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Group Public and Prudential Affairs

Mr Svein Andresen
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Email address : fsb@bis.org

September 2nd, 2011

Subject: BNP Paribas contribution to FSB Consultative Document "Effective Resolution of Systemically Important Financial Institutions"

Dear Secretary General,

You will find attached BNP Paribas' contribution to the FSB consultative document published 19th July 2011 and entitled 'Effective Resolution of Systemically Important Financial Institutions '.

The FSB Consultative Paper gives an accurate and complete analysis of the difficulties that can arise in the resolution of systemically important financial institutions, for which a certain number of remedies are proposed.

However, we are very disappointed that the FSB gives up recommending an approach based on an international treaty and is eventually satisfied with promoting only bilateral or possibly multilateral agreements that we know will be very difficult to make work and keep consistent, particularly without an international agreement on burden sharing. Alleged pragmatism should not have superseded ambition from our point of view.

We also believe that some key issues warrant further attention:

1) Financial Institutions are not, and should not, be managed with a view to "successful failure". Authorities should refrain from requesting organization and business changes in order to increase banks' resolvability.
2) Resolution must be a last resort measure once all the recovery actions have failed and the market confidence has been lost. It can only have the outcomes of the firm being wholly sold, partially sold, deeply restructured or liquidated, but in no instance should it be used as an early 'rescue' mechanism leaving eventually the firm untouched in its business and organizational profile.
3) Resolution must be construed as an ultimate step to preserve the remaining value of the institution to the benefits of the stakeholders, which means keeping it running during the

resolution/restructuring phase. As such, the entry into resolution should not be by itself an event of default.

4) The cost of a bank restructuring or failure should first be borne by shareholders and holders of other loss absorbing instruments. Senior creditors should suffer losses only in exceptional circumstances where all alternative measures have been explored and exhausted.

   In this context, the suggested resolution tool of ‘bail-in within resolution’ is a very significant improvement on bail-in schemes that have been discussed to date, and provided that it is surrounded by the necessary safeguards to ensure that it is implemented only when essential, legitimate and in stages, we would be supportive of the proposal.

5) Resolution, as well as Recovery planning, should be conducted on a group wide basis, i.e. encompassing all consolidated entities, under the leadership of the home authority, with a mandate shared by all the concerned authorities to maximise global financial stability and global stake-holder value.

6) In that respect, the home resolution body must have this primacy expressed through some form of worldwide global legal arrangement enforceable across countries, ideally through the Resolution Treaty we are pleading for.

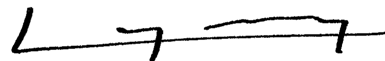
7) Confidentiality of the Recovery & Resolution plans is critical and must be guaranteed by law.

8) The contemplated framework raises multiple and complex issues, particularly the ones in relation with the actual resolution process and the financial clearing system role that must combine possibly contradictory objectives: maximizing the resolution outcome, maintaining the fair treatment of all the stakeholders and reducing the systemic risk. Further work is needed in liaison with the Industry; the current consultation is a significant step forward but the allotted timeframe was too short to pretend that all the relevant issues have been thoroughly addressed.

Home authority primacy and group level resolution will clearly require, to be effective, significant changes to national regulatory and insolvency systems. These changes must take place in a harmonised time frame and be entirely consistent between jurisdictions.

We urge the FSB to be more ambitious in this regard by clearly marking its attachment to the creation of a harmonised international resolution regime to be implemented within a defined and worldwide time-table rather than relying on progress through voluntary bilateral agreements. Hence, we strongly encourage the FSB to recommend to the G20 a resolute move towards a global resolution regime that would result from the negotiation of an international treaty.

Yours sincerely,



Christian LAJOIE

BNP PARIBAS

31 August 2011

EFFECTIVE RESOLUTION OF SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

BNP Paribas contribution

Response sent by 2 September to: FINANCIAL STABILITY BOARD
fsb@bis.org

BNP Paribas welcomes the opportunity to comment on the FSB Consultative Document, 'Effective Resolution of Systemically Important Financial Institutions', published on 19 July 2011.

GENERAL REMARKS

BNP Paribas commends the efforts of the FSB in publishing this consultative document. We subscribe to the objective of creating a consistent international regime for the resolution of financial institutions without exposing the tax-payer to the risk of loss, and find that the proposals elaborated in the consultative document are a significant step forward towards the achievement of this objective, which is essential to foster global financial stability.

The document gives an accurate and complete analysis of the difficulties that can arise in the resolution of systemically important financial institutions, for which a certain number of remedies are proposed.

We do not in all instances share the proposed view of correct remedies, as more fully explained in the detailed comments below. In addition, we are very disappointed that the FSB gives up recommending an approach based on an international treaty and is eventually satisfied with promoting only bilateral or possibly multilateral agreements that we know will be very difficult to make work and keep consistent, particularly without an international agreement on burden sharing. Alleged pragmatism should not have superseded ambition from our point of view.

The key issues, which we feel warrant further attention, are:

1) Financial Institutions are not, and should not, be managed with a view to "successful failure". Authorities should refrain from requesting organization and business changes in order to increase banks' resolvability.
2) Resolution must be a last resort measure once all the recovery actions have failed and the market confidence has been lost. It can only have the outcomes of the firm being wholly sold, partially sold, deeply restructured or liquidated, but in no instance should it be used as an early 'rescue' mechanism leaving eventually the firm untouched in its business and organizational profile.

3) Resolution must be construed as an ultimate step to preserve the remaining value of the institution to the benefits of the stakeholders, which means keeping it running during the resolution/restructuring phase. As such, the entry into resolution should not be by itself an event of default.

4) The cost of a bank restructuring or failure should first be borne by shareholders and holders of other loss absorbing instruments. Senior creditors should suffer losses only in exceptional circumstances where all alternative measures have been explored and exhausted.

   In this context, the suggested resolution tool of 'bail-in within resolution' is a very significant improvement on bail-in schemes that have been discussed to date, and provided that it is surrounded by the necessary safeguards to ensure that it is implemented only when essential, legitimate and in stages, we would be supportive of the proposal.

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We urge the FSB to be more ambitious in this regard by clearly marking its attachment to the creation of a harmonised international resolution regime to be implemented within a defined and worldwide time-table rather than relying on progress through voluntary bilateral agreements. Hence, we strongly encourage the FSB to recommend to the G20 a resolute move towards a global resolution regime that would result from the negotiation of an international treaty.

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ANSWER TO THE CONSULTATION

*1. Comment is invited on whether **Annex 1: Key Attributes of Effective Resolution Regimes** appropriately covers the attributes that all jurisdictions' resolution regimes and the tools available under those regimes should have.*

Scope

We do not fully share the manner in which the scope of the resolution framework is expressed. In our view, resolution planning must be carried out at the group level of a systemically important financial institution. The framework should therefore not be 'extending to' bank holding companies, branches of foreign financial institutions and significant non-regulated operating entities. Such entities should, in our opinion, form part of the core resolution framework of financial institutions from the outset. Otherwise, regulation would negate the existence of banking Groups and would simply substitute an administrative "working out" regime to current judicial processes that can be made swifter and more efficient, if needed.

Foreign branches, in particular, are an integral part of their parent institution, and should be treated as such for the purpose of resolution, implying that the resolution authorities of the parent entity should be responsible for resolution of overseas branches of the financial institutions within their remit.

Wholly-owned subsidiaries are often, in our view, economically indistinguishable from branches, and should be dealt with similarly. Indeed, it is frequent that subsidiaries are created at the insistence of a local regulator, whereas the institution would prefer, for reasons of simplicity, to carry out business through a branch.

Resolution authority

It would in our view be preferable that there be only one resolution authority per jurisdiction, but where there are multiple resolution authorities, there must be a chairperson or a unique spokesperson. In our view, the resolution body should be made up of representatives of the Central Bank, the Supervisory Authority and the Ministry of Finance. Governance rules should be formally set up in order to institute efficient decision making.

The responsibilities devolved to a resolution authority are far reaching and entirely derogatory to the normal operation of commercial law. Whilst these powers are necessary in order to contend with the unique problems posed by the resolution of complex financial institutions, it is essential that the exercise of these powers by a resolution authority be controlled by extensive rights of judicial review (see comments on speed, flexibility and adequate safeguards below).

The proposals would benefit from additional clarification of the possible role of resolution authorities in relation to financial institutions that are in 'business as usual' mode. Whilst it is clear that resolution authorities are responsible for resolving non-viable institutions, there is some confusion in the proposals over the split of roles between supervisory authorities and resolution authorities. Paragraph 2.7 seeks to give resolution authorities 'unimpeded access' to firms for the purpose of resolution planning. Beyond the fact that we feel that the home resolution authority should be the sole responsible for resolution planning (see comments on legal framework below), it should be supervisory authorities who are in contact with the institution for as long as it has not entered resolution. Section 11 of Annex 1, concerning Recovery and Resolution planning, refers consistently to 'supervisory and resolution authorities' in the context of both recovery and resolution. Given that recovery actions are taken under the auspices of the institutions management and under normal supervisory oversight, it is difficult to justify the role of resolution authorities in the approval and implementation of recovery plans.

Entry into resolution

Whilst we agree that the resolution regime should provide for timely entry into resolution, and agree with the definition of the entry point proposed, it should be made completely clear that resolution should be a last resort that follows the visible failure of recovery actions and is decided at the point at which it becomes evident that the institution, although not balance-sheet insolvent, is no longer viable or will cease to be so in the near future.

The decision to place an institution in resolution should be taken by the supervisory authorities on the basis of their judgment of the viability of the institution. Whilst the criteria that will be taken into account should be clearly described, we do not believe that there can or should be numerically defined indicators that trigger resolution, as experience shows that non-viability is far more a consequence of the loss of market confidence in an institution than a question of non-respect of indicators or thresholds.

Given that the entry into resolution will have far-reaching and irreversible consequences, it is essential that, unless the decision to enter resolution has been taken with the agreement of the institution, there be legal approval of the decision. This approval must not unduly delay the entry into resolution, but we feel that it is essential that, in the case of disagreement between authorities and management on the non-viability of the institution, a form of emergency hearing be held in the hours following the decision to place an institution in resolution, in order to confirm the legality of the decision. Once resolution has been entered, irreversible actions must and will be taken, and we feel that the possibility of such a decision being subsequently contested must be limited by some form of official and legally binding approval. This could be along the lines of the hearing that is catered for by the Orderly Liquidation Authority under the Dodd-Franck Act, to ensure that the commencement of orderly liquidation is not 'arbitrary and capricious'.

Resolution powers

We are in broad agreement with the list of powers that should be made available to resolution authorities, although we have significant comments on the powers concerning bail-in and the ability to impose moratoria and stays, which are detailed in our responses to the questions relating to Annexes 2 and 8 below.

We feel that the list of powers covers all the tools that a resolution regime should contain, and that given that they are very comprehensive and override many basic legal principles, they must be used with significant care and protection for the shareholders and claim holders. The general rule should be that the latter's financial interests would not eventually suffer more than in the case of a judicial liquidation, a condition that is rightly recalled and outlined by the FSB consultation.

Funding of firms in resolution

Paragraph 6.3 of Annex 1 seems to introduce some confusion between Deposit Guarantee Schemes and Resolution funds. We believe that DGS funds and resolution funds should be managed separately, which does not necessarily mean that there should be two legal entities in charge of these funds. This difference that has to be made between the two funds is due to the fact that they do not have the same purpose. The DGS must be able to pay off the insured deposits and be subrogated into their rights without specific preference whereas the resolution fund will pay for the residual losses at the end of the liquidation process: i.e. cost of the process, shortages between the asset sale proceeds and the paid written down claims due to time lags and valuation issues.

As envisaged in paragraph 6.2, it is clear that in many circumstances temporary sources of funding will need to be made available to an institution in resolution in order to maintain critical economic functions or activities that may have significant value. Although it is not suggested in the document that this would be the case, we feel that it should be made clear that the provision of such temporary funding is not the responsibility of either DGS funds or resolution funds. We see little alternative to an intervention of the central bank to provide such funds if it is determined that this course of action will maximise financial stability and stake-holder value. This 'new money' in resolution should benefit from

a preferred ranking to ensure that it is recovered in priority to any recovery by shareholders and unsecured creditors (see Question 6 below).

Speed, flexibility and adequate safeguards

We are in broad agreement with the proposals, although we would draw a distinction between the decision of entry into resolution and the implementation of resolution tools.

The decision to enter into resolution, which has irreversible consequences, should be agreed upon by the institution or receive legal approval through a form of emergency hearing that should confirm the justification and legality of the decision to place an institution in resolution. Subsequently, the decision to enter resolution should not be subject solely to *ex-post* review, given the extraordinary difficulty, or even impossibility, of determining what would have been the position of creditors had the decision not been made.

Once an institution has been placed in resolution, we agree with the proposals that judicial review of the resolution actions taken should effectively be *ex post* and should not result in the reversal of measures taken. The principle that no creditor should be 'worse off' than he would have been under a 'normal' liquidation must always be upheld and provision for redress through compensation should be made. We strongly support this principle proposed by the FSB.

Legal framework conditions for cross-border cooperation

We are in full agreement with the principles contained in paragraphs 8.1 and 8.2 of Annex 1, and feel that they should be reinforced such that the statutory mandate of resolution authorities should oblige them to seek cooperative solutions with foreign resolution authorities. We are concerned that without this principle being enshrined in the mandates of resolution authorities, there is considerable danger that national self-interest may prevail over the global interest in the resolution of a global SIFI. This is another justification for setting up the international treaty we are referring to in many instances. In absence of such Treaty, the concerns over the way in which the principles in 8.1 and 8.2 are diluted in later paragraphs of Annex 1 would certainly materialize.

In relation to 8.4, we do not feel that, save for emergency situations only, 'host' resolution authorities should have resolution powers over local branches of foreign financial institutions. The home resolution authority should have power over a failed financial institution and should be responsible, with the cooperation of host resolution authorities, for the resolution of the institution, including its foreign branches and wholly-owned subsidiaries, with the mandate to preserve global financial stability and optimise the outcome of the global resolution of the firm for all the stakeholders.

Paragraph 8.6 provides for foreign resolution authorities to gain control over assets, but adds the proviso that this should not prejudice local creditors. This proviso clearly opens the door to unequal treatment of creditors across a financial institution, dependant upon the assets present in given jurisdictions. The proviso should read 'provided that the local resolution authority is satisfied that local creditors will be treated equitably with all other creditors of a financial firm being resolved in a foreign jurisdiction'.

We are in agreement with the principles relating to confidentiality in paragraphs 8.7 and 8.8, which are an essential requirement for effective cross-border cooperation and for financial institutions to be assured that the highly sensitive information contained in Recovery and Resolution Plans is adequately protected. This point is so important that it should also be addressed by the Treaty.

Institution-specific cross-border cooperation agreements

We fail to see how the making public of these agreements serves in any way the cause of global financial stability. Probably, the FSB believes that disclosing the fact that such agreements have been signed between home and host authorities and concern the 'x' largest banks in a given jurisdiction could be information that can give comfort to the markets globally. We consider that it could equally well destabilize the markets in the absence of global consistency of the existence of these agreements

or because of possible arbitrage between creditors of the same banking Group. In any case, we are strongly opposed to any more detailed disclosure.

Cross-border Crisis Management Groups

We are in agreement with the limited proposals contained within the consultation document, but feel that the governance of CMG's should be far more extensively documented.

If the resolution of an international SIFI is to proceed in an orderly manner, the decision making process within a CMG must be more fully documented, and the means of resolving deadlock within a CMG provided. Until an international treaty on the resolution of financial institutions is agreed upon, we feel that that the FSB should provide, as a minimum first step pending the negotiation of a treaty, overarching principles to be respected by all resolution authorities, which would notably include the priority given to the global common interest rather than the national interest. In other word, the principle that there should be no local arrangement made at the expense of the global fair treatment of all the stakeholders.

In order to be effective, the number of permanent members of CMG's should also be limited, without prejudicing the interests of those jurisdictions which may have an interest in the resolution of an institution. We would suggest that the CMG be limited to the representatives of the jurisdictions where the institution has the greatest presence or systemic importance. The need to protect the interests of those jurisdictions not present in the CMG places considerable responsibility on those jurisdictions present in the CMG, in particular the 'home' authorities, and reinforces further for the need to impose by statute the respect of the global common interest rather than the national interest.

We would suggest that the FSB should also address the issue of how to address deadlock within a CMG, which we would suggest would be giving clear decision-making authority to the 'home' resolution authority of the concerned institution. Disagreements between resolution authorities could also be arbitrated by a high level international authority.

Recovery and Resolution planning

We are in agreement with the proposals, with the exception of the paragraphs 11.6 and 11.11.

We do not believe that, as countenanced in 11.6, host authorities should maintain local resolution plans save in truly exceptional circumstances, as this would be in contradiction with the principles of cross-border cooperation introduced in Section 8.

We do not agree with the powers expressed in paragraph 11.11, and comment more fully on the issues involved in our response to questions 16 to 19 relating to Annex 6.

*2. Is the overarching framework provided by **Annex 1: Key Attributes of Effective Resolution** specific enough, yet flexible enough to cover the differing circumstances of different types of jurisdictions and financial institutions?*

Although we are in agreement with many of the elements contained in Annex 1, as shown by our responses to question 1, we feel that in many instances the proposals represent a missed opportunity. The difficulties in orderly resolution of large international financial institutions are real and have been correctly identified, however the solutions proposed by the FSB, whilst imposing new burdens on financial institutions and their national regulators, do not seek to find international solutions for the uniquely international problems of successful resolution of systemically important financial institutions.

In too many instances the proposals seek to preserve the autonomy of national authorities and miss the opportunity to promote an overarching international harmonisation of financial supervision, of resolution regimes and of deposit guarantee schemes.

Where the FSB proposals take the path of least resistance in proposing that supervisory and resolution authorities cooperate through bilateral agreements and institution-specific cross border

cooperation agreements, we consider essential that the FSB sets out an ambitious multilateral programme to address the resolution of financial institutions, to be implemented with the active support of the G20 and the leaders of non G20 countries. This programme should be part of the binding multi-lateral treaty that would lay down the principles of resolution of multi-national financial institutions.

Without a clear commitment from the FSB and G20 to move towards a harmonised international resolution regime that enshrines the principles of global equity of treatment of financial institutions in resolution and their creditors, we fear that a bi-lateral or multi-lateral through individual negotiation will provide only painfully slow progress towards the stated objective of effective resolution of systemically important financial institutions.

*3. Are the elements identified in **Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes** sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?*

The ‘bail-in within resolution’ tool is significantly different from other bail-in mechanisms that have been discussed recently, and is, in our view, an important step forward in the integration of bail-in into a functional resolution framework.

We are therefore favourable to the proposed ‘bail-in within resolution’ regime, on the following conditions:

- Recourses against shareholders and holders of other loss absorbing instruments have been exhausted. I that respect, we believe it useful to structure bail-in as a two-step mechanism. In many instances, capital and subordinated debt will suffice to absorb losses and to come up with a viable solvency situation. This first restructuring should not be considered as an even of default. The bail-in of the senior debt will be decided in a second step, if absolutely necessary in the perspective of the orderly liquidation of the firm.
- The tool must rely on a statutory, and not contractual, authority whose conditions are fully harmonised at international level
- The tool must be used exclusively within resolution, and thus at a point at which the non-viability, or impending non-viability, of the institution has been decided by the relevant authorities either with the agreement of the institution or with the adequate expeditious legal blessing.
- Bail-in, particularly in its first stage, should be used as a tool to facilitate resolution of those parts of a failed financial group that may still have value or conduct critical economic functions.
- The bail-in should cover as wide a range of liabilities as possible.
- The bail in mechanism does not alter the order of seniority of claims.

Under these conditions, we believe that bail-in within resolution would preserve rather than deteriorate the interests of unsecured senior debt holders, who would only be subject to bail-in at a point at which their interests would already be seriously under threat. However the actual effect of such statutory bail-in on the other contractual obligations of the concerned institution, and particularly its impact on its qualification as an Event of Default and hence on the Early Termination Rights are unclear to us. The interplay between these issues and those raised in questions 26 to 34 needs yet to be clarified.

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4. Is it desirable that the scope of liabilities covered by statutory bail-in powers is as broad as possible, and that this scope is largely similarly defined across countries?

We would agree that the scope of liabilities covered should be as wide as possible, and concur with the proposals in Annex 2 5.3 stipulating that instruments containing contractual bail-in or conversion features should be bailed-in or converted before any statutory bail-in, which should take place at a conversion price reflecting the loss of value of the institution. This is essential in order to preserve the fundamental nature of senior debt.

In respect of clause 5.2, we consider that bail-in or conversion powers should always, as a point of principle, be applied consistently with the capital structure and respect the ranking of senior creditors.

The scope and functioning of bail-in powers should be entirely consistent across jurisdictions in order to ensure effective resolution of international institutions, and should be enshrined in national legislation or preferably in the international treaty referred to in our responses above.

The necessity for international cooperation on this issue is shown by the content of clause 2.3 of Annex 2. It is not, in our opinion, the responsibility of financial institutions to compensate, through negotiation of contractual terms, for the inability of national legislators to come to international agreement on a common corpus of law for resolution of financial institutions.

5. What classes of debt or liabilities should be within the scope of statutory bail-in powers?

All senior unsecured debt should be within the scope of bail-in, subject to the discussion of depositor preference and protection in Annex 7, and subject to exclusions below (question 6).

6. What classes of debt or liabilities should be outside the scope of statutory bail-in powers?

The classes of debt or liabilities that fall within senior debt but which should be excluded from bail-in powers should in our view be limited as far as possible, in order to avoid structuring and arbitrage.

We would suggest the following classes should be excluded from bail-in:

- Debt or liabilities that rank above senior debt (eg secured debt)
- New money provided following entry to resolution if not already protected by ranking
- Liabilities related to settlement and payment positions open on entry to resolution
- Liabilities to providers of basic material services required for keeping the operations running

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7. Will it be necessary that authorities monitor whether firms' balance sheet contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring minimum level of bail-in debt ? If so, how should the minimum amount be calibrated and what form should such a requirement take, e.g.,:
(i) a certain percentage of risk-weighted assets in bail-inable liabilities, or
(ii) a limit on the degree of asset encumbrance (e.g., through use as collateral)?

On the assumption that the scope of liabilities subject to bail-in within resolution is as wide as possible, as proposed, it should certainly not be necessary for authorities to introduce quantitative tracking of amounts of bail-in debt.

Supervision authorities regularly monitor the composition of financial institutions' balance sheets, and should continue to do so in the course of their normal supervision. It is the responsibility of ongoing supervision to ensure that an institutions balance sheet is built up in a prudent manner that avoids excessive recourse to secured funding. The introduction of further elements of numerical reporting is no substitute for well-judged supervision and would be of no added value, not to mention that the market is already very watchful of these factors.

The introduction of quantified targets for bail-in debt would also, paradoxically, imply that there could simultaneously be the creation of unsecured non bail-in debt, which is an eventuality to which we would be opposed. This would simply equate to transforming senior unsecured debt into a "tranche" of 'partly subordinated' debt that would be junior to the 'new senior debt' created by the issuance of bail-in exempt instruments. This would simply be a factor of further difficulty in the analysis of institutions' credit-worthiness, and lead to ever greater complexity in the resolution of institutions that had issued such debt.

8. What consequences for banks' funding and credit supply to the economy would you expect from the introduction of any such required minimum amount of bail-inable liabilities?

As stated above, no such minimum requirements should be needed, as all senior unsecured debt, subject to limited exceptions, should be bail-inable. Our belief is that the introduction of bail-in within resolution of senior unsecured debt, on as wide a base as possible, and without the possibility of creation of non-bail-inable debt, would be the option that would minimise the impact on bank funding.

Resolution regimes allowing for bail-in within resolution of nearly all senior unsecured debt would in effect be confirming that senior creditors do take effective credit risk, that no institution can be considered 'too big to fail', and would thus reduce considerably the moral hazard associated with the perception that senior debt will always be privileged. This will undoubtedly result in higher funding costs for financial institutions because of the creditor perception of the realities of the risk associated with senior unsecured debt. However, these additional costs will be differentiated between institutions according to investors' perception of their risk of entering resolution, which is precisely the effect that is being sought.

9. How should a statutory duty to cooperate with home and host authorities be framed? What criteria should be relevant to the duty to cooperate?

Whilst institution-specific cross-border cooperation agreements will be essential for preparing and organising efficient resolution of failing institutions, we fear that they will prove immeasurably complex to put in place between multiple jurisdictions if the duty to cooperate is contained solely in bi-lateral agreements. Our strong belief is that a statutory duty to cooperate under the leadership of the home

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authorities should be created by a multi-lateral treaty that lays down the principles of resolution of financial institutions. This cooperation should have as its aims to promote global financial stability and to preserve as far as possible the interests of depositors and creditors of institutions in resolution.

Within such a multilateral framework, institution-specific agreements could then be addressed to the specificities of each institution, and deal effectively with the identifications of areas of particular difficulty that may arise in relation to each institution and with the establishment of preferred resolution methods for that institution.

We regret that the FSB considers that '*there is no immediate prospect of …..formal multi-lateral agreement addressing the set of issues raised in the resolution of financial institutions*'. The resolution of multi-national financial institutions poses problems that by definition will concern multiple jurisdictions, and progress towards an effective global system may be painfully slow if it is dependant upon the signature of an extensive series of bilateral cooperation agreements, and upon individual national adoption of legislative changes, that will moreover need to be mutually consistent in order to provide a coherent framework in which resolution plans for individual institutions can be drawn up. Although an international treaty may not be at first sight the easiest option to pursue, we feel strongly that it is the solution which will finally prove to be the most effective for rapid implementation of a coherent resolution framework.

Institutions and their regulators can commence planning for a hypothetical resolution situation, but if these plans are built in a legal environment that is constantly changing as individual countries proceed with local statutory modifications, all bilateral agreements and institution resolution plans will be in a state of permanent amendment and updating to reflect the latest state of play of national law in the countries where a given institution is present. Such a situation will be far from conducive to the early establishment of realistic and effective resolution plans.

We urge the FSB to encourage the G20 to proceed as rapidly as possible towards the implementation of an international treaty covering the resolution of financial institutions. It is high time for our global economy to be governed on a truly international legal basis. Patches will not be taken seriously by the market.

*10. Does **Annex 3: Institution-specific Cross-border Cooperation Agreements** cover all the critical elements of institution-specific cross-border agreements and, if implemented, will the proposed agreements be sufficiently reliable to ensure effective cross-border cooperation? How can their effectiveness be enhanced?*

We believe that Annex 3 captures the critical elements of cross-border agreements, but as described above, believe that their effectiveness can only be assured when they form the institution-specific part of an agreed international resolution framework.

As outlined in our responses to the questions in Annex 1, we feel that two elements in particular warrant further detailed attention, confidentiality and CMG governance.

Confidentiality impinges differently upon recovery plans and resolution plans.

- Recovery plans, through their documentation of preferred recovery options, convey highly confidential information concerning an institution, in particular through its definition of its core activities, those that it would see as being candidates for disposal, and the mapping of its activities by country and legal entity. Much of this information is not currently communicated outside the institution. In the case of listed institutions, this is highly market sensitive information that cannot be communicated without the institution being certain that all onward communication by regulators is on a legally binding basis of confidentiality, and would only take place on a strict 'need-to-know' basis.

- Resolution plans, although the responsibility of resolution authorities, will need significant input of data and details of legal structure from the concerned institution, and will by definition make explicit the actions required in order to split an institution into its constituent parts in order to dispose of or liquidate them in a manner that maximises value for creditors and potentially shareholders. This is also highly sensitive information that should be conserved exclusively for the use of resolution authorities.

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Making either resolution or recovery plans public, either fully or partially, can in no way serve the cause of global financial stability. Publishing blue-prints for the dismantlement of systemically important financial institutions is most likely to be a self-fulfilling prophecy than a factor of stability. In addition, the existence of such disclosure would turn the exercise into a completely watered down and hence useless administrative chore.

Once a comprehensive global system for the resolution of SIFI's has been drawn up, and the resolution tools available to resolution authorities are known to and understood by financial markets, we can see that there may be some potential merit in making public the fact that resolution plans are in existence and cover the world's largest institutions, but this could itself be a double-edged sword. In publicising the fact that certain institutions are now subject to agreed resolution plans, there is a danger that the perception of those institutions not yet the object of resolution plans could be negatively affected.

The governance of CMG's and resolution processes is an area where absolute clarity is required. In order to be effective, a CMG must be made up of a limited number of members, which we would suggest should be the 4 or 5 jurisdictions in which an institution has the greatest importance. A two-tier system – decision making and ratification – could be envisaged for institutions with exceptional wide presence. The split of responsibility and decision-making powers between home and host authorities must be clearly established in advance if a resolution is to be managed decisively and efficiently.

We feel that primacy must be given to home authority, who should be responsible for coordinating and leading the resolution of a failed financial institution, with a mandate to minimise disruption to financial stability and maximise creditor value, pursuing both objectives at a global, and not merely national, level. The home authority should lead and guide the actions taken by host authorities, acting through the CMG for those jurisdictions present within the CMG, and acting in liaison with host authorities that are not present in the CMG. CMG decisions should prevail over those of host authorities, be they present or not within the CMG.

The commitments of home and host authorities as expounded in sections 4 and 5 of Annex 3 are, we believe, correct in the direction taken, but should be strengthened. The references to 'best efforts' and to 'where possible and feasible' in 4.1 (iv) and (v) should in our opinion be removed or considerably limited. It is essential that the mandate of a home authority should be clearly based on a duty to minimise instability and protect stake-holders interests in all relevant jurisdictions. Similarly the caveat in 5.1 (iii) reserving the right to 'act on their own initiative if necessary……to achieve domestic stability' should be removed or severely limited and if retained should make reference to global rather than domestic stability.

Clearly situations may arise in which there is dissension within a CMG, but the home authority should have the power of final decision, subject to a limited power of veto afforded to host authorities where they are convinced that the decisions of the home authority do not respect the mandate of preservation of global financial stability and stake-holder value. In such cases, governance mechanisms for resolving dead-locks need to be introduced. We would suggest that an international authority be designated to act as a 'court of appeal' for host authorities who have serious misgivings about the direction taken by a home authority or a CMG.

11. Who (i.e., which authorities) will need to be parties to these agreements for them to be most effective?

We would suggest, as outlined above, that authorities from the 4 or 5 jurisdictions in which an institution has the greatest importance would be the optimum size for an efficient CMG, and clearly these authorities should be signatories of any institution-specific agreements.

The nature of the authorities should also be clarified. The consultation paper refers in Annex 3 to 'relevant authorities', 'Parties' and authorities as '(resolution or supervisory)'. As the overview makes it clear (page 7) 'ensuring that financial institutions are resolvable……..will require a reorientation of the supervision of SIFI's'. The respective roles of supervisory and resolution authorities need to be clarified.

In our opinion, resolution authorities should be comprised of representatives of the supervisory body, the central bank and the Ministry of Finance of the relevant jurisdiction, to which the Justice Ministry could potentially usefully be added, at least until harmonisation of international resolution regimes has been achieved. Governance principles, including the existence of a Chair, must be defined. Resolution authorities should be focussed on preparation of detailed and effective resolution plans, and should ensure that they have sufficient resources potentially available to them to conduct a resolution if needed. Their role is essential, but they should be concerned solely with deciding resolution actions on the bases of proposals elaborated and, latter on implemented, by an administrator and/or the remaining management of the institution.

There should not be confusion with the role of supervisory authorities, whose role is to oversee the functioning of the institution in normal circumstances, and who should be the primary, or possibly sole, point of contact for institutions in relation to their recovery plans.

Drawing a clear distinction between the responsibilities of resolution authorities and the ongoing-management focussed responsibilities of supervisory authorities is an essential step in avoiding the often cited danger of ‘supervising for failure rather than supervising for success’. This need to clarify the roles of different authorities also extends to distinguishing, along the same lines, between CMG’s and supervisory colleges.

Over and above the questions of optimal membership of CMG’s and signatories to institution-specific agreements, we would reiterate that by far the most important step towards effectiveness in resolution would be the creation of a consistent international framework for resolution of financial institutions.

*12. Does **Annex 4**: **Resolvability** **Assessments** appropriately cover the determinants of a firm’s resolvability? Are there any additional factors to be considered in determining the resolvability of a firm?*

Annex 4 describes in outline the key elements of the resolvability of an institution, and we concur with the elements presented in Section 5 as being the key factors to be examined to ascertain the potential systemic impact of an institution entering resolution.

However, the idea developed in section 2 (ii) that factors affecting resolvability are of two types, those endogenous to an institution (structure) and those exogenous to the institution (resolution regime and cross-border cooperation framework), should be consistently developed throughout the remainder of annex 4, and carried forward to Annex 6, which fails to mention any onus on authorities to address the factors exogenous to an institution, and indeed seeks to place the responsibility for remedying such obstacles on the institutions. We comment further on this issue in our response to question 17.

We also feel that excessive attention is paid to intra-group exposures in section 4.3 (and which colours Annex 6 section 3). Intra-group exposures are a general feature of multi-national financial institutions and not of themselves an obstacle to resolution provided that resolution is envisaged as a group level process that has the objective of minimising disruption and maximising creditor value at a global level. The emphasis on intra-group exposures is, in our opinion, driven by an over-emphasis on legal entity resolution at a national level, which we believe to be ill-suited to the resolution of multinational financial institutions. As outlined in our answer to Question 1, Scope, we feel that resolution for such entities should be conducted at group level.

*13. Does **Annex 4** identify the appropriate process to be followed by home and host authorities?*

We agree with the three stage process proposed in Section 3, and with the notion that this should be a continuous process.

However, in line with the analysis referred to above between exogenous and endogenous factors, it should be made clear that in the process of remediation, each type of factor should be addressed by

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those most capable of doing so. Whilst Section3 (iii) does refer to actions being addressed to relevant regulatory authorities, we feel that it should be made clear that any remediation required relating to the issues examined in Questions 4.9 to 4.13 should be addressed specifically to the relevant home and host country authorities (see also our response to Question 17).

*14. Does **Annex 5: Recovery and Resolution Plans** cover all critical elements of a recovery and resolution plan? What additional elements should be included? Are there elements that should not be included?*

Annex 5, in our opinion and according to our experience to date in preparing an RRP, does cover the critical elements required. We would suggest some additional inclusions and exclusions as described below.

- Recovery plans

We disagree with the statement in 3.1 that firms should identify 'criteria…….which would trigger the implementation of an RCP'. An RCP should never be implemented as a result of a trigger being met, but exclusively as the result of a management decision, potentially with input from supervisory authorities. An RCP will be made up of a series of potential operations such as capital raising or restructuring measures that management of the institution may choose to implement at any point in time, whether the institution is under stress or not. We do not subscribe to the belief that entry into recovery can or should be defined by specified criteria, if only because the circumstances in which an institution can find itself in difficulty are extremely variable.

Furthermore, any decision by management to implement an RCP, or to use one or more of the options contained within an RCP, should remain strictly confidential between the institution and its supervisory authorities. An RCP will need time to be effective, and any suggestion or rumour that an institution has officially entered recovery will in all likelihood hasten its decline and remove the time needed for the RCP to be effective.

If the aim of documenting triggers or back-stops is to prevent management or supervisory forbearance, we recognise that this can have some merit as a fall-back position, but are not convinced that circumstances leading to recovery are sufficiently predictable for precise levels of triggers to be defined in advance that adequately translate in all circumstances the necessity to commence RCP implementation. If back stop triggers to prevent forbearance are to be defined, it should be clear that the taking of a reasoned decision, at an appropriate moment, to implement an RCP is the responsibility of management, potentially with input from supervisory authorities, and that this decision should be taken as and when management feel it is necessary, not only when back-stop trigger levels are reached.

In summary, we feel that while back-stops may be a useful fail-safe device, the entry into recovery should not be envisaged as a defined moment in defined circumstances, but should be left to the discretion of management and should remain confidential. Supervisory authorities have the ability to suggest to management that implementation of an RCP should be considered, and should rely on their knowledge of the institutions that they supervise, and not quantitative triggers, to determine the point at which such discussions should be initiated.

- Resolution plans

Whilst we understand that the implementation of resolution plans will necessarily be the responsibility of resolution authorities, we are concerned that the processes documented in Annex 5 do not allow for sufficient discussion of resolution plans with the concerned institutions, particularly as Annex 6 opens the possibility of institutions receiving requests to make changes to their structures or organisation in order to improve resolvability. If RSP's are to be practical and effective, it is essential to ensure through discussion with the management of the institution that the information provided by the institution to facilitate preparation of the resolution plan has been correctly interpreted and that the resolution measures envisaged by the resolution authorities are the most suited to the circumstances of the institution.

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We would suggest that an additional element should be added to resolution plans, which is the analysis by resolution authorities of the exogenous impediments to effective resolution, including any lack of consistency of resolution regimes between jurisdictions potentially involved in the resolution, and the concrete steps that authorities have implemented or will implement in due time to limit or remove these impediments.

*15. Does **Annex 5** appropriately cover the conditions under which RRPs should be prepared at subsidiary level?*

We do not see where the preparation of RRP's at subsidiary level is documented in Annex 5, save that the introduction refers to RRP's being required 'for any firm which is assessed by its home authority to have a potential impact on financial stability'.

As already stated in our responses to Questions 1 and 12, our belief is that RRP's, and the process of resolution itself, should be conducted at group level, which means all consolidated legal entities. The treatment of minority interest, particularly when the concerned subsidiaries are public companies, has yet to be further elaborated. This difficulty has so much upside that it can certainly be overcome. The non-bank subsidiaries should also remain within the scope of the Recovery & Resolution planning but the legal basis of such a position will have to be addressed. In the case of recovery planning, we can see no merit in individual subsidiaries preparing stand-alone recovery plans that would be implemented in circumstances where the subsidiary were under stress, but not its parent. In such circumstances, we would expect the parent to support the subsidiary, and simultaneously, if deemed necessary, impose measures that could resemble recovery actions on its subsidiary, but this is an aspect of normal ongoing management of a financial group that does not warrant the formality of individual recovery plans.

In the case of resolution planning, we suggest, as in several places in this document, that effective resolution of multi-national financial institutions must be conducted at a group level, and with a mandate to maximise global stability and value preservation. The implication that RRP's could be drawn up at subsidiary level, and thus approved and implemented by a host resolution authority, opens the door to ring-fencing of assets and unequitable treatment of stake-holders, all of which have been correctly identified by the FSB as impediments to effective resolution of complex financial institutions.

We would further add that it is often the case that structures where subsidiaries are created by large financial institutions are often imposed by regulatory authorities in host jurisdictions, certainly in some instances in order to protect domestic financial stability through ring-fencing of assets. If it is made clear that resolution will take place at group level, the motivation of national authorities to impose the use of subsidiaries may be limited, allowing institutions to simplify their structures through a greater use of branches covering a wider range of activities.

It is clear that implementation of group-level resolution of large financial institutions requires extensive changes to company law in all jurisdictions in order to make this a workable outcome. Yet without these changes, or an ambitious commitment to proceed towards such changes, we feel that progress towards a consistent international system for resolution will be extremely slow. As explained in our response to Question 9, we believe that rapid progress towards an international treaty on resolution of financial institutions is the optimal path towards effective resolution of financial groups.

*16. Are there other major potential business obstacles to effective resolution that need to be addressed that are not covered in **Annex 6**?*

We believe that the four key areas identified cover most major difficulties that can be encountered in resolution.

In relation to outsourcing, we would add that the situation where an institution is a provider of outsourced services to other financial institutions should also be considered. Whilst this will be

identified by the other institutions in their RRP's, the identification of services offered to the market is not explicitly mentioned in Annex 6.

17. Are the proposed steps to address the obstacles to effective resolution appropriate? What other alternative actions could be taken?

We agree that timely and comprehensive management information is essential to the management and supervision of an institution in both normal operations and in crisis management, and that this information should be available at legal entity and consolidated level. Attention should also be paid to the availability of information at 'business line' level, which covers a coherent subset of activities that are managed within an institution and may cover a range of legal entities, none or few of which may be exclusively devoted to that business line.

We would also point out that Section 2, dealing with SLA's, proceeds from the assumption that operational functions that are centralised for reasons of efficiency are carried out by separate legal entities under the control of the institution or by third parties. However, in many instances, operational functions common to many parts of the institution may be carried out by specialised departments within the institution. Internal SLA's will generally be in place, but by nature will not be legally enforceable contracts. We would suggest that firms should identify these instances of 'internal outsourcing', which are a significant source of operational efficiency, such that were the institution to enter resolution and a split of activities to be implemented (eg partial transfer to a bridge bank), then service contracts could be rapidly documented at that point in time, appropriate to the split of activities that was decided.

18. What are the alternatives to existing guarantee / internal risk-transfer structures?

We are surprised by the analysis of organisational complexity and intra-group transactions contained in Section 3.

The analysis of the impact of intra-group guarantees and back to back booking practices seems biased. Whilst it may be true that the insolvency of a parent may hasten the insolvency of guaranteed subsidiaries, the opposite is equally true; the existence of a solvent parent will defer or eliminate the insolvency of its guaranteed subsidiaries, thus limiting the impact on financial stability.

The discussion of back to back booking practices is dominated by the idea that differing resolution regimes and local ring-fencing can trap value in one group entity to the detriment of others. Whilst this may be true today, we cannot follow the argument that the remedy is to be found in firms seeking to limit intra-group exposures or reconstitute separate legs of transactions. Surely the most adequate and effective remedy is to ensure that authorities renounce ring-fencing and collaborate in resolution plans that maximise stake-holder recovery at the global level. This reinforces our call for ambitious progress towards an international treaty covering the resolution of financial institutions.

*19. How should the proposals set out in **Annex 6** in these areas best be incorporated within the overall policy framework? What would be required to put those in place?*

We are concerned that the overall tenor of the proposals to address resolvability issues is too centred on immediate changes in a going-concern environment in order to address obstacles that would arise only in a hypothetical resolution situation. Financial institutions are not, and should not, be managed with a view to 'successful failure'.

Whilst it is clearly a duty of management to bear in mind the eventuality of a failure, to limit its probability and to foresee the problems that could arise in that event, we do not believe that the going-

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concern business models freely chosen by institutions under private management should be called into question by resolution authorities.

Such resolvability improvement measures seem all the more intrusive that they could be applied to a healthy institution not experiencing any particular difficulties. Whilst they should not be ruled out under certain circumstances, it should be specified in any policy framework that they should only be imposed in a proportionate manner, if an objective link can be established between the organization of the group and its financial stability and, in any event, without the authority dictating organizational models to private groups that must preserve their freedom of action and enterprise.

Synergies and integration are critical to the development of an efficient and strong banking system; breaking up the operating architecture of banking groups would certainly not serve the cause of financial stability.

Any policy framework should draw a clear distinction between requiring a firm to take steps to improve its current financial stability and requiring a healthy viable firm to make significant organisational changes simply to make it more easily resolvable in the event of failure. The business model that is optimal for straightforward resolution may not be the same business model that is optimal for efficient risk management in a healthy institution. We are clearly prepared to satisfy the first set of objectives; we quite opposed to the second one.

We would also like to underline that any powers to request changes to operational models should be strictly controlled. Firstly, the multiplication of uncoordinated and possibly inconsistent requests across countries must be avoided. In that respect, we reiterate our plea for the constitution of a narrow resolution college. Secondly, these requests for action formulated by the supervisory authorities must remain open to suspensive appeal under national legislation.

20. Comment is invited on the proposed milestones for G-SIFIs.

The timetables proposed arevery ambitious, but may in our view be achievable, at least as a preliminary exercise, provided that work is already underway towards realisation of the objectives. In the case of global SIFI's, those banks that commenced work on draft RRP's in early 2011 at the latest should be in a position to complete first drafts by December 2011 for RCP's and to have provided a first tentative set of information to supervisors for RSP's by June 2012.

We are unable to comment on the extent to which authorities will be able to meet the objectives assigned to them in the areas of confidentiality, cross-border cooperation agreements, resolvability assessments and CMG outreach whereas these points are clear stumbling points.

We would point out that one essential element is completely absent from the proposed timetable, which is the harmonisation of national resolution regimes, preferably through international treaty, but failing this, through national legislation and the bi-lateral and multi-lateral agreements. In the absence of such harmonisation, the task of regulators and financial institutions will be considerably more difficult and less effective in addressing the problem of resolution of SIFI's.

21. Does the existence of differences in statutory creditor rankings impede effective crossborder resolutions? If so, which differences, in particular, impede effective crossborder resolutions?

Differences in creditor rankings between jurisdictions are a clear impediment to effective cross-border resolution.

Whilst the general order of preference outlined in Annex 7 that runs from secured creditors through to senior debt, subordinated debt and shareholders is a framework that is generally respected, difficulties of application arise when;

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- Jurisdictions give privileges to certain classes of creditor (eg the state) that are not present in other jurisdictions
- The definition of depositors covered by deposit guarantee schemes differ between jurisdictions
- The amounts covered by deposit guarantee schemes differ significantly
- Depositor preference and/or deposit guarantee scheme preference is present in some jurisdictions and not others.

These differences should obviously be ironed out.

22. Is a greater convergence of the statutory ranking of creditors across jurisdictions desirable and feasible? Should convergence be in the direction of depositor preference or should it be in the direction of an elimination of preferences? Is a harmonised definition of deposits and insured deposits desirable and feasible?

Greater convergence of statutory rankings, of the definition of deposits and insured deposits are certainly desirable to facilitate international resolutions.

The feasibility of such convergence is dependant on the will and ambition of political leaders to work towards such an international harmonisation. We would, as is clear from our other comments on the proposals, be strongly in favour of such international harmonisation.

The debate on depositor preference raises many complex issues. In our view it is essential to draw a clear distinction between depositor protection through deposit guarantee schemes, and depositor preference over other senior creditors.

The protection of retail and SME depositors, up to a reasonable maximum amount, is in our opinion essential for the global financial stability and the maintenance of confidence in the financial system. The guaranteed amount should be set at a level that protects a high proportion of retail and SME depositors but exposes the largest retail depositors to potential losses.

This protection does not in our view constitute depositor preference, which would only be present if non-insured depositors, and the DGS, subrogated in the rights of the insured depositors, were to benefit from preference over other senior creditors. We believe that convergence should be in the direction of elimination of preferences.

23. Is there a risk of arbitrage in giving a preference to all depositors or should a possible preference be restricted to certain categories of depositors, e.g., retail deposits? What should be the treatment of (a) deposits from large corporates; (b) deposits from other financial firms, including banks, assets managers and hedge banks, insurers and pension funds; (c) the (subrogated) claims of the deposit guarantee schemes (especially in jurisdictions where these schemes are financed by the banking industry)?

We do not believe, as outlined above, that depositors should benefit from preference over other senior creditors of a failed institution. Retail deposits should be protected, in order to maintain confidence in the banking system, but this protection should be provided by deposit guarantee schemes. Once subrogated in the rights of the insured depositors, their claims should rank equally with other senior creditors.

We do not feel that the fact that the deposit guarantee scheme may be funded by the banking industry should affect the ranking given to the scheme. In the case of failure of a SIFI, the banking industry will in all likelihood be exposed to the institution as a senior creditor, and therefore any cost limitation afforded by a preference given to the deposit guarantee scheme will translate at least partially into reduced recovery under senior creditor exposures.

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Therefore, retail deposit insurance aside, we feel that all depositors should rank equally with other senior creditors of a failed institution, and can therefore be subject to losses and/or bail-in within resolution.

General depositor preference is in our view a dangerous option that would encourage arbitrage towards instruments that benefit from the preference and strengthen the belief that depositors can be immune from losses, which is a major contributory factor to moral hazard. The practical difficulties in the definition of a deposit for general preference purposes would also be a major obstacle. It would prove to be exceptionally difficult to lay down consistent rules that would adequately make the distinction between a sight deposit, a term deposit, a certificate of deposit, commercial paper, medium term notes and senior unsecured bonds. The potential for structuring and arbitrage of financial instruments would be enormous.

We would also be opposed to any form of depositor preference linked to the term of a deposit (eg 12 months or less). In our view this will simply serve to push investors towards shorter term instruments, thus increasing the likelihood of financial instability.

24. What are the costs and benefits that emerge from the depositor preference? Do the benefits outweigh the costs? Or are risks and costs greater?

For the reasons explained above, we believe that the risks and costs of depositor preference outweigh the benefits.

25. What other measures could be contemplated to mitigate the impediments to effective cross-border resolution if such impediments arise from differences in ranking across jurisdictions? How could the transparency and predictability of the treatment of creditor claims in a cross-border context be improved?

Improvements to resolvability linked to the ranking and treatment of creditor claims must be addressed by international agreement between regulators and legislators.

26. Please give your views on the suggested stay on early termination rights. What could be the potential adverse outcomes on the failing firm and its counterparties of such a short stay? What measures could be implemented to mitigate these adverse outcomes? How is this affected by the length of the stay?

The financial crisis in 2007-2008 clearly demonstrated that close-out netting mechanisms for financial contracts work in practice and resulted in an efficient mitigation of the widespread systemic risk related to the failure of financial institutions. Accordingly, any temporary stay of close-out netting rights must not have an adverse impact on the demonstrated importance of close-out netting in maintaining financial stability.

In our view, a coherent process for close-out, clear protections for title transfer collateral and security arrangements, as well as a suitably comprehensive set of definitions (e.g. covering close-out, netting, set-off, etc) should be set out in the relevant resolution legislation. Indeed, an international consensus on netting and close-out rights should be obtained, if possible, before attempting an international consensus on resolution. In addition, the regulatory capital treatment of a temporary stay/suspension of contractual rights, and possible transfer of those rights to a third party, needs careful consideration. We believe that a temporary stay or transfer of contractual rights should not result in increased regulatory capital requirements against relevant positions because the netting and associated mitigating arrangement would no longer be considered as effective. This kind of measure should be capital neutral.

Detailed consideration should be given to the treatment of existing Events of Default ("EoDs") under financial contract netting agreements, in particular those that do not arise solely by reason of a resolution order. In our view, any proposals must not prevent other EoDs either: (a) taking effect in accordance with their terms (e.g. a pre-existing failure to pay); or (b) the "re-testing" of other EoDs post-resolution, once the suspension is lifted (e.g. a credit-rating downgrade EoD under an ISDA Master Agreement). If any acceleration or termination is stayed whilst resolution action is being taken, irrespective of the nature of the EoD giving rise to such rights, then various additional issues need to be considered. For example, can an EoD for which the grace period elapses during the suspension be called and, if so, at what stage in the process? This may be relevant not only for the close-out and netting agreement but also for other reasons (e.g. credit event triggers for credit derivative transactions where the failing institution is the Reference Entity). These are issues that will need to be addressed in detail, to avoid legal uncertainty.

We note in Annex 8 (II.4) that the stay would be aimed at achieving continuity of operations and consequently would not extend to all payment and delivery obligations and would not prevent close-out for reasons of failure to pay or delivery. Annex 8 gives the example of margin calls that would still have to be met, if due, during the temporary stay and if not met, once called, would entitle the counterparty to close-out the relevant financial contracts.

BNP Paribas is favour of excluding specific payment and delivery obligations from the temporary stay and preserving the right to terminate a contract for non-performance. However, if a contracting party is entitled to close out a transaction(s) automatically upon a failure to deliver/pay margin during a stay, this begs the question of the precise purpose of the stay and the achievement of continuity of operations. For example, if a margin call is made on day one, the failure to pay occurs on day 2, and 2 days discussions ensue to resolve the failure (e.g., valuation dispute), what the stay has actually delivered is to add up to a week of uncollateralised risk, ergo the utility of a temporary stay. In addition, it is noted that the stay is likely to have the effect of leading to higher margin requirements (especially initial margin) which is likely to have adverse liquidity implications.

It is of fundamental importance that a contracting counterparty to a failing institution should not be required to continue making payments to that institution whilst its close-out rights (or where the other institution's related payment obligations) are suspended. Otherwise this is likely to have major adverse credit risk and liquidity implications. We believe this mutual suspension of payments would not interfere with the rationale for the proposed temporary stay.

We believe that, *prima facie*, all creditors at the same "level" (e.g. unsecured, unsubordinated creditors) should be treated equally, so that, for instance, swap counterparties should not have payments suspended whilst bondholders do not. We appreciate that there may some clearly defined exceptions to this general principle, but that this should remain the starting assumption.

27. What specific event would be an appropriate starting point for the period of suspension? Should the stay apply automatically upon entry into resolution? Or should resolution authorities have the discretionary right to impose a stay?

There should be a clear and precise definition of the beginning and end of the stay with reference to objective criteria, e.g. formal notification or publication by the resolution authority. Notification mechanisms should also be foreseen to inform contractual counterparties of the transfer of their positions to a new entity i.e. identity of the relevant entity and the positions in question. All such notifications should occur rapidly to enable counterparties to decide how to exercise their rights against the post-resolution entities on a fully informed basis.

28. What specific provisions in financial contracts should the suspension apply to? Are there any early terminations rights that the suspension should not apply to?

The ability to suspend contractual termination rights must be clearly defined in scope and limited in application in a manner that does not impact the legal recognition of the validity and enforceability of

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close-out netting. In practice, the prohibition on exercising any form of acceleration or termination right would preclude not only the exercise of close-out rights during a resolution period, but also the exercise of ETOs, despite the fact that counterparties may wish to exercise an ETO based on market movements during the resolution period, rather than as a response to the use of the resolution power. We believe that the exercise of options in a resolution period requires clarification and further study by the FSB, particularly bearing in mind (i) the different types of ETOs (e.g. ETOs which terminate at nil payment and those which generate a mark-to-market valuation and payment); and (ii) the possibility of other option exercise rights arising during the suspension period.

Furthermore, we believe that discussion is required as to whether or not a temporary stay would also extend to termination, valuation and set-off rights more generally and also what role mutuality has to play in determining the eligibility to set-off and the protections against the "splitting" of rights and liabilities that are protected under a title transfer collateral arrangement, a set-off arrangement or a netting arrangement, and whether third party guarantees are impacted by the stay. In principle, we are not in favour of the splitting of positions that are protected under a single title transfer collateral arrangement, a set-off arrangement or a netting arrangement.

29. What should be an appropriate period of time during which the authorities could delay the immediate operation of contractual early termination rights?

The length of a stay should be as short as possible to limit the possible negative financial impacts of such stay and to avoid legal uncertainty. In this respect, we understand a 24 hour period currently exists under the US Federal Deposit Insurance Corporation ("**FDIC**") regime in the U.S. There should be a degree of international consistency as to the length of stay imposed (particularly with reference to the possibility of counterparties facing different entities within cross-border groups, potentially under multilateral close-out arrangements).

30. What should be the scope of the temporary stay? Should it apply to all counterparties or should certain counterparties, e.g., Central Counterparties (CCPs) and FMIs, be exempted?

We would be inclined to believe that cleared positions with CCPs and any related collateral and security arrangements should remain in such CCPs and be excluded from the scope of the stay in order to contain the systemic risk. We would also draw your attention to the European Commission's thinking on this and the suggestion on page 73 of their Discussion Paper that that the transfer, cancellation or modification of property, rights or liabilities of a failed bank should not affect the operation of systems and rules of systems covered by the Settlement Finality Directive (Directive 98/26/EC).

A related issue is whether transactions entered into by Central Banks and by payments and securities settlement systems should be excluded from the scope of the suspension. Whilst there may be systemic risk arguments in favour of this approach, we would query: (i) whether this would be consistent with the principle of equal treatment of creditors above; and (ii) if the aim of the use of the resolution power is to resolve the failed institution and allow all or part of it to continue as a going concern, why contracts entered into with Central Banks, [CCPs] and payments and securities settlement systems should not also continue in principle, to ensure market continuity to the relevant institution.

31. Do you agree with the proposed conditions for a stay on early termination rights? What additional safeguards or assurances would be necessary, if any?

The purpose of set-off and netting arrangements is to combine several rights and obligations under a single agreement in order to allow close-out netting. In this context, any possibility that a resolution authority can undo such an arrangement would threaten the prudential treatment given to netting arrangements by calling into question their enforceability. This leads to the conclusion that such close-out netting rights contained in the relevant agreements, and all transactions covered thereby, must be transferred as a whole or not at all in order to prevent any potential cherry-picking of transactions or partial transactions. We support the recognition in Annex 8 (II.vi) that the authorities would only be entitled to transfer all of the contracts with a particular counterparty to a new entity and that cherry picking would be prohibited. Any possible form of “cherry picking” would weaken the legal certainty attached to netting and broader set-off arrangements (which by definition can refer to non derivatives-related transactions). In our view, any possible flexibility given to the resolution authority undermining safeguards effects will lead to an increase in systemic risk.

As a general rule great care should be taken when drafting the safeguards from use of resolution powers to have a sufficiently comprehensive list of contracts covered (unless the idea is to use an “all inclusive” approach and then list specific exclusions). For example, in the UK context, we would draw your attention to the potential issue (highlighted as a result of the UK Banking Act 2009 and deficiencies in the original Safeguards Order - Banking Act 2009 Restriction of Partial Property Transfers Order 2009) where financial market arrangements were defined by reference to MiFID or Banking Consolidation Directive (“**BCD**”) instruments. We believe that protected contracts should not be limited to contracts covered by any particular harmonised financial services regulatory regime (e.g. MiFID or the BCD).

Further and careful consideration needs to be given to the treatment of assets located outside home jurisdictions, as well as rights and liabilities governed by the law of a third jurisdiction. This is particularly relevant, for example, in the case of Title Transfer Collateral, where the entitlement to securities forming part of the transferred margin (and related obligation to return equivalent securities) may be governed by the law of one jurisdiction (e.g. an English law governed ISDA Master Agreement incorporating a Credit Support Annex), but the securities may be held in a central securities depository and/or listed on an exchange in a third country, and may therefore be subject to different rules or procedural requirements. We believe that it would run contrary to the “no creditor worse off” principle if a resolution authority were free to use a resolution power in such a way that affects the rights of a contracting counterparty under a master agreement, without any reference to how assets which constitute collateral or margin for the underlying obligations would be treated under their lex situs. In our view, the relevant legislation should impose a firm obligation to ensure that the benefit of security is transferred with the obligations that it secures, as well as any related assets. This would be consistent with the general premise that a resolution regime should prevent the transfer of assets against which a liability is secured unless both the liability and the benefit of the security are also transferred.

Another example of cross-jurisdictional issues would be the effectiveness under the law of the contract of any “forced” transfer (e.g. to a bridging bank) which is inconsistent with a “no transfer without consent” provision in the relevant master agreement, and which therefore would have to be specifically dealt with under the laws of the specific jurisdictions (particularly where the failing institution does not have a branch or subsidiary within the jurisdiction of the governing law of the contract) as part of the implementation of this proposed regime on an “international” basis (most probably via an appropriate treaty).

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The treatment of non-derivatives positions is significant. In practice, cross-contract rights of set-off, netting and close-out may exist under a range of contracts, which seek to cover all financial dealings between counterparty and failed institution. In some cases, these arrangements may be multilateral (e.g. including affiliates of the counterparty, the failed institution or both). A principle of equal treatment of different types of financial contracts should ideally be hard-wired into any legislation. Resolution authorities should not, for example, have the discretion to favour particular obligations (e.g. bonds) over derivatives, which could lead to an early outflow of assets to certain creditors ahead of others. In other words, all creditors should in principle be treated pari passu, subject to certain limited exceptions.

32. With respect to the cross-border issues for the stay and transfer, what are the most appropriate mechanisms for ensuring cross-border effectiveness?

33. In relation to the contractual approach to cross-border issues, are there additional or alternative considerations other than those described above that should be covered by the contractual provision in order to ensure its effectiveness?

34. Where there is no physical presence of a financial institution in question in a jurisdiction but there are contracts that are subject to the law of that jurisdiction as the governing law, what kind of mechanism could be considered to give effect to the stay?

This group of questions raises complex legal issues that necessitate detailed study and analysis. We are not in a position to provide any meaningful response at this stage due to the short consultation period.