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Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
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07 December 2012

Re: Comments on the FSB consultation paper "Recovery and Resolution Planning – Making the Key Attributes Requirements Operational"

Dear Sir or Madam,

UBS would like to thank the Financial Stability Board for the opportunity to comment on the consultation document on "Recovery and Resolution Planning – Making the Key Attributes Requirements Operational".

UBS appreciates the FSB's effort to encourage the alignment of recovery and resolution practices and national institutional frameworks with the Key Attributes as we believe that a greater degree of consistency and common standards is essential for a successful cross-border resolution.

Please find attached our response to the draft guidance and specific questions outlined in the consultation paper. We would be happy to discuss with you in further detail any comments you may have. Please do not hesitate to contact Thomas Pohl, Head Executive and International Affairs, UBS Group Governmental Affairs (thomas.pohl@ubs.com), on +41 44 234 7670.

Yours sincerely,

UBS AG

Steve Hottiger
Head Group Governmental Affairs

Thomas Bishof
Head Legislative and Regulatory Initiatives

UBS response to the FSB consultation on "Recovery and Resolution Planning – Making the Key Attributes Requirements Operational"

Introduction / General Comments

- UBS welcomes the efforts of the FSB to encourage the alignment of recovery and resolution practices and national institutional frameworks with the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions.
- UBS advocates the introduction of a common set of criteria with respect to recovery and resolution triggers. UBS further agrees with the assessment regarding the importance of qualitative triggers, and supports the view that triggers should not be linked to specific compulsory actions but rather to a clear and predetermined escalation and information process to senior management within the firm. Management should have the flexibility to determine a response in accordance with the specifics of the situation and it should be stressed that automatic and compulsory recovery responses to breached triggers are counterproductive.
- UBS agrees that there is a need for a greater degree of consistency and for a common framework of standards regarding cross-border resolution. In general, UBS welcomes the approach of providing common processes and definitions in order to identify critical functions. However, the determination **of critical functions will need to be linked to a jurisdiction and must not be global**. Functions that are deemed critical for a specific economy and / or financial system will need to be determined by the respective regulator.
- UBS is concerned that **the description of the resolution strategies (SPE and MPE) could be viewed as a departure from the aim of international cooperation** in resolution measures, which seems inconsistent with the requirements for cooperation under the FSB Key Attributes.
- Lastly, UBS believes that it will be **challenging to develop a combined SPE and MPE approach** given the requirement that losses incurred at the subsidiary level need to be assumed by the holding company. In particular, the fact that losses flow automatically to the holding company would undermine the partial MPE approach for the holding company.

Feedback / comments on specific questions

Annex 1 - Guidance on Recovery Triggers and Stress Scenarios

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?*

- We believe that the number of recovery triggers must not be excessive to avoid dilution in monitoring of such triggers. In particular, a distinct number of generally recognized triggers covering liquidity / funding (e.g. Liquidity Coverage Ratio / Net Stable Funding Ratio), capital ratios and other select indicators (e.g. senior debt spread) should be aligned with the standard risk monitoring, which will also facilitate the positioning of the recovery plan as an integral part of the risk management framework and reporting. We would advise, however, against using macro economic data (e.g. GDP forecast, rise in public debt) as recovery plan triggers, as these are not a reflection of the institution specific health standing.
- With respect to recovery triggers we are concerned that there are currently no standards used by regulators and resolution authorities around the globe to assess a firm's status in a uniform and predictable way. We believe that it is essential for predictability and procedural clarity as outlined in the FSB Key Attributes that firms are assessed based on a common set of criteria with respect to recovery and resolution triggers. The main reasons from our view are:
  - It will allow market participants to correctly price securities issued by banks. This is of particular importance for securities subject to bail-in tools.
  - The increased predictability will have a positive effect to avoid sudden disruption in the market, should a firm move closer to the recovery and resolution triggers.
  - A harmonized trigger framework will help to avoid regulatory arbitrage.
- Accordingly, we suggest that the FSB should recognize the need for a harmonized regime in its general guidance on recovery and resolution triggers.
- In addition, we are not convinced that the range of triggers adequately reflects the quantitative capital and liquidity triggers used in practice. In particular, we do not understand how the trigger "rise in public debt" (other than potentially for state owned banks) can be constructed as a sensible trigger for individual banks. Hence we recommend providing additional guidance on the common capital and liquidity triggers.

2. *Are there certain quantitative recovery triggers that are likely to be more effective than others across different types of financial institutions?*

- We refer to our response to Q1 with respect to a harmonized regime of triggers. The phasing in of Basel III as a global standard from 2013 onwards provides an ideal opportunity to set a number of common capital and liquidity triggers across financial institutions. For example, CET1 ratio, leverage ratio, Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR). This will provide members of the crisis management groups with the ability to better understand an institution's trigger thresholds.
- Where such triggers are externally focused (e.g. share price, CDS spread, credit rating), they need to be defined in such a way that they clearly indicate a cause for concern for the firm and not a general industry correction (e.g. share price movement should be set in relation to the share price movement of a basket of peers).

3. *What kind of qualitative recovery triggers are likely to be most helpful to decision makers within the banking group?*

- Qualitative recovery triggers must be complementary to the quantitative recovery triggers by providing early warning signals. We believe that such quantitative triggers are institutions specific and thus refrain from suggesting generally applicable qualitative recovery triggers.

4. *How can financial institutions achieve the goal of early and effective internal triggers, while avoiding negative market reaction to recovery actions taken?*

- As part of regular risk management, firms should have early warning signals which, when breached, could trigger the initiation of preventive actions. These early warning indicators serve to monitor disruptions (minimum to severe) and ensure appropriate management attention and action before going in a recovery situation. The use of early warning signals will allow firms to respond to threats prior to them becoming so severe as to trigger a formal recovery response.
- With respect to recovery measures, senior management of firms and regulators need to ensure that communication is sufficiently forthcoming, factual, clear and transparent to avoid unwarranted reactions by market participants.

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?*

- Early warning indicators that are more forward looking are useful to provide management with sufficient time to take action before the severity of the crisis requires more drastic and immediate actions. However, for obvious reasons true forward looking indicators are difficult to find. It is clear, however, that triggers based on accounting metrics are by nature backward looking.

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 further requirements are to be defined as rule setting related to TBTF has already been excessive. It is now about implementation, including capital standards across the G20 states who have committed to do so.

Annex 2 - Guidance on Developing Resolution Strategies and Operational Resolution Plans

7. *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?*

- While we agree with many of the statements made with respect to resolution strategies, we are concerned about a number of issues outlined in the FSB paper:

  a) The FSB resolution strategy concept appears to be based on the assumption that cooperation between resolution authorities would not work. Under both the SPE and the MPE strategies the FSB assumes essentially no cooperation between resolution authorities. Under the SPE approach, the home resolution authority takes the relevant decisions and the FSB proposal has the consequence that host resolution authorities do not have to get involved as losses incurred at subsidiary level are assumed by the holding company. Under the MPE approach the FSB proposes that firms should not be allowed to hold material branches in host countries, therefore eliminating the need for cooperation of resolution authorities. We believe that the proposal can be viewed as a departure from the aim of international cooperation in resolution measures, which seems inconsistent with the requirements for cooperation under the FSB Key Attributes. It may also be an oversimplification of realities and we believe that it should be reconsidered before leading to specific recommendations. We believe that a departure from the aim of cooperation would not be in line with current resolution planning by banks, which rely on that concept.

b) We are not convinced that the SPE strategy necessarily requires that losses incurred at the subsidiary level are assumed by the holding company. While we agree that this may be the factual consequence in many cases, there are a number of instances where other solutions may be preferable. In essence, it should be noted that the proposal is a departure from the fundamental concept of limited liability of shareholders. As such, it needs to be carefully considered, including all its implications, before putting it forward as an FSB requirement. We take the view that further consideration should be given to the implication before any reference should be made to loss assumption in FSB guidelines. Rather, the existence of sufficient loss absorbing capital (which does in our view not necessarily need to be located at the holding company level to qualify as an SPE approach) should allow the firm/home resolution authorities to downstream necessary resources in all but extraordinary circumstances, where a different approach to resolution may be warranted in close cooperation between resolution authorities. We also believe that historic experience does not provide evidence for a perceived market failure in this respect to warrant intervention. To the contrary, history shows that banks do not lightly let subsidiaries fail, even if it jeopardizes their own survival.

c) In addition, we note that the FSB stresses that resolution strategies "do not prescribe the precise course of action that the authorities will pursue" (p. 14). The FSB recognizes that authorities rightfully want a sufficient amount of discretion when deciding how to deal with a specific crisis. We fear that an automatic loss assumption would largely prejudice the actions taken by authorities and would render the desired discretion meaningless.

d) As outlined in a) UBS does not agree that the MPE approach necessarily requires that the banking group only has non-material foreign branches. This statement assumes that the system of recognition of foreign resolution mechanisms and cooperation between regulators does not work, which seems inconsistent with the requirements for cooperation under the FSB Key Attributes.

In addition, there are some points where further clarification or policy choices would be helpful:

- Section 4.1: UBS acknowledges the need for a "presumptive path" as this would help in providing guidance and clarity on what the market could expect in a resolution. It would be helpful if the FSB would provide guidance on the type of information, which should be included in such a "presumptive path".
- Section 4.4: With regard to the SPE strategy it should be highlighted that the home resolution authority and host resolution authorities should not take any pre-emptive action without first having discussed it with other involved authorities. Otherwise a SPE strategy is not credible and such a primus inter pares approach would be valuable for an MPE strategy as well. In addition, as we have outlined in our response to Q1, the FSB should strive to develop a common understanding across jurisdictions of when a firm enters resolution. This is of paramount importance to avoid creating distortive incentives, to increase predictability and legal certainty and to avoid regulatory arbitrage.
- Approach to Financial Market Infrastructure: The operational resolution plan developed by the authorities should include an approach to ensuring that access to key FMI can be maintained. This will not just require the home resolution authority to consult with FMI during the development of the operational resolution plan or to have an information sharing approach similar to that with non CMG host authorities, but will require that bank resolution authorities have the legal power to ensure that banks in resolution maintain access to FMIs. In particular resolution authorities need to be in a position to prevent the termination of access rights (whether they are on a contractual or corporate basis such as membership rights), to ensure that no value is unnecessarily destroyed by virtue of loosing access to vital services. The fact that resolution authorities are involved should give FMIs sufficient confidence that their position is not jeopardised by continuing to deal with a bank in resolution. Maybe a case can be made for granting FMIs a preferential position in the creditor hierarchy with respect to obligations incurred during resolution.
- Temporary stays on termination and close out rights: It might be helpful for the FSB to highlight this issue and suggest that the industry helps to address it through standard industry documentation promulgated by ISDA and other trade bodies so that there is a corresponding private sector approach to the legislative power already given to the authorities.

8. *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?*

- Regulatory cooperation (i.e. either host regulators allowing home regulators the time to act in an SPE approach or coordination among all relevant authorities in a MPE approach) is the main challenge. An additional challenge is around the recognition of bail-in action where debt is issued under the law of a host jurisdiction but bail-in will be ordered by the home authority. Barring legislative changes or international agreements, the finalization of Cooperation Agreements among relevant authorities may provide some additional legal certainty by providing evidence of regulatory intent. Identification of specific classes of liabilities that are either within the scope of bail-in or are specifically excluded from bail-in also may help. There are a number of proposals for this and further harmonization of concepts would be useful.

9. *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?*

- SPE and MPE strategies should be capable of being implemented in just about any corporate form - it is more a matter of having clarity around the chosen strategy and then ensuring that documentation is as strong as it can be and the appropriate legal powers exist in each relevant jurisdiction and are exercised in a sensible fashion. This is up to the authorities to ensure.
- MPE would push the organisations to a structure consisting of more self-sufficient entities (subsidiarisation), which would have significant disadvantages (e.g. loss of diversification benefits, reversal of "internationalisation" benefits).

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

- The two approaches are fairly well distinguished and outlined. As an overarching principle, the FSB should avoid that its recommendations will result in requirements to submit multiple versions of resolution plans. It should be the overall aim to submit one basic set of information that is sufficient to allow regulators to think about different permutations of SPE and MPE strategies.

11. *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?*

- There should be some requirement for the home authority for any G-SIB to provide clear information to host authorities on the planned resolution strategy and the operational resolution plan. This should be intended to prevent the need for host authorities to make requirements for resolution planning on the branches or subsidiaries located in their jurisdiction. Home authorities should be encouraged by the FSB to keep the others informed.

12. *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?*

- The link between the particular resolution strategy being selected by the authorities and the information required of the firm could be stronger. Once a basic resolution strategy is determined by the relevant authorities then this should be used to determine the information requirements for any specific firm. Tailoring information needs to resolution strategies will make resolution planning more efficient and effective for both supervisors and firms.

Annex 3 - Guidance on Identification of Critical Functions and Critical Shared Services

13. Is the two-part definition of "critical" and the distinction between "critical functions" and "critical shared services" a useful taxonomy?

- The distinction is useful as there are different approaches in resolution planning for "critical functions", which provide critical services to the markets (outside view) and the critical shared services which are required to support these functions and allow continuation of services in resolution (internal view).

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

- The framework overall is appropriate and the criteria provided are helpful and give more guidance then what we have seen from some of the regulators so far. It is useful if regulators adopt a common methodology for determining / designating "critical functions" and that the current definitions are aligned with the FSB framework.
- From an UBS perspective it is always preferable to have a principle-based rather than a rule-based approach, as it leaves sufficient room for interpretation and judgement and allows flexibility to reflect company-specifics and the way in which the business is conducted (global vs. local). While the designation of a SIFI is based on its global systemic relevance (by its overall structure, size and impact on the markets), the criticality of a function needs to be determined in a local context. However, the provisioning of a full menu of potential functions and shared services to chose from as a starting point for analysis (in analogy to the US long list of critical operations) would be helpful and would over time achieve a common level of granularity to be applied throughout the plans of G-SIFIS.

15. 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?

- We refer to answers to question 14/16

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

- The framework is flexible enough so that G-SIFI have enough discretion to define the relevant aspects and to provide a meaningful set of information, which is tailored for the specific institution. The individual institution should always have the flexibility to add onto a predefined set of potential critical activities.

17. 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?

- Planning should be based on the assumption of an idiosyncratic event as this provides a realistic basis to analyze the credibility of the resolution planning. Depending on the severity of a presumed market crisis, results and scenarios are difficult to predict and it is questionable in how far useful information could be gained.
- However, substitutability is an important concept and in this regard, G-SIFIs could be asked in how far substitutability of a "critical function" would be impacted by a severe stress in the financial system.

18. *Is the definition and framework for determining "critical shared Services" appropriate? If not, what aspects are missing or need to be changed?*

- Whilst we understand the potential challenges outlined in chapter 3.3, the importance of goal-congruence and regulatory cooperation should also be mentioned and reflected. This has a huge impact on the way forward and in which way a future set-up would need to be structured (e.g. requirement for a specific legal entity structure).
- Regulators / industry bodies should play an important role with regards to ensuring ongoing service provisioning from FMIs in a resolution situation. It is essential to find industry-wide solutions with providers of market infrastructure as it is almost impossible to solve this issue on the level of a stand-along financial institution.

19. *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 level of analysis required for "critical functions" and "critical shared services" currently varies across jurisdictions. It would be helpful to define a common standard across jurisdictions to make resolution planning more efficient and allow for re-usage of information across jurisdictions and avoid too many local add-ons.