September 2, 2011

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sir/Madam:

Re: CBA¹ Comments on the Financial Stability Board’s Consultative Document: Effective Resolution of Systemically Important Financial Institutions

Thank you for the opportunity to comment on the Financial Stability Board’s (FSB) Consultative Document entitled Effective Resolution of Systemically Important Financial Institutions (Consultative Document). For your consideration, below is a summary of our key concerns.

Managing for failure at the expense of managing for success

Whilst we are supportive of the creation of a special resolution regime for financial institutions that minimizes the systemic and fiscal consequences of bank failures, we believe that such a regime and the political imperative of avoiding tax payer bail outs must be balanced against the equally important imperative of managing for the success of financial institutions and re-energizing national economies.

The recommendations set out in the Consultative Document reach the heart of the strategy and structure of major financial institutions. Further, recovery and resolution plans add to the cost of regulation, having far reaching organizational and strategic consequences. Such costly impositions can have destabilizing effects on financial institutions. The stability and efficiency of financial institutions contributes to a growing economy and maintaining their contribution to national and global economic developments has to be balanced against mitigating the risk and impact of failures through additional regulatory measures.

¹ The Canadian Bankers Association works on behalf of 52 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 267,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada’s economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.
In our respectful opinion, the recommendations outlined in the Consultative Document swing the pendulum too far in favour of measures that result in a conflict between managing for failure at the expense of managing for success. For example, the restrictions on intra-group guarantees have the potential impact of limiting certain strategic initiatives. Intra-group guarantees are a prudentially recognised risk management tool within banking groups on whose effectiveness group members rely. We are therefore of the view that the use of intra-group guarantees should not be restricted, provided that they are entered into at arms length and well documented.

Recovery and resolution plans should not be used for supervisory intervention in the structure or operation of healthy financial institutions without restructuring or resolution having become necessary. These measures must be a very last resort when orderly resolution seems otherwise impossible. In sum, the strategic priority of financial institutions should be focused on managing for success and as such, measures to improve resolvability should be reasonable.

**Lack of transparency**

We are concerned that the FSB’s recommendations are not sufficiently specific and transparent to permit a rigorous analysis of the impact of the proposals. Most specifically, the trigger mechanism within the resolution framework should be as transparent as possible and well defined in advance by law/regulation. For example, regulatory triggers ought to be scaled to differentiate between various points along the crisis management continuum using a mix of hard and soft triggers for early intervention. The corresponding resolution tools should also be more clearly assigned within the timescales of these phases clearly differentiating between recovery and resolution objectives.

The information requirements noted in Annex 5 paragraph 5 of the Consultative Document are also vague and open to interpretation. For example, further guidance is needed with respect to what constitutes ‘essential information’ (Annex 5 paragraph 5) and ‘operational data’ (Annex 5 paragraph 5.2). It would also be helpful if the FSB provided guidance on what is meant by ‘systemically critical financial services and functions’ (Annex 1).

**Cross-border cooperation**

We are supportive of the establishment of cross-border cooperation arrangements between home and host regulatory authorities prior to, and in the event of, a cross-border resolution of a systemically important financial institution. However, we believe that financial institutions should have input into such cross-border cooperation and coordination arrangements and, in the case of institution-specific arrangements, the institution itself should have input into the arrangements. The prominent role of the home country regulator should also be emphasized with respect to the cross-border cooperation process.

**Temporary stay on close-out netting**

We are concerned about the proposed suspension of the close-out netting mechanism referred to in Annex 8 paragraph 3 of the Consultative Document. As you are most likely aware, netting arrangements are an essential instrument for effective risk mitigation and have conversely been encouraged by the Basel Committee in various initiatives. We therefore believe that the impact of a close-out netting suspension should be considered prior to its imposition.
Bail-in

We are of the view that the impact of debt-write down/bail-in mechanisms should be further analysed before it is introduced as part of the proposal. If introduced it should be a last recourse action once other tools have failed and only in situations which are transparent (i.e. predictable and observable) and leave the holders of the ‘bailed-in’ instruments in no worse a position than had the bank become insolvent and liquidated in an orderly fashion.

Ranking of claims

We agree that greater consistency in the statutory ranking of creditors, and in particular the treatment of depositors, would promote cross-border cooperation and facilitate the implementation of certain resolution measures.

We do not believe that depositors should be given preference over other unsecured creditors upon insolvency. Many jurisdictions already provide protection to depositors up to a certain coverage limit through deposit guarantee schemes. If deposits are given preferential treatment over the coverage limit, we believe that this would lead to moral hazard and conflict with the system of limited deposit protection. Further, this preference would disadvantage other unsecured creditors (e.g. service providers, suppliers or official authorities).

While national deposit guarantees schemes may differ, we are of the view that the differing obligations of schemes to depositors does not justify national arrangements that give depositors priority claims over specific sets of assets in their jurisdictions. The expectation of national priority claims could create incentives for ring fencing and therefore non-cooperative behavior on the part of authorities and administrators of insolvency estates. This would hinder efforts to put in place meaningful cross-border arrangements. Therefore, we believe that the objective should be to eliminate provisions in national insolvency or resolution arrangements that create obligations on national authorities to act in this pre-emptive way.

The issues raised in Annex 7 (in relation to depositor preference), particularly in connection with cross-border implications, need to be further considered as part of the cross-border resolution review. This will allow for the development of concrete recommendations with respect to the ranking of claims across jurisdictions, thereby increasing the willingness of national authorities to cooperate and achieve coordinated cross-border solutions.

Confidentiality

We do not agree with the recommendation that institution-specific cross-border cooperation agreements be made public. We believe that recovery and resolution plans should be kept confidential.

Timeline

We are concerned about the timeline proposed by the FSB. Given that the final recommendations will not be published until November 2011, the timeline poses significant challenges in that it will not allow jurisdictions to adequately prepare for and incorporate (at times, through legislative changes) the FSB’s recommendations into their national regimes.
Single lead regulator

We recommend that a lead regulator, in most cases the home country regulator, coordinate the recovery and resolution plans and the resolution process of a business in multiple jurisdictions.

Burden of systemic risk

The trade-off between operating efficiency and system-wide financial stability is likely to hit major financial institutions the hardest. Whilst the financial crisis demonstrated that large, complex and interconnected financial institutions can generate disproportionate risks to financial stability, we believe that systemic risk should be borne by all key interested stakeholders, including home and host governments where appropriate.

Future re-assessment

We appreciate that the development of the SIFI resolution framework set out in the Consultative Document is only in the very early stages of development, and acknowledge that there are many complex and analytical challenges that will be addressed by the FSB in due course. As such, we could appreciate the opportunity to re-assess the proposed framework at a later point in time when it is more developed.

In conclusion, the unintended consequences of resolution planning need to be considered, particularly within the context of the potential outcomes from the introduction of a wide range of regulatory reform. We are concerned about the considerable challenges that recovery and resolution plans pose for financial institutions, ranging from the practicalities of implementation to the viability of business models.

We thank you for taking our comments into consideration and would be pleased to discuss these issues further at your convenience.

Sincerely,