bail-inable debt shrink considerably if sight deposits were excluded, but also for the stability of the system as a whole which would be promoting a "biased, enhanced taste" for sight deposits relative to term deposits, potentially unleasing anomalies in banks' funding structures.

By way of this precision, the broader the scope of bail-inable debt, the lesser the need for a percentage minimum requirement on a specific category of debt instruments which would lead to an increased risk premium in return and which would give rise to significant funding costs for entities.

The last important aspect is that the strategy should be agreed between the different resolution authorities and these should strongly commit with the terms of the agreement. In the Multiple Point Entry (MPE) strategy, these commitments should refer to the adequate and timely exchange of information and close coordination lead by the home supervisor. In the Single Point of Entry (SPE) strategy, the home should (among others) commit to bailing-out the operational subsidiaries in case of resolution, and the host authorities should commit to not pursue a national resolution strategy but to cede the responsibility of the resolution process to the home authority and deploy any action in its jurisdiction decided by this latter under the resolution process. Moreover, as the final say with respect to stakeholder rights is not on the resolution authorities but on the judicial authorities, an agreement between home and host judicial authorities is all the more necessary for this strategy to be effective. Thus, if the host authorities are not willing to accept the decisions undertaken by the home resolution authority (i.e due to national sovereignty issues), the SPE strategy will not be feasible.

Regardless of the strategy chosen, there will have to be a clear indication of how the judicial authorities can influence the outcome of a resolution strategy and to what extent.

Santander identifies the Multiple Point of Entry (MPE) resolution approach as the most suitable for businesses organized in distinct subsidiaries, autonomous in capital and liquidity but subject to common corporate policies.

The prerrequisites envisaged in the paper for each strategy are in general sensible. However, with respect the MPE strategy we consider the following one is too prescriptive: "*the use of intra-group guarantees is similarly limited (or their application can be suspended by local law upon application of the resolution powers.*" (pg.18).

Santander supports a model that allows the institution's management to decide on case-by-case basis to provide support to a troubled unit if it does not put the whole group at risk and complies with all the existing prudential regulation (i.e. capital consumption and large exposures). This approach provides the group with valuable flexibility, and the financial system

where the group operates, with the necessary certainty that a problem in one of the parts of the group will not put the rest of the group in jeopardy. This framework respects the legal status of each unit, allocates responsibilities accordingly and allows market discipline to be exerted. The home resolution authority, and not the hosts, should be entitled to block this support if any of the of the aforementioned prerequisites are not met at the time when the support is to be granted.

Finally, **Santander** considers vital for the success of any resolution strategy to draw a comprehensive and credible post-resolution plan that lays down the business reorganization scheme envisaged as well as the constraints under which the authorities will operate (i.e. compliance of state aid rules for temporary partially or wholly publicly owned bridge banks and asset management vehicles).

Annex 3 provides guidelines on the Identification of Critical Functions and Critical Shared Services.

Santander sustains that the preservation of critical functions is one of the key goals of resolution, and it endorses the FSB's efforts in providing a common ground for CMGs to carry out these assessments.

An institution should prove that its critical functions could be preserved in resolution. However, this should not equate to proving how these functions should be automatically separated in resolution if the continuity of these functions can be guaranteed without separation.

On the identification of critical shared services, and in relation to the previous point, **Santander would like to highlight that its model of shared services centers, consisting of autonomous, separate legal entities within the Group, already exhibits a large degree of affinity with the proposed FSB framework**. In this regard, this model avoids the drawbacks linked to the provision of services by internal units (which could be severely crippled if the bank entered in resolution) and those linked to the provision of services by external providers (which could entail significant renegotiating costs in case of resolution). Thus, a shared services centers model contributes decisively to ensuring the continuity of critical functions without separation.

Finally, we would like to underscore that it is vital for banks to develop their own model within the categories proposed by the FSB, to avoid the pitfalls of one-size-fits-all formulas. Insofar as entities comply with the requirements established, there should be freedom to choose the most adequate path within each model.

Conclusion

Santander appreciates the opportunity to constructively continue to comment on the FSB's efforts in implementing the *Key Attributes*. The points raised in our response highlight, some of our major concerns at present. **Santander** aims to continue to work with the official sector and the rest of the industry in building a more robust, predictable and transparent international recovery and resolution framework.