Deutsche Bank

1 December 2014

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Dear Sir / Madam,

Deutsche Bank response to Financial Stability Board consultation document on cross-border recognition of resolution action

Deutsche Bank strongly welcomes the Financial Stability Board's (FSB) consultation on how to ensure that cross-border resolution is effective. The FSB has already made major progress by putting cross-border recognition at the core of the *Key Attributes*, developing global guidance on key issues and monitoring progress on recovery and resolution plans.

While, ultimately, the most effective solution to achieve cross-border resolution would be an multi-lateral convention of some kind, we recognise that agreement could take years. In the absence of such a mechanism, we strongly welcome and support the FSB's renewed focus on what can be done to achieve cross-border recognition. Hopefully, this will also lay the groundwork for formal cross-border agreements to be developed in future, such as those envisaged in the EU Bank Recovery and Resolution Directive with third countries.

The recent FSB progress report on resolution planning of global systemically important financial institutions (G-SIFIs) highlighted three areas presenting particular barriers to resolvability: the legal and regulatory framework; institutions' own financial, legal and operational structures; and cross-border cooperation and coordination. As two out of the three depend on actions by regulators themselves, it is critical that the FSB does more to drive forward progress - particularly in the final area of cooperation and coordination.

This consultation comes as resolution authorities start to consider what actions to require from institutions to address barriers to resolution. We do not believe institutions should be required to make intrusive changes to business model and/or structure where barriers arise from a lack of implementation of the Key Attributes or insufficient efforts to reach cross-border agreement. Furthermore, while firms can do some things - including around contractual arrangements - to help achieve cross-border recognition, these are no substitute for statutory and regulatory support which would materially facilitate continuity of critical functions and effectiveness of resolution tools.

Our detailed responses to the questions are below and are based on our experience of resolution planning. Please do not hesitate to let us know if you have any questions about any of these points, or if you would like to discuss any other related issues further.

Yours sincerely,

Daniel Trinder
Global Head of Regulatory Policy

Q1. Are the elements of cross-border recognition frameworks identified in the report appropriate? What additional elements, if any, should jurisdictions consider including in their legal frameworks?

We agree these are the important elements to cover, particularly 1-6, as they set out the minimum factors to address in a domestic legal framework for recognition of foreign resolution action. These will help provide predictability and some certainty for firms, investors and home authorities about the path that resolution will likely take.

We particularly welcome the recognition that differences between domestic and foreign law could give rise to inconsistencies, and potentially result in decision-making that would be detrimental to the effectiveness of cross-border resolution. The most important action that the FSB can take to address this is to ensure that the *Key Attributes* are fully implemented in every member country. We welcome the commitment in the recent progress report that the FSB intends to undertake further monitoring of national implementation, and urge the FSB to start reporting publicly against the assessment methodology as soon as possible. We would welcome a particular focus in these exercises on the areas identified by the FSB as where the least progress has been made: resolution powers including bail-in, imposing temporary stays on early termination rights, and cross-border cooperation to give effect to foreign resolution.

In the absence of full implementation, this “minimum list” of elements of cross-border recognition frameworks is very helpful and will go some way to address procedures at the point of resolution. However, it should do more to encourage ex-ante coordination to help provide more predictability between authorities, but also with firms. For example, many support measures around regulatory approvals to recognise transfer orders (licensing, change of control procedures, fit and proper persons tests) and operational continuity (intra-group service level agreements, financial market infrastructure memberships etc) can and should be planned for in advance.

In addition, the elements should do more to actively discourage host authorities from taking action which could undermine the overall group resolution strategy. In particular, this is important where there are powers to take action in relation to branch assets in insolvency - e.g. in Australia or India - which could undermine the effectiveness of a transfer order. At the very least, there should be consultation with home regulators before initiating such measures.

Similarly, resolution triggers may differ from jurisdiction to jurisdiction and may give rise to time inconsistencies - as one authority may act too early, or another too late. Where clarity on resolution triggers is lacking in the legal framework, national authorities should where possible provide some public guidance on their approach to resolution decisions. At a mininum, home and host authorities should discuss ex-ante the circumstances that in their view would give rise to resolution action. Likewise, where the local approach to identifying critical economic functions varies from FSB guidance or the home regulator approach, home and host authorities will need to discuss and agree how to address this ex-ante.

Two additional elements for cross-border recognition frameworks should therefore be considered to help encourage ex-ante cooperation and clarity on these points:

(i) **Information-sharing**, in line with the recent FSB guidance on national legal gateways and confidentiality regimes and, where appropriate, through participation in firm-specific cooperation agreements; and

(ii) **Encourage regulators to publicly outline their overall approach to resolution, including cross-border recognition.** We have seen positive examples of this from Swiss, US and UK authorities and such public high level “approach” documents can be very useful to increase predictability for firms and the wider market.

Finally, there are a few issues in the elements that we think should be further refined in final guidance:

- **Point 4**: needs to emphasise that equitable treatment should generally mean non-discrimination between creditors of a particular firm based on their nationality or the location of their claims which results in different recovery ratios. A comparison between treatment under foreign or domestic laws should only apply in specific circumstances, and will depend on the nature of the firm's establishment, the law of specific creditor claim(s) and the nature of domestic insolvency law. This is a key area where clarity from the FSB guidance is essential, to limit inconsistency.
- **Point 5**: the final guidance should also require national authorities to consider what recognition procedures or support measures can be agreed ex-ante, as outlined above. It should also be more specific about what is meant by "necessary speed". Some resolution actions require decisions to be taken in a weekend; others may take longer. It should be clarified which cannot be agreed ex-ante but are critical in a short timeframe.
- **Point 6**: in the same way that authorities and officials should have legal protections for actions taken in good faith, locally regulated bank staff should be entitled to the same legal protections where they take actions to give effect to resolution decisions taken by foreign resolution authorities, where recognised by domestic authorities.
- **Point 7**: there are several areas where this point could be clearer. First, it should specify that contractual approaches are only appropriate where there are policy inconsistencies, or as a short-term interim measure where statutory regimes are planned but are not yet in place, or where ex-ante coordination between authorities and firms themselves cannot provide sufficient legal certainty that resolution decisions will be effective. In addition, it should also be clear this would only apply to new contracts, as firms are unable to unilaterally change terms of existing contracts. Authorities should also ensure no competitive disadvantage is created - e.g. should apply to all firms subject to the resolution regime.

Q2. Do you agree that foreign resolution actions can be given effect in different ways, either through recognition procedures or by way of supportive measures taken by domestic authority under its domestic resolution regime? Do you agree with the report's analysis of these approaches?

We agree that foreign resolution actions can be given effect in different ways and that - in the absence of a cross-border convention on bank resolution - recognition procedures and support measures are the two main ways to achieve this. Contractual approaches are only appropriate where neither is possible or in place yet, and for issues critical for effectiveness of resolution.

However, the FSB should recognise that there is a "hierarchy" of effectiveness. In our view, the best mechanism for cross-border recognition would be a multi-lateral convention of some kind, although we recognise that agreement will take years. The "next best" solution is recognition procedures, which are the most effective bilateral measures for providing the legal certainty that is needed in resolution. At the same time, recognition will itself often rely upon a large degree of alignment between authorities and / or "equivalence" between resolution regimes. Only once the *Key Attributes* have been fully implemented, will it be possible to know which differences in regimes are the results of national policy decisions and which are due to a lack of progress in implementation. Currently, firms may be required to change business activities in some foreign jurisdictions to improve resolvability, without knowing what final resolution regimes will look like.

In the current absence of full alignment with the FSB *Key Attributes* to facilitate recognition, we believe that statutory support measures are the most effective "stopgap" solution, rather than contractual approaches. Necessary actions in key jurisdictions should be identified in crisis management groups (CMG) and, as needed, in extended CMGs which involve host authorities where the institution has a systemic presence. Depending on the resolution strategy and the nature of the supporting measure required, home and host authorities should engage with each other (and with firms themselves) to develop as far as possible ex-ante commitments as to who will undertake what actions, under what conditions, and when in resolution. This is particularly important for tools, such as transfer orders or bridge banks, which may trigger regulatory approval processes in host jurisdictions. As described in our answer to Q1 above, we strongly consider that this requires discussion on the circumstances for taking resolution action, as well as what tools authorities are likely to deploy and what concrete steps are needed to support their effectiveness. This discussion will also help to clarify what issues might need coordinated action from the host authority, or where just choosing not to take action would suffice to facilitate cross-border recognition.

Having said that, we agree that for particular resolution actions or scenarios, either recognition procedures or support measures may be preferable, and the annex provided by the FSB is very helpful in this regard. Other scenarios where we believe some illustrative guidance would be helpful are around (i) change of control procedures resulting from a transfer order - shareholder, licensing or fit and proper persons tests - and (ii) operational continuity, in particular where there are cross-entity services provided within the group or where it depends on continuity of a relationship with a financial market infrastructure not in the home authority jurisdiction.

Q3. Do you agree that achieving cross-border enforceability of (i) temporary restrictions or stays on early termination rights in financial contracts and (ii) 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity is a critical prerequisite for the effective implementation of resolution strategies for global systemically important financial institutions (G-SIFIs)? Is the effective cross-border implementation of any other resolution actions sufficiently relevant for the resolvability of firms that the FSB should specifically consider ways of achieving their cross-border enforceability?

We agree that these two aspects are particularly critical, as they are areas where lack of recognition could have a material effect on a firm's resolution, including jurisdictions where the firm has no physical presence. Especially given the lack of progress on national implementation of the *Key Attributes*, we agree these are two key areas that must be addressed in order to ensure cross-border enforceability. However, it should be recognised that enforceability of temporary stays and bail-in are critical issues for the resolvability of all financial firms with material cross-border activity, not just for G-SIFIs.

We also strongly believe that contractual approaches, while useful to provide some legal certainty, must still be supported by statutory measures, even if they are initially limited and will ultimately be replaced by full statutory implementation of the *Key Attributes*. We comment further on this - in particular in relation to the ISDA Resolution Stay Protocol and similar future measures - below in answer to Q4.

There are two other areas where we consider that the FSB could do more to materially improve consistency and legal certainty in resolution, by developing further statutory guidance and supporting contractual approaches, which could in turn improve the cross-border enforceability of resolution actions:

- **(i) Operational continuity** - in particular when it comes to critical support services provided across entities or jurisdictions. We see major divergences in approach emerging in different jurisdictions which could be to the detriment of banks' group-wide efficiency and ongoing business. Operational continuity is an area where host authorities are likely to require legal certainty before they will recognise resolution action (as described under point 3 in section 1.2). As such, we consider global standards in this area could support cross-border recognition. We strongly welcome the FSB's recent commitment to develop guidance for authorities in this area by the end of 2015. We believe this should be primarily focused on what expectations firms should deliver on to ensure continuity of critical functions and support services. We strongly agree that existing service level agreements will need to be improved. As part of its guidance, the FSB should therefore consider setting out some principles for contractual language that enhanced service level agreements should include (similar to that provided in this consultation on contractual recognition of bail-in). However, whether operational, legal or structural changes are required to ensure resolvability will depend on the individual firm's resolution strategy and its CMG's assessment of whether it has sufficiently met the expectations in the guidance and removed any material impediments to resolution. Therefore, the FSB should avoid any suggestion that specific infrastructure entities or shared services companies are automatically required.

(ii) **Financial market infrastructures (FMIs)**: This is an area where the recent update to FSB *Key Attributes* has provided welcome high level guidance. However, despite the welcome presumption that systemically important participants' memberships should continue in resolution, it leaves much of the detail for how this should be achieved up to the individual FMIs' own rules and procedures. Even where FMI members' resolution is addressed in rules, this still leaves a great deal of discretion to the FMI or imposes requirements that cannot be met in the short term (e.g. requirements for membership might include a rating, which a new institution will take time to receive). While the safety and soundness of the FMI is a key concern for authorities and broader system stability, we believe there would be significant value in the FSB working with CPSS-IOSCO, key global FMIs and their regulators to develop model language for continuation of membership for G-SIFIs in particular. This may include, for example, temporary waivers of criteria for members in resolution or "fast-track" approvals for membership transfers to a bridge bank. The ability of firms to negotiate such terms on their own across multiple FMI memberships is severely limited, and doing so in concert with other firms would potentially breach anti-trust laws. As such, it is ultimately something only regulators can help firms to achieve, by encouraging standardised terms that facilitate continued membership in a way that still protects the interests of the FMI and its other members.

Finally, although not strictly a "contractual approach" in the sense of contracts between banks and other private sector market participants, we believe the FSB could encourage a similar approach to regulatory approvals. Currently, countries have very different formats and requirements, and we believe there would be value in developing a resolution-specific template that could help "fast-track" the process for successor entities to failed banks (e.g. bridge banks).

Q4. Do you agree that contractual approaches can both fill the gap where no statutory recognition framework is in place and reinforce the legal certainty and predictability of recognition under the statutory frameworks once adopted?

We agree that contractual approaches may go some way to fill the gap until statutory frameworks are aligned, but we also agree that they have limitations and are no substitute for statutory solutions. As the FSB rightly states, they do not provide the same level of legal certainty as widespread adoption of statutory frameworks and their enforceability has not been tested in courts. Furthermore, contractual approaches may meet civil law obstacles.

For example, since the substance of the clauses cannot be negotiated, this may be seen as a violation of the principle of freedom of contract in certain jurisdictions, unless a court confirms that financial stability concerns outweigh that principle. Furthermore, some jurisdictions apply unfair contract terms laws not only to consumers but also to corporates. Particularly with regards to conversion or write-downs in bail-in, contractual terms are untested and the consequences are unclear. As such, these clauses could be held to be “intransparent”.

Deutsche Bank strongly supports the creation of effective cross-border resolution mechanisms and will work with regulators to ensure this is achieved. As evidenced by our participation in the ISDA Resolution Stay Protocol, we believe contractual approaches can be an important first step. However, further steps are needed, as the contractual approach is not enough in isolation.

We have some comments on the ISDA Resolution Stay Protocol in particular, which we hope will help the FSB to (i) provide greater clarity for signatories to this Protocol and other market participants in terms of next steps; and (ii) help improve the process for extending contractual approaches to other types of financial contracts.

In terms of the Protocol itself, we strongly welcome the agreement that certain safeguards should be in place which protect the rights of non-defaulting parties. In particular, that there is an “opt-out” if netting and set-off rights are not protected and limiting the duration of temporary stays on early termination rights. This provides some guarantee that, where resolution regimes are inconsistent with the *Key Attributes*, is not required. This is a general principle that should be applied when developing approaches for other types of financial contract.

We also appreciate that the safeguards help to ensure that the Protocol is “capital-neutral”, and our own internal analysis has shown this to be the case for the six pre-approved G-18 home jurisdictions. However, this will need to be confirmed as additional eligible regimes are identified under the Protocol in future. The potential effect on capital should be taken into account from the outset when developing approaches for other types of financial contract.

However, we continue to be very concerned about broader market adoption of the Protocol. To be truly effective in ensuring the resolvability of any entity with significant derivative exposure, the Protocol has to be adopted by the vast majority of that entity’s counterparties. While it made sense to start with a voluntary approach involving major dealers, this only covers part of the market. Buy-side firms, in particular, have legitimate concerns about their ability to adhere to a Protocol that potentially breaches their fiduciary duty to clients or oversteps their client mandates.

Requiring only G-SIFIs to adhere to the ISDA Protocol does not go far enough. While regulators have indicated their intention to foster broader adoption, we believe that at a minimum all prudentially regulated firms in all FSB member jurisdictions should be required to adopt it. When it comes to non-prudentially regulated firms, however, the FSB should be clear that where markets regulators have powers to require adoption, they should do so.

Not providing such statutory support for its wider adoption will be detrimental to financial stability. Market participants who are not obliged to adhere to the Protocol by regulation would be incentivised to trade with counterparties that do not require them to adopt it (i.e. non-prudentially regulated financial firms). In the medium term, these competitive distortions could result in a migration of market activity towards less regulated jurisdictions and shadow banks.

Finally, in developing future contractual approaches, and in addition to mitigating similar risks to those outlined above, we would also like to underline that FSB regulators could work even more closely with industry standard-setters and associations. Regulatory support is needed, not only during the drafting process to take on board the concerns of market participants, but also in promoting the adoption of contractual approaches. It is very difficult for private firms to encourage adoption on their own.

Q5. Are the key principles for recognition clauses in debt instruments set out in the report appropriate? What other principles or provisions do you consider necessary to support the exercise of 'bail-in' powers in a cross-border context?

As outlined above in our response to Q4, we believe that there is a particular risk that contractual approaches to bail-in for liabilities governed by foreign law may not be effective, since their legal enforceability is untested and the lack of clarity on the consequences of bail-in may result in such clauses being found "intransparent" under civil law on contract terms.

That said, we acknowledge that such clauses can provide some comfort, given the current lack of implementation of bail-in powers even within FSB member jurisdictions. Given the importance of cross-border recognition, EU firms subject to the Bank Recovery and Resolution Directive (BRRD) are required (under Article 55) to include a contractual clause recognising bail-in in the terms of any liability eligible for bail-in that is governed by non-EU law. The European Banking Authority (EBA) is currently consulting on draft Regulatory Technical Standards (RTS) on these terms. The proposed points 1-3 are broadly aligned with these RTS.

However, there are three major differences between the EBA's proposals and the FSB's approach that we think should be taken into account in the final guidance to ensure proportionality. First, contractual provisions are not necessary in the BRRD where there is a cross-border resolution agreement. Second, while the BRRD has a very broad scope of liabilities eligible for bail-in (i.e. not just debt instruments) there is also the possibility to exclude from bail-in some of these at the point of resolution for reasons of preventing contagion or achieving operational continuity, which narrows the scope of liabilities likely to be subject to bail-in in practice. Finally, a legal opinion as to the enforceability of the bail-in power is not automatically required. In the BRRD, resolution authorities only "may" require a legal opinion. From what we understand, many authorities intend to require this only in relation to instruments counting towards the minimum requirement for own funds and eligible liabilities - the EU equivalent of a total loss-absorbing capacity requirement.

With regards to the first point, we believe the FSB should also be explicit that contractual provisions are not needed where cross-border agreements exist. Contractual provisions - especially where the scope of bail-in under the foreign resolution regime is not aligned with the home authority's - may put firms operating in those jurisdictions at a disadvantage and so should only be applied where necessary to ensure the feasibility and credibility of bail-in. As outlined above, given that we believe contractual approaches are less effective than statutory recognition, we also believe that contractual provisions should not be required where recognition procedures exist or where support measures have been agreed that could provide a high degree of legal certainty about the enforceability of the bail-in order for the instrument.

On the second and third points of difference between the BRRD and FSB's approach, we agree with the BRRD's principle that contractual recognition should be required for all liabilities that are likely to be bailed-in. However, the FSB should encourage jurisdictions to distinguish between liabilities that are legally potentially subject to bail-in, those that are operationally possible and therefore likely to be bailed-in, and those where legal certainty is necessary because they count towards a minimum loss-absorbing capacity requirement. We therefore believe that official measures to support use of contractual provisions in debt instruments should focus primarily on liabilities eligible for inclusion in minimum loss absorbing capacity requirements, and beyond that only consider contractual bail-in clauses for those that are feasible and credible to be bailed-in in practice.

As such, we believe that points 1-3 broadly make sense to apply to all liabilities that are feasible and credible to be bailed-in, while points 4 and 5 should only be necessary for liabilities to be recognised as eligible for the minimum loss-absorbing capacity requirement.

A further two changes to the principles should be incorporated in the final guidance to make them practicable. First, under point 1, it suggests that further agreement that other terms and conditions will be overridden is needed. This is not necessary but potentially disruptive. The usual approach to terms and conditions is that they set out what conditions apply and in what circumstances. As the investor would explicitly agree to be bound in the case of bail-in, a further agreement to override other terms and conditions adds nothing to enforceability but could provoke unpredictable investor reactions, given the uncertainty such an override could create. As such, we suggest deleting the requirement for this further agreement.

Second, it should be acknowledged that legal opinions have their own limitations. For example, they may find a certain requirement may not be waived - potentially rendering the clause unenforceable. The consequence for this could be derecognition from the minimum loss absorbing capacity, but anything further would be disproportionate. In general, the nature of legal opinions is such that they are unlikely to provide an unequivocal view, especially given the untested nature of such contractual clauses. Point 5 should therefore only require the opinion to attest that there is a reasonable prospect the clause is enforceable.

We also welcome the focus on new issuances, and the recognition that replacing instruments will take time. Official measures to "improve resolvability" either by requiring renegotiation to include contractual provisions or by prohibiting issuance of liabilities in third countries without sufficient cross-border recognition should only be pursued if necessary to ensure that minimum loss absorbing capacity is met. In any case, these should not be required until after it is clear that the implementation of the *Key Attributes* will not be fully consistent with FSB requirements.