European Banking Federation

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Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.
The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

Positioning in respect of the FSB Consultation on Effective Resolution of Systemically Important Financial Institutions

Key Points

- The establishment of an effective, cross-border resolution framework which allows for firms to be resolved without undue systemic disruption is likely to be the most effective way to addressing the moral hazard problem.

- The EBF therefore welcomes the overall approach set out by the FSB as an important step forward, while emphasising that the final framework should be as complete as possible and must be consistently applied across jurisdictions.

- The FSB and the G20 should pursue the creation of a harmonised international resolution regime by international treaty within a defined time-table.

- There is still need for a cumulative impact study on the combination of Basel III, the effective resolution regimes of SIFIs as well as of the additional loss absorbency requirement for G-SIBs and other regulatory changes currently being introduced.

- Recovery and Resolution Plans or other measures should not be used for supervisory intervention in the structure or operation of healthy financial institutions without restructuring or resolution having become necessary.

- The trigger for resolution needs to be well defined in advance by law. The trigger mechanism should be set at a high threshold, be as transparent, objective and predictable as possible, however without being automatic based on numerical thresholds.

- There is a need for delicate balance between transparent and acceptable reporting and disclosure for investors while maintaining necessary confidentiality.

- There needs to be legal certainty with regard to the accountability and liability of the institutions and authorities involved in crisis management.

- The home supervisor should draw up and coordinate resolution measures and provide a clear definition of tasks for both home and host supervision authorities. The home supervisor should always serve the cause of global, not merely national, financial stability.

- There should be no unduly burdensome restrictions on intra-group guarantees (or cross-default provisions). At the same time intra-group financial support should remain a voluntary management decision.

- The suspension of the close-out netting mechanism should be considered carefully following an impact assessment that analyses whether the advantages of a possibility to suspend close-out netting outweigh the disadvantages for risk mitigation and financial stability.

- If implemented, a suspension of close-out netting mechanism should be subject to strict time limitations and only in connection with the transfer of assets and liabilities as part of a resolution measure as well as safeguards preventing the separation of assets, rights and liabilities covered by a netting arrangement.

- The cost of a bank failure should be borne by shareholders and holders of other loss absorbing instruments. Creditors should suffer losses only in exceptional circumstances, equivalent to a liquidation, where all alternative measures have been explored and exhausted. Only subsequently should the wider industry be called to absorb further costs.

- The framework should ensure equitable treatment of creditors and shareholders across home and host jurisdictions and maintain financial stability for all jurisdictions concerned.

- A bail-in statutory framework is a potential resolution tool that needs to be further explored following a thorough impact analysis. Below we set out the conditions we believe are necessary to implement a workable regime.

- If introduced, statutory bail-in should be as flexible and as broad as possible, used as a last resource tool. It could ultimately be applicable to all liabilities, respecting the natural ranking of creditors and only as a recapitalisation tool for financing the resolution. Bail-in should be applicable globally, to all financial institutions, and not only to SIFI's.

- However, the introduction of a bail-in regime should be appropriately timed when markets have returned to business as usual while also allowing for sufficient time for markets to sufficiently understand the new bail-in framework.

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Related documents: FSB Consultative Document http://www.financialstabilityboard.org/publications/r_110719.pdf

GENERAL REMARKS

1. The European Banking Federation (EBF) welcomes the publication of the FSB Consultation on Effective Resolution of Systemically Important Financial Institutions. The policy proposals sets out by the FSB represent an important step forward in addressing the issue of systemic risk and the moral hazard.

2. The EBF generally regards the FSB's proposed policy approach to be the right one. The establishment of an effective, cross-border resolution framework which allows for firms to be resolved without undue systemic disruption is likely to be the most effective way to addressing the moral hazard problem and will ultimately have more impact than other measures, such as a capital surcharge.

3. The EBF agrees that prevention is better than cure and particularly, welcomes the strong focus in the FSB's proposals on recovery and resolution planning. In particular, the proposals to strengthen the cross border cooperation in the case of a crisis represent a crucial step forward. The resolution tools put under consultation are effective and coherent with the best practices under discussion at international level.

4. It is of the utmost importance to ensure that the final framework is as complete as possible and that there is consistent implementation across jurisdictions. In this regard, there are certain areas of the draft proposal, which will need further discussion and analysis, beyond the limited time afforded by the short consultation period. This is particularly the case for the two topics in the discussion notes, but also the recommendations on bail-in and resolvability assessments require further refinement.

5. A cumulative impact study on the combination of Basel III, the effective resolution regimes of SIFIs as well as of the additional loss absorbency requirement for G-SIBs and other regulatory changes currently being introduced would also be useful. We also encourage the FSB to submit proposals as regards the introduction of an international large exposures regime, as requested by the G-20 Leaders in their Summit in Seoul.

<u>With regards to the specific annexes:</u>

6. The EBF welcomes the Key Attributes which recognise the need for a resolution framework which applies to all financial institutions that could be systemically significant. Restricting such a framework to credit institutions and investment firms would be too short-sighted an approach to effectively address systemic risk.

7. Recovery and Resolution Plans or other preventative measures should not be used for supervisory intervention in the structure or operation of healthy financial institutions without restructuring or resolution having become necessary. Resolution measures must be a very last resort when orderly resolution seems otherwise impossible. These measures should be considered in close dialogue with the institution in a Pillar II context in order to be sure that resolvability obstacles could not be overcome by other means: supervisors should not have the ability to *defacto* impose restructuring of a viable, normally operating institution.

8. One of the key elements of an effective resolution framework is that the trigger for resolution is well defined in advance by law. The trigger mechanism should be as

transparent, objective and predictable as possible, however without being automatic based on numerical thresholds. There should be a high hurdle for putting an entity under the resolution authority to prevent it from becoming a means to circumvent shareholder and other protections that would otherwise apply. Entry into resolution should certainly not take place until it is clear that the recovery measures contained in the recovery plan have failed to be effective.

9. There is a need for delicate balance between transparent and acceptable reporting and disclosure for investors while maintaining necessary confidentiality to preserve commerciality, especially around some components of Recovery and Resolution Plans.

10. There needs to be legal certainty with regard to the accountability and liability of the institutions and authorities involved in crisis management. Resolution authorities should be and remain accountable for the measures taken; this is particularly relevant where a resolution authority may displace the management of a institution.

11. Although the consultation emphasises the key role of home regulators, some exceptions mentioned with respect to local branches of foreign institutions may foster ring fencing measures in a crisis of the respective firm which could hamper effective cross-border resolution due to an increase of conflicts (e.g. scope of local measures in relation to home authority measures). Within globally accepted principles of cross-border cooperation, the home supervisor should draw up and coordinate resolution measures and provide a clear definition of tasks for both home and host supervision authorities. Having in mind the aim to maintain financial stability across borders, the home supervisor should always serve the cause of global, not merely national, financial stability.

12. There should be no unduly burdensome restrictions on intra-group guarantees (or cross-default provisions). Intra-group guarantees (or cross-default provisions) are a legitimate option for those banking groups that voluntarily decide to rely on them. It is essential to recognise at the same time that the provision of intra-group financial support should remain a voluntary management decision of the entities concerned.

13. Netting arrangements are an essential instrument for effective risk mitigation. The suspension of the close-out netting mechanism as an element of a resolution tool should therefore be considered carefully and following an impact assessment that analyses whether the advantages of a possibility to suspend close-out netting outweigh the disadvantages for risk mitigation and financial stability. If implemented, a suspension of close-out netting mechanism should be subject to strict time limitations and only in connection with the transfer of assets and liabilities as part of a resolution measure as well as safeguards preventing the separation of assets, rights and liabilities covered by a netting arrangement. In the interest of legal certainty it should not be considered to provide for any exemption from these safeguards.

14. The cost of a bank failure should be borne by shareholders and holders of other loss absorbing instruments. Creditors should suffer losses only in exceptional circumstances, equivalent to a liquidation, where all alternative measures have been explored and exhausted. Only subsequently should the wider industry be called to absorb further costs.

15. Should a fund be needed, the EBF supports coordinated requirements for resolution funds to ensure a level playing field and to avoid goldplating, e.g. alternative funding requirements, calculation of contributions and provisions to avoid double taxation. The EBF maintains that countries should have national discretion and flexibility with regards to the funding for early intervention and resolution Where DGS are able to finance resolutions, there is no need to create a resolution fund. However, national jurisdictions should maintain flexibility to make this decision on their own and to tailor their use of DGS funds, their fund structure and funding methods according to the profile and needs of their financial industry. Given the differing starting points in terms of funding for DGS and varying preferences for ex-ante vs ex-post funding and the appropriate institutions, an evolutionary approach towards harmonisation starting with overarching principles and flexibility in delivery should be proposed.

16. The framework should ensure equitable treatment of creditors and shareholders across home and host jurisdictions and maintain financial stability for all jurisdictions concerned. None of the steps taken in the home or host jurisdiction shall have a negative impact on financial stability in the other jurisdictions. Differences in treatment of creditors and shareholders for cross-border financial institutions require equal procedural rules with legal certainty: a central source of information on these treatments which is accessible to creditors and shareholders to inform investment decisions would be helpful.

17. A bail-in statutory framework is a potential resolution tool that needs to be further explored. A thorough impact analysis should be done before it is introduced. Reviewing historical examples of previous financial institution failures should prove illustrative in identifying in broad terms the likely scale of a possible write-down/haircut and how this would be affected by the range of liabilities available. The impact on commercial banks' capacity to access funding should be carefully assessed. Its legal restrictions and consequences for market stability should be clearly understood.

18. Interplay effects with other regulatory proposals, such as the new liquidity requirements under Basel III, should also be carefully considered. The introduction of a Net Stable Funding Ratio (NSFR) as currently envisaged would require banks to invest in long-term, stable sources of funding in order to withstand financial distress on a one year-time horizon. It thus seems contradictory to encourage, on the one hand, longer-term funding while penalising, on the other, financing through senior unsecured debt.

19. It is important to stress that at the current juncture, with the price and availability of bank funding under significant pressure and significant changes to capital and liquidity requirements in process, there is a risk that the introduction of bail-in could have particularly pronounced impacts on bank funding. It may therefore be prudent for the regulators to allow a phasing-in period of such other measures before the introduction of a debt bail-in regime. Transition and phase-in arrangements for bail-in of new and existing debt would also be very important to allow the market to adjust.

20. If introduced, statutory bail-in should be as flexible and as broad as possible, used as a last recourse where other tools are assessed as unlikely to achieve an orderly resolution or protect creditors' interests in a gone concern phase, not as a going concern measure. The EBF supports bail-in to be initiated by the group resolution authority and coordinated at the resolution college level. In deciding to use bail-in, resolution authorities should be

required to undertake and document an assessment comparing the impact of liquidation versus the impact of use of bail-in, to ensure that holders of debt are no worse off than they would be under liquidation.

21. In a worst-case-scenario, it could ultimately be applicable to all liabilities, although respecting the natural ranking of creditors and only as a recapitalisation tool for financing the resolution. For level playing field issues, in order to avoid arbitrage, or in order to prevent financial engineering, bail-in should be applicable globally, to all financial institutions, and not only to SIFI's.

22. Bail-in will interfere with both owners' and creditors rights, requiring changes in national laws. The timings of implementation and retroactivity should also be addressed. Incentives should not be distorted. Loss absorbency ranking should reflect the weight in the decision power and ability to exert market discipline (informational asymmetry justifies this ranking). Thus shareholders should bear losses before junior creditors, and these in turn before senior creditors.

23. The timeline proposed by the FSB appears to be challenging given that the final recommendations will not be published until November. The timeline contains no objectives for jurisdictions to seek convergence of their resolution regimes through the legislative changes needed to incorporate the tools and powers set out in the Key Attributes into their national regimes, which will require more detailed rules. Further, the assessment of resolvability of SIFIs will be dependent on not only the provision of a resolution framework in the home country but also within the many host jurisdictions where it is located.

EBF DETAILED COMMENTS AND RESPONSE TO QUESTIONS

Effective resolution regimes

*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.*

The EBF welcomes the Key Attributes of Effective Resolutions set out in Annex 1. The attributes identified are sufficiently comprehensive and should prove to be effective. However, it may be necessary to adapt the framework to a number of different market participants (e.g. SME banks, hedge funds and insurance companies) and situations. For this reason, jurisdictions should be able if necessary to supplement the toolkit with instruments tailored to the specific circumstances in their own country. It will nevertheless be necessary to ensure that these country-specific instruments are not obstacles to cross-border crisis management and do not create incentives for regulatory arbitrage.

The industry would welcome the provision of a central source of information on the various regimes. This would assist institutions with recovery and resolution planning as well as informing business-as-usual strategic decisions, e.g., whether to open a branch or a subsidiary in another jurisdiction. It would also be helpful to authorities in a variety of ways, for example, in the context of a Crisis Management Group (CMG), it would be a useful reference for working out how a Resolution Plan would crystallise in practice.

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?*

The design of resolution tools and powers should be governed by the principle of harmonisation. Nevertheless the tools may be applied with national flexibility. Where cross-border groups are concerned there is need for greater consistency of application which should be achieved through resolution colleges or CMGs. For the sake of harmonisation, and to ensure a level playing field, there should be a common minimum set of tools and powers. Such a common minimum set of tools and powers would be crucial to coordinate resolution in cross-border cases. As a practical matter, efforts should be made to resolve any linguistic misunderstanding, i.e., it would be appropriate for supervisors to agree meanings and ensure that translations reflect the true definition of terms well in advance of the next crisis.

It is, in particular, doubtful whether the associated and in some cases serious interference with – constitutionally protected – positions to prepare resolution of an institution or allow it at an early stage would be justified e.g. the restructuring of a firm to improve resolvability. It should be absolutely clear that shareholders and management remain fully responsible for the firm and the steps taken to restore it to health until all recovery options have been exhausted.

To this end the EBF suggests that more detail needs to be provided in terms of when and where resolution tools are used. The resolution phase and therefore the powers to apply the resolution tools and the explicit responsibilities of the resolution authority should start at the point of non-viability. The decision to consider an institution as non-viable should depend on a case by case assessment by the authorities of the facts that have given rise to the problems, and simultaneously take into consideration a set of triggers or criteria available. It is also crucial that the framework has provisions of notification and reasonable publicity of a resolution proceeding; though transparency should not be an end of itself, and communication to the market and general public should be carefully managed to prevent contagion/extreme market reaction. The entry point to resolution needs to clear a high hurdle and be reasonably clear to provide investors with some certainty.

The EBF is of the opinion that the trigger must have the following features. It must:

- be after all alternatives have been explored to keep the bank in going concern;
- be objective, appropriately transparent and predictable;
- be holistic – i.e. combining current and expected deterioration of liquidity and solvency indicators;
- not be automatic – some safeguards must be in place to prevent an irrational move into resolution phase;
- be internationally harmonised; and
- be easy to understand for investors and wider public.

Therefore it is not appropriate or at least not sufficient to have only a "hard" quantitative trigger such as a solvency ratio which although transparent would be too automatic and simplistic to capture all crisis situations.

Any trigger will need supervisory judgement confirming the "point of non viability" of the institution in order to determine whether orderly winding-down or liquidation can take place. Given the extensive and irreversible effects of the entry into resolution, the decision taken either by the authorities to declare an institution in resolution should be challengeable by the management of an institution. In case of disagreement, the decision should be mediated taking into consideration the underlying justification and legality by an emergency judicial review, which must not, of course, unduly delay the final decision.

EBF Members are critical against the backdrop of European and international law of the idea that branches of foreign financial institutions will be handled by the authority of the host country (Annex 1, 1.1 and 8.4). Under the EU regime local branches are subject to the home regulator (in close and efficient cooperation with the host regulator) as they are not separate legal entities and they cannot be subject to separate insolvency proceedings. This is sensible and works within the fundamental statutory concept of legal entities, i.e., insolvency proceeding happen to legal entities, not ad-hoc bits and pieces of an institution arbitrarily designated by an external party.

There should be no deviation from this. This is also contrary to the European Directive 2001/24/EC on the reorganisation and winding up of credit institutions, which gives the authority of the home country the responsibility. Giving the host authority the power to close a branch independently not only gives rise to the risk of ring-fencing, but it also can lead to an uncoordinated final settlement of a group, which delivers sub-optimal results for creditors, communities, tax payers, and consumers. In addition, it is unlikely to incentivise supervisory cooperation if a host regulator feels that rights over branches negate the need to liaise with the home supervisor in either day-to-day or crisis mode.

It is vital that the FSB template sets out the respective responsibilities for home and host authorities as clearly as possible. It is reasonable to expect that in another crisis, particularly if the economic situation is fragile, political influence will be brought to bear on the authorities. The FSB template can provide the home and host authorities with the mandate they will need to proceed in a timely and effective manner with the resolution of a SIFI.

Paragraph 2.4 states that the resolution authority should have the authority to enter into agreements with resolution authorities of other jurisdictions. The EBF takes the view that it should be clarified and determined that the home resolution authority should not be entitled to delegate powers to resolution authorities of other jurisdictions. In other words: The credit institutions being subject to the competences of the home resolution authority shall remain subject to that resolution authority only. Further, any requirements on data protection, banking and commercial secrecies should be observed. The exchange of confidential information should be limited to the extent necessary and based on clear transparent provisions clearly defining what should be covered and what should not be covered. It should be avoided that the result of such agreements would be that the credit institution would face various resolution authorities.

The proposed blanket exclusion of liability for supervisory actions, performed during resolution upon the exercise of their powers in good faith (Annex 1, 2.6) is far-reaching and should be critically examined. Inappropriate regulatory action (such as wrongful dismissal of an executive director) should always be capable of challenge and – where appropriate –

redress, e.g., through the rights of said individuals to raise the matter with either an employment tribunal or court.

Paragraphs 8.5 states that national laws should not discriminate against other creditors, but then also says that where such provisions exist, they should be disclosed. We believe that national jurisdictions should remove such provision in a specific timeframe. Until then, any such provisions should be publicly disclosed.

Regarding the funding of firms in resolution (Annex 1, 6.) we believe it is right to propose that the costs of resolution should be borne first and foremost by the owners of the credit institution concerned. Thereafter, the creditors should be asked to bear a share of the costs, e.g. via debt for equity swaps.

<u>Bail-in powers</u>

*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 an important step forward in the integration of bail-in into a functional resolution framework.

As stated in the consultation document, the objective of bail-in is to ensure that the costs of resolution are borne by the firm's owners and creditors, rather than by taxpayers. That being said, the creation of a new regulatory resolution framework that contemplates a bail-in tool should be as broad and flexible as possible since it is impossible to determine *a apriori* the:

- events that will lead a bank to resolution;
- macroeconomic and financial environments under which events that led to the resolution took place;
- measures that will be necessary to carry out in order to save or liquidate a bank.

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

- bail-in should be applicable globally, to all financial institutions, and not only to SIFI's – in order to avoid distortions amongst the industry, the EBF finds a global approach to debt-write down to be essential, as a new resolution tool that is only implemented in some jurisdictions (or to some institutions) would put financial institutions from those jurisdictions in a less favourable position compared to others. If a bail-in regime is introduced the criteria **that allow its application (entering into resolution)** must be clearly defined in advance, transparent and consistent at an international level. Reducing predictability for creditors of a bank would make it impossible to find enough investors, which could undermine the purpose of the bail-in mechanism;

- bail-in should be as flexible and as broad as possible, potentially affecting all liabilities. All investors should be ultimately prepared to assume losses (the cost of failure) rather than the taxpayer. Although EBF Members believe that affecting senior debt or deposits (beyond the level of what is covered by the DGS) should be an ultimate "last-last resort" measure. The measure will reflect what would have happened if the financial institution were to be sent directly to liquidation;
- in deciding to use bail-in, resolution authorities should be required to undertake and document an assessment comparing the impact of liquidation versus the impact of use of bail-in, to ensure that holders of debt are no worse off than they would be under liquidation;
- an implementation date should be established in the future which allows sufficient time for the market to adjust;
- statutory bail-in should be used solely as a resolution tool in exceptional circumstances, 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);
- applied only at a resolution stage at discretion of the resolution authorities: the tool must rely on a statutory, not a contractual, authority;
- bail-in should be used as a tool to facilitate resolution;
- under no circumstances should bail-in be used simply as a tool to re-launch a failed financial institution;
- the bail-in mechanism does not alter the seniority order of claims.

Some issues however remain to be discussed within the application of a statutory bail-in. For instance, bail-in will simultaneously and directly interfere with the rights of owners and creditors:

- Owners: At the resolution stage, authorities will be able to decide upon the issuance of equity and change company's ownership structures at its own discretion without consent of stockholders. National laws will need to be adjusted for that to happen.
- Creditors: By converting or writing down credits, authorities will directly interfere with the creditors contractual rights. Several issues arise at this point:
  - Creditors should not be withdrawn from their right to appeal to court; however, this action should not be an impediment for the application of a bail-in; and, if the right of the creditor is recognized by the court, the compensation should be monetary and not have consequences such as reversal of the bail-in operations (which could damage the whole restructuring process);
  - The interference with the rights of investors will require profound legislative changes.

The write down of senior debt is not acceptable unless as a last resort measure, equivalent to an orderly liquidation, only where other tools are assessed as unlikely to achieve an orderly resolution or protect creditors' interests, and always respecting the debt structure creditors' rankings. The "no creditor worse-off than in liquidation" principle, rightly adopted by the FSB *in Section 6 of Annex 2* is equally important and requires complete clarity.

Finally, given the complexity of the issues raised above and the limited time provided for consultation, the EBF urges that the FSB allow for further time for analysis and reflection. This should include a call for further analysis of the impact on financial stability and effectiveness of different approaches towards depositor preference and the scope of bail-in liabilities.

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?

Yes, in order to ensure a uniform application, and thereby ensuring a level playing field, the scope should be harmonised internationally.

- A statutory bail-in measure should be a discretionary decision taken by the authorities potentially applicable to all liabilities, although respecting the natural ranking of creditors when being applied;
- The triggers would be the entering of the institution into resolution. Bail-in would happen by a discretionary decision by the authorities once a financial institution is at a resolution stage, with bail-in being a possible measure the authorities may apply, or not;
- No limits or conversion ratios should be pre-defined in a statutory bail-in, in order to increase flexibility and the effectiveness of the measure, and to limit financial market arbitrage during times of distress.

A statutory bail-in is perfectly compatible with specific “bail-in-able” securities which are no more than current convertibles which financial institutions already issue. 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.

A broader scope of liabilities covered by statutory powers will carry several advantages:

- the authorities will have higher flexibility when applying a bail-in solution;
- the impact upon the cost of funding will probably be lower, since the statutory bail-in regime will be equivalent to a new regulatory framework under a scenario of resolution (almost bankruptcy), applicable to the whole financial sector, and potentially to all liabilities; hence, the potential increase in the cost of funding will be diluted amongst all liabilities;
- both the risk of arbitrage between asset classes and the risk of financial engineering that could endanger the application of a bail-in will be minimised.

Senior debt should only be affected when other instruments are not sufficient to absorb losses and the impacts and legal restrictions should be understood and dealt with.

Further, it is necessary to establish coordination with ISDA, since resolution implies a credit event or can impose forced trade unwinds that will deteriorate a bank’s situation even further.

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

Potentially all junior debt classes up to and including senior unsecured liabilities 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.

Some EBF Members would suggest the following classes should be excluded from bail-in:

- debt or liabilities that rank above senior debt (e.g. 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 essential services required for continuing operations.

In a scenario where depositors (to the extent covered by the deposit guarantee schemes) and the above listed classes are protected, the risk of runs should be lowered as stated above. In addition the systemic risk should be reduced when the risk of contagion is lowered.

Given the far reaching impact of such exclusion, the scope will need further careful analysis.

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)?

No, it is impossible to predefine the amount and conditions of a statutory bail-in, since:

- it will always depend on the circumstances and the nature of the problems that generated the potential failure of the institution;
- bail-in is a potential measure to be applied at a resolution stage, but not a mandatory measure to be applied;
- this would be perceived as an additional capital requirement, with the result to increase the overall minimum regulatory capital.

Specific "bail-in-able" securities will always be converted before the application of a statutory bail-in. Additionally, as mentioned before in the answer to question 4 above, we believe that a statutory bail-in should potentially apply to all liabilities. A specific layer of bail-in securities will simultaneously:

- be seen as a simple new capital buffer of convertible securities,

- and will imply the loss of at least some of the advantages stated above (please read answer to question 4 above).

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?

It is important to stress that at the current juncture, with the price and availability of bank funding under significant pressure and significant changes to capital and liquidity requirements in process, there is a risk that the introduction of bail-in could have particularly pronounced impacts on bank funding.

It may therefore be prudent for the regulators to allow a phasing period of such other measures before the introduction of a bail-in regime. This is particularly important as access to liquidity has been one of the largest issues during the recent crisis and a key objective must be to find a regime which avoids unnecessary pressure on the liquidity of banks. Transition and phase-in arrangements for bail-in of new and existing debt would also be very important to allow the market to adjust.

Nevertheless, as stated above, no minimum requirements for bail-in capital 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.

With regard to the FSB proposals for bail-in regime, the impact upon the cost of funding will probably be diminished, since the statutory bail-in regime will be equivalent to a new regulatory framework under a scenario of resolution (almost bankruptcy), applicable to the whole financial sector, and potentially to all liabilities; hence, the potential increase in the cost of funding will be diluted amongst all liabilities,

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.

Bail-in will need to be implemented simultaneously and consistently in the major markets to be effective and to avoid negative implications on funding raised in specific markets. If bail-in implementation is not coordinated, or not convincing, it has the potential to cut off or disproportionately increase the cost of funding for specific institutions. Announcement of a framework for bail-in within resolution, where exposure of certain debt classes in resolution has not clearly been understood up to now, is likely to affect the market for both existing debt and new obligations well before any measures take effect legally.

In addition, there will also be potential technical limitations for certain types of investors, such as other banks (due to Basel III liquidity approach) and insurers and pension funds (due to Solvency II requirements). Other investors may face non-regulatory restrictions related to their mandates, although there is some flexibility possible over time.

Provided that statutory bail-in within resolution is implemented as outlined above, we would not expect this to significantly damage credit supply to the economy. Thus, the EBF endorses a statutory bail-in which is expressly:

- limited to resolution situations;
- with as wide a base of debt instruments as possible;
- applied to all financial institutions in all jurisdictions.

Cross-border cooperation

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?

The EBF supports the aim of fostering cooperation and cross-border communication between supervisors and resolution authorities on the resolution of financial institutions. For this purpose, clear-cut rules on processes, powers and responsibilities need to be established for cooperation during normal times as well as during times of stress.

The group resolution authority should lead and coordinate the work of the resolution colleges and determine their composition within reasonable guidelines determined by, e.g., the FSB to avoid resolution colleges being convened with an arbitrary representation in response to interest-group lobbying or other inappropriate preferences. In general, as many as possible of the resolution authorities responsible for systemically significant parts of the group in the event of its resolution should be represented in the college, provided that this does not result in it becoming unmanageably large. Multiple authorities should coordinate inquiries and avoid duplication or slight variations on the same requests, at least during normal times. Home supervisors should have the lead role in reviewing Recovery and Resolution Plans and resolvability assessments, managing information flow between relevant host supervisors.

Resolution requires major decisions to be taken within a very short period of time (e.g. a weekend) and this also holds true for the resolution of a failing group. It is important to give adequate consideration to the interests of all parties involved while still retaining the ability to act swiftly. This applies particularly to the decision by the group level resolution authority on whether or not to wind-up the group in its entirety. Cooperation will only be able to function in a crisis, however, if the ground rules and groundwork (e.g. development of group level Resolution Plans) have been properly laid down in advance and tested to ensure that they are sufficiently robust.

This exchange of information must, however, always be subject to compliance with rules on data protection rules and commercially-sensitive information. Information relating to individual institutions should, as a rule, be kept within the circle of supervisors or resolution authorities directly responsible for overseeing them. Supervision depends on open communication between supervisors and supervised institutions. Confidentiality will become even more important, moreover, once work on contingency and recovery planning is underway and national supervisors enhance cross-border coordination. Given the sensitivity of financial markets, the disclosure of confidential information, especially if related to a threat to an institution's existence, also risks sparking severe market disruption. Individuals engaged in CMGs should be reminded of relevant market abuse and other legislation; indeed, there may be a case for a tailored enforcement regime for individuals or authorities which inadvertently or deliberately release sensitive information, e.g., suspension from FSB.

As things stand, therefore, financial institutions and, in particular, supervisory authorities cannot exclude the possibility of information being divulged to third parties. This seriously undermines the basis of trust which is essential to efficient supervision and international cooperation. Yet open communication and cooperation are prerequisites for the ability to successfully counter threats to financial stability.

In group situations, the home regulator should lead the decision-making process within colleges of supervisors of the group. The home regulator should coordinate inquiries from host regulators and avoid duplication or slight variations on the same requests, at least during normal times.

The EBF is of the view that resolution arrangements and the home/host relationships in crisis management should at a minimum be reinforced through promoting multilateral legally binding means such as Concordats which set out principles for cooperation, confidentiality, exchange of information and appropriate allocation of responsibilities between home and host resolution authorities. Ideally the FSB and G20 should aim towards an international treaty that would create a harmonised resolution regime for all financial institutions.

In the meantime the Concordat should be seen as a legal way to recognise the economic unity of integrated cross-border banking groups and the role of the parent company within the group, both in normal times and in crisis.

To ensure an effective management of a crisis, in fact, the Concordat should provide for the home resolution authority to have the primary responsibility for coordinating the process, ensuring appropriate flows of information and joint decision making, while guaranteeing equitable treatment of creditors and shareholders.

The FSB could play a decisive role setting up a model of Concordat which would ensure a level playing field at global level, and by maintaining a record of Concordats as a resource to ensure that documents are available when needed dependent on the nature of the crisis.

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?*

Cross-border crisis management will only work if the measures required are also coordinated quickly between supervisors. This is why clear-cut procedural rules and decision-making structures are required in this area – crisis management should not be thwarted by any national reservations.

Cooperation between national supervisors in the supervisory colleges implies that they should seek to reach agreement on joint measures and decisions. In cases in which the supervisors involved are unable to reach agreement, uniform, effective supervisory action must nevertheless be ensured. Particularly where decisions are taken in difficult or even crisis situations, there must be a clear-cut division of responsibilities. Transferring tasks and powers to the consolidating supervisor therefore appears appropriate.

Particularly where cross-border institutions are involved, uniform decisions are especially important. On the one hand, a level playing field must be ensured and, on the other, supervisory arbitrage has to be avoided. If supervisors are unable to reach agreement after a joint decision-making phase, there must be a mechanism which allows functional and effective action. This includes enabling binding decisions to be made for the authorities involved. This is the only way to ensure uniform, cohesive supervision. We therefore believe that it is right if supervisors take part in the decision-making process but that the consolidating supervisor should lead on the decision making and that host supervisors can convey this decision to a higher authority in the event of disagreement.

To obtain a consensus-based solution endorsed by all in the event of disagreement between national supervisors, a mediation procedure should be adopted. Such a procedure enables conflicting views and assessments to be discussed and balanced accordingly. In our opinion, a superordinate authority such as the FSB should assume the role of mediator. We therefore believe that this can be best achieved by means of a decision by a higher authority that is binding on all college supervisors.

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

The EBF believe that the home authority should determine which authorities should be parties to the agreements, in consultation with the firm's management. Participants should include authorities of the financial stability net that have a role in the oversight and management of a firm should be included. This may include in particular the following:

- Treasuries or Finance Ministries;
- National or Central Banks;
- Micro and Macro-prudential Supervisors;
- Resolution Authorities (if not identical with the Supervisory Authority);
- Deposit insurance schemes and other relevant compensation schemes; and

It will be important to ensure that membership of the Crisis Management Group is sufficiently representative and systemically relevant. It should encompass not just core colleges but also representation from countries where the institution could constitute a systemic risk and also all countries of strategic importance to the institution, whilst remaining at a size that is still effective and functional.

Resolvability assessments

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?*

A Resolvability Assessment is a crucial part of an effective Crisis Management Framework, because it may help uncover existing weaknesses. However, there are great concerns about whether on the basis of very superficial criteria it is possible to reach an internationally similar standard in the assessment. For this it would require further definitions that also increase the predictability of the regulatory institution's rating scale.

A firm should not be penalised because of the authorities' failure to make the necessary changes to their legal powers and capacity to use them. Either such part of the assessment should be suspended until the legal changes needed are made, or, at the least, there should be a substantial transition period before any action is taken against a firm that depend on the lack of legal or regulatory changes that are outside of the control of firms. This is not to say that assessment should be suspended indefinitely or that firms should expect unrealistic changes to legal systems to facilitate their Resolution Plans.

Regarding intra-group exposures (Annex 4, 4.3), we refer to our answer to question 18

The requirements for management information on firms which will be needed to support recovery and resolution planning and supervisory monitoring can be expected to be significant. In particular, it is required that that the necessary information is held not only daily, but also at the level of individual legal entities. As imposing additional reporting requirement should be avoided to the extent possible, we propose to examine what data are already available to regulators and to avoid unnecessary duplication between the group level and individual units. In any case, institutions will need a reasonable implementation period to adapt their IT systems to these requirements. Any additional reporting and data collection requirements should be developed in consultation across the regulatory community and with the industry.

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

The coordination of national regimes and resolution tools is key for the resolution of an international group. Therefore, the manner of this coordination should be assessed before a crisis occurs. However, the EBF would have serious concerns about resolution planning permitting authorities to require changes to an institution's structure if they had reservations about the legal framework in another country. The decision in this case would be based on circumstances (i.e. a foreign legal system) over which the financial institution has no control.

A power of this kind could end up being tantamount to a ban on business in some countries. We note that this may be viewed by some countries as akin to 'sanctions' which are typically within the purview of other international bodies, e.g., the UN, and urge caution around how the FSB progresses here.

Recovery and resolution plans

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?*

Recovery Plans

Recovery Plans are to be implemented under the full responsibility of the institution´s management. As such, the required contents of Recovery Plans and the tools to be used for timely recovery should be consistent with the private nature of the institution. The EBF believes that it makes sense to improve recovery planning under Pillar II and to focus it more on how capital or liquidity can be preserved or generated in stressed situations so as to comply with supervisory ratios and ensure that an institution remains a going concern.

With this in mind, the level of detail in a Recovery Plan should be such that suitable measures can be decided on and implemented in an adequate time frame. A Recovery Plan should be flexible, consisting of a detailed list of mechanisms available to management according to the facts and circumstances of the particular case.

Since Recovery Plans will contain highly sensitive information, it must be ensured that the plans will be held strictly confidential, with no public disclosure.

The particular set of actions chosen from the Recovery Plan (which might have been updated by the time the bank enters recovery) should be decided by the bank’s management, who inform the supervisor, bearing in mind that the measures to be applied should be proportionate to the severity of the institution’s situation and in accordance with the confidentiality needs. In addition, as regards listed credit institutions, there should not be a duty to disclose to the market the contents of the Recovery Plan, which implies that they should not be submitted to the shareholders for approval.

The principle of proportionality should apply to the contents of Recovery Plans imposed on credit institutions, depending on their size, structure and complexity.

Resolution Plans

The EBF agrees that Resolution Plans are primarily a competence of the authorities. For this, firms must comply in providing necessary information to authorities for effective planning, but close cooperation between institutions and authorities is required in order to ensure that Resolution Plans are realistic and achievable.

To nevertheless keep the administrative burden for institutions within limits, the information needed to prepare Resolution Plans should be obtained mainly from already existing sources (solvency reporting, banking statistics, etc.). Only in justified cases should additional information be collected by supervisors. Moreover, we do not believe that a requirement to continuously gather comprehensive information on creditors and intra-group exposures and update it at regular intervals would be helpful. Instead, institutions should demonstrate to supervisors that they can generate the relevant information, such as that already identified by the Commission, within a reasonable time frame. Finally, we estimate that firms should not be responsible for strategy and scenario analysis within the Resolution Plan, contrary to what is proposed in article 1.10.

Additionally, the EBF maintains that a further condition is needed for Resolution Plans to become a valuable instrument in a crisis situation. It is essential to ensure a permanent dialogue, monitoring and coordination between the supervisory and the resolution authorities so that Resolution Plans are updated regularly and can be easily applicable to the effective circumstances of the crisis situation. And it should be underscored that the timeline for the implementation of RRPs must be consistent with that for data sharing protocols.

The resolution authority and bank should in any case closely work together to develop the Resolution Plan. Here, the consideration of the FSB may be hindering this dialogue, as it leaves it to the discretion of the authorities to disclose the Resolution Plan to the bank in question (Annex 5, 1.14). This approach could mean that the Resolution Plan is developed at too great a distance from the institution to be of any practical application. The secrecy of the plan would hinder the bank to prematurely recognise any errors or areas for improvements while also not allowing management to be able to familiarise itself with the plan. RRPs should be understood as a shared responsibility between the bank and its supervisor.

Finally, the EBF would like to reiterate that Resolution Plans must not enable authorities to inappropriately interfere in the business model of banks, or to require changes to their legal or operational structure. It is not the role and not the responsibility of the authorities to shape ex ante, through Resolution Plans, the organisation of healthy banking institutions when it is not fully justified. The intervention in the legal and operational structure must be a very last resort when orderly resolution seems otherwise impossible. This decision should take place in close dialogue with the institution in a Pillar II context in order to be sure that resolvability obstacles could not be overcome by other means, and to ensure that resolution authorities and supervisors have clarity on the justification for and benefits accrued from particular structures in order to balance this against the ease of resolvability.

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

As a general principle, RRPs should be elaborated solely at the group level, to ensure that:

- capital and liquidity are allocated effectively and efficiently both in normal times and in crises;
- uniform, coordinated crisis management is implemented and recovery measures function properly; and
- coordinated recovery planning is managed and updated using the same processes.

Improving resolvability

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

It is important to stress that decisions on “improving resolvability” raise important issues for an international level playing field. There must be an international uniform approach to achieve consistency among the types of measures required of financial institutions in all jurisdictions. The considerations should be reasonably objective and predictable so firms can apply them in ways that seem to them to be appropriate, without waiting for supervisory judgment, and minimising the risks of failing to anticipate supervisory judgment correctly.

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

The solutions proposed and the powers to be granted to resolution authorities in respect of Resolution Plans may facilitate excessive intervention by resolution authorities in the business models adopted by credit institutions.

Appropriate safeguards have to be introduced in the framework to maintain an appropriate balance between the effective resolvability of institutions and groups and preserving the correct functioning of the global financial market. For most institutions, group level resolution planning will be preferable.

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

Intra-group guarantees (or cross-default provisions) are a legitimate option for those banking groups that voluntarily decide to rely on them. The proposal to impose restrictions on intra-group guarantees (or cross-default provisions) should therefore be further considered. It is essential to recognise at the same time that the provision of intra-group financial support should remain a voluntary management decision of the entities concerned and is not mandated by the authorities.

*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.

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, the EBF does not believe that the going-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 considering 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 organisation of the group and its financial stability and, in any event, without the authority dictating organisational models to private groups that must preserve their freedom of action and enterprise.

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. Banks are clearly prepared to satisfy the first set of objectives.

The EBF 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. The 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 EBF notes that the timelines involve only the technical aspects of co-operation agreements, development of Recovery and Resolution Plans, resolvability assessments and CMG outreach. What is missing are timelines for the legislative and regulatory changes that are necessary to implement the Key Attributes, on which the resolvability assessment will be based, including mandates for authorities and confidentiality protections. In Europe the legislative changes are needed both at EU and national level. Without such timelines the technical aspects could be useless.

Discussion note on creditor hierarchy, depositor preference and depositor protection

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

A convergence of the creditor rankings as part of an international harmonisation process is in principle a desirable objective. Policy makers and regulators should prevent all measures of ring fencing hampering the resolution process of international financial groups. However, in the short to medium term the main target should be to avoid discriminatory treatment of creditors according to nationality and/or jurisdiction, rather than absolute convergence of the ranking of creditors (which could only be achieved in the long term). EBF feels that the FSB and G20 should progress international harmonisation as a matter of priority.

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?

While the EBF supports a greater harmonisation of creditor ranking, current preferences should not be re-established but be phased out. All unsecured creditors should be treated equally during a bankruptcy or resolution, without prejudice of the normal functioning of

Deposit Guarantee Schemes (see reply to question 23). The principle of the equal treatment *(pari passu)* for all creditors should be enshrined in law. Deviation from this principle should be permissible only with the agreement of those affected. In the absence of such agreement, supervisory authorities should not be able to deviate from the principle of equal treatment since this could open the door to the regulatory arbitrage. In addition, markets would probably take a negative view of the uncertainty thus caused, which would place banks, in particular, at a disadvantage when competing with other financial sector firms for institutional investors.

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)?

The EBF sees no reason to give preference to deposits during a bankruptcy. In the EU private and SME depositors are already protected up to the coverage limit of EUR 100.000 through the Deposit Guarantee Scheme Directive. If deposits should be given preferential treatment over the coverage limit, this would lead to moral hazard and conflict with the system of limited deposit protection. Also, this preference would lead to other creditors, for example, service provider or official authorities (tax office) to be disadvantaged.

Deposit guarantee schemes should be subrogated to the claims of depositors to the extent paid out by such schemes as recommended by the BCBS and IADI Core Principles. While national deposit guarantees may differ, the differing obligations of schemes to the depositors do not justify national arrangements that give them priority claims over specific sets of assets in their jurisdictions. Expectation of national priority claims could create incentives to ring fencing and result in non-cooperative behaviour on the part of authorities and administrators of insolvency estates. This would hamper efforts to put in place meaningful cross-border arrangements ex ante. 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 rule on global resolution should be that assets of a firm should be made available for the fair resolution of all claims on the failed firm, respecting the established hierarchy without discrimination by nationality.

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?

Giving further preference to depositors beyond the deposit insurance limit would be in a direct trade-off with increased moral hazard by depositors (See comments above under question 23).

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?

EBF would also welcome the possible establishment of an international group insolvency regime allowing integrated treatment of group entities, provided it merely calls for the appointment of a single administrator for all entities while at the same time maintaining separate proceedings for these.

At a minimum the EBF would urge for enhancing coordination and cooperation among different jurisdictions when referring to the *insolvency* of a group at the international level. A special regime purely for banks may not be required, however. Instead, such a regime should be applicable to all corporate groups. The EBF refers to the UNCITRAL recommendations on group insolvency law, which provide some useful ideas for a body of European procedural law governing group insolvencies.

The FSB and G-20 is urged to aim for an international legal framework of harmonised substantive insolvency rules in the long term. However, the industry recognises that establishing an international legal framework in this field that fits in with national legal regimes and avoids any unjustified discrimination of creditors and counterparties is unlikely to be feasible in the short to medium term.

Further work is also needed with respect to application of bail-in powers in the case of cross-border resolution under a group structure. In such a situation where debt issued by a subsidiary would be converted into equity, creditors would effectively become shareholders in the subsidiary, which would in effect cease to become a subsidiary of the holding company. In order to prevent this interference with group structure, one solution would be for equity received in the failing bank to be swapped for equity in the holding company. However, this in turn raises complications as regards to whether the host jurisdiction would be able to recognise such an operation. We think this is an important issue which could benefit from further consideration by the FSB.

Discussion note on conditions for a temporary stay on early termination rights

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 suggested temporary suspension of close out netting rights raises general concerns as such a suspension runs contrary to the core concept of close out netting. The essence of close out netting is an early termination of the respective transactions and netting of mutual rights and liabilities of parties and their replacement with a single net claim. This mechanism leads to substantial and direct reduction of the counterparty risk by reducing the mutual claims to one net sum and is thus beneficial for both the troubled credit institution and its counterparties.

Any impairment of the close-out netting mechanism can have serious repercussions. Furthermore, legal certainty over the effectiveness of close-out netting in a jurisdiction is a major factor for the competitiveness of financial institutions operating in the jurisdiction. The EBF therefore urges the FSB to conduct an in-depth impact assessment to investigate the impact of such suspension for the global banking sector and the financial stability.

The EBF believe that the benefits generated by the risk mitigating effect of netting agreements for the financial markets as a whole clearly outweigh the disadvantages close-out netting provisions entail for the affected counterparty: Close-out netting ensures that the effects of an insolvency of a counterparty are contained directly and effectively thus preventing the contagion of the financial markets. This mechanism relies on the effectiveness and enforceability of contractual termination rights of the counterparties on the occurrence of events that materially affect the risk exposure, in particular insolvency or similar events. Any legal restriction on the right to exercise the contractual termination rights of the close-out netting mechanism, or anything which puts the effectiveness or enforceability of these contractual rights into question, can have serious adverse effects on the counterparties (specifically their ability of to mitigate their counterparty risks) - and ultimately the financial markets as a whole.

In case the FSB decides to follow through with temporary suspension of close-out netting the EBF support the approach of the FSB to consider any right of the resolution authority to suspend the effect of termination rights under netting agreements only subject to clearly circumscribed limitations, specifically subject to strict and short time limits, and in connection with certain safeguards regarding the transactions covered by the same netting agreement. Consideration should be given to the means of giving timely notifications on these measures to all counterparties.

When considering the introduction of a special right of a resolution authority to override or suspend such contractual termination rights in connection with measures aimed at preventing the collapse of an institutions and/or the financial markets, it will thus be necessary to take steps to minimise the potentially far reaching negative consequences for the counterparties and the financial markets.

The proposal largely strikes the correct balance between the interests of the institution subject to resolution measures on the one hand and those of its counterparties and the financial markets on the other:

In particular, the proposed time limit of 48 hours in combination with the restriction of the suspense effect to termination rights triggered by specified resolution measures undertaken by the resolution authority (and not triggered by causes unrelated hereto) can help to restrict the negative effects of the suspension on the risk mitigation capabilities to an acceptable degree.
In addition, the proposal also addresses the crucial issue of preventing the splitting up of rights and liabilities resulting from transactions covered by the same netting agreement. The ability to combine all rights and liabilities resulting from any of the transactions made under the same netting agreement to one single agreement is an essential prerequisite for the beneficial effects of netting. It is thus of paramount importance that resolution measures do not allow the separation of transactions covered by the same netting agreement. The proposed safeguards against a partial transfer should generally serve to achieve this end.

The EBF welcome the fact that the Discussion note appears to cover most of the above mentioned conditions/limitations for a stay. As to the serious concerns raised by a discretionary power to impose a stay, see response to query 27 below.

However, the EBF would like to draw attention to the fact that the introduction of a stay as part of a resolution regime would presumably require an alignment or clarification of the current capital requirement rules under Basel II/III in respect of netting arrangements: In order to prevent any uncertainty, it should be confirmed that the existence of a resolution framework which includes the possibility of a limited stay on early termination rights under netting arrangement for financial transaction, and/or the imposition of such stay in connection with a resolution measure, does not adversely affect the recognition of the risk mitigating effect of netting arrangements for regulatory purposes.

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?

Specific trigger event

As set out above, we strongly recommend that the trigger event is defined as clearly and objectively as possible to avoid uncertainties. To this end the relevant event should be connected to an objective factor/the notification of the public that a specific action by a specific official authority has been taken in connection with the applicable resolution framework.

In this connection, we strongly believe that the possibility to impose a stay as part of a resolution measures should be restricted to only one resolution tool, namely the transfer of assets and liabilities to a bridge institute. The infringement of the rights of the counterparties by a stay can only be justified if it serves an overriding interest and purpose ultimately beneficial to all market participants. Such overriding interest can be assumed to exist in the event of a transfer of assets and liabilities to bridge institution but not in connection with other measures.

Strictly limited discretionary powers

Any power to impose a stay must be clearly circumscribed: Thus any discretion of the resolution authority has to be limited to the question of whether to impose a stay or not following the occurrence of a predefined trigger event. There cannot be any discretion regarding the trigger event for the stay, the scope of termination rights affected or the length of the stay. Any room for discretion in respect of the trigger event, scope and length would invite arbitrariness and result in clearly untenable uncertainties for the counterparties and the financial markets.

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?

As to the general concerns raised by a stay affecting close-out netting provisions, see our comments above to Question. 26.

If a stay is to be introduced which would also affect close-out netting provisions in master agreements for financial transactions, the effects of such stay would need to be limited to:

- early termination rights triggered by the initiation of insolvency proceedings or similar measures etc. (such as a restructuring or a reorganisation) which might otherwise arguably be triggered by resolution measures, or
- the transfer of assets and liabilities as part of a resolution measure.

Early termination rights, triggered by other default events or actions have to remain unaffected by a stay. In particular, a stay cannot affect termination rights triggered by:

- a failure to pay or perform other contractual obligations (e.g. delivery of securities etc. or a failure to post additional collateral) or other material causes, or
- a transfer of assets and liabilities which results in a separation of transactions and/or rights and obligations resulting from transactions entered into under a master agreement (that is transfers disrupting the unifying effect of a master agreement/resulting in "cherry picking").

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

A period of no more than 48 hours appears to strike the right balance between the need to afford the resolution authorities to take the necessary measures to ensure a transfer of assets and liabilities and the need to minimise the impact of a stay on the counterparties and the financial markets (see above response to Question 26.

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?

The EBF believes that CCPs should be excluded from the effects of such a suspension in light of the increasing systemic importance of CCPs: CCPs rely on close-out netting as a highly effective instrument to mitigate risks emanating from the default of their members (usually referred to General Clearing Members - GCMs). A suspension of the termination right and thus close-out netting as a risk mitigation technique would significantly impair their risk mitigation capabilities. Whereas such impairment may be manageable for the counterparty in the case of a bilateral relationship (subject to the certain conditions, see our comments above) this may not be the case for a CCP, having to manage a potentially significantly more complex and higher level of exposure. An exclusion (limited to CCPs meeting the strict requirements of the future regulation on central counterparties) would thus be merited. The same largely applies to payments and securities settlement systems falling within the scope of the Settlement Finality Directive. Furthermore, an exclusion should probably also apply to central banks.

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 principles set out in the proposal appear to address most of the concerns raised (see also our response to Question 26 as well as well as our concerns in respect of discretionary powers to impose a stay).

However, the EBF believe that any framework setting out a stay on close-out netting provisions should also be accompanied by provisions underlining, confirming and protecting the effectiveness of close-out netting as a risk mitigation instrument. This should entail a call for a further harmonisation of the legal framework ensuring the validity and enforceability of contractual close-out netting provisions.

Currently, the legal frameworks covering close-out netting can differ considerable between jurisdictions. This causes not inconsiderable legal uncertainty. Greater legal certainty over all key elements of close-out netting will greatly serve to improve risk management capabilities of all market participants which against would have a stabilising effect. Such greater legal certainty will be particularly welcome as the introduction of provisions implementing a stay as part of a resolution mechanism may result in unwanted new uncertainties or an exacerbation of already existing uncertainties in the different jurisdictions.

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

The key element appears to be a further international harmonisation of the relevant legal framework, including ancillary aspects such as contract law, company law, insolvency law and the rules on conflict of laws. In view of the general difficulties harmonisation efforts will encounter in these areas (see our response to Question 25); these would have to be restricted in scope to the specific issue of close-out netting.

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?

See comments above under Question 32.

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?

See comments above under Question 32.