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30 September 2020

FSB consultation on the evaluation of the effects of TBTF reforms: UBS feedback

Dear Prof. Buch and Mr. Domanski,

UBS would like to thank the Financial Stability Board for the opportunity to comment on the consultation report on the "Evaluation of the effects of too-big-to-fail reforms" (the "report"). We appreciate the efforts and the work undertaken by the FSB to better understand the consequences of regulations.

UBS agrees with many of the findings of the report, in particular that too-big-to-fail ("TBTF") reforms have made banks more resilient and resolvable and that the risk of moral hazard has been reduced significantly. We also concur with the FSB that there are still some remaining obstacles to resolvability and that there are gaps that need to be addressed to further improve the effective and efficient implementation of TBTF reforms. We have set out below our considerations on a number of specific open aspects with the aim of supporting future policymaking and contributing to the effective implementation of the TBTF reforms. These comments complement the industry responses of the Institute of International Finance and Global Financial Markets Association, to which we have contributed and which we fully support.

1. Liquidity and Funding in resolution ("FiR")

We agree with the FSB's findings that resolution funding remains an area where further work is required to operationalize resolution. A single-point-of-entry ("SPE") resolution can only be successful if there is no breakup due to uncoordinated measures taken bottom-up by host jurisdictions. In addition, in such an event, liquidity is needed fast, in the necessary currencies, location and amount. It must be available in a transparent manner to ensure comfort, provide credibility to bail-in and flexibility to resolution authorities and (new) management. This in turn requires upfront clarity and consistency on how liquidity is provided in a crisis and how banks' gone concern requirements are calculated.

Central banks' role and commitments in a crisis

We believe that further clarity is needed on central banks' commitment to supporting recovery and resolution with lender of last resort ("LOLR") facilities. However, we recognize that in order for central banks to provide such clarity, they will require clarity themselves from their respective governments on the provision of a public backstop in the form of guarantees to support the extension of liquidity to banking groups in resolution (even where collateral is received). We would thus welcome additional FSB guidance and promotion of best practices emphasizing the need for commitment of central banks in recovery and resolution, including:

- *Pre-agreed public facilities for recovery and resolution, including public backstops.* More transparency on the availability and modalities to access Emergency Liquidity Assistance and Resolution Liquidity Assistance is needed.

While we recognize moral hazard concerns, we view such concerns as more manageable for resolved entities where resolution authorities have taken control and can determine the extent to which external creditors are bailed in and hence the extent of remaining liabilities which have claims on the assets of the resolved firm, thereby mitigating concerns that a LOLR may take undue credit risk when providing liquidity assistance in a resolution. In the case of resolved banks, it appears appropriate for central banks to communicate a presumption that they will provide liquidity in the tenor and currency needed to support resolution. Such clarity is also important to create confidence to both investors and foreign authorities. The Bank of England has set an excellent example in this respect.

- *The most relevant terms and conditions are to be agreed in advance.* This should include the eligibility criteria of collateral, lending duration, currency, maximum amount and the existence of a public backstop. The latter is understood as a government guarantee to the central bank to indemnify the central bank and establish the required credibility and certainty in a resolution vis-à-vis the market. Moreover, this implies that central banks and the banks in advance must put in place the facilities for extended collateral to be acceptable to the central bank in such a situation. We note that this is not yet the case in all jurisdictions.

Separately, the guidance should reiterate the need for transferability of assets between entities and jurisdictions in resolution without undue restrictions, as such transfers may be required to address all kinds of crises and move collateral and access liquidity where it is most needed. Such additional guidance at the FSB level would be helpful in driving internationally consistent frameworks, avoiding inefficient allocation and ring-fencing of resources as well as excessive local requirements.

Gone-concern liquidity requirements

We also believe that it is important to ensure internationally aligned gone-concern liquidity requirements and note that going- and gone-concern requirements should be clearly differentiated and not be additive.

In this context, the US approach, which is in line with the FSB guidance of June 2018[1], is the most advanced. It is based on the Resolution Liquidity Execution Need ("RLEN"), which defines the liquidity requirement for an orderly execution of the preferred resolution strategy, considering both bank-specific liquidity stress assumptions and the liquidity impact of the management actions and restructuring measures. The RLEN combines a Peak Funding Need and the Minimum Operating Liquidity. The latter includes additional requirements for placing collateral with Financial Market Infrastructures ("FMIs") in a crisis and reflects (intraday) liquidity requirements of FMIs in a resolution scenario. This approach represents in our view international best practice and thus we would appreciate if the FSB encouraged other jurisdictions to pursue a similar approach.

Furthermore, while progress has been made in the area of funding in resolution since the issuance of the FSB 2018 guidance, we believe that more clarifications and detailed best practices should be provided including on RLEN representing a trigger level at which resolution proceedings would be expected to commence and that this is conceptually different from, and not additive to, going concern liquidity requirements such as the Liquidity Coverage Ratio (LCR).

[1] FSB, Funding Strategy Elements of an Implementable Resolution Plan, June 2018

Pre-positioning of liquidity (going- and gone-concern)

While not directly in scope of the analysis, the report rightly recognizes that "*one of the drivers of (…) market fragmentation could be the ring-fencing of liquidity (…) within local markets*" (see page 64 of the report).

The lack of international agreement on the pre-positioning of liquidity currently leads to a sub-optimal constellation in which jurisdictions tend to impose higher local liquidity requirements, thereby ring-fencing liquidity at the expense of the overall group's financial stability. As resources are scarce and the sum of parts typically exceeds consolidated requirements, there is no surplus liquidity to be distributed and authorities need to work closely together.

In the current situation, risks associated with the trapping of liquidity are similar to those affecting iTLAC (as recognized in the report on page 65: "*excessive pre-positioning of internal TLAC could also reduce financial stability by making the banking group less resilient*"). With high levels of ring-fenced liquidity and without any pre-positioning guidance, banks under stressed conditions may be unable to move liquidity resources across the group to where they are most needed.

To mitigate this issue, we suggest that, similarly to iTLAC, international standards-setters should provide guidance on the pre-positioning of liquidity within a group. Such standards could serve as the basis for discussions within crisis management groups ("CMGs") aimed at ensuring the optimal allocation of liquidity, balancing the interests of both home and host jurisdictions. Such guidelines should propose pre-positioning in a range to reflect different Global Systemically Important Banks' ("G-SIBs") structures, with exact allocation ultimately resulting from discussion in CMGs. International guidance on the pre-positioning of liquidity would provide the basis for such discussions in CMGs.

2. Cross-border coordination

We also agree that further work is still needed to enhance cross-border coordination and supervisory collaboration in a crisis. In our view, firms, in particular G-SIBs, have made important efforts in this regard and mostly fulfil the FSB Key Attributes of Effective Resolution Regimes. However, we believe that this is an area in which further work from the authorities is required.

We note that a lack of coordination and mutual understanding can result in higher requirements in home and even more so in host jurisdictions. We are of the firm opinion that the industry should not be subject to additional costs, for examples via additional buffer requirements, due to such lack of alignment by the authorities. We suggest that the FSB consider a review across relevant authorities to assess the degree to which agreements have been reached at CMG level concerning the pre-positioning of TLAC and liquidity resources within G-SIB groups, and to issue additional guidance to this end.

Crisis management groups

CMGs play an essential role in enabling the resolution of a global institution. We strongly encourage authorities to further formalize their collaboration based on cooperation agreements/ memoranda of understanding. Furthermore, pre-agreed playbooks for the international cooperation between supervisory authorities in resolution would be helpful and should be tested in simulations between relevant authorities.

Post-resolution adjustments

More clarity is still needed on post-bail-in recapitalization needs and procedures for both going- and gone-concern requirements following a resolution. In particular, the timelines for TLAC and iTLAC replenishment should be coordinated between the CMG members in a flexible way reflecting the circumstances of the crisis situation. It should be clear that such CMG decisions will be respected in home and host jurisdictions.

We would like to emphasize that beyond TLAC requirements, internationally coordinated action by the Basel Committee on Banking Supervision ("BCBS") and FSB is still needed to consider other metrics, in particular the Net Stable Funding Ratio ("NSFR"), post-bail-in. Following the bail-in of TLAC (long-term liabilities), NSFR requirements are unlikely to be met and the Basel framework currently does not provide for an exemption allowing for a sufficient period of time to meet the requirements again.

3. Internal Total Loss Absorbing Capacity ("iTLAC")

While UBS agrees with a number of the challenges identified in the report, we believe that the FSB's conclusion that there is currently no evidence of fragmentation related to iTLAC might be premature. The FSB report acknowledges that "evidence on the effects of internal TLAC [in relation to market fragmentation] is not yet available" (p. 65). Thus, the conclusion of the report that the evaluation did not find evidence of fragmentation related to iTLAC seems to be premature given the statement that (certain) evidence is not yet available.

In fact, we do observe fragmentation emerging in the form of different local requirements and remain concerned that a number of jurisdictions are setting pre-positioning requirements for internal TLAC at the top end of the range foreseen in the FSB TLAC term sheet, or possibly even exceeding the range and/ or imposing requirements at the level of non-material subsidiaries. Such developments could potentially lead to an overshooting of TLAC on a consolidated level. If these developments continue, they will make TLAC instruments less useful than initially considered, since they trap resources at subsidiary level, further increase fragmentation and thereby threaten resilience and financial stability.

We believe that another element of fragmentation comes from the different terms of required instruments (e.g. Minimum Requirement for Own Funds and Eligible Liabilities ("MREL") in the European Union vs. US long-term debt). This is in particular an issue as instruments should not have different triggering mechanisms to avoid uncoordinated bottom-up resolution interventions across different jurisdictions.

While the term "failing or likely to fail" or "point of non-viability" is widely shared as entry point to resolution across jurisdictions and enshrined in both internal and external TLAC instruments, there is no harmonized interpretation of the term, leaving open the possibility that resolution authorities take different views on when this status is reached. We would call on the FSB to encourage its members to strengthen the dialogue amongst resolution authorities on this point in good times to avoid surprises in bad times, when resolution authorities are under considerable time pressure.

We strongly encourage the FSB to continue its monitoring of consistent implementation of post-crisis reforms to ensure aligned standards and to encourage further cooperation between the authorities.

4. Further considerations: lessons learned from the COVID-19 pandemic

We believe that the lessons from the ongoing coronavirus pandemic ("COVID-19") situation should be considered in the final report. The crisis has in particular shown that regulators have managed the pandemic successfully, while the majority of banks showed strong resilience, remained substantially above minimum regulatory levels and have been an integral part of the authorities' efforts to stabilize economic activity and employment.

The COVID-19 pandemic has also proven again that once a crisis is emerging, focused and effective actions not only by individual banks, but also by governments and central banks are required. An important COVID-19 related lesson is that the (USD) swap lines between central banks and open market operations to commercial banks have proved to be a key factor enabling provision of USD liquidity. Consideration should be given to maintaining these open market operations to commercial banks on a permanent and daily basis. Moreover, collateral requirements should be aligned. In this context, the crisis has also shown that extending the scope of collateral types (e.g. corporate loans) is possible and worked successfully. Another major lesson is therefore that the technical tools for exchanging collateral between banks and central banks are needed. These should be put in place prior to any crisis in order to allow increasing the available tools in the toolset effectively when most needed. This in turn requires that the central banks clarify in advance what kind of collateral will be acceptable in such a situation.

Conclusion

As recognized in the report, there is strong evidence that TBTF reforms are achieving their objectives and we believe that these significant achievements should be more positively acknowledged. The enormous efforts of policymakers and the industry in recent years have led to a robust framework with a much lower likelihood of government interventions.

Key is therefore for the reforms to be appropriately and consistently calibrated with a view to full and consistent implementation. We must, however, also recognize that complete certainty is not achievable and that it will not be possible to cover all potential crisis scenarios, which highlights the importance of the public backstop discussion.

Please do not hesitate to contact us in case you have any further questions. We would be pleased to further discuss our feedback with you.

Yours sincerely,

UBS Group AG

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