Response to the European Commission Consultation on Technical Details of a Possible EU Framework for Bank Recovery and Resolution

March 2011
Executive Summary

Part 1 Scope and authorities

We are broadly supportive of the application of the regime proposed by the consultation document to all credit institutions, including the investment firms which have been proposed and bank holding companies.

We also support the establishment of resolution authorities in each Member State (and resolution colleges around the core supervisory colleges). However, further engagement is required on how the authorities will interact with the supervisor (particularly concerning requests for information) and we don’t believe that the resolution authorities should have the ability to take actions until resolution is triggered. We are generally of the view that decisions in relation to cross-border groups, whether in relation to recovery or resolution, should be taken on a group basis by the consolidating supervisor or the group resolution authority, as appropriate.

Part 2 – Supervision, preparation and prevention

We are generally supportive of the enhanced supervisory measures proposed and support the production of a recovery plan at a group level.

Currently, institutions are able to transfer assets intra-group subject to various company law and tax requirements. Our understanding of the proposals is that they will provide additional flexibility for institutions to bypass these requirements at a time of stress subject to certain conditions. We support greater flexibility; however, the required conditions should not be applied to transfers which may already be made in accordance with the current requirements. These proposals should only be for transfers which
cannot be made easily under the current regime and should be applied at the choice of management.

The proposals regarding resolution plans are comprehensive and include the items we would expect. However, we have significant concerns regarding the preparatory and preventative measures which seem to have a disproportionate focus on institutions as a gone concern and we would urge the Commission to reconsider which of these are really necessary and also who should be able to exercise such powers as we are generally of the view that this should be the supervisor. For instance, requiring groups to make structural changes primarily to aid resolution has implications for the financial soundness of a firm during normal course operations. More ring fenced structures may impede integrated risk management across groups leading to increased levels of systemic risk.

**Part 3 – Early intervention**

We oppose the early intervention powers proposed, in particular the appointment of a special manager. We consider that this has the potential to cause more damage to a financial institution through the market perception and we consider there are still some significant details to work out before this regime would be capable of implementation.

**Part 4 Resolution tools and powers**

We generally support the resolution triggers, objectives and the general principles governing resolution. We strongly support all Member States having the same set of resolution tools consisting of sale, bridge, asset separation and debt-write down. It would probably makes sense that the tools be executed by the same mechanism (whether by executive order or receivership) and suggest further study on the merits of a one-step (executive order) versus a two-step process (receivership), particularly in relation to the proposed suspension on termination and close out netting rights. We broadly support the resolution objectives and the principles governing resolution, particularly the no creditor worse off principle (NCWO), which is a particularly important safeguard for creditors given the untested nature of these resolution tools (especially debt write-down).
Part 5 - Group resolution

We support the group resolution authority being responsible for planning and coordinating the resolution of a global group (where the group’s resolution plan has contemplated a group-wide basis for resolution). We have some questions about the ability of a Member State to opt out of group resolution. We strongly support the Commission’s aspiration to strive for an internationally coordinated resolution regime and suggest that the EU framework be explored as a possible template for a regime of wider international scope (possibly G20).

Part 6 - Financing Arrangements

A general theme which runs through our submission is that in the event of a resolution, the liability of a fund should be no more than it would have been in the event of a liquidation. We believe that the allowable uses of funds should be strictly and explicitly defined. We consider that the idea of joining resolution funds with deposit guarantee schemes should be explored further.

Annex - Debt write down

As a general matter, the industry accepts that a robust financial system will entail the removal of implicit State guarantees, and in that regard, AFME is pleased that the Commission is exploring debt write-down as a potentially useful resolution tool to avoid both taxpayer-funded bail-outs and systemically costly liquidations. We recognise the comparative ease and clarity of the targeted approach, in relation to the comprehensive approach, although neither option is completely without difficulties. We recognise that it would be difficult to size an instrument buffer ex-ante and there may be cases in which the targeted approach is inadequate to absorb the losses and allow for an orderly recapitalisation. In these instances, we believe it is appropriate that a comprehensive approach also be available to regulators – although the majority of our members believe this should only be used as a last resort.

It will be important to understand the effect of the debt write-down provisions in the context of the new Basel III rules, particularly in relation to the capital treatment of bail-inable debt, and the new drivers (for example, the LCR or the NSFR) which will cause firms to seek additional sources of longer term financing. These requirements in combination may cause a significant level of pressure on institutions in a market which is currently undetermined.
Responses to consultation questions

PART 1 – SCOPE AND AUTHORITY

1a. What category of investment firms (if any) should be subject to the preparatory and preventative measures tools and the resolution tools and power?

In principle, we support the application to the Markets in Financial Instruments Directive 2004/39/EC (MiFID) definition of “investment firms” (subject to the carve out noted in our response to question 1b) for identifying the firms that are subject to the preparatory and preventative measures tools and powers, irrespective of the perceived systemic importance of such institutions.

We believe that further clarification should be provided in relation to how the regime will apply to branches or subsidiaries of ‘third country banking groups’ as this is not currently clear.

1b. Do you agree that the categories of investment firm described in Question Box 1 are appropriate? If not, how should the class of investment firm covered by the proposed recovery and resolution framework be defined?

We are supportive of capturing a population of investment firms based on the MiFID definition but also excluding those firms which are not subject to prudential requirements and supervision under Directive 2006/49/EC. It is then important that the proportionality of the regime in application ensures that the regime is appropriate for different entities and reflects the risks that they pose: the more far reaching resolution tools must be seen to be last resort measures.

We also support applying the regime to investment firms which are part of a banking group (although banking group does not seem to be defined so further clarity will need to be provided in this regard) as a group recovery plan is likely to consider/be applied to such entities and so would be captured in management’s considerations already. However, we do not believe these entities should be required to produce a recovery plan separate to that of the group.
1c. Are the resolution tools and powers developed for deposit-taking credit institutions appropriate for investment firms?

We believe these tools and powers are also appropriate to investment firms, subject to the overarching public interest test which is incorporated in the use of these tools.

2a. Do you agree that bank holding companies (that are not themselves credit institutions or investment firms) should be within the scope of the resolution regime?

It is not clear from the consultation document what is meant by the term ‘bank holding companies’. Our impression is that this is not a description which is widely used in existing legislation and so we are not certain which entities it is intended to capture.

We consider that the regime should apply to European Union (EU) financial holding companies where one or more subsidiaries is a credit institution as defined in Article 4(1) of Directive 2006/48/EC or an investment firm within the scope of the regime.

We think it should also be made clear that any unregulated activities within a group are not automatically subject to the regime by virtue of being a subsidiary of a financial holding company, for example, a group which has also invested in a retail chain.

2b. Should resolution authorities be able to include bank holding companies in a resolution even if the holding company does not itself meet the conditions for resolution: i.e. is not failing or likely to fail (see conditions for resolution)?

We agree that resolution authorities (RAs) should be able to include bank holding companies in a resolution even if the holding company does not itself meet the conditions for resolution - subject to the clarification of the term ‘bank holding companies’ as noted in question 2a.
2c. Are further conditions or safeguards needed for the application of resolution tools to bank holding companies?

Further conditions or safeguards are needed for the application of resolution tools to bank holding companies. The framework will need to establish principles to determine when to capture any part of the group below the 'bank holding company' which is not a financial institution. These principles should include the relative size of the financial institution in comparison to the non-financial component of the group, the extent to which parts of the group which are not directly caught by the regime stand alone from those entities caught by the regime (i.e. the level of integration of entities which are not credit institutions or in scope investment firms and other types of entities).

See also our response to question 2a above.

Authorities Responsible for Resolution

3a. Do you agree that the choice of the authority or authorities responsible for resolution in each Member State should be left to national discretion? Is this sufficient to ensure adequate coordination in case of cross border crisis?

Yes. This choice should be left to national discretion subject to the need for efficient information sharing and clarity of roles as noted in 3b. We believe that this will still allow for adequate coordination in the case of a cross border crisis.

3b. Is the functional separation between supervisory and resolution functions within the same authority sufficient to address any risks of regulatory forbearance?

Yes. We also believe that this is a preferable approach to ensure that information is provided to the relevant authorities in the most efficient way without firms having to duplicate information for different purposes.

Ideally, the RA would be an ‘independent’ group (with their own objectives specified) within the same structure as the supervisor (or parallel to it) which would allow the RA to freely request information from the firm through the supervisor. The RA could then be subject to separate
governance arrangements to ensure that there is no risk of forbearance and to protect against the arbitrary use of resolution powers.

Direct access powers should be given to the RA but should only be utilised when a trigger condition for resolution is expected to be met imminently and so it has become appropriate to access information directly, rather than through the supervisor.

Further guidance should be developed which will make clear what powers can be exercised by the RA and when to ensure that any overlap with the supervisor's powers is limited to times of financial stress. This is an area where it would be particularly helpful to discuss the issues further with the European Commission (EC).

3c. Is it desirable (for example, to increase the checks and balances in the system) to require that the various decisions and functions involved in resolution – the determination that the trigger conditions for resolution are met; decisions on what resolution tools should be applied; and the functional application of the resolution tools and conduct of the resolution process – are allocated to separate authorities.

Yes. Subject to the ability for those authorities to share information as noted in question 3b which would not rule out them falling under the same umbrella organisation.

3d. Even if resolution authorities are a matter of national choice, should an EU framework specify that they should act in accordance with principles and rules such as those set in this document to take account of the fact any bank crisis management action in one Member State is likely to have an impact in other Member States?

We support the establishment of an EU framework which promotes coordination of the RAs in each relevant Member State in the case of cross border groups. We would also encourage the EC to further their work on trying to establish a similar framework which would work on a global level.
The role of the European Banking Authority

Whilst no specific question is raised in this section on the role of the European Banking Authority (EBA) we would support the EBA as a mediator subject to the following:

- The EBA will be sufficiently resourced to undertake its tasks.
- The role should be clearly defined and constrained to matters of acting as mediator.
- The role should not grant powers to the EBA to take decisions beyond those powers which it already has.
- Powers should remain with the consolidating supervisor.
- Any mediation action should be done within a clearly defined timescale of, say, one month (for issues which are not time critical).

PART 2 – SUPERVISION, PREVENTION, AND PREPARATION

Supervision

4a. Should the stress tests be conducted by supervisors, or is it sufficient for institutions to carry out their own stress tests in accordance with assumptions and methodologies provided by or agreed with supervisors, provided that the results are validated by supervisors?

Whilst it will always be at the discretion of the supervisor to request any tests they consider to be necessary either relating to an individual institution or across institutions, resource constraints must be recognised such that it may be more appropriate for individual institutions to perform this using a methodology agreed with the supervisor. It is important that this is applied proportionately.

We support a consistent stress testing framework which should be agreed between supervisors. The detailed methodologies and assumptions should be determined by the supervisor (or consolidating supervisor) in close consultations with each institution to ensure that they are appropriate to their business. The level of the validation of these by the supervisors is likely to depend on the extent to which the supervisors feel they need to be closely involved in agreeing the methodologies and assumptions used by the institution and so should be at the supervisor’s discretion. We believe that mechanisms are already in place to allow this validation.
4b. The current crisis has shown that stress test disclosure is necessary to reassure markets and to bring to light potential problems before they become too large to be managed. It cannot, however, be excluded that in some circumstances disclosure without consideration of the possible impact in the market could do more harm than good. Do you agree that under exceptional circumstances the results of the stress tests should be made public only after appropriate safeguards have been agreed and introduced?

Appropriate safeguards should be agreed and introduced for exceptional circumstances. However, this should not in itself lead to the harm which it is intended to prevent. If a market expectation develops for the results of stress tests to be published for a group at a particular time/interval and this does not happen it is likely to cause the market disruption which the safeguards are trying to avoid.

We believe that results should be provided at a group level only as individual subsidiary stress tests are of limited use to the market and can easily be taken out of context with the potential of causing unwarranted market concern.

4c. Do you agree that in an integrated European market, stress testing should be conducted on the basis of a common methodology agreed at the EU level and subject to cross verification?

There should be a consistent framework and methodology agreed between supervisors for stress testing but the detailed assumptions and models may need some modification to ensure that they are appropriate to the institution.

Any cross verification should not be firm specific.
5. Please estimate:

- the one-off costs in EUR (e.g., investments in IT systems);

- the additional ongoing annual costs (e.g. human, subcontracts etc.) that your institution would be likely incur in carrying out the activities related to enhanced supervision.

Detailed cost estimates are outside of the scope of this response.

Recovery planning

6. Are the required contents of preparatory recovery plans suggested in section B1 sufficient to ensure that credit institution undertake adequate planning for timely recovery in stressed situations? Should we include additional elements?

Yes. We do not believe that any additional elements are necessary as the items listed are suitably broad which we believe is appropriate when setting the required content.

We also highlight that a number of countries (for example, UK, US) have already made progress on the structure and content of recovery plans, with some providing details of the information they expect to receive. We encourage the EC to utilise the work already done in this area to ensure that those firms which have already started (or substantially completed) recovery plans in response to those pilot programmes can leverage as much of that work as possible. We believe that these details will fit within the suggested contents listed in the consultation document.

7a. Is it necessary to require both entity-specific and group preparatory recovery plans in the case of a banking group? How to best ensure the consistency of recovery plans within a group?

Only group level recovery plan should be mandated.

Entity-specific recovery plans are of limited use as the objective of management must be to set out actions to restore the long term viability of the group so that the plan is realistic and capable of implementation. This is how management will manage the group at a time of crisis (or any other time) and so it is the decisions and actions of the group management which will be most relevant. Producing entity-specific plans risks creating
competing objectives for individual entities in a group which are likely to lead to the recovery plan becoming less effective and potentially create inefficiencies in the group at times of no stress.

We therefore consider that plans should be made at a group level only (meaning the full group irrespective of whether the highest parent company is located in the EU or not).

Further requests for information should only be made when significant; it should follow the same format and contain only the same content as the group plan.

7b. **Should supervisor of each legal entity be allowed to require any changes to entity specific recovery plans, or should this be a matter for the consolidating supervisor?**

No. It is important that an individual supervisor cannot jeopardise the potential recovery of the group by being able to take action which is not determined by the consolidating supervisor to be appropriate in the context of the group. It is, however important that the consolidating supervisor should have regard to the issues raised by the supervisors in other relevant Member States. This should be done through the college of supervisors.

Strict protocols will need to be established to ensure that confidentiality is maintained. Where there are concerns confidentiality may not be maintained or the material is considered to be of a heightened sensitivity it may only be appropriate for the plan to be shared with the home regulator.
7c. Is a formal joint decision (in accordance with the procedure set out in Article 129 of the Capital Requirements Directive (CRD))\textsuperscript{1} between the consolidating supervisor and the other relevant competent authorities appropriate for decisions regarding the group preparatory recovery plan?

No. In order to ensure minimum disruption to the financial markets, it should be the consolidating supervisor who, in the context of the group, makes decisions regarding the ‘preparatory recovery plan’.

7d. Should the EBA play a mediation role in the case of disagreement between competent authorities regarding the assessment of group preparatory recovery plans?

Please see our response to question 3d above.

8. Please estimate:

(a) the one-off initial costs (e.g., investment in IT and other systems);

(b) the additional ongoing annual costs, including the costs of Full-Time Equivalent employees (FTEs), and the number of such FTEs, that your institution would be likely to incur in carrying out the activities related to recovery planning suggested in section B.

Detailed cost estimates are outside of the scope of this response.

**Intra-group financial support**

The need for the intra-group financial support arrangements is not immediately obvious. Currently institutions are able to transfer assets around a group subject to various company law and tax requirements. Our understanding of the proposals is that they will provide additional flexibility to bypass some of these requirements at a time of stress subject to certain conditions. We are supportive of greater flexibility; however, the required conditions should not be applied to transfers which are made in accordance with any current requirements. These proposals should only be for transfers

\textsuperscript{1} We have assumed this reference to be to directive 2006/48/EC
which could not be made easily under any current regime and should be applied at the choice of management.

We are currently unclear how the intra-group support proposals will interact with Basel III liquidity standards when they are implemented under CRD4 in regard to the treatment of intra-group commitments and scope of application.

The EU framework for Liquidity Coverage Ratio (LCR) discussed the treatment of intra-group deposits, loans and commitments favouring a symmetrical treatment but outlining both symmetric and asymmetric treatment as options. The treatment was not outlined in the Basel III published rules in December 2010.

The possibility of asymmetric treatment (i.e. for a group commitment example, the entity benefitting from the commitment cannot assume a liquidity inflow while the entity providing the commitment has to assume the outflow) is a key concern for all banks. The EC’s February 2010 consultation document on CRD4 indicated that the EC was seeking to address this asymmetry but we do not know the outcome of this discussion, so further engagement is needed on how the proposals on intra-funding under the crisis management framework might sit alongside the treatment of intra-group flows. In the February 2010 consultation the EC also contemplated that, subject to a waiver and certain restrictions, liquidity standards might not be applied at a legal entity level. Again, we do not know the outcome of this CRD4 proposal, but we suggest that the operation of crisis management on intra-group funding will need to be considered in light of such a waiver.

Consideration may also need to be given to large exposures which can limit the extent to which members of a group are able to support or advance funds to one another.

9. Is a framework specifying the circumstances and conditions under which assets may be transferred between entities of the same group desirable? Please give reasons for your view.

We consider that it is appropriate to include an optional framework for management which sets out when a transfer, which would normally be prevented, may be made if an entity is experiencing financial difficulties in order to maximise the possibility of securing the long term recovery of the group. However, this new regime should not be extended to support arrangements which are already permissible.
We also have concerns that this regime will be difficult to operate in practice given the interaction with existing rules (which may vary across Member States). It is not obvious how the authorisations and approvals will be capable of circumventing company law and it is also unclear what the position of creditors will be after a transfer is made under such an agreement. We believe this is an area which will require additional engagement with industry before it is implemented.

If the proposals are pursued, the EC should make clear what is meant by financial difficulties – possibly in a recital. It is also important that the regime allows entities to respond quickly (in our view, within a week).

The regime should also allow for the consolidating supervisor to have oversight over the agreements and transfers given that the objectives of the support is preserving or restoring the financial stability of the group as a whole.

10. Section CI suggests that the support that might be provided under an agreement should be limited to loans, guarantees and the provision of collateral to a third party for the benefit of the group entity that receives the support. Do you agree that financial support should be restricted in this way, or should it allow a broader range of intra-group transactions?

In our view a broader range of intra-group transactions should be allowed such as those included in the UNCITRAL definition, this will help to maximise the success of the group recovery.

11a. Should this type of financial support be provided only down-stream (parent to subsidiary) or also up-stream (subsidiary to parent) and cross-stream (subsidiary to subsidiary), or should this be left to the discretion of the parties, (subject to approval by competent authorities)? What would be the advantages and disadvantages of each option?

This should be left to the discretion of the institutions in order to maximise the objective of preserving or restoring the financial stability of the group as a whole being met. Limiting such support may cause a group to fail unnecessarily. We see no advantages to restricting the transfers.
11b. Should the agreement be restricted to credit institution and investment firms subsidiary, or should it be able to include financial institutions on the grounds that these are also subject to supervision on a consolidated basis?

The agreement should not be restricted to credit institutions and investment firms subsidiaries – application to broader financial institutions would make it more likely that the objective of preserving or restoring the financial stability of the group as a whole will be met.

12. Is a mediation procedure necessary, and if so, would the approach under consideration be effective?

We support a mediation process but it must be effective and be capable of operation at short notice, even for the authorisation of the agreement between parties.

Whilst the proposed approach would be satisfactory in the context of agreements being put in place where no transfers will take place for up to four months, it does not work for entities which have not had agreements approved but are in a situation where a transfer is needed. In such a case we believe that the authorisation would need to take place within one week.

13a. Should the agreement specify the consideration for the loans, provision of guarantees or assets, or simply set general principles as to how consideration should be determined for each specific transaction under the agreement (e.g. how the rate of interest should be set)?

The agreement should simply set general principles. This is already considered under existing frameworks for transfer pricing, contract law and distributable profits and so we see no need for these transfers to be subject to a different framework.

13b. If the remuneration is determined by the agreement, how frequently should the terms for remuneration be reviewed?

It is not appropriate to be specific about the remuneration.
14. Do you agree with the conditions for the provisions of intra-group financial support suggested in section C4?

We agree with the conditions suggested subject to the following:

- The conditions should not be too subjective (for example (a), which makes reference to a ‘reasonable prospect’ of the support redressing the financial difficulties, would need to be made more specific).
- The conditions should consider materiality.
- The conditions should not restrict an entity from providing financial support under existing frameworks.
- It should be made clear whether all the conditions need to be met or not.

15. Do you agree that the decision to provide financial support should be reasoned? Are the criteria suggested in section C5 appropriate?

We agree that the decision to provide financial support should be reasoned and the suggested criteria are appropriate.

16a. Do you agree that the supervisor of the transferor should have the power to prohibit or restrict a proposed transaction under a group financial support agreement on the grounds suggested? Should any other grounds for objection be included in the framework?

We do not agree with the power to prohibit or restrict a proposed transaction under a group financial support agreement. The consolidating supervisor should be the only supervisor with the power to prohibit or restrict a proposed transaction, albeit, being required to take into account the views of other relevant supervisors.

16b. What is the appropriate time limit for the reaction of the competent authority?

Our members consider that a firm would need to be able to affect a transfer within one week; therefore, a response time of 48 hours would seem to be adequate. This timeframe should therefore be applied to the consolidating supervisor, who should be the only supervisor with the power to prohibit or restrict a proposed transaction.
16c. Should a time limit be set also for the reply to the consultation by the supervisor of the beneficiary?

No. This should be left to the consolidating supervisor.

17. Do you consider that supervisors should have the power to require an institution to request financial support?

In our view, the supervisor already has a range of tools at their disposal and so this additional power is not necessary and will be ineffective in practice.

We believe that it is also only appropriate for the consolidating supervisor to have powers relating to transfers in the case where these are being made in the context of preserving or restoring the financial stability of the group as a whole. It is also inappropriate for a supervisor to have a power to require assistance under an agreement which is put in place at management’s discretion. We believe this may lead to reluctance by management to enter such agreements, or the design of the agreements being altered such that they can be cancelled making the supervisor’s power ineffective.

18a. Is either or both of the suggested mechanisms for protecting the claim of a transferor in relation to intra-group financial support appropriate?

The suggested safeguards may be appropriate, but we suggest further study. Claw-backs create uncertainty and generally we do not support such provisions. We also see potential difficulties as it is unclear what the exact nature and circumstances giving rise to the priority claim that the transferor would have against the insolvent transferee. This is particularly the case where funding arrangements remain in place over a long period of time and/or are renewed or replaced by new extensions of credit.
18b. If adopted, should either be subject to a time limit (for example, the priority claim or claw back right would apply only if the relevant insolvency is commenced within a specified period – such as 12 months – after the transfer)?

Yes. These should be subject to a time limit and 12 months is reasonable in this regard.

19. Do you agree with the exclusion of liability for management proposed in section C9?

Yes, if the transfers are made in accordance with the framework and the consolidating supervisor has not objected to either the agreement or the specific transaction.

20. Do you agree that agreements for intra-group financial support should be disclosed?

It is our view that disclosure risks introducing legal uncertainty regarding a creditor’s right to place reliance on the assumption of group support - we therefore believe that disclosure is not appropriate.

Resolution plans

21a. Should resolution plans be required for all credit institutions or only those that are systemically relevant?

We are supportive of resolution plans being required for all credit institutions and investment firms where a public interest test is likely to be met. As proposed in the consultation document, RAs may only exercise resolution tools and powers when their use can be justified in the public interest and so it would seem sensible that they would only require resolution plans for those entities which they deem would meet this test on the exercise of the tools or powers. The regime will require a degree of flexibility and will need ongoing review with regards to which entities are captured. Given that plans will not be prepared for all entities under the public interest test, it will be necessary to keep the identity of the institutions required to prepare resolution plans confidential.
21b. Would the requirements for resolution plans suggested above adequately prepare resolution authorities to handle a crisis situation effectively? Are additional elements needed to ensure that resolution plans will provide adequate preparation for action by the resolution authorities in circumstances of both individual and wider systemic failure?

The list provided covers all items which we would consider necessary for handling a crisis situation and we encourage regulators to work globally to coordinate their approach to maximise the effectiveness of this regime.

Whilst we are supportive of the list provided on page 32 of the consultation document we believe that it is important that information requests are made with due regard to the usefulness of the information to the regulators (and their ability to process it) and the burden placed on firms to prepare the information, particularly if it will not materially add to the effectiveness of a resolution plan. It is therefore important that RAs exercise judgement with regards the level of detail required and avoid developing a “one size fits all” detailed information list.

We would like further guidance on when a RA will reassess a plan (for example, what is a material change which a firm should notify the RA of.

21c. Please estimate:

- the one-off costs in EUR (e.g., investments in IT or other systems);

- the additional ongoing annual cost (e.g. human, subcontracts etc.), including the cost and number of Full-time Equivalent employees, that your institution would be likely to incur in complying with requirements related to recovery and resolution plans.

Detailed cost estimates are outside of the scope of this response.
Preparatory and preventative powers

22a. Are the preparatory and preventative powers proposed in section D3 sufficient to ensure that all credit institutions can be resolved under the framework proposed? Are any further specific powers necessary?

We have concerns that a number of the powers proposed overlap with the powers which supervisors have. Whilst we understand the different objectives, we think that two bodies having the same powers at the same time is not appropriate and, instead, we think that the RA should seek to implement any changes it wished through the supervisor until the triggers for resolution are met.

In addition, requiring groups to make structural changes primarily to aid resolution has implications for the financial soundness of a firm during normal course operations. More ring fenced structures may impede integrated risk management across groups leading to increased levels of systemic risk.

Context of powers

We have concerns regarding the preparatory and preventative powers proposed as these are very far reaching and seemed to be provided with no context. They seem to be more akin to resolution powers but capable of operation at anytime which we don't believe is appropriate and so we are not supportive of these. In particular:

- No guidance is provided on what is considered to be a significant impediment which would allow the resolution tools to be applied.
- It seems that the RA can apply these tools without due consideration of the likelihood of the impediment which they seek to address.
- The focus must always be on helping institutions remain a going concern and we are concerned that these overarching powers of RAs could prove to be detrimental to this if used prematurely or inappropriately as they are likely to invoke a negative market reaction at a time when the institution may not have contravened any regulatory requirements.
- The powers should be understood to be deployed only where their exercise is necessary for meeting the resolution objectives included on page 49 of the consultation document.
- The measure to be taken should take into account the effect on the ongoing business of the institution; it is important to avoid the temptation to exercise powers to simply resolve in the easiest way possible. We suggest that the lowest cost powers are exercised, subject to a systemic override.
Given that the early intervention powers discussed later in the consultation document have strict triggers before they can be used (and are expected to be exercised only at a time where there are potential issues with the viability of the institution) we recommend that if the EC pursues these preparatory and preventative powers, it develops a staged approach and clearly defined triggers to determine when it may be appropriate to apply these tools, particularly as they may be exercised when the entity has no financial difficulties (or even the prospect of them).

Consultation process

Finally, we have concerns with the piecemeal approach to consulting on particular matters included in the powers. Measure (g) is one which assumes a minimum amount of convertible capital instruments. As noted elsewhere in the consultation document, no such minimum has been consulted upon or agreed and so we do not believe it is appropriate to be giving this power to the RA when the context and consequences are not fully developed.

22b. Specifically, should there be an express power to require limitations to intra-group guarantees, in order to address the obstacles that such guarantees may pose to effective resolution? (The FSB has identified such an obstacle: the guaranteed activities may be more difficult to separate from the rest of the organisation in times of stress, and may limit the ability to sell the guaranteed business.)

Whilst we acknowledge the concerns of the FSB there seems to be a conflict with the proposed approach to restrict guarantees with the relaxation of rules concerning intra-group financial support. We believe that these are similar in nature and so should be subject to the same framework and should be focused on ensuring that the entity continues as a going concern. It is important to continue to permit normal course of business inter-company guarantee arrangements and that RAs should not be empowered to require firms to terminate or limit the issuance of these. Any attempt to limit the use of these at the point of near non-viability could trigger the very demise it is intended to prevent, as it would clearly telegraph to the market that the firm was in some form of financial distress.
If the EC does go ahead with a limitation on guarantees, it is important that the transitional provisions make it clear that existing relationships are grandfathered.

22c. **In what cases, if any, might the exercise of such powers have an impact on affiliated entities located in other Member States?** In such cases, should the EBA play a mediation role, or should the group level resolution authority make the final decision about the application of measures under section D4 to single group entities (irrespective of where they are incorporated)?

It is quite possible that the exercise of these powers will have impact on entities in other Member States and that is one of the reasons that we believe that the framework for the application of these powers needs to be significantly enhanced, as noted in our response to question 22a.

Where entities in more than one Member State are involved, the group level RA should make the final decision about the application of measures.

23a. **Do the provisions suggested in sections D4 to D6 achieve an appropriate balance between ensuring the effective resolvability of credit institutions and groups and preserving the correct functioning of the single market?**

We have concerns regarding the range of powers and how they should be used as noted in our response to questions 22a. This will be further exacerbated if all Member States have powers and rights over entities within a group which they can exercise in relation to the individual entity in their jurisdiction. It is therefore important that powers are exercised only by group level RAs and supervisors.

We would also welcome some additional clarity of the principles to be considered for something to be judged in the public interest: the FSB paper on Reducing the Moral Hazard Posed by Systemically Important Financial Institutions considered factors such as whether disorderly failure of the institution would cause disruption to the wider financial system and economic activity because of the institution’s size, complexity and interconnectedness.
23b. Do you consider that only the group level resolution authority (rather than the resolution authorities responsible for the affected entities) should have the power to require group entities to make changes to legal or operational structures (see point (e) in the list of possible preparatory and preventative powers in (E4))? 

As noted above, we have significant concerns with these powers being granted. If they are, we consider that only group level RAs should have this power.

23c. Are there sufficient safeguards for credit institutions in the process for the application of preparatory and preventative measure that is proposed in sections D4 to D6?

The nature of the powers suggested is wide ranging and will almost certainly be exercised against the recommendation of management. Given this we do not believe that the proposed safeguards are sufficient. For example, how is premature exercise of the powers to be prevented? We are particularly concerned that the safeguards do not seem to allow the institution to challenge whether the ‘significant impediments’ identified by the resolution are appropriate, only to propose alternative remedies to impediments.

With regards to the judicial appeal/review process proposed, it is vital that the status quo is maintained whilst this process is conducted. It would not be appropriate for changes to be made based on the exercise of powers by the RA until any objections by the institution have been heard and resolved.

PART 3 – EARLY INTERVENTION

We oppose the proposed early intervention powers, in particular the appointment of a special manager. We consider that this has the potential to cause more damage to a financial institution through the market perception and we consider there are still some significant details to work out before this regime would be capable of implementation.
24a Is the revised trigger for supervisory intervention under Article 136(1) CRD (i.e. extended to include circumstances of likely breach) sufficiently flexible to allow supervisors to address a deteriorating situation promptly and effectively?

We have concerns with the extension of the powers of the supervisor as proposed. In particular, we believe that an entity which is not in severe financial difficulties, albeit there is a risk of breach, will have actions forced on it which are likely to be exercised against the recommendation of management and which will adversely affect the institution through the intervention of the supervisor causing confidence in an institution to be reduced (this action may in itself lead to a breach).

We are also concerned that giving these powers at the point of ‘likely breach’ is too subjective and will create unnecessary and potentially destabilising uncertainty. The advantage of the current drafting of the triggers in the CRD is that they are clear and provided certainty as to when supervisors can act. This is important in order to maintain market stability. Any use of powers based on a ‘likely to breach’ trigger should also be subject to an overarching requirement that there is no reasonable prospect that the credit institution will be able to rectify the relevant circumstance.

We also note that there is a risk that the supervisors may be considered to be acting as shadow directors, which will give rise to a question of moral hazard.

24b. Are the additional powers proposed for Article 136 sufficient to ensure that competent authorities take appropriate action to address developing financial problems? Are there any other powers that should be added?

An additional power which the EC may wish to consider is the ability for the Supervisor to remove an external auditor.

25a. Should supervisors be given the power to appoint a special manager as an early intervention measure?

We oppose the appointment of a special manager as an early intervention measure for the following reasons and our response to the following questions should also be taken in this context:
The market perception of the appointment of a special manager is likely to lead to greater instability for the institution (with the possible exception of where there are significant concerns relating to fraud or corruption).

The appointment of a special manager is likely to trigger default clauses with counterparties.

We are concerned that the effect of having a special manager in situ at a time of crisis will complicate the decision making process at a time when speed and action may be of the upmost importance.

We are unclear of the liability regime that will be applied to these special managers and how it will operate in practice (including how the liability of the existing directors will be affected).

It is not clear who the EC have in mind with regards these appointments and how will the supervisor ensure that they are suitably qualified.

It is important that given the potential effects on the institution in the marketplace of the appointment of a special manager that this is only done as a measure of last resort if the EC goes ahead with bringing forward such a proposal.

25b Should the conditions for the appointment of a special manager be linked to the specific recovery plan (Option 1 in section E2), or should supervisors have the power to appoint a special manager when there is a breach of the requirements of the CRD justifying intervention under Article 136, but the supervisors have grounds to believe that the current management would be unwilling or unable to take measures to redress the situation (Option 2 in section E2)?

We are supportive of Option 2.

25c. If the conditions for appointment of a special manager are based on Article 136, is an express proportionality restriction required to ensure that an appointment is only made in appropriate cases where justified by the nature of the breach?

We believe that a proportionality restriction should be required as this measure should only be taken as a last resort.
Recovery plans

26a. Do you agree that the decision as to whether a specific group recovery plan, or the coordination at group level of measures under Article 136(1) CRD or the appointment of special managers, are necessary should be taken by the consolidating supervisor?

We agree this decision should be taken by consolidating supervisor.

26b. Should the supervisors of subsidiaries included in the scope of any such decision by the consolidating supervisor be bound by that decision (subject to any right to refer the matter to a European Authority that could be the EBA)?

Yes. Other supervisors should be bound by that decision.

26c. Is a mechanism for mediation by a European Authority appropriate in this context and should the decision of that Authority be binding on all the supervisors involved?

Whilst we would expect much of the discussion regarding the operation of a group recovery plan to have been had in advance of specific measures being taken (including when group recovery is appropriate), we are supportive of the EBA as a mediator, in addition to our comments included in question 3d above. Any mediation action should be done within a clearly defined timescale of, say, 24 hours and where this is not practical the consolidating supervisor should not be obliged to wait for the EBA to mediate.

26d. Is the suggested timeframe (24hours) for decisions by the consolidating supervisor and the EBA appropriate in the circumstances?

We believe that in practice 24 hours would be considered a maximum time which could be used to make such a decision and given that decisions may need to be made in less than this time the involvement of the EBA should only be ‘where practical’ in this case.
27. Do you agree that the consolidating supervisor should be responsible for the assessment of group level recovery plans?

We agree that the consolidating supervisor should be responsible for the assessment of group level recovery plans.

PART 4 – RESOLUTION TOOLS AND POWERS

Resolution: conditions, objectives and general principles

28. Which of the options proposed, either alone or in combination is an appropriate trigger to allow authorities to apply resolution tools or exercise resolution powers? In particular, are they sufficiently transparent, and practicable for the authorities to apply? Would they allow intervention at the appropriate stage?

For the resolution triggers, we would support a combination – on an ‘earlier of’ basis, of option 2 (threshold conditions) and option 3 (relating to CRD4). We suggest this because while the failure to meet (or likely to fail) the threshold condition, it will involve a degree of discretion by regulators, the CRD4 capital requirements would provide a more objective test.

Given the discretion of ‘likely to fail’ component of the threshold condition test, we think it is important that the bar for resolution be higher, and in that regard, we welcome the proposals for additional conditions in the form of a public interest test and a condition that there be no reasonable prospect that the credit institution will take rectifying action (on its own or through other private means).

29. Do the resolution objectives suggested in section F3 comprehensively encapsulate the public interest considerations that justify resolution? Should any have precedence? Are there any other objectives that we should consider?

We suggest that the four resolution objectives of continuity of essential services, avoiding adverse effects on financial stability, and protecting public funds and protecting insured depositors are the appropriate objectives and are sufficiently comprehensive to encapsulate the public interest considerations that justify resolution.
Generally, we recommend that the EC includes client asset protection. In the event that a credit institution is liquidated, we recommend similar client asset principles as those provided by the UK Special Administration Regime, including an objective to ensure the prompt return of client assets and money by a) setting a bar date for claims to client assets, and b) to allocate shortfalls in client assets held in omnibus accounts on a pro rata basis.

30a. Are the guiding principles for resolution suggested in section F4 appropriate?

The guiding principle of allocating losses in accordance with statutory and contractual priority is appropriate. Additionally, we support a principle whereby no creditor incurs a greater loss in resolution than they would otherwise incur in liquidation (the NCWO principle).

However, the principle that RAs should ensure senior management bear losses in accordance with its responsibility is vague and unnecessary. Existing national and EU laws address breaches of duty by management. Management will also bear losses insofar as their interest in shares or the debt instruments of their firm is compromised.

Additionally, it may not be necessary in all circumstances to replace all members of management when applying the resolution tools and exercising the resolution powers. Management, or certain members of, may in fact be needed to see a successful resolution through. Therefore, authorities should have the flexibility to deal with the particular circumstances before them.

30b. In particular, is it necessary to include a general principle that creditors of the same class should be treated equally or should resolution authorities be able to derogate from this principle in specific circumstances?

We support a general principle that creditors of a same class are treated equally but note that there are practical considerations that deserve further study for unsecured creditors.
30c. Is it necessary to require independent valuation, and are the objectives of that valuation appropriate?

We recommend requiring an independent valuation of the credit institution when the RAs are applying the resolution tools and exercising the resolution powers as it will provide a safeguard for the purposes of ensuring NCWO.

Resolution tools, powers, mechanisms, and ancillary provisions

31a. Are the tools suggested in section 2 and elaborated in the following sections sufficiently comprehensive to allow resolution authorities to deal effectively with failing banks in the range of foreseeable circumstances? Are there any others that we should consider?

We believe the suggested resolution tools are sufficiently comprehensive to allow the RAs to effectively deal with failing banks in the range of foreseeable circumstances. In particular, we are pleased that the DG has taken up the industry’s suggestions for a debt write-down/conversion tool.

31b. Should resolution authorities be restricted to using these tools, or should Member States be able to supplement the proposed EU resolution framework with national tools and powers?

In order to ensure predictability in the financial markets and to increase the speed and ease with which cross-border firms are resolved, we recommend all Member States have the same resolution powers and tools available and to apply them in generally the same way.

32. Do you agree with the conditions for the sale of business tool suggested in section G2, and in particular the requirement for marketing?

Generally, AFME agrees with the conditions for the sale of business tool. RAs should be required to carry out good practice in the sale of the credit institution; however, they should have flexibility in how they achieve this, and in particular, obtain the best value in the sale of a credit institution. Marketing requirements may not be appropriate or possible in the
circumstances (e.g. may cause unnecessary time delays). Additionally, marketing should be on a non-discriminatory basis within the EU.

The EC suggests that supervisors carry out requirements of Article 19 of Directive 2006/48 (supervisory approval of change of control) in a timely manner that does not delay the application of the sale of business tool. However, we recommend that the RAs be given the ability to override the requirements.

33a. Should the EU framework include an express requirement that the residual bank (i.e. the entity that remains after the transfer of some, but not all, assets and liabilities to a purchaser) must be wound up? Are there likely to be circumstances where the residual bank is required to provide support to the purchaser or other remaining group entities?

Residual banks should be required to be wound up at some point, but whether that period is two, three or five years, should be left to the relevant RA to determine based on the nature of the business, assets, and liabilities left with the residual bank.

We can envision circumstances in which the residual bank is needed to provide support to the purchaser or other remaining group entities, in the way of essential services, which could be handled by transition services agreements.

33b. Should a bridge bank be permitted to operate without complying with the CRD requirements, in particular without minimum capital? If that is the case, should its activities be subject to restrictions

The RA, in consultation with the firm’s supervisor, should be able to override CRD requirements, provided the RA and supervisor have placed appropriate restrictions or limitations on the bridge bank’s activities. The decision to override and impose restrictions should take into account any potential anti-competitive impacts on other firms and the decision to override/impose restrictions should be made transparent to the market place.
33c. A bridge bank is intended to be a temporary structure. Is it appropriate to limit the operation of the bridge bank to 2 years maximum? Would it be preferable to impose a shorter or a longer limit?

We recommend that there should be flexibility as to how long a bridge bank can stay in operation. However, State aid rules will need to be considered in exercising this flexibility.

34. Should the use of the asset management tool as a stand-alone tool for resolution be prohibited in order to avoid the 'rescue' of a failing bank?

RAs should not be prohibited from using the asset separation tool as a stand-alone tool because flexibility may be needed under any particular set of circumstances. However, we recognise there is a delicate balance in preventing net economic assistance to a failing firm, on the one hand, and in ring fencing toxic assets in order to prevent systemic contagion, on the other.

35. The powers set out in this section G5 are intended to ensure that resolution authorities have all the necessary powers to apply the resolution tools. Are the suggested powers comprehensive? Are any additional powers necessary?

The list of powers set out in section G5 is sufficiently comprehensive to ensure that the RAs have all the necessary powers to apply the resolution tools.

36. The ancillary provisions set out in section G6 are intended to ensure that where a business has been transferred to another entity through the use of a resolution tool, the transfer is effective and the business can be carried on by the recipient. Are the suggested provisions sufficient? Are any additional provisions necessary?

Generally, we suggest that the ancillary provisions are sufficiently comprehensive.

However, it should be noted that in the event of a transfer, the ancillary provisions do not specifically include the power to transfer employees, ensure the continuity of employment contracts, or to amend documents as necessary to effect the transfer.
In the context of structured finance and default triggers, where no person can exercise a right or power to terminate, accelerate, or declare a default under any contract to which a credit institution is a party or to obtain possession or exercise control over any property of a credit institution without the consent of the RA, may have adverse implications. For example, an issuer or trustee in a structured finance transaction may be prevented or delayed in exercising a termination right in a contract with a credit institution, such as a servicing agreement, and compel the issuer to continue with the contract despite any effects this may have on the rating of the bond issued. Also, we suggest that the termination restriction should not prevent a later termination for failure to perform. We refer to the document in Annex 2.

37. Should the power suggested in section G7 be extended to allow authorities to impose equivalent requirements on other entities of the same group as the residual credit institution?

The RA should have the power to require the residual credit institution, or other entities within the group, to provide services or facilities necessary to allow the transferee to operate the business effectively; however, these services should generally be limited to IT, administration, and back-office functions, and should not constitute financial support.

In relation to securitisation or covered bond transactions, however, it may be important for the RA to have power to require a residual credit institution to continue to provide financial support, assuming it is in a position to do so, to those transactions, such as liquidity support or a subordinated loan for credit or expenses support, at least for a temporary period after the commencement of resolution, until such facilities can be replaced in accordance with the provisions of the transaction documents and rating agency counterparty criteria. It is likely that an affected credit institution will be disqualified from providing financial support due to loss of credit rating. Any comments above in relation to financial support are subject to our comments in Part 6.
38. The objective of the provisions suggested in section G8 is to ensure that where a transfer includes assets located in another EU Member State (e.g. in a branch) or rights and liabilities that are governed by the law of another Member State, the transfer cannot be challenged or prevented by virtue of provisions of the law of that other Member State. Are the suggested provisions sufficient to achieve this objective? Is any additional provision necessary?

We think it is sensible that transfers of foreign property located in a Member State other than the country of the RA cannot be challenged under the law of that other Member State.

39a. Should all member States be required to make provision in national law for all three mechanisms by which resolution can be carried out that are suggested above? If the same mechanisms are not available in all Member States, could this pose an obstacle to coordinated cross-border resolution?

We note that the three resolution mechanisms are not the same in that the receivership and administration mechanisms normally involve and the executive order model may involve a two-step process for the exercise of any transfer power under the relevant resolution mechanism in terms of which:

- step one involves the process by which the relevant RA takes control of the institution and decides which assets and liabilities should be transferred;
- step two involves the process whereby effect is given to such transfers through the use of a resolution tool, i.e. the assets and liabilities are transferred.

Where the RA does not give notice of its intention to use a resolution tool and power under a the executive order model, the executive order will involve a one step process, whereby the sale of business tool, bridge bank tool and asset separation tools are used without any preliminary step, i.e. taking control of the institution or giving notice of an intention to exercise a resolution tool power, but going instead directly to step two, i.e. giving effect to a transfer through the use of a resolution tool.

This distinction is important in the context of the temporary suspension of payment or delivery obligations discussed in the response to question 42 below.
In a two-step process, the RA will normally require a suspension to protect the institution under resolution from the activities of its creditors in terminating contracts to which they and the institution are a party and frustrate the orderly transfer of assets and liabilities. The suspension is, therefore, necessary to give the RA a breathing space to ensure that it can identify properly those rights and assets that should be transferred to and to give effect to those transfers in an orderly fashion.

In a one-step process, the suspension is not normally required as the RA’s process for identifying properly those rights and assets that should be transferred to and giving effect to those transfers in an orderly fashion is undertaken in secret. Where, however, there is a risk that the process may become public thereby causing creditors to terminate contracts and frustrate the orderly transfer of assets and liabilities, a temporary suspension may also have a role to play in the one-step process where the RA can make public its intention to transfer assets and liabilities.

To the extent that the EC seeks to give Member States the option to adopt any of the receivership, administration or executive order, the EC should ensure, as discussed further below, that it matches the appropriate powers or protections to the particular mechanism, i.e. (a) suspension power to the two step process and (b) use of resolution tool not itself triggering a close-out to the one step process. These are discussed in more detail in the response to question 42 below.

39b. Should receivership – which allows resolution authorities to take full control of the failing institution - be the primary framework for resolution?

Receivership, which enables a RA to take full control of a failing institution, may not be necessary at all in order to implement the resolution tools. Hence, the other mechanisms (executive order or decree and administration) alone may be sufficient to implement the resolution tools.

39c. Is any provision considered in this section necessary, or is it sufficient simply to provide for the resolution tools and powers?

Regarding the mechanisms suggested by the EC through which resolution can be carried out, we recommend Member States be provided with flexibility as to how to implement the resolution tools and powers.
40. Are the notification and publication requirements suggested in section G10 appropriate and sufficient to ensure that all affected persons are adequately informed about a resolution action?

After applying the resolution tools and powers, the RAs should be required to notify the affected firm and the EBA with a copy of the order/instrument by which relevant powers are exercised. Notice documentation should be posted on the websites of the RA, the EBA and the failed firm (as that is where retail customers are likely to look first).

RAs should have flexibility as how to conduct best practice regarding shareholder and creditor notification after applying a debt-write-down or conversion.

41. Are the principles suggested in section G11 sufficient to ensure that creditors receive appropriate compensation?

We support the suggested core principles to ensure that Member States provide adequate compensation to shareholders and creditors for interference with their property rights. Also, in order to ensure that the NCWO principle is preserved, we support that an independent valuer determines the amount of compensation.

As for the source of the compensation, it should be paid with any realised proceeds of the sale or transfer of any assets. The resolution fund is designed to fund administrative and legal costs of the resolution. In the event of a resolution, the liability of a fund should be no more than it would have been in the event of a liquidation. We refer to our comments in Part 6.

42. Please give your views on the suggested temporary suspension of payment or delivery obligations? Is it appropriate to exclude eligible deposits? Should any other obligations be excluded?

We have concerns with the temporary suspension of payment or delivery obligations and suggest that the EC consider its potential for causing systemic contagion among affected counterparties. For example, if the failing firm's obligations to deliver securities or payment are suspended, even temporarily, a firm's counterparties could become, as a result of the failed firm's suspension, unable to meet its payment or delivery
obligations which in turn could have further knock-on effects on its counterparties, and so on and so forth.

With respect to the length of any suspension period pursuant to the exercise of the suspension powers, we believe that option (a) has the advantage of being more certain and avoids a result which could be detrimental to market confidence while potentially giving a RA more time than is strictly necessary to make a decision on the exercise of a resolution tool or power. With respect to the second point, the EC would also need to ensure that any suspension was terminated upon the transfer of assets and liabilities where this occurred sooner than the expiry of the statutorily defined period.

Where a member state decides to adopt mechanisms that involves a one-step process, such as an executive order, without any preliminary step, i.e. taking control of the institution or giving notice of an intention to exercise a resolution tool or power, then the EC needs to consider the effect which the transfer of any assets or liabilities will have on any payment or delivery rights. In particular, the EC needs to consider whether provisions are necessary to ensure that:

- the transfer of assets or liabilities; or
- the resolution condition for the use of the resolution tool that gives rise to the transfer

should not of itself displace any payment or delivery rights or trigger any termination rights (subject to the partial transfers safeguards covered in H1).

We agree that eligible deposits within the meaning of the Deposit Guarantee Scheme should be excluded from the suspension powers. However, we see no reason why any other obligation should be excluded.

For securitisation or covered bond transactions, where the credit institution is under an obligation to act as a mere collecting agent for another entity by collecting monies from borrowers and then paying those collections to an entity such as a special purpose vehicle (SPV) issuer, or asset holder in the case of a covered bond transaction, the 48 hour suspension provisions could be problematic. Specifically, if the suspension was to occur immediately prior to a collection date or an interest payment date of a large amount of funds not covered by liquidity facilities, the suspension period may affect the payment of interest or principal. If the same credit institution provides the liquidity facilities, it is likely that the
suspension powers would capture those facilities as well. Therefore, AFME recommends that consideration be given to whether it may be appropriate to exclude any funds which are held by a credit institution, acting merely as a collecting agent, but belong to another entity in connection with a finance arrangement (i.e. the issuer) from the suspension powers.

43. Please give your views on the temporary suspension of close out netting rights suggested in section G13, including the appropriate length of the suspension. Should any classes of counterparty be excluded from the scope of such a suspension: for example, Central Banks, CCPs, payment and securities settlement systems that fall within the scope of the Settlement Finality Directive?

We refer to our comments on the temporary suspension of payment and delivery obligations above, including our comments with respect to the length of any suspension period and the need for protections where a Member State chooses a one step process.

Notwithstanding our comments above, we suggest the following on the exercise of any suspension power in the context of close out netting rights:

- the time period in respect of which a RA may suspend early termination rights must be strictly limited and strictly adhered to.

- the relevant agreements containing close out netting rights and all transactions under them must be transferred to an eligible transferee as a whole or not at all so that there is no possibility of “cherry-picking” of transactions or parts of transactions. (We note that the EC proposes safeguards in this respect but it is necessary to consider this also in the context of the exercise of the suspension powers)

We note that the resolution regime in the US, administered by the Federal Deposit Insurance Corporation (FDIC), currently applies the conditions above on the suspension powers that enable RAs to suspend early termination and close out netting. AFME also notes that the existence of a limited Suspension Power in the US has not prevented supervised institutions from obtaining legal opinions in relation to US banks subject to the FDIC regime that are sufficiently robust to comply with current requirements for recognition of close-out netting for regulatory capital purposes. However, we stress that in order to maintain necessary legal certainty, any regime that implements a suspension power must limit the power and do so clearly.
With respect to the exclusion of counterparties, we take the view that certain classes of counterparty, such as Central Banks, Central Clearing Parties (CCPs) and any “System” within the meaning of Directive 98/26/EC should be excluded from the temporary suspension powers.

In this respect, we note that the Oderly Liquidation Authority provisions of the Dodd Frank Act in the United States contains a specific exemption from the stay for clearing organisations (COs) which allows a CO to exercise its rights under a Qualified Financial Contract if the FDIC as a receiver fails to meet its margin, collateral, or settlement obligations except that this exemption does not appear to apply to margin, collateral or settlement obligations that arise because of the appointment of the receiver. As a result, the CO can exercise its rights, notwithstanding the stay, if the failed counterparty fails to meet its ordinary-course contractual obligations but the CO is subject to the stay for rights arising upon a receivership.

44. Do you agree that judicial review of resolution action should be limited to a review of the legality of the action, and that remedies should be limited to financial compensation, with no power for the court to reverse any action taken by resolution authorities? Alternatively, should the court have the power to reverse a transfer of assets and liabilities in limited circumstances where unwinding of the transfer is practically feasible and would not cause systemic risk or undermine legitimate expectations?

We agree that a judicial review of a resolution action should be limited to the legality of the action. We also agree that remedies should be limited to financial compensation and give no power to the court to unwind the action. Also, where a Member State fails to meet its obligations, our concerns in question 41 apply.

45. Would the provisions suggested in section G15 provide adequate protection for confidential information?

The provisions suggested in section G15 provide adequate protection for confidential information and we recommend that they should apply to all information gathered in the period leading up to resolution.
Safeguards

46a. Do you agree that the classes of arrangement suggested in this section should be subject to the suggested safeguards in the case of partial property transfers? Should any other market arrangements be included?

We agree that the suggested classes of market arrangements should be subject to the suggested safeguards. We also agree that it is important for the text of any final directive to highlight the fact that the arrangements are protected, regardless of whether they are created by contract, trust or other means.

The EC should also note our comments in response to question 43 above, regarding the transfer of assets and liabilities and the transfer of agreements continuing close out netting rights.

In the event of a transfer during resolution, as mentioned above and below, relevant agreements containing close out netting rights and all transactions under them must be transferred to an eligible transferee as a whole or not at all, so that there is no possibility of "cherry-picking" of transactions or parts of transaction.

In addition, any provisions governing transfer should specify the following:

- the proposed transferee is a financially sound entity with whom the counterparty would prudently be able to contract in the normal course of its business;

- the early termination rights of the counterparty are preserved as against the transferee in the case of any subsequent default by the transferee; and

- should the authorities decide not to transfer the relevant agreements upon the expiry of the suspension period, the counterparty retains the right to close out immediately against the failed financial institution.

Qualified Financial Contracts (QFCs) include swap agreements, securities contracts, repurchase agreements, forward contracts, and commodity contracts. We note that in the US, where a bridge company or other acquirer with a requirement is appointed as a receiver, the FDIC may transfer QFCs to it. In the event that this occurs, similarly to that which is proposed by the EC, no partial transfer of QFCs can be made.

In order to ensure optimum co-ordination between the FDIC and any Member State RA, we suggest that the EC aligns the market arrangements, in respect of which the partial transfer safeguards would apply, with those of the US. Any arrangement that is captured within definition of a QFC should, as a minimum, be included in within scope of the market arrangements.
46b. As a general approach, this Section H suggests a set of outcomes that Member States need to achieve (i.e. transfer of all or none of the property, rights and liabilities that covered by the various kinds of market arrangements that are specified here). It does not prescribe how that should be done or, in particular, the consequences if a transfer contravenes these provisions. Is such further provision necessary?

Each Member State may have its own formal requirements for achieving the outcomes covered the various kinds of market arrangements. Therefore, further provisions prescribing how to achieve the outcomes are unnecessary.

We note, however, that the EC must ensure that each Member State RA permits the transfer of rights or liabilities to a non-EU transferee only if the contractual rights and liabilities would be enforceable in the jurisdiction of the non-EU transferee entity. (We note that this is different to the situation envisaged in the penultimate paragraph of Section H1.)

46c. Is further harmonisation of the definitions of the financial markets arrangements covered under this section necessary for the safeguards to be effective?

Subject to our comments in response to Question 46a above regarding the types of arrangements, and to the comments below in relation to structured finance arrangements, we do not believe that any further harmonisation of the definitions is required save that the EC should ensure that any definitions are consistent with the provisions of the proposed Netting Directive.

The protections in paragraph H4 refer to "structured finance arrangements" but these are not defined. It will be necessary for any Resolution legislation to define a structured finance arrangement for use in each Member State. This may not be easy and if the proposals in the consultation document are to be implemented uniformly in each Member State, there may need to be significant more detail in the Directive on these matters to ensure uniformity is achieved.
46d. The objective is to ensure appropriate protection (‘no cherry picking’) for legitimate financial market arrangements. Is there a risk that the necessary flexibility for resolution authorities could be undermined or frustrated, for example if non-related derivatives are included in a protected netting arrangement?

The need of safeguards to ensure appropriate protection for legitimate market arrangements outweighs any loss of flexibility. We suggest that it is important for the EC to align the safeguard provisions as much as possible with those applicable to the FDIC.

Specifically, the FDIC as a receiver must either:

- transfer all QFCs between the entity subject to receivership and an individual counterparty and the counterparty's affiliates to the same bridge financial company or other acquirer; or
- not transfer any QFCs involving that counterparty and the counterparty's affiliates.

In addition, if the "no cherry picking" protection is to be achieved, any transfer should be subject, at minimum, to the FDIC requirements.

47a. Please give your views on the safeguards for title transfer financial collateral arrangements and set-off and netting arrangements suggested in section H2.

Regarding the safeguards for title transfer financial arrangements, set-off, and netting arrangements, we repeat our comments in response to questions 46a to 46d above.

The EC should ensure that the financial collateral arrangements are at least equivalent to those identified in the Collateral Directive and the proposed Netting Directive.

In order to ensure arrangements that have the same effect as the collateral arrangements identified in the Collateral Framework and proposed Netting Directive are not excluded, the EC should provide RAs the authority to include other arrangements that are not expressly identified.
47b. Do you agree that certain retail rights and liabilities and rights and liabilities relating to subordinated debt should be excluded from the suggested safeguard

AFME agrees that certain rights and liabilities relating to retail or subordinated debt should be excluded from the suggested safeguard.

48. Please give your views on the safeguards for security arrangements suggested in this section

AFME has no objections to the safeguards for security arrangements.

49a. Please give your views on the safeguards for structured finance arrangements suggested in section H4.

The safeguards for structured finance arrangements seem to be based largely on the provisions of the UK Banking Act 2009, which has some advantages in that the proposals have a precedent which has been previously reviewed and commented upon by the financial community. This is helpful. However, these provisions were developed in a solely UK context and may need adaptation for use in other jurisdictions. For example, we understand the situation in Germany may be complex because similar resolution legislation already exists. On the other hand, our members in the Netherlands agree with our comments in this paper and have nothing more to add. Moreover, the UK approach leaves some room for improvement.

In particular, in our view, a safeguard for structured finance arrangements should apply beyond a partial property transfer context in order to provide meaningful protection, as the concerns in a structured finance context go beyond keeping certain assets together. Structured finance arrangements are typically multilateral and involve banks in a number of roles (originator/sponsor/servicer/trustee/swap counterparty etc.). They also involve the creation and transfer of proprietary, as well as contractual, claims. As a result, the key aim of a structured finance arrangement safeguard should be to ensure that the exercise of the resolution tools and powers does not adversely affect the operation of those roles, or entitlements to those claims (in a partial property transfer context, as well as a whole property transfer context). In this regard, contractual certainty is key. If the integrity of the arrangement is not protected, then this will have an impact on the true sale and enforceability
of legal opinions upon which such transactions rely, which in turn may result in adverse consequences for their credit quality and ratings, and possibly in the efficiency of structured finance arrangements as funding tools in general.

The statement that the safeguard proposals should apply to arrangements irrespective of how they are created whether by "contract, trust or other means or arise automatically by operation of law" is useful in helping to ensure that structured finance transactions will be protected however they are created in the different EU Member States. We refer to our comments on the implications for structured finance elsewhere in this document.

49b. Do you consider that property, rights and liabilities relating to deposits should be excluded from the suggested safeguards?

If the objectives of removing moral hazard from credit institution recovery are to be achieved and creditors are to bear the costs of resolution then it would seem right that deposits are carved out of any structured finance protections. In any case, retail deposits up to specified limits are already protected across the EU under banking authority compensation schemes. In relation to more detailed legislation in those jurisdictions relying on trust law, care should be taken that in relation to property held on trust by an affected credit institution (such as the legal estate in assets which have been transferred by an unnotified equitable assignment) for a securitisation or covered bond SPV, that any partial property transfer makes adequate provision for the transfer of that legal estate.

Protection of trading, clearing and settlement systems

50. Is express provision in relation to the protection of trading, clearing and settlement systems necessary, or are the provisions of the Settlement Finality Directive sufficient? If express provision is needed in this context, should the protections be drafted more broadly than those in the Settlement Finality Directive?

Yes. The scope of the Settlement Finality Directive is too narrow to offer the protections which the market protections are intended or should provide. The relevant protections under the Settlement Finality Directive do not extend to CCPs and various other trading, clearing and settlement systems. If the market protections retain their current scope, these other trading, clearing and settlement systems will not be protected which could
result in the exclusion of these trading, clearing and settlement systems from European markets.

We note, however, that this should not prevent the ability for a relevant institution's membership of a clearing house or exchange to be transferred. Although, we also think that a CCP or other trading, clearing and settlement system should not be required to accept a bridge bank or other transferee to whom market contracts have been transferred as a member simply because those market contracts are cleared, traded or settled through or on that trading, clearing and settlement system.

51. Is the provision suggested in section H6 sufficient to ensure that creditors would receive appropriate compensation? Is it necessary to specify the details of such compensation arrangements in an EU framework?

We recommend the provision to ensure appropriate compensation is given to third parties in partial transfers is appropriate. Particular emphasis should be given to the NCWO provision. In addition, the EU framework should focus on the outcomes and does not need to specify the details of compensation arrangements.

PART 5 – GROUP RESOLUTION

52. Do you agree that the group level resolution authority should decide on the composition of the resolution colleges?

AFME agrees that the group resolution authority (GRA) should establish a resolution college to facilitate the exercise of the tasks in relation to group resolution plans, including deciding on the composition of the resolution college, and the inclusion, where appropriate, of third country RAs.

The GRA should have discretion to determine which RAs should be present at meetings; the GRA should consider the subject matter, the impact of the decisions to be taken on each Member State, and the need for confidentiality. All members of the resolution college should be kept generally informed of developments, irrespective of whether they participate in meetings and decisions.

The EBA’s participation could be useful in certain meetings and the GRA should have the discretion to determine its inclusion based on similar criteria as for determining inclusion of particular RAs.
53a. Does the framework suggested in Part 5 strike an appropriate balance between the coordination of national measures that is necessary to deal effectively with a failing group, and the proven need for authorities to act quickly and decisively where the situation requires it?

As AFME understands the proposal, group resolution is triggered when two or more members of the GRA meet the triggers for resolution, and the GRA has taken into account (within one calendar day) whether:

- the resolution objectives would be better achieved by group resolution than by discrete or uncoordinated action, and
- measures that an individual RA is likely to take would have an adverse impact on other members of the group, which group resolution would avoid.

AFME believes this framework strikes the appropriate balance between coordination and need for decisive action, particularly given the ability of an RA to opt out and take independent action where it reasonably considers that such measure is necessary for national financial stability. However, in order to ensure certainty, the resolution framework should be within a managed framework; therefore, if smaller Member States decide to opt out, it could disrupt the framework and undermine the resolution process.

Also, the proposal is not clear as to when the clock for the one calendar day period commences.

53b. Should the framework set out explicit detail about how each resolution tool might be applied at group level?

AFME believes that the common resolution powers and tools represent considerable progress such that the EC at this stage does not necessarily need to impose explicit detail as to how RAs might apply each tool. However, it is important that RAs prevent investor uncertainty by publicising to the financial markets how they would apply the resolution tools. Ideally, over time, as the powers and tools are used, the manner of implementation will converge across Member States. In addition, firm-specific resolution plans should also detail how the tools would be used.
54. Should it be a priority for the EU to strive for an internationally coordinated approach?

AFME believes it should be a priority for the EU to strive for an internationally coordinated approach. We would encourage policymakers to explore whether the EU framework could serve as a template for G20 cross-border resolution. The EU framework has advanced the dialogue beyond the platitudes of cooperation and coordination to provide procedures for establishing and running resolution colleges and determining when, and how, a group resolution plan should be implemented.

A G-20 framework could possibly be tied into Basel III and overseen by the Financial Stability Board or it could possibly be governed by a UNCITRAL type mechanism.

We recommend policymakers consider whether the rules contained in the nonbinding protocols employed in large international corporate insolvencies could be adopted more formally as a foundation for a global framework (as well as the EU regime). These protocols are based on the principle that the various entities making up a global firm operating in multiple jurisdictions will require insolvency administration in multiple forums, making them no less interdependent in insolvency than they were prior to insolvency. These protocols set out useful rules (albeit nonbinding) for the efficient administration of each group member’s individual proceedings in concert with the other proceedings, and their effective case management and consistent judgments among tribunals. An example would be an agreement for a common methodology for reconciling intercompany claims, which could provide guidance for matters to be included in a firm’s resolution plan.

As an example of a cross-border insolvency protocol, we attach one used in the Lehman proceedings at Annex 3.

We note that some national insolvency laws impose duties on administrators to preserve assets for creditors that may prevent administrators from joining in such a protocol (however nonbinding). This issue merits study as a part of the EU’s planned harmonization review of EU insolvency laws.
55. **Should firm specific arrangements with third country authorities be required?**

Firm specific arrangements with third-country RAs may be desirable, but we have concerns about the practicalities of devising them and the burden that would result from these additional requirements.

56. **Do you agree that if the resolution authority is not satisfied about the resolution framework of a third country it should be able to require changes to the organisation or operating structure of the credit institution?**

We suggest that supervisors rather than the RA perform the role of working with a firm on its resolution plan whatever the reason for dissatisfaction with that plan is.
PART 6 – FINANCING ARRANGEMENTS

Preface to our responses to questions 57 to 61 in part 6.

It may be helpful first to set out some general thoughts on resolution funds, and how they might relate to deposit guarantee schemes. A general theme which runs through our submission is that in the event of a resolution, the liability of a fund should be no more than it would have been in the event of a liquidation.

Our understanding is that the objective of resolution funds is broadly to cover particular costs arising from the resolution process, such as administrative costs (e.g. legal, accounting, auditing, valuation fees) and also, potentially, financing costs associated with transferring (at market value) certain assets; the resolution fund itself would not take on the market risk or credit risk relating to the assets, and so would not participate in any profit or loss either on transfer or on subsequent management of the assets.

Our understanding is that the objective of deposit guarantee schemes is to protect insured depositors (up to a maximum limit per depositor).

Now it may be that the method of resolution involves transferring, to a new bank or to an existing third party bank, the liabilities due to insured depositors. The resolution may also involve certain assets being transferred (at market value) from the failing bank to a new bank or to an existing third party bank.

In such a case, the resolution fund would bear administrative costs, plus the cost represented by the amounts paid to the new bank or existing third party bank to enable them to take on the liabilities to the insured depositors, plus financing costs in the case where the fund lends to the new bank or existing third party bank to enable them to purchase the assets.

Our expectation would be that the administrative costs and financing costs associated with asset transfers would typically be significantly smaller than the amounts paid in relation to the insured deposits.

Accordingly, this line of thinking would suggest joining the resolution funds onto the existing deposit guarantee schemes; however, this would of course raise additional questions around any contributions to be made by non-deposit taking institutions and how these might be reflected both in collecting contributions and disbursing them. Overall though, additional contributions would likely be significantly smaller than the contributions already made to the deposit guarantee schemes.
Our understanding is also that in addition to transferring liabilities representing insured deposits, it may be that the resolution fund could be used to transfer other services (for example, related to payment systems) considered essential for financial stability. We consider that the contributions likely to be required to cover this would be relatively small, particularly taking into account the effect of the crisis management and resolution changes as a whole (i.e. that all firms should be resolvable, and that the likelihood of resolution being required should be reduced due to the early intervention powers and due to the recovery and resolution plans).

For these reasons, as well as the reasons noted above, we would suggest that the simplest approach in practice would be to collect any additional contributions (i.e. over and above the contributions already collected by the DGS) on an ex-post basis. Moreover, any discussion of ex-ante funds should acknowledge the difficulties of such funds. These include the difficulty of determining the appropriate size of such a fund, the possible creation of moral hazard, and the rendering of capital unavailable for lending.

We note also that should the current proposals for a new directive on deposit guarantee schemes be adopted, there will be an element of pre-funding of such schemes.

Finally, we consider that in the context of group resolution, it will be important for the EC to clarify its thinking on which fund should ultimately bear the costs of resolution. For example, if a subsidiary in a Member State were being resolved pursuant to a group resolution process, would the costs of resolution of that subsidiary ultimately be borne by the fund established in the jurisdiction of the subsidiary, or would the costs ultimately be borne by the fund established in the jurisdiction of the parent company of the group?

57. Is it sufficient to make a general reference to the financing of resolution tools or is it necessary to be more explicit about what a fund can or cannot finance (e.g. recapitalisation, loss sharing, etc.)?

We consider that it is necessary to be more explicit about what a fund can or cannot finance.

Resolution funds could be used for administrative costs, financing costs relating to the asset transfers (or the transfer of other essential services) and the cost represented by the amounts paid to the new bank or existing third party bank to enable them to take on the liabilities to the insured depositors (up to a maximum limit per depositor).
Resolution funds should not replace central bank functions, and they should not be used to recapitalise or otherwise bail out failing banks. It may be useful for the EC and/or the Member States to be quite specific as to the meaning of terms such as recapitalisation.

In the event of a liquidation, the use of the fund would be triggered (i.e. the fund would make payments to insured depositors, up to a maximum limit per depositor); the fund would then rank as an unsecured creditor in the liquidation, and would therefore receive proceeds of the liquidation if sufficient assets are realised. Where a firm enters into resolution as an alternative to liquidation, we consider that the liability of the fund should be no more than it would have been in the event of a liquidation.

Also, as noted in the preface, where a fund is used to finance the transfer of certain assets (at market value), our understanding is that the fund would not take on the market risk or credit risk relating to the assets, and so would not participate in any profit or loss either on transfer or on subsequent management of the assets.

58. Should there be more explicit provision about the alternative funding arrangements, for example reference to specific types of arrangements such as debt issuance or guarantees?

The approach considered in the document is as follows:

(i) raise “ordinary funds” expected to achieve a target size;
(ii) if not sufficient, raise “extraordinary funds” not exceeding \([y]\)% of eligible liabilities;
(iii) if still insufficient, raise “alternative funds”,

We recognise that even with the new resolution framework, there may still be cases where the funds are not sufficient to finance resolution. In such a case, we can see that there could be a need for some alternative funds as defined above.

We would suggest that if the contributions required are significant (perhaps an unlikely scenario) then it may be appropriate for the extra contributions to be spread over a suitable period. Whilst the industry would still bear the cost of contributions, there would need to be a mechanism for the fund to borrow part of the amounts required, and to repay the borrowing over time using the extra contributions.
59a. Should the basis for the calculation of contributions be fully harmonised or left to the discretion of Member States?

We consider that the basis for the calculation of contributions should be left to the discretion of Member States.

In this connection, we think it is important that the EC clarify the treatment of branches and subsidiaries of non-EU parents who may be contributing to funds of their own jurisdictions, not least to ensure that the risk of double contributions is avoided.

It is suggested in the consultation document that branches established in a Member State by a credit institution which has its head office outside the EU would have to contribute to the fund within the territory in which they (i.e. the branches) are established. It is not clear to us, though, why this should be the case, and we suggest that the matter should be considered further.

It is suggested in the consultation document that every credit institution and certain investment firms authorised under the territory of each Member State shall contribute to the fund. We believe it is important to clarify what this means. For example, where the parent of a group is authorised under Member State A and passports as a branch into another Member State B, we assume that the intention is that contributions would be made in Member State A and not in Member State B.

The position of entities which are established in a Member State as subsidiaries will also need to be clarified in the light of the outcome of discussions on group resolution, which should determine which fund would ultimately bear the costs of resolution.

We appreciate that the EC is separately consulting on proposals relating to deposit guarantee schemes and would suggest that the proposals be coordinated should the EC consider joining the resolution fund with the deposit guarantee schemes.
59b. Are eligible liabilities an appropriate basis for calculating contributions from individual institutions, or a more risk adjusted basis be preferable? The latter might take account of elements such as: a) the probability that the institution would enter into resolution, b) its eligible liabilities, c) its systemic importance for the markets in question, etc. However, would that add too much complexity?

Clearly, eligible liabilities are one possible basis for calculating contributions. A more risk-adjusted basis might more accurately reflect the expected costs and would have the value of linking the risks inherent in an institution’s business model or capital and funding structure to the scale of its contributions. It would of course be necessary to avoid undue complexity in doing this. We suggest that any guidance from the EC on this matter could take into account the current negotiations on deposit guarantee schemes insofar as those negotiations address possible complexities.

60. Do you agree that when the DGS of a Member State is also able to finance resolution, this should be taken into account when calculating the contributions to the Fund? Are additional safeguards necessary to protect the interests of insured depositors?

Following on from the preface to our responses to part 6, we consider that the idea of joining the DGS and the resolution fund should be explored further. It would of course be necessary to address additional questions around any contributions to be made by non-deposit taking institutions and how these might be reflected both in collecting contributions and disbursing them.

It is important to safeguard the interests of insured depositors (up to a maximum limit per depositor), and this is where we think the earlier question 57 is very important. So long as it is explicit that a DGS/resolution fund is only to be used for the purposes of protecting insured depositors (up to a maximum limit per depositor) and financing the transfer of other essential services, and potentially for financing costs associated with asset transfers, we believe that there is little incremental risk to the insured depositors. On the other hand, if it rather vague as to what a DGS/resolution fund can do, then there could indeed be incremental risks to the insured depositors.
61. Do you agree that a resolution fund should have a priority ranking over the claims of all other unsecured creditors? Do you consider that this privileged position should be extended to other creditors in order to ensure temporary funding in the context of resolution?

The various possible uses of resolution funds, as set out in our response to question 57 above, may be divided into two categories, temporary financing (e.g. loan to purchase assets), and outright compensation (payment to new bank or third party bank to take on the liabilities of the insured depositors, up to a maximum limit per depositor).

We consider that where the resolution fund provides temporary financing, that should have a priority ranking over all other unsecured creditors.

We consider that this privileged position should also be afforded to creditors (such as central banks) providing liquidity support.

Any provider of funding in the implementation of a resolution should have priority; if there is more than one provider, the priority should be shared pari passu.
ANNEX 1

Debt Write-Down

As a general matter, the industry accepts that a robust financial system will entail the removal of implicit State guarantees. In that regard, AFME is pleased that the EC is exploring debt write-down as a potentially useful resolution tool to avoid both taxpayer-funded bail-outs and systemically costly liquidations.

The EC proposes two broad alternative approaches to debt write-down:

1) A ‘targeted’ approach that would require banks to hold a fixed amount of ‘bail-in-able’ debt but that would exclude senior debt from the scope of any write-down; and
2) A ‘comprehensive’ approach would give RAs the statutory power to write down senior debt.

In both cases, debt write-down is a resolution tool, to be used as an alternative to liquidation, which itself is unsuited to many financial institutions. In a gone-concern scenario, when resolution comes into play, the focus should be only absorbing losses, maximising value for creditors and averting a systemic crisis. Shareholders should be required to bear losses as a precondition to any debt write-down.

On the whole, our members recognise the comparative ease and clarity of the targeted approach, in relation to the comprehensive approach, although neither option is completely without difficulties. We recognise that it would be difficult to size an instrument buffer ex-ante and there may be cases in which the targeted approach is inadequate to absorb the losses and allow for an orderly recapitalisation. In these instances, we believe it is appropriate that a comprehensive approach also be available to regulators – although the majority of our members believe this should only be used as a last resort. Moreover, it may be appropriate to insert a delay between the write-down of subordinated debt and any write-down of senior debt. Some members caution, however, that this two-step approach might exacerbate losses, both individually and systemically, and point to the example of Ireland to illustrate this risk.

As a practical matter, the targeted approach offers significant benefits in terms of clarity and, to some extent, ease of implementation. The targeted approach would identify a tranche of capital earmarked to absorb losses (after shareholders). The terms of the conversion, trigger and timing would be set contractually. The contractual approach has the advantage of providing clarity to markets, which helps pricing to accurately reflect risk.
However, until market norms develop, there is the risk of ambiguity if the provisions differ between issuances by different institutions. The targeted approach also avoids the principal challenge of the comprehensive approach, namely concerning which classes of creditors to exclude, but as such instruments currently do not exist, and investors will have the option to invest in non-bail in senior debt, a ready market for them is not assured.

We think the targeted approach can and should be aligned with the recent Basel III requirements that make all subordinated Tier 1 and Tier 2 instruments fully loss-absorbent at the point of non-viability. We believe that the EC should have regard to these developments, and produce a study of the protection they afford, to assess the extent to which loss absorption needs to be extended to other class of instruments or creditors. We think that it is essential that such a study should be done and note that:

- Based on historical data drawn from the crisis, the full loss absorption of subordinated securities would likely have allowed the major banks to maintain satisfactory capital levels for an orderly recapitalisation.
- The revised regulatory framework under Basel III is already designed to provide a significant amount of extra cushion, in the form of higher and better quality capital requirements as well as potential additional capital requirements for systemically important banks.
- The point of non-viability as describe by Basel appears very similar to the point of resolution described by the EC.
- The Basel approach will be applied consistently across the globe, providing a level playing field for all banks.

We think that at this stage the EC should fully evaluate the merits of the Basel approach in respect of the protection of the public interest before considering adding further measures, bearing in mind the economic cost of additional requirements. A full alignment between Basel’s non-viability requirements and the EC’s resolution would have the further benefit of providing greater clarity and certainty to both regulators and markets.

While we are confident that revised capital standards will in most instances be sufficient to allow a bank to move into an orderly wind-down, we recognise that, in very limited cases, there may be the need to consider writing down creditors beyond subordinated debt. The critical question is: ‘which creditors?’ In our Prevention and Cure paper (August 2010), we suggested that a bail-in should follow the principles akin to corporate restructurings that protect liabilities arising in the normal course of business; this is done so that the bank can continue to operate, even if only until it is sold or wound down. These liabilities are analogous to an industrial company’s ‘trade creditors’ as distinguished from its ‘financial creditors.’ But
the nature of a bank’s business – credit – makes it more difficult to distinguish its trade creditors from its financial creditors.

Thus even a last-resort application of the ‘comprehensive approach’ poses difficulties, which we hope the EC will consider fully. Clarity around these issues will be vital in supporting market confidence and preventing a dramatic increase in banks’ cost of funding. Overall we believe EC decision-making should take into account the specific financing features of the European banking sector, which relies significantly on the wholesale market for senior unsecured and secured funding. In that respect, we feel that risks imposed to senior creditors would affect European banks more onerously than their US or Asian counterparts.

We would suggest that the EC authorise further study on the question of whether certain classes of debt should be explicitly excluded, and if so, how. This analysis should take into account the tensions between the fast-moving and idiosyncratic nature of an individual bank failure, and the risk of creating incentives to work around these rules – for example to over-encumber the liability structure.

Finally, we stress that providing clarity to all stakeholders (shareholders, counterparties and various class of fixed income investors ranging from money market funds to subordinated debt holders, rating agencies and analysts) is key to ensuring that markets function effectively. If the procedures for resolution are left vague until an event, there is a risk ad hoc actions may undermine regulators’ credibility and further destabilise markets. Further, we think that the authorities have a significant role to play in providing market education, which will be essential for a smooth transition to a framework where there is no implicit state guarantee.

Other issues

*Write Down Within Groups.* We think any write-down of a subsidiary’s debt should be addressed in the recovery and resolution plans of its broader group
Memorandum

TO Richard Hopkin, AFME
     Gilby Strud, AFME
     Kevin Ingram, CC

DATE 7 March 2011

COPY TO

FROM Chris Oakley

DIRECT DIAL +44 207006 2027

Comments on DG Internal Market and Services Working Document

Proposals for Credit Institution Recovery and Resolution

1. Introduction

(a) We have reviewed the above paper of January 2011 regarding the Technical Details of a possible Framework for Credit Institution Recovery and Resolution (the Document) having regard for issues which may affect securitisation and covered bond transactions carried out by credit institutions prior to resolution.

(b) We note that the powers in the Document are based largely on the powers in the Banking Act 2009 as a precedent which has some advantages in that the proposals in the Document have a precedent which has been previously reviewed and commented on by the financial community. However, these powers were developed in a solely UK context and may need adaptation for use in other jurisdictions. Comment from lawyers in other relevant jurisdictions on the Document may be helpful.

(c) In particular, we have compared the powers which are proposed to be given to supervisory authorities under the Document with those given to the Bank of...
England under the *Banking Act 2009* so far as they may be relevant to structured finance transactions.

(d) We have also compared the protections which are proposed to be made for structured finance transactions under the Document with those made under the Banking Act 2009 and subsidiary legislation made thereunder, including under the *Banking Act 2009 (Restrictions on Partial Property Transfers) Order 2009 (SI 2009/322)* (the PPT Order).

(e) We also set out some more general comments on the Document which are not necessarily connected with structured finance transactions.

(f) The Document proposes a "harmonised EU regime for crisis prevention and credit institution recovery and resolution" under "the same substantive and procedural rules". The Document does not state specifically whether this would be by way of an EU Regulation which would have direct effect in the EU Member States or by way of a Directive which would require implementation in each EU Member State. My colleagues in our regulatory group advise me that this is likely to be implemented by way of Directive. This has interesting issues for the UK given that we already have a resolution and recovery regime for banks under the Banking Act 2009. If implemented by way of Directive (as most other financial legislation from the EU has been) the UK may not need to pass further legislation in this area, or at least only such legislation so as to bring it into line with any EU Directive.

2. **Protection for Structured Finance**

(a) The protections for structured finance transactions are set out in paragraph H4 of the Document and are very short. They are a virtual "copy-out" of paragraphs 6(1), (2) and (3) of the PPT Order and effectively achieve the same protections for structured finance arrangements as in the PPT Order.

(b) These protections are included to protect creditors in structured finance transactions from the powers contained within the Resolution Tools in section G. These tools include the ability to transfer assets and liabilities of an affected credit institution to a bridge bank under the proposals in section G3, the ability to transfer assets to an asset management vehicle under the asset separation tool in section G4, the ability to transfer assets and liabilities of an affected credit institution under the resolution powers in section G5 and the ancillary powers under section G6 to be provided when transferring assets or liabilities of an affected credit institution.
Safeguards apply to structured finance however created

(c) We note also in paragraph H1 of the Document that the safeguard proposals should apply to arrangements irrespective of how they are created whether by "contract, trust or other means or arise automatically by operation of law". This is a useful statement in order to ensure that structured finance transactions will be protected however they are created in the different EU Member States.

Continuity – Q36

(d) The Banking Act 2009 (see section 36) contains significant provisions regarding continuity arrangements which can be made in a property transfer instrument so that any impediments which may arise in relation to an effective transfer of property, rights or liabilities can be removed.

(e) In the Document, some of these continuity provisions have been inserted in the Ancillary provisions in section G6 and in the continued support from transferor provisions in section G7. We note that Question 36 asks if the provisions in G6 are sufficient. By comparison with the powers in section 36 BA 2009, the powers contained in the Document seem rather limited but at this early proposal stage of legislation one would not expect to see all the relevant detail. However, we note that the powers in section G6 do not specifically include the power to transfer employees and ensure the continuity of employment contracts nor the power to amend documents as necessary to effect the transfer. The former may however be covered by the words "the continuity of contracts" in G6(a) on page 58.

Default triggers – Q36

(f) There were some difficult issues in relation to the termination of contracts and continuity arrangements between a bank and an spv in a structured finance transaction under the BA 2009. Similar issues will arise under these proposals as in section G6 the Document proposes that where a resolution tool has been used, no person may exercise a right or power to terminate, accelerate or declare a default under any contract to which the credit institution is a party or to obtain possession or exercise control over any property of a credit institution without the consent of the resolution authority.
(g) This provision has several implications for structured finance. Unless consent is obtained from the resolution authority, it may, for example, prevent or delay the Issuer or Trustee in a structured finance transaction from exercising a termination right in a contract with the credit institution such as a servicing agreement, swap agreement or liquidity facility and compel the Issuer to continue with such contract, despite any effects this may have on the rating of the bonds issued. This termination restriction should not however prevent a later termination for failure to perform and therefore it would be worth getting clarification in answer to Question 36 that this restriction only applies as a result of the exercise of the resolution tool and not from matters arising independently thereafter or to obtain an exemption from the restriction for contracts in relation to structured finance contracts.

(h) It is worth noting however that there is a similar provision in Banking Act 2009 (section 38) and ultimately this did not seem to give the rating agencies undue concern but certainly exercised a lot of time in getting comfortable with. Maybe the position for structured finance in this EU proposal can be improved over the position in the Banking Act 2009.

Support from transferor – Q37

(i) In relation to Question 37 and securitisation or covered bond transactions, it may be important for the resolution authorities to have power to require a residual credit institution to continue to provide financial support to those transactions, such as liquidity support or a subordinated loan for credit or expenses support, at least for a temporary period after the commencement of resolution, until such facilities can be replaced in accordance with the provisions of the transaction documents and rating agency counterparty criteria (it is likely that an affected credit institution will be disqualified from providing financial support due to loss of credit rating).

Transfers of foreign property – Q38

(j) We note in paragraph H1 of the Document that the protections provided by paragraph 6(4) of the PPT Order in relation to the transfer of property rights relating to a capital market arrangement where part of such property is "foreign property" have been effectively included and would presumably apply to any of the safeguard regimes under paragraph H of the Document.

(k) Specific provisions for transfer of foreign property are made in section G8 which are similar to those in the Banking Act 2009. The Document states a desire to ensure that any transfer of foreign property has effect in or under the
law of another Member State. These provisions try to go further than the equivalent provisions in the Banking Act 2009 (see section 35(1)). The Document also proposes to impose obligations on other EU Member States to provide the resolution authority dealing with an affected credit institution with assistance to ensure that the transfer of any foreign property is effected in accordance with any applicable requirements of national law. Perhaps this obligation to provide assistance is to be achieved by a system of mutual obligations in the laws of each Member State.

Limited suspension of certain obligations – Q42

(l) In section G12 of the Document, it is recommended that resolution authorities have the power to suspend payment or delivery obligations pursuant to any contract with a credit institution from the time the credit institution enters resolution for a period of approximately 48 hours. This provision potentially may affect securitisations or covered bonds where the credit institution is under an obligation to collect monies from borrowers and then pay those collections to a spv issuer or asset holder in a covered bond transaction. The 48 hour suspension may not matter in terms of timing but could affect the payment of interest or principal on securitisation notes or covered bonds if the suspension were to occur immediately prior to a collection date or an interest payment date and were to be for a large amount of funds not covered by liquidity facilities. If the liquidity facilities had been provided by the same credit institution it is likely that if such a suspension order had been made it would cover those facilities also. Perhaps in answer to Question 42, we should attempt to carve out from such a suspension, any funds which are held by a credit institution but which belong to another entity in connection with a structured finance arrangement (i.e. the Issuer) and for which the credit institution is merely acting as a collecting agent.

No definition of structured finance arrangement – Q46c

(m) It should be noted however that the protections in paragraph H4 refer to "structured finance arrangements" where these are not defined in the Document. As you are aware, the PPT Order builds on an existing regime in the UK of protections for "capital market arrangements" as defined and protected in Section 72B and in Schedules A1 and 2A of the Insolvency Act 1986 in connection with the exception to the "small companies moratorium"
and the prohibition of appointment of an administrative receiver" for capital market arrangements.

(n) It will be necessary for any Resolution legislation to define a structured finance arrangement for use in each Member State. This is not likely to be easy. As we have experienced, the UK definition is by no means satisfactory in its random "shopping list" approach and its lack of definition of an "arrangement" creates many problems regarding structures which have steps taken at different times. In addition, in the UK there are minimum debt levels to qualify as a capital market arrangement, that is £50m in the context of the exception to the abolition of administrative receivership and £10m in connection with the exception to the small companies moratorium. If the proposals in the Document are to be implemented uniformly in each Member State, there may need to be significant more detail in the Directive on these matters to ensure that uniformity is achieved. Interestingly, in the recent amendments to Article 77 of the Regulated Activities Order to enable regulated sukuk finance to be introduced into the UK, a new Article 77A was created which contained a descriptive definition of an "alternative investment bond". Rather confusingly, this definition in fact covered almost all asset backed transactions effected in the UK capital markets apart from the fact that that Article required such bonds to be listed and rated. That could be an example of an alternative approach for a definition of a "structured finance arrangement".

Protection for deposits – Q49b

(o) We note that section H4 carves out protection for deposits in the same way that the PPT Order does. Question 49b in the Document asks whether it is right that deposits should be carved out. If the objectives of removing moral hazard from credit institution recovery are to be achieved and creditors are to bear the costs of resolution then it would seem right that deposits are carved out of any structured finance protections. In any case, retail deposits up to specified limits are already the subject of protections across the EU under banking authority compensation schemes such as the FSA FSCS scheme.

Transfers of property held on trust

(p) In relation to more detailed legislation we will need to be careful however that in relation to property held on trust by an affected credit institution (such as the legal estate in assets which have been transferred by an unnotified equitable assignment) to a securitisation or covered bond spv that any partial property transfer makes adequate provision for the transfer of that legal estate
which under English law can only be effected by giving notice to the underlying debtors. There is an issue as to whether legislation can provide that the legal estate can be transferred without the giving of such a notice given the requirements of section 136 Law of Property Act 1925.

3. **Other comments**

   (a) In P1.2 on page 3 it is suggested that the resolution and supervising authorities should be separate entities. For the UK this may be problematic as there will be a single regulator for credit institutions under the Banking Act 2009, the Bank of England will perform both roles once the FSA is abolished.

   (b) In para. (c) of Resolution Powers (G5) on page 56, there is power of a resolution authority to transfer debt instruments issued by a credit institution. Presumably this means to transfer the issuer of those bonds not to transfer a holding of bonds held by a third party. If the former, then in relation to covered bonds it would be necessary to ensure that under the continuity arrangements, the contractual liabilities of the credit institution were also transferred to the transferee.
PROPOSED CROSS-BORDER INSOLVENCY PROTOCOL 
FOR THE LEHMAN BROTHERS GROUP OF COMPANIES

This cross-border insolvency protocol (the “Protocol”) shall govern the conduct of Lehman Brothers Holdings Inc. (“LBHI”) and its affiliated debtors worldwide that are parties hereto (collectively, the “Debtors” and, collectively with their non-debtor affiliates, “Lehman”) in the Proceedings, as such term is defined herein.

Background

A. The Proceedings

Commencing on September 15, 2008 and periodically thereafter (as applicable, the “Commencement Dates”), the Debtors commenced (or in some cases, had initiated against them) plenary insolvency, administration, liquidation, receivership, or like proceedings (“Plenary Proceedings”) in different jurisdictions (the “Plenary Fora”) and before different courts and governmental, regulatory, or administrative bodies (the “Tribunals”), as well as proceedings that are secondary or ancillary to a Plenary Proceeding (“Limited Proceedings,” and together with the Plenary Proceedings, the “Proceedings”).

In certain of these proceedings, the Debtors remain authorized to operate their businesses and manage their properties as “Debtors in Possession,” while in others, liquidators, administrators, trustees, custodians, or curators have been appointed to manage the Debtors’ affairs and represent their insolvency estates (collectively, with Debtors in Possession, the “Official Representatives”). Furthermore, in certain of these Proceedings, one or more statutory committee of creditors or equity holders has or have been appointed (the “Committees”).

B. Lehman’s Global Business

Lehman was a truly global group of companies. Prior to the events leading up to these Proceedings, Lehman was the fourth largest investment bank in the United States, and one of the largest financial services firms in the world. For more than 150 years, Lehman was a leader in the global financial markets by serving the financial needs of corporations, governmental units, institutional clients and individuals worldwide. Its headquarters in New York and regional headquarters in London and Tokyo were complemented by a network of offices in North America, Europe, the Middle East, Latin America and the Asia Pacific region.

To manage their businesses efficiently, Lehman utilized a centralized cash management system to collect and transfer the funds generated by its operations and disburse those funds to satisfy the obligations required to operate their businesses. The cash management system facilitated Lehman’s cash monitoring, forecasting, and reporting, while ensuring compliance with the regulatory requirements of various jurisdictions. Furthermore, prior to the commencement of the Proceedings, LBHI and its direct and indirect subsidiaries continuously worked together and shared information in unison. This information was spread across 2,700
different software applications and dispersed throughout ledger accounts in its subsidiaries across the globe.

C. The Need for a Protocol

Given the integrated and global nature of Lehman’s businesses, many of the Debtors’ assets and activities are spread across jurisdictional borders and require administration in more than one forum. Consequently, the Debtors are no less dependent on each other today than they were prior to the commencement of these Proceedings. The efficient administration of each of the Debtors’ individual Proceedings naturally depends upon cooperation among the Debtors’ Official Representatives. In addition, effective case management and consistent judgments require cooperation and communication among Tribunals.

Accordingly, this Protocol is designed to facilitate the coordination of these Proceedings, and to enable the Tribunals and Official Representatives to operate efficiently and effectively in the interest of all of the Debtors’ creditors.

Terms

1. Purpose and Aims

1.1. The parties hereto agree to the terms of this Protocol, representing a statement of intentions designed to minimize the costs and maximize fair recoveries for all creditors of these Proceedings, by promoting the sharing of information among the parties and the international coordination of activities in the Proceedings, while respecting the separate interests of creditors and other interested parties to each Proceeding, and the independence, sovereignty, and authority of each Tribunal.

1.2. Official Representatives should coordinate with each other and cooperate in all aspects of the Proceedings, subject in appropriate cases to bilateral protocols and protocols for communication among Tribunals and Committees, in order to meet the aims of this Protocol.¹

¹ Text based on Principle 4 of the Concordat (“Each forum should coordinate with each other, subject in appropriate cases to a governance protocol”); ALI Procedural Principle 14 (‘Cooperation’), (“The administrators in parallel proceedings should cooperate in all aspects of the case”); and Wessels, Guideline 12.1 (“Liquidators are required to cooperate in all aspects of the case”). See also Order Approving the Stipulation Regarding Cross-Border Insolvency Protocol, In re Everfresh Beverages, Inc., Case No. 95-B-45405-06, United States Bankruptcy Court for the Southern District of New York; Order Approving Cross-Border Insolvency Protocol, In re Everfresh Beverages, Inc., Court File No. 32-077978 (the “Everfresh Protocol”) (“The Debtors and the Interim Receiver will (i) have regard to the proceedings initiated by Everfresh under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court and under the Act in the Canadian Court; (ii) co-operate with actions taken in both the Bankruptcy Court and the Canadian Court; and (iii) take steps to coordinate their respective administrations under the Bankruptcy Code and the Act in the Bankruptcy Court and the Canadian Court.”).

Ontario Court of Justice (General Division)
1.3. The aims of this Protocol are:

1.3.1. Coordination – To promote international cooperation and the coordination of activities in the Proceedings; and to provide for the orderly, effective, efficient, and timely administration of the various Proceedings in order to reduce their cost and maximize recovery for creditors.

1.3.2. Communication – To promote communication among Official Representatives and Committees; and to provide, wherever possible, for direct communication among Tribunals.

1.3.3. Information and Data Sharing – To provide for the sharing of information and data among Official Representatives in order to promote effective, efficient, and fair administrations, and to avoid duplication of effort and activities by the parties.

1.3.4. Asset Preservation – To identify, preserve, and maximize the value of the Debtors' worldwide assets for the collective benefit of all creditors and other interested parties.

1.3.5. Claims Reconciliation – To avoid the unfair treatment of creditors by coordinating the claims process; and in particular, to provide for a consistent and measured approach to the calculation and adjudication of intercompany claims that avoids unnecessary intercompany litigation.

1.3.6. Fair Distribution – To cooperate in marshalling the assets of the Debtors in order to obtain a fair distribution of funds and maximize recovery for all of the Debtors’ creditors.

1.3.7. Comity – To maintain the independent jurisdiction, sovereignty, and authority of all Tribunals.

2. Notice

2.1. The Official Representatives in each forum, as well as any Committees established in each Proceeding, shall receive notice of all matters in which they have an interest in all Proceedings, by email if possible, otherwise by overnight mail delivery service or fax.

2.2. Notice of any meetings, court hearings, or statutory deadlines shall be provided by each Official Representative to all other Official Representatives by email as far in advance as possible.
3. **Rights of Official Representatives and Creditors to Appear**

3.1. Official Representatives shall have the right to appear in all of the Proceedings, whether before a Tribunal or in statutory meetings convened pursuant to applicable law. If required in a particular forum, an exequatur or similar proceeding may be utilized to implement recognition of the Official Representative.

3.2. The Official Representatives shall be subject to jurisdiction in all fora for any matter related to the Proceedings, provided, however, that appearing in a forum shall not subject an Official Representative to jurisdiction for any other purpose except to the extent otherwise set forth herein to the contrary.²

3.3. If an Official Representative cannot be present before the Tribunal, the parties hereto shall consent to the Official Representative’s communication of any observations to the Tribunal prior to any order being made, provided that such communication is made in

² Text based on Committee J Cross-Border Insolvency Concordat, Sept. 17, 1995, International Bar Association Section on Business Law (the “Concordat”), Principle 3A:

(A) If there is more than one forum, the Official Representatives appointed by each forum shall receive notice of, and have the right to appear in, all proceedings in any forum. If required in a particular forum, an exequatur or similar proceeding may be utilized to implement recognition of the Official Representative. An Official Representative shall be subject to jurisdiction in all fora for any matter related to the insolvency proceedings, but appearing in a forum shall not subject him/her to jurisdiction for any other purpose in the forum state.


2. The Debtors, the Creditors’ Committee and the Interim Receiver, and any other official representative that may be appointed by the Bankruptcy Court or the Canadian Court, shall receive notice of all proceedings in accordance with the practices of the respective Courts, and have the right to appear in all proceedings in any for a, whether in the Bankruptcy Court or the Canadian Court…. The Debtors and the Interim Receiver shall be subject to jurisdiction in both for a for any matter related to the insolvency proceedings, but appearing in a forum shall not subject him/her to jurisdiction for any other purpose in the forum estate, except to the extent otherwise set forth herein to the contrary.

See also BOB WESSELS & MIGUEL VIRGÓS, EUROPEAN COMMUNICATIONS AND COOPERATION GUIDELINES FOR CROSS-BORDER INSOLVENCY 37 (INSOL Europe 2007) (“Wessels”), Guideline 17.1 (“Notice of any court hearing or the making of any order by a court should be given to each of the liquidators at the earliest possible point in time where the hearing or order is relevant to that liquidator”); Transnational Insolvency: Principles of Cooperation Among the NAFTA Countries, by the American Law Institute at Washington D.C. (May 16, 2000) (“ALI Procedural Principles”), Principle 16 (“Notice of any court hearing or the making of any order by a court should be given to each of the administrators at the earliest possible time, if the hearing or order is relevant to that administrator. Notice and approval should always be in advance of such an action if possible or if required by applicable law.”).
writing and copies of such communication are delivered to all interested parties or filed on the Tribunal’s public records.³

4. Communication and Access to Data and Information Among Official Representatives⁴

4.1. Each of the Official Representatives shall keep all other Official Representatives fully apprised of their activities and all relevant information and material developments in matters involving the Debtors and their Proceedings.⁵

4.2. To the extent permitted, non-public information available to the Official Representatives shall be shared with other Official Representatives, subject to appropriate confidentiality arrangements and all privileges under the applicable rules of evidence.⁶

4.3. Official Representatives agree to share information regarding the Debtors, and their assets and liabilities, which each may lawfully share with the other; provided, however, that with respect to work product or other privileged information, Official Representatives may, but are not obliged, to share such information with each other.

4.4. Official Representatives agree that each shall not (and shall direct their respective agents and representatives not to) provide any non-public information received from

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³ Text based on Wessels, Guideline 17.2 (“Where a liquidator cannot be present in person before the court, the court is advised to invite the liquidator to communicate any observations to the court prior to any order being made.”).

⁴ See, generally, Cross-Border Insolvency Protocol in Re Manhattan Investment Fund Limited between United States Bankruptcy Court for the Southern District of New York (Hon. Burton R. Lifland), Case No. 00-10922BRL, (April 2000) and High Court of Justice of the British Virgin Islands (Chief Justice Austin Ward), Case No. 19 of 2000, (April, 2000) and Supreme Court of Bermuda (Mr. Justice Kenneth A. Benjamin), Case No. 2000/37, (April 2000) (the “Manhattan Inv. Fund Protocol” ¶¶ 9 - 12.

⁵ Similar provisions can be found in the European Union Convention on Insolvency Proceedings, opened for signature Nov. 23, 1995, (the “EU Convention”) (did not come into force) art. 31 (“Subject to the rules restricting the communication of information, the liquidator in the main proceedings and the liquidators in the secondary proceedings shall be duty bound to communicate information to each other. They shall immediately communicate any information which may be relevant to the other proceedings, in particular the progress made in lodging and verifying claims and all measures aimed at terminating the proceedings.”); and the European Convention on Certain International Aspects of Bankruptcy, opened for signature June 5th, 1990, Europ. T.S. No. 136 (the “Istanbul Convention”), art. 25 (“The liquidators in the main and secondary bankruptcies shall promptly communicate to each other any information which might be relevant to the other proceedings, in particular all measures aimed at terminating the procedures.”).

⁶ Text based on the Concordat, Principle 3(D) (“Information publicly available in any forum shall be publicly available in all fora. To the extent permitted, non-public information available to an official representative shall be shared with other official representatives.”) Cf. Everfresh Protocol ¶ 5 (“Information publicly available in any forum shall be publicly available in both fora. To the extent permitted, non-public information shall be made available to official representatives of the Debtors, including any official committee appointed in these cases and shall be shared with other official representatives, subject to appropriate confidentiality arrangements and all privileges under the applicable rules of evidence.”).
the other to any third party, unless such information is (i) agreed to by the other party, (ii) required by applicable law, or (iii) required by order of any Tribunal.\(^7\)

4.5. The entry of an order approving this Protocol shall constitute the recognition by each Tribunal and Official Representative that communications among Official Representatives and their respective professionals, employees, agents, and representatives are subject to, and do not waive any attorney-client, work-product, legal, professional, or other privileges recognized under any applicable law.\(^8\)

4.6. Each Official Representative shall cooperate in the gathering of certain data and share analysis of certain transactions by:

4.6.1. sharing, via free, read-only access, all information and data relating to (i) material interest holders of an asset, (ii) re-appointment transactions, and (iii) information that assists an Administrator to fulfill his duties, except where (x) litigation has commenced (or is contemplated), or (y) statutory or regulatory requirements prohibit disclosure;

4.6.2. coordinating the investigations of pre-filing activities, so long as the interests of the Official Representatives coordinating such investigations do not diverge; and

4.6.3. liaising on matters (i) in which multiple Debtors have a significant mutual interest, and (ii) relating to a significant strategy to exit from a Proceeding.

4.7. Any sharing of information and data shall not include automatic access to (i) documents relating to a Debtor’s post-filing transactions, or (ii) working papers, summaries, or other work product drafted by an Official Representative, and any professionals retained in the course of a Proceeding.

5. Communication Among Tribunals

5.1. The Guidelines Applicable to Court-to-Court Communication in Cross-Border Cases (the “Guidelines”) attached as Schedule “A” hereto, shall be incorporated by reference and form part of this protocol in whatever form they are formally adopted by each Tribunal, in whole or in part and with or without modifications (if any). Where there is any discrepancy between the Protocol and the Guidelines, this Protocol shall prevail.

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\(^7\) Text based on Manhattan Inv. Fund Protocol ¶ 12.

\(^8\) Text based on Manhattan Inv. Fund Protocol ¶ 10.
6. **Communication Among Committees**

   6.1. To the extent permitted, non-public information available to the Committee in any forum shall be shared with other Committees, subject to appropriate confidentiality arrangements and all privileges under the applicable rules of evidence.\(^9\)

7. **Asset Preservation**

   7.1. Each forum should administer the assets within its jurisdiction, except to the extent otherwise set forth herein to the contrary.\(^10\)

   7.2. Official Representatives will analyze assets under their respective control in the ordinary course of the Proceedings to realize value for assets under their control.

   7.3. If, during the course of such analysis, an Official Representative learns or believes that another Debtor could have a material interest in a particular asset that is (i) under threat, (ii) not being dealt with, or (iii) diminishing in value, such Official Representative should notify that Debtor’s Official Representative that may have such material interest of the condition of the asset.

   7.4. Furthermore, if, during the course of a Proceeding, an Official Representative learns or believes that another Debtor could have a material interest in a particular asset, such Official Representative shall, where practical, consult with the Official Representative of the Debtor that may have such material interest prior to: (i) the sale, abandonment, or any disposition of such asset; (ii) the termination, suspension, or other transition of any employees managing such asset; or (iii) the commencement of any judicial, or non-judicial, proceeding affecting such asset.

   7.5. In the event that property which does not belong to a particular Debtor is transferred to, or received by, that entity, the Official Representative of such entity shall cooperate, with the Official Representative of the Debtor from whose estate such property was transferred, in:

     7.5.1. Assessing the ownership of such transferred property and provide all information, to the extent not otherwise restricted, allowing each Administrator to ascertain ownership of the property;

     7.5.2. Promptly returning such transferred property to the Official Representative of the Debtor establishing its right to such property, taking into account any applicable legal requirements; and

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\(^9\) Text based on the Everfresh Protocol ¶ 5.

\(^10\) Text based on Principle 4B of the Concordat (“Each forum should administer the assets within its jurisdiction…”).
7.5.3. Refraining (to the extent an Official Representative may do so) from transferring or co-mingling property once another Official Representative establishes ownership of such transferred property.

7.6. Each Official Representative shall cooperate to realize the value of assets for which multiple Debtors have an interest. In the event an Official Representative of a Debtor chooses to fund (the “Funding Estate”) an asset in which it has an existing interest, but such asset is, at the time of such funding, a part of another Debtor’s estate (the “Funded Estate”), the Funded Estate’s Official Representative shall allow and acknowledge such funding if: (i) the Funding Estate has provided the Funded Estate with information sufficient to establish a prima facia case that the Funding Estate has an existing interest in an asset; and (ii) such funding does not materially impair, and remains neutral to, the Funded Estate.

7.7. Should the Funded Estate, after appropriate consultation with the Funding Estate and after obtaining any necessary approval in an applicable Insolvency Proceeding, (i) dispose of the asset receiving funds from the Funding Estate, and (ii) receive proceeds in respect of such disposition, then the Funding Estate shall receive a fair allocation of share of such proceeds.

7.8. Should a Funded Estate realize a tax savings as a result of actions taken by a Funding Estate, then the Funded Estate shall share the savings with the Funding Estate.

8. Claims

8.1. To the extent that there are two or more Proceedings pending as to the same Debtor, those being one Plenary Proceeding and one or more Limited Proceedings, a claim should be filed only in the Plenary Proceeding. If a claim is filed in more than one forum, distribution must be adjusted so that recovery is not greater if the claim were filed in only one forum. 11

8.2. If a claim against one or more Debtors is subject to a guarantee issued by another Debtor (the “Direct Claim”), the Official Representatives shall seek to adjust distribution so that (i) recovery is first made against the Direct Claim, and (ii) if there is subsequent recourse on the guarantee, that recovery does not exceed the full amount of the claim.

11 This is known as the “hotchpot” rule. The text is based in part on the Concordat, Principle 4 (“A claim should be filed in one, and only one, plenary forum, at the election of the holder of the claim. If a claim is filed in more than one plenary forum, distribution must be adjusted so that recovery is not greater if the claim were filed in only one forum.”). Cf. the Everfresh Protocol ¶ 7 (“Any creditor of Everfresh may file a proof of claim in both the Bankruptcy Court or in the Canadian Proceeding. However, if a creditor files a claim in both the Bankruptcy Court and the Canadian Proceeding, then distribution to such creditor will be adjusted so that recovery is not greater than if the claim were filed in only one forum.”).
8.3. Official Representatives shall endeavor to coordinate notice procedures and establish the same deadlines for the filing of claims in their respective Proceedings, and in all other matters regarding the filing, reviewing and objecting to claims.12

9. Special Procedures for Intercompany Claims

9.1. Intercompany claims shall be measured as of a certain date, to be determined by the Procedures Committee (as defined in section 9.4).

9.2. Official Representatives shall not object to claims filed by other Official Representatives on the basis of (i) the allocation of overhead or expense from one Debtor to another Debtor, (ii) the flow of funds from one Debtor to another Debtor, (iii) the incurrence of a liability by one Debtor on behalf of another Debtor, or (iv) a transaction between Debtors (collectively, “Intercompany Claims”), provided that the Official Representative who filed the claim has shown (i) a document or accounting record to or for the benefit of an affiliate for such claim, (ii) the basis for the claim or substance to the transaction that gives rise to the claim, and (iii) an identifiable affiliate.

9.3. Subject to the provisions of section 9 of this Protocol, the Official Representatives shall endeavor to negotiate in good faith to attempt to reach a consensual resolution of any differences in their accounting of Intercompany Claims. Only to the extent that Official Representatives certify that they are unable to consensually resolve in good faith any differences in their accounting of Intercompany Claims, the Official Representatives shall resort to adjudication by the Tribunal holding jurisdiction over such claims.

9.4. The Official Representatives shall establish a committee (the “Procedures Committee”), whose members shall be jointly appointed by the Official Representatives and the Committees (where applicable), and confirmed by the Tribunals overseeing each Proceeding, to consensually resolve in good faith any differences in the accounting of Intercompany Claims to be filed in their respective Proceedings.

9.5. The Procedures Committee shall propose the procedures and accounting methodologies that it intends to use in its calculation and consensual resolution of Intercompany Claims (the “Accounting Procedures”). Furthermore, if two or more Debtors were counterparties to a derivative contract in which the contractual obligations are keyed to one or more underlying assets or indices of asset values and subject to movements in the financial markets (such as contracts for the purchase, sale, or loan of securities; forward contracts; repurchase agreements; or swap agreements; and in some cases, multiple such agreements governed by a master agreement) (the “Intercompany Derivative Contracts”), and if an Intercompany Derivative Contract has been rejected, terminated, liquidated, or accelerated by any of the Debtor counterparties thereto, any damages (the “Intercompany Derivatives Claims”) that arise shall be measured and fixed by the Procedures Committee, pursuant to a methodology to be agreed upon by the members of the Procedures Committee (the “Derivatives Methodology”).

9.6. As soon as is practicable after the Procedures Committee has agreed upon its Accounting Procedures and Derivatives Methodology, the Official Representatives shall seek approval from their respective Tribunals for the use of the Accounting Procedures and Derivatives Methodology in their respective Proceedings.

9.7. The Official Representatives shall endeavor to submit the findings of the Procedures Committee (the “Procedures Committee Findings”) in a form substantially similar to each other for approval by their respective Tribunals.

9.8. To the extent that creditors or other interested parties object to (i) the application of the Accounting Methodology, or (ii) the application of the Derivatives Methodology, or (iii) any of the Procedures Committee Findings, all Official Representatives shall endeavor to coordinate a response to such objections.

10. Submission of Winding-Up Plan, Plan of Reorganization or Liquidation, or Deed of Company Arrangement

10.1. The Official Representatives shall endeavor to submit a winding-up plan, plan of reorganization or liquidation, or deed of company arrangement (a “Plan”) in each of their respective Proceedings substantially similar to each other, and the Official Representatives shall endeavor to coordinate all procedures in connection therewith, including, without limitation, all solicitation proceedings relating to their plans. All voting procedures, the treatment of creditors, and the classification of claims shall be established by the Official Representatives after consultation with each other, unless otherwise ordered by the Tribunals of their respective fora.

10.2. In order to coordinate the contemporaneous filing of each Debtors’ plan of reorganization, the Official Representatives shall take the actions necessary to seek extensions from time-to-time of the date for the filing of the plan, and shall take the actions necessary from time-to-time to seek extensions of the exclusive time period during which only the Official Representatives may file a plan of reorganization pursuant to the laws of their respective fora.13

13 Text based on the Everfresh Protocol, ¶ 13:

To the extent permitted by the laws of the respective jurisdictions and to the extent practicable, the Interim Receiver and the Debtors shall endeavor to submit a proposal in Canada and a plan of reorganization in the United States substantially similar to each other and the Debtors, the Interim Receiver and the Trustee shall endeavor to coordinate all procedures in connection therewith, including, without limitation, all solicitation proceedings relating thereto, and all procedures regarding voting, the treatment of creditors, classification of claims, and the like, will either be established by the Debtors after consultation with the Trustee of the Proposal or be dealt with pursuant to a further order of the Bankruptcy Court and or the Canadian Court. In order to coordinate the contemporaneous filing of the Proposal and the plan of reorganization, the Debtors shall take the actions necessary to seek extensions from time-to-time of the date for the filing of the Proposal, and the Debtors shall take the actions necessary from time-to-time to seek extensions of the exclusive time period during which only the Debtors may file a plan of reorganization pursuant to Section 1121 of the Bankruptcy Code.

This provision is consistent with Principles 4A (“Each forum should coordinate with each other, subject in appropriate cases to a governance protocol”) and 4E (“Classification of common claims should be coordinated..."
11. **Comity**

11.1. The parties hereto agree that each Tribunal is an independent, sovereign Tribunal, entitled to preserve its independent jurisdiction and authority with respect to matters before it and the conduct of the Official Representatives.\(^{14}\)

11.2. Each Tribunal shall have sole jurisdiction and power over the conduct of the Proceeding in that forum; the appointment of the Official Representatives and their professionals, their retention, tenure in office, and compensation; and the hearing and determination of matters arising in that forum.\(^{15}\)

11.3. Nothing in this Protocol is intended to interfere with the exercise of jurisdiction by each of the Tribunals in these Proceedings, or to interfere with the natural rules or ethical principles by which an Official Representative is bound according to applicable national law and professional rules.\(^{16}\)

12. **Amendment**

12.1. This Protocol may not be waived, amended, or modified orally or in any other way or manner (including, without limitation, pursuant to a plan of reorganization) except by a writing signed by a party to be bound and approved by order of the Tribunal with jurisdiction over that party. Notice of any proposed amendment or modification to this Protocol shall be provided via email by the party or parties hereto proposing such to all Official Representatives, and their respective Committees. The Protocol may be supplemented from time to time by the parties hereto as circumstances require with any supplementing stipulations as approved by the Tribunals of each forum.

12.2. Subject to the agreement of the parties hereto, and the entry of an order by each of the Tribunals, additional parties may be added to this Protocol.

13. **Execution and Application**

13.1. This Protocol shall not prejudice the rights of the Official Representatives to seek the substantive consolidation of their proceedings in accordance with applicable law.

13.2. This Protocol shall be binding on and inure to the benefit of the parties hereto and their respective successors, assigns, representatives, heirs, executors, administrators, among plenary fora. Distributions to common claims should be pro-rata regardless of the forum from which a claim receives a distribution") of the Concordat. *See* Nielsen, *supra* n. 18 at 560.

\(^{14}\) Text based on Manhattan Inv. Protocol ¶ 25.

\(^{15}\) Text based on the Everfresh Protocol, ¶ 15.

\(^{16}\) Text based on Wessels, Guideline 3.
trustee, receivers, custodians, or curators, as the case may be. Nothing herein shall create a right for any entity that is not a party to the Protocol.

13.3. Any request for the entry of an order which is contrary to the provisions of this Protocol must be made on notice to all Official Representatives and their respective Committees by the proponent of the order.

13.4. Each party represents and warrants to the other that its execution, delivery, and performance of this Protocol are within the power and authority of such party and has been duly authorized by such party, except to the extent that Tribunal approval is required.

13.5. This Protocol may be signed in any number of counterparts, each of which shall be deemed an original and all of which together shall be deemed to be one and the same instrument, and may be signed by facsimile signature, which shall be deemed to constitute an original signature.

13.6. The Tribunals of each forum shall retain jurisdiction over the parties for the purpose of enforcing the terms and provisions of this Protocol or approving any amendments or modifications thereto.

13.7. The parties hereto are hereby authorized to take such actions and execute such documents as may be necessary and appropriate to implement and effectuate this Protocol.

13.8. This Protocol shall be deemed effective upon its approval by the Tribunals of each forum where a Proceeding is pending.

IN WITNESS WHEREOF, the parties hereto have caused this Protocol to be executed either individually or by their respective attorneys or representatives hereunto authorized.

Dated: [] [], 2009