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“An EU framework for cross-border crisis management in the Banking Sector”: a preliminary response by the Association for Financial Markets in Europe (AFME)

INTRODUCTION

The Association for Financial Markets in Europe (AFME ó EC register of interest representatives ó 84360841127-33) represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. (AFME was formed on 1st November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association.)

We welcome the opportunity to comment on the European Commission’s Communication and we thank the Commission for bringing forward such a helpful analysis of the issues ó together with the description of different arrangements in the Member States ó in the Staff Working Document. This should help to clarify the issues that will need to be thought through and should assist a co-operative approach by the authorities in determining the best way forward.

We agree that recent events have highlighted the need to address the mechanisms for early intervention and resolution. The Commission’s material confirms the range of issues that need to be addressed, and their complexity, and draws on ó as is appropriate ó current arrangements. However, it is important to recognise the changes in the existing regime that are under way both as regards improvements to the Regulatory Regime and the initiative on Living Wills, so that modifications to the framework for cross-border crisis management must be designed to fit with the structure to emerge as a result of these discussions. It is important to secure agreement on the *principles* that should underlie future work and AFME’s members have approached the questions raised in the Communication and in the context of the Basel Committee’s Cross-Border Bank Resolution Group report and recommendations* in that light.

This submission concentrates on the issues raised by the Commission as regards preventative early intervention but the fifteen key principles that we summarise below are relevant to pre-insolvency resolution and to the questions raised in the Communication about insolvency proceedings as well.

* A copy of our response to the latter is attached^E for information

PRINCIPLES TO UNDERLIE FUTURE WORK ON CROSS-BORDER CRISIS MANAGEMENT

1. We agree with the Authorities' conclusion that it is essential to establish arrangements that enable the efficient resolution of failing banks, so as to help to address the moral hazard problem engendered by the 'too big to fail' perception. If necessary, new EU legislation should require Member States to provide competent authorities with the necessary powers which must include the ability to make partial property transfers and bridge bank arrangements as well as powers for transfers to private sector purchasers and temporary public ownership. Such rules will need to confirm how assets transferred are to be priced.
2. The Authorities will need to have the power to intervene in respect of a bank's activities within *all* the markets where it undertakes business ó any regional rules will need to recognise the global perspective and will need to take into account what is realistically achievable: there is the potential danger of the best becoming the enemy of the good. (For example, we do not consider the establishment of a harmonised EU insolvency regime to be practical at this stage.)
3. The Authorities should be in a position to intervene prior to a firm's insolvency for the reasons specified in the Commission's paper but the consequences of this must be recognised ó namely the need to establish a framework that does not undermine the risk mitigation steps that counterparties/creditors have taken to protect their interests (and on this aspect ó although the drafting was not without difficulty ó we would highlight the Safeguards legislation as amended introduced by the UK's resolution regime established under the 2009 Banking Act, for example as regards netting and the position of security interests) and that recognises the position of shareholders: a No Creditors Worse Off safeguard will assist on this front as would a limitation on the use of resolution powers to cases where a failure would pose systemic risk.
4. As noted the regime must allow pre-insolvency intervention by the Authorities. However, given the varying nature of firms' business, it is not possible to prescribe definitively all the circumstances in which Resolution could be triggered, so scope for regulatory judgment is necessary. In turn though, and also as noted above, this entails the establishment of safeguards to provide confidence to counterparties and shareholders that their rights will be recognised.
5. As regards recovery and resolution plans, also referred to as Living Wills, our members agree ó in principle ó that systemically important firms should have precautionary arrangements in place to address the kind of risks to their continuing activities that might arise from their business models: however, it is clearly important to ensure that these arrangements recognise that firms establish their structures according to business needs as a going concern and are not so onerous as to prevent legitimate commercial activity: supervisory requirements in this area should not be used to impose arrangements that regulators are seeking for other reasons

6. Within the EU, and as the Commission helpfully highlight, there are questions as regards the circumstances in which intra-group asset transfers can be made and whether some kind of "group interest"/"compensatory group advantage" criterion can be developed. The issues here are complex, given for example the need not to undermine the credit assessments that counterparties have made, and our members are still considering this aspect of the consultation so that we may need to provide a further submission on this and on the questions raised as regards the extension of liability to affiliated entities and contribution orders/substantive consolidation.
7. In a similar vein, although it is clear that cooperation amongst the Authorities in the different Member States where a bank is undertaking business is essential, further thought is needed on the potential advantages and questions that will need to be addressed in any move to establishing a "lead administrator or liquidator" regime for banking groups or the introduction of a "28th Insolvency Regime".
8. As regards the position of the Company Law directives, which may well need to be modified to allow for rule changes in Member States to introduce resolution regimes, we believe that the amendment process will be facilitated if the legislation does not seek to focus on systemically important firms or cross-border banking groups alone because of the definitional difficulties that could arise.
9. We note that as part of the review of deposit guarantee schemes that the Commission will be bringing forward shortly, the possible role of schemes in funding resolution measures will be considered: we welcome this debate and intend to contribute to it. Our members are also currently considering the issues surrounding the establishment of an European Resolution Authority and we may wish to make a further submission on this aspect in due course: It is important to make a clear distinction between a scheme for paying out eligible depositors and a fund for bailing out a failed bank. We believe that the Commission is referring to the former as the latter would prove, not only insufficient to rescue even a middle-sized firm and yet very expensive to fund, but also would be counterproductive to the Commission's objective to avoid associated moral hazard: we would also not support pre-funded schemes.
10. Given the problems to which the Lehmans failure gave rise, it is important that the development of an European framework for systemically important banks should recognise that there needs to be arrangements – albeit perhaps different in focus – for systemically important investment firms as well. This is particularly important because, and as the Commission know, there is no legislation currently equivalent to the Credit Institutions Winding Up Directive to cover investment firms.
11. A key principle that cuts across early intervention, resolution and insolvency issues is the importance of an effective relationship between a firm and its supervisors. A full dialogue will enhance the understanding of the business

- model, structure and risks facing the organisation, which will help minimise the need to use early intervention powers/tools and firm failures.
12. A common understanding of the regulatory framework, convergent practices and co-operation between home and host supervisors are also essential to ensure that issues within firms/groups are picked up at an early stage and discussed in the appropriate regulatory fora to ensure appropriate action can be taken.
 13. Firms also bear their share of responsibility for minimising the risks of failure by determining an appropriate risk profile and business model, supported by an appropriate group structure and risk management framework and to ensure that these factors and the risks posed to the firm are communicated to the relevant supervisors. We do not think that one model of group structure is necessarily any better than any other – each has its own strengths and weaknesses. Under competitive markets, complexity will generally exist only if it is commercially justified or driven by legal/regulatory requirements; the appropriateness of risk management should be the prime focus rather than facilitating resolution. Diversity of business models and structures are important to the health of the financial system as a whole, encouraging both competition to provide products and services to consumers efficiently and a more resilient financial services sector.
 14. Given the global nature of many groups, it is essential that a coherent globally consistent approach to early intervention and resolution is developed as noted above. Specifically, this means that the EU authorities must work in close co-operation with the FSB and the Basel Committee; it is also vital that all relevant supervisors (not just those within the EU) are involved in the development of crisis management plans for individual groups.
 15. Supervisors will also need to make sure that they are appropriately resourced to undertake the additional work required to address the proposals addressed in the Communication and associated Staff Working Paper.

EARLY INTERVENTION BY SUPERVISOR

Tools

We support the concept that supervisors should have access to a consistent range of early intervention tools in order to address developing problems.

We do not, at this stage, wish to comment on the full range of specific early intervention tools, but in this context. However:

- we caution against any powers being granted to supervisory or resolution authorities to vary contracts or to impair legal certainty in any way unless in absolute extremis, for example for the purpose of effecting transfer of all/part of an entity to a new parent. Legal certainty is essential to the smooth running of markets and therefore to systemic stability.
- We would like to note our support for the minimum requirement that a supervisory authority should be able to effect the replacement of the management

of a firm. The degree of transparency under which this power is used will also be a crucial decision for the authorities. Where replacement of management is effected on a discreet basis reputational damage to the firm may be contained but in some circumstances a highly visible replacement of a team perceived to have been failing could be a confidence boosting measure.

- We do not raise an objection, per se, to the potential suspension of voting rights as an early intervention measure but we recognise that it is a more difficult question, not least as it could only be a highly transparent move which would have a negative signal and might further prejudice the condition of the institution.

Use of tools

If early intervention is to be successful in restoring a distressed institution to a sound footing, then the manner in which the tools are used will be as important as the range of tools that can be used. We have identified the following issues which we think should be taken into consideration:

Use of tools should not exacerbate the position of the firm concerned

In considering when early intervention measures should be used, each tool must be assessed against the criterion that it does not accelerate the decline or exacerbate the general condition of the institution which is in question. It is important to bear in mind that immediate actions that are undertaken with the intent to support the institution can sometimes have later, adverse, consequences (a risk reducing trade may signal to the market that the firm is in distress).

Where institutions are vulnerable and are entering into potentially distressed or unsustainable situations, early action is likely to be more effective, providing that it does not deliver signals to the market that could damage the firm. In this regard we think that any agreed supervisory metrics should be monitored on an ongoing basis as part of the normal supervisory relationship, to ensure that supervisory review does not undermine market confidence. In addition, supervisors will need to ensure that there are appropriate safeguards to ensure the confidentiality of any data provided by firms with signs of distress and of the supervisory discussions regarding actions to be taken.

Communication to the outside world will therefore be an important part of any plan for dealing with a distressed firm ó the timing, nature and responsibility for communication will need to be considered carefully, particularly given Market Abuse Directive considerations. The handling of public disclosure obligations also needs to be closely coordinated with authorities from other jurisdictions, in particular those of the United States, given the number of double listings of EU incorporated firms ó solving the issue at EU level would not suffice.

Flexibility/discretion

One significant aspect of any early intervention regime is whether the benefits of a discretionary/more flexible regime outweigh the potential certainties of a more automatic non-discretionary application of supervisory tools.

Although consistency is often cited as being important, we consider that flexibility in approach is essential to maximising the chances of the institution being returned to stability. This is because no two firms/groups are the same in their business model or the way in which they are structured or managed. Early intervention is therefore an area where one size cannot fit all cases and discretion in choice, timing and use of tools is likely to be critically important for authorities dealing with cross border groups and also when it is a domestic group or firm.

That said it is vital that supervisors have a common understanding of the firm/group. An understanding on common triggers could assist in that process, although we are wary about common triggers leading to immediate *automatic* action. This is why colleges and co-operation between supervisory authorities are vital.

Cooperation between supervisory authorities

When one or more entity within a cross border group is in a position where it may require early intervention procedures then supervisory cooperation and information flow is essential.

Depending on the nature of the group structure, the location of the balance of its business, different elements of the business may require different action. Early interventions in one part of the group could have significant implications for other jurisdictions. Discussion between supervisors about the appropriate course(s) of action will be necessary to ensure that the overriding principle of not exacerbating the situation is met. However, we acknowledge that there is a balance to be struck between the need to take early action, and thus preventing a situation deteriorating, and the need to for supervisors to discuss the situation to ensure appropriate action is taken.

The lead supervisor is likely to play a pivotal role in ensuring that this process runs as smoothly as it can, in ensuring that all relevant supervisors are aware of triggers being hit and of proposed courses of action. However, we recognise that issues could arise where the lead supervisor is less affected than other supervisors in the college or where the actions proposed by the lead supervisor in its own jurisdiction could have significant implications for other parts of the group. Each college, will, therefore, need discuss how they might address such issues on a periodic basis; for example how and who can trigger an intervention mechanism and the responsibility for taking it forward.. Host supervisors will need to have the ability to raise questions and provide information and to force discussion if the lead supervisor fails to act. Firms will also need to be involved in the discussions, to give their view on the likely ramifications of actions under consideration and the appropriateness thereof.

Cross border dimension – branches

Equally it is necessary to have regard to the situation of all potential creditors of a failing institution; it would be invidious to ignore those of branches because they happen to be located in a different Member State. However, we recognise that the position of branches within the Single Market and the powers attributed to both Home and Host supervisors make this a singularly thorny issue. We therefore think that it is appropriate

to review the situation, but think that it is important not to come to a conclusion without a full consideration of the implications.

‘Wind down plans’ as a tool for crisis management

Firms should obviously plan to manage their business to minimise the risk of their failure in keeping with their responsibilities to their owners; as such their structure and risk management frameworks should support the desired risk profile and reflect developments in the market. Firms should also consider potential risks and stress that can have a material impact on their business and have in place plans to address those issues. However, ignoring the terminology used to describe it (some of which is possibly less helpful than others) the industry recognises and accepts the natural desire of the Authorities to have access to certain key pieces of information to ensure that when a crisis event occurs appropriate action can be taken in a timely manner. Members wish to assist the Authorities in reaching agreement on the most practical and suitable methods for delivering this outcome.

We have identified a number of issues that we think require consideration:

- Purpose
- Scope of application
- Level of application
- Nature of information
- Global co-ordination and consistency
- Sensitivity of information

Purpose

There would appear to be two aspects to crisis management:

- Identifying serious risks to the business and for there to be a credible plan to address them. As noted in the introduction to this section we believe this aspect is primarily the responsibility of firms; although there should obviously be a robust dialogue with the supervisor over the content and realism of the plans.
- The case where distress is so severe that recovery is impossible to achieve, should be a plan for resolution or insolvency. This second aspect is primarily the responsibility of the Authorities in whose hands the ability to act actually rests. In developing this plan for resolution/insolvency the Authorities should bear in mind that there is a balance to be struck between planning for low probability/worst case events, and the ongoing efficiency of firms and markets to provide financial services to consumers and businesses alike. As such these plans should not be used for the purpose of forcing firms into a particular business model or group structure. Diversity of business models and structures are important to the financial health of the system as a whole; convergence on a single approach can produce further risks to financial stability.

While both are important, it is this latter aspect that we consider in this part of the response and the role of firms in this process.

Scope of application

A side benefit of reviewing the information that would be necessary for the Authorities to handle a crisis situation would be to focus both management and supervisory minds on factors that might attract less attention in the ordinary course of business. As such, we believe that it should be good business practice for all institutions, and not just those with systemic significance, to review and address the relevant issues and information requirements, particularly since smaller firms, as a group, can also be a source of systemic risk. Proportionality considerations would require that such an exercise should reflect the nature, scale and complexity of a firm's business.

For the exercise to prove meaningful it will be necessary to include all entities within the firm's group. However, the nature and scale of information provided may vary (see nature of information below).

Level of application

Albeit that, currently and for the foreseeable future, resolution and insolvency will be a national issue, contingency planning information should be collected at the group level not legal entity level. Problems in one part of the group have to be considered in the context of the group as a whole if a coherent plan is to be adopted that minimises the risks to the financial system.

Nature of information provided

Determining the information to be provided will undoubtedly have to be an iterative process, with the focus on what is critical and practical to achieve. Ideally, the provision of information should be complimentary to the reporting already done by a firm rather than a repeated provision of the same or similar information in a different format.

It will be important to achieve clarity around what information is required on a 'real time' basis should an emergency situation develop. There should therefore be a differentiation between 'static' information, which firms should maintain up to date on an ongoing basis, and dynamic information, which should be updated periodically but for which management information systems should be developed to deliver more frequently when a crisis emerges (for example information on counterparties).

Differentiation of information requirements may also be necessary in relation to core versus non-core activities reflecting the different approaches that may be taken in a crisis to different parts of a firm's group (e.g. sale or maintenance of the business capabilities).

Practical considerations will need to be borne in mind when developing the suite of information requirements. As noted above a balance has to be struck between planning for a crisis and ensuring the ongoing efficiency of markets and firms in providing financial services to customers and businesses.

Global co-ordination and consistency

Given the global nature of markets and firms, a global approach to contingency planning will need to be taken. It will be counterproductive if regional approaches are developed that are inconsistent to those taken elsewhere.

Supervisors will need to co-ordinate on contingency plans beyond EU borders to accommodate the range of firms that operate here.

Sensitivity of information

The information provided by firms for contingency planning exceeds that of any other submission that firms provide to their supervisor. Consequently it will be essential for safeguards to be put in place for such information and for there to be tight controls around access to the information and any planned actions and undertakings that the information will not be used by the supervisor for any ancillary purpose. Information sharing agreements will have to be drawn up internationally; ideally principles should be developed in advance.

CONCLUSION

We would be pleased, of course, to discuss the issues covered in this submission with the Commission or to provide further information about any of the matters which our members have raised if that would be helpful.

AFME
29 January 2010



31st December

Sent by e-mail to: baselcommittee@bis.org

The Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
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Dear Ms Hüpkes and Mr Krimminger

Report and Recommendations of the Cross Border Bank Resolution Group

The Association for Financial Markets in Europe¹ (AFME) is pleased to have the opportunity to respond to the report of the Cross Border Bank Resolution Group. AFME represents the shared interests of a broad range of global and European participants in the wholesale financial markets.

In responding to the report, which in general we support, we have included our more detailed comments in the attachment to this letter, but we would like to draw attention to some of the issues touched upon by the Cross Border Bank Resolution Group.

In particular we would like to express our strong support for and encouragement of cooperation between supervisors. We consider that such cooperation is the foundation for the effective day to day supervision of financial groups and is essential for the orderly and successful crisis management or resolution mechanisms which need to be managed in cross border situations.

There are, however, some aspects of the report and recommendations which we regard as highly sensitive and we would like to draw attention to our concerns in these areas.

¹ AFME was formed on 1st November 2009 by the merger of the London Investment Banking Association (LIBA) with the European operations of the Securities Industry and Financial Markets Association (SIFMA).

Rescue & Resolution plans

The sensitivity of the business information contained in a Living Willö exceeds that of any other submission that firms provide to their regulator. Consequently it will be essential for safeguards to be in place for such documents. Given the sensitivity of these plans, we suggest there is a need for international principles to be agreed with respect to how Living Willös are drawn up, to whom the documents are reported and under what circumstances this information can be shared.

Scope of application of requirements

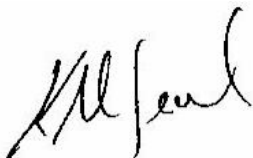
Documents such as Rescue and Resolution plans (or Living Willös) represent a group strategy, rather than a collection or amalgamation of national plans. Therefore, although further details should be capable of being provided with respect to relevant national jurisdictions, such documents should be required and prepared at group level so that a global focus can be achieved.

Diversity of group structure is important

We are concerned to avoid a presumption that complexity cannot co-exist with good management, or that complexity within a group structure is always necessarily undesirable. The predominance of any group structure can create the possibility of systemic weakness developing. In particular, national ring fencing brings a risk of fragmentation which would be highly disruptive to global markets. Diversity of structure is important for the financial sector as a whole.

We would be happy to discuss any of these comments further in this important area in which thinking is developing rapidly. If you would like to contact us to raise questions or discuss our views please contact Peter Beales (peter.beales@afme.eu).

Yours sincerely



Katharine Seal
Managing Director
AFME

AFME Final Response BCBS Principles on Cross Border Resolution

Recommendation 1 – Effective national resolution powers

The first recommendation indicates a range of tools that should be available to the authorities. We agree with the broad thrust of the recommendation as authorities should indeed have appropriate tools to deal with all types of financial institutions in difficulties. Instruments to provide functional continuity where appropriate, such as bridge banks and procedures to transfer assets, may contribute to financial stability. Their design, however, should reflect a thorough cost-benefit analysis. Many members consider that the power to nationalise a failing institution should be listed specifically, for example as in the UK approach where the Banking Act 2009 includes provisions on “Temporary public ownership” as one of the stabilisation options along with “private sector purchase” and “bridge bank”. It is possible that the Committee intended this concept to be implicit in the details set out, many firms believe it would be helpful for this approach to be identified clearly albeit that this option should only be considered as a last resort.

We also propose that thought be given to a financial stability override mechanism that should be a feature of all national resolution regimes. This would enable the authorities to implement the resolution regime (rather than following normal insolvency rules) as the former contains an explicit financial stability objective. Such a mechanism could only be invoked pre-insolvency and should in principle be available to institutions that are or are capable of being systemically important. Of course such a mechanism would require “systemic importance” to be identified. For these specific purposes we suggest a non exhaustive list of criteria be established, as the creation of hard boundaries around the definition could lead to adverse outcome and restrict supervisory flexibility just when it was most needed. The override mechanism would also set out the generic conditions upon which it could be used.

In studying the Basel report, we identify possible regulatory support for a resolution fund to be established. We do not recommend such a development. Such a fund would inevitably risk increasing moral hazard within the financial services industry (ie “pre-paying the next disaster”). The other significant concern would be the scale at which a fund would have to be created. In practice a major new financial entity would be created and its “funds” would be reinvested in the market and would be subject to risks of losses also. By contrast, we broadly support the approach taken by the regulatory community so far which is to focus on strengthening the regulations and standards of supervision of the financial community which will act to reduce the possibility of future failure in institutions.

Recommendation 2 – Framework for a coordinated resolution of financial groups

We support this recommendation however would note that much of it is addressed to the public authorities. In our view it is also important that the authorities recognise that there

is a continuum of outcomes ranging between the remedial and ultimate resolution scenarios. This dimension is clearly recognised in the FSA Discussion Paper 09/04 (Turner Review Conference Discussion Paper) and we welcome this.

It is also noticeable that there is a strong emphasis in the Basel paper on convergence of practice between authorities and also a tacit assumption of seamless international coordination. We note, however, that the risk remains of different outcomes in different regions, despite efforts at convergence and coordination. In order to make further progress we consider that a top down process, agreed at global level, may be required to achieve a greater degree of certainty and equity in the eventual outcome for groups that encounter distress.

Recommendation 3 – Convergence of national resolution measures

Recommendation 3 is clearly welcome. Strong public commitment to coordination and convergence is essential and without agreement on this principle further progress would be blocked. However, we recognise that more is needed. It is clear that recommendation 3 articulates a minimum necessary level of agreement. We also consider that there should be a convergence of pre-crisis tools for regulators as well as of national resolution regimes specifically designed for financial institutions.

Recommendation 4 - Cross border effects of national resolution measures

We find recommendation 4 to be reasonable and welcome. In particular we would like to endorse strongly the importance of mutual recognition. Mutual recognition of the key phases of supervisory activity/intervention (e.g. intensive supervision, thresholds, trigger, when to make public, any harmonised exemption from the market abuse - inside information - regime) are among the most critical issues on which greater legal certainty should be achieved. In essence, it is the legal certainty which needs to be paramount and therefore there are issues on which mutual recognition needs to develop carefully, or in which there may need to be exceptions to this principle. For example, the extent to which resolution procedures in a home state jurisdiction would disrupt or interfere with collateral arrangements entered into in a local jurisdiction or the operation of settlement finality rules in that state would benefit from clarity that the local law rules of the relevant payment/clearance systems should prevail.

Recommendation 5 – Reduce complexity and interconnectedness of group structures and operations

We recognise the regulatory concerns expressed in this recommendation but some elements of the proposal need to be considered carefully.

We agree that it is important for both the firm and the regulator to assess and examine a firm's group structure and ensure that its purpose is clearly understood. It is appropriate for firms to assess on a regular basis whether its group structure is fit for purpose or

whether it has developed some elements of unnecessary complexity. This is prudent management and good housekeeping.

However, we are concerned that there is a presumption in this text which is that complexity cannot co-exist with good management, indeed that regulators regard complexity within a group structure as necessarily undesirable. In our view good management sometimes requires complexity of structure although we agree that ensuring the basis for complexity is understood by management and transparently communicated to regulators is an essential component. It is also important to remember that there could be a number of reasons for complexity some, perhaps most of which, derive from local regulations and restrictions on how certain business activities must be structured. Hence not all elements of complexity found within a group structure will be discretionary.

As an over arching point we believe that there is a risk that too great a focus is placed on facilitating resolution to the extent that there is insufficient attention paid to whether the group structure is well designed for risk management purposes, and may be an important instrument in mitigating risk in the day to day operations of the firm in normal conditions. In other words we are concerned that there is a risk that adjustments will be encouraged or insisted upon that will be at the expense of the risk management and control environment.

We consider that there is a bias developing in the regulatory community for a particular style of group structure. We find this unfortunate, as of course the greater the extent to which firms share the same structures the greater the risk that systemic weaknesses may develop from that source. In particular any preference for national ring fencing brings with it a risk of fragmentation which would be highly disruptive to global markets. Diversity of structure is important for the financial sector as a whole. All structures, whether through a complex use of branch structure or through constellations of national subsidiaries have strengths and weaknesses. The important test is whether the firm (and regulator) has thought through the potential weaknesses and has viable strategies in place to deal with adverse outcomes should they arise.

As such we do not agree with proposals that apply extra capital charges to incentivise less complex group structures, without the careful examination of the current group structure and whether there is in practical terms a more simple structure available. We strongly believe that capital requirements should be risk sensitive. If a more simple structure is available and the firm does not address the regulatory concerns, this may point to undue risk for which capital may be the appropriate mitigant. At this stage further capital should/could be demanded. In our opinion this would fall well under the Pillar 2 and Supervisory Review framework.

In our view concerns around ease of resolution, while extremely important, are not as significant as concerns that the ongoing risk management environment of a firm, and the good overall management oversight of the firm should be as strong as possible. On balance we consider that clarity, meaning transparency and understanding by both regulator and the firms management, of the structure and business purpose of the group would be a more fruitful way forward. We strongly wish to encourage the Committee to include a specific reference to the need for the regulators to discuss the group structure

actively with a firm and to be transparent with the firm about the regulatory assessments of the group structure.

Recommendation 6 – Planning in advance for orderly resolution

We naturally recognise the supervisory desire to have robust contingency plans and wish to support the organisation of contingency planning in the most efficient and practical manner possible. More study and consultation is needed between regulators and the industry to develop and test such plans so that the result is fit for purpose, but does not impose an additional cost infrastructure that may not be effective or efficient. As a general comment, however, we note (and this is relevant to both recommendation 5 and 6) that an institution's organisation structure cannot and should not be predicated on the fact that a primary aim is to facilitate resolution. Recovery and resolution plans (or Living Wills) should not be used as a tool to force changes in group structure as the purpose of Living Wills is to demonstrate how the business model survives stress and that the firm would be able to respond effectively. Living wills should be looked at in a global way with a focus on information about connectivity within the organisation and between it and other market participants.

Sensitivity of Living Wills. The sensitivity of the business information contained in a Living Will exceeds that of any other submission that firms provide to their regulator. Consequently it will be essential for safeguards to be in place for such documents and regulators would also need to provide assurances of tight controls around access, and specify which regulators will have access to the plans. Hence, given the sensitivity of these plans, we suggest there is a need for international principles to be agreed with respect to how Living Wills are drawn up, to whom the documents are reported and under what circumstances this information can be shared.

Scope of application. A Living Will represents a group strategy, not a collection of national plans and although further details should be capable of being provided with respect to relevant national jurisdictions such documents should not be required for each subsidiary.

Information requirements. We would recommend that the authorities approach the issue as an iterative dialogue, on a top down basis to establish clearly with firms what information is critical and practical to achieve. It will be important to achieve clarity around what types of information will be required on a real time basis should an emergency situation develop and from what stage such information would be required. We also propose that the information pack is differentiated into information which is likely to remain more static and information that will be more dynamic (meaning highly granular information such as aggregated counterparty exposures or liquidity flows that relates to the business condition of the firm at a point in time) and may be appropriate to require only at the point where the authorities are concerned that the firm/group is in or at risk of distress or failure. We would, however, expect that firms should ensure that the static data is maintained and a robust management information system is in place so that

the firm would have the capability of delivering all the information, including the dynamic in a reasonable timeframe, for example the information on counterparties.

Recommendation 7 – Cross border cooperation and information sharing

We strongly support the need for cross border cooperation. We advocate the need for a clear decision making framework for supervisors to allow quick decisions to be made when groups encounter a crisis situation. The competent authorities of the Home State should have a leading role in ensuring the efficiency and effectiveness of the decision-making process. It is important that a decision framework can be reached that has a global span and we are concerned that regional arrangements should not interfere with or obstruct or delay the efficiency of global arrangements, either in a crisis situation or in normal operation. In this context we are conscious that there are some significant sensitivities around the use and transmission of information. For example the more complex and involved the college structure, the greater the potential for information to be leaked which might prejudice a successful outcome of resolution or insolvency measures. We consider that special care will be needed with respect to information transition in times of crisis management. We also consider that there should be an internationally coordinated approach to address mutual recognition of any exemption from the insider information regime.

Recommendation 8 – Strengthening risk mitigation mechanisms

In respect of comments on Recommendations 8 and 9, and in addition to the views that we express in the paragraphs below, AFME would like to draw attention to its support of the response prepared by ISDA which focuses in particular on the issues raised by these recommendations.

Established risk-mitigation techniques, such as enforceable netting agreements, repos and collateral (including rehypothecation, which activity can play a valuable role in enhancing market liquidity), should be safeguarded and further developed (cf. Recommendation 1). They represent the first line of defence to prevent financial contagion and reduce systemic risk. Therefore, risk mitigation devices should be exempted from any restriction on termination rights.

In our view, authorities' efforts should focus on making best use of and enhancing such existing risk mitigation mechanisms. Further harmonisation and convergence of national rules governing close-out netting and collateral arrangements, addressing scope of application and legal effects across borders where not already done, are most welcome and we would support national authorities' efforts to promote such convergence further.

While OTC derivatives markets have remained operational during the crisis, we recognise that further improvements to market infrastructure will lead to risk reduction benefits. When assessing the need for regulatory action, however, the distinct features of the various OTC derivatives segments as well as existing risk mitigation infrastructure need to be fully taken into account. Many asset classes have a long-standing history of

developing effective and efficient mechanisms for trading, clearing and settlement. In addition, over the past months, the industry in close dialogue with the authorities has taken significant steps to further reduce counterparty risk in important derivatives segments such as Credit Default Swaps.

We support the call for greater use of central counterparties as long as these meet highest quality and risk management standards. At the same time, there will always be a need for customised contracts and hence a considerable number of OTC trades that are not liquid enough to qualify for central clearing. For this reason, bilateral collateralisation and trade compression must be recognised as vital and efficient ways of mitigating counterparty risk. Requirements for regulators to uniformly impose or raise initial and variation margins for bilateral transactions should be discarded. Focus should instead be placed on the quality of collateral posted and how quickly that collateral can be liquidated in a counterparty default scenario.

In a similar vein and contrary to the recommendation, we consider that exchange trading is not a panacea towards more resilient OTC derivatives markets. Exchange trading, which is often wrongly associated with process and legal standardisation, is not required to achieve standardisation of process and legal uniformity, nor does it necessarily increase liquidity, or insulate or reduce losses in challenging market environments. The requirement of using central counterparties needs to be distinguished from the question of exchange trading, which may be a more political or exchange business driven desire than an actual need.

Whilst systemic risks of interconnectedness among financial institutions can be reduced through standardisation and clearing through central counterparties, such systems need to be designed carefully and in a robust manner so as not to create new, much more serious systemic risks. For example, only contracts and products that are sufficiently simple in design and standardised should be centrally cleared, as otherwise new systemic risk could be created e.g. if such instruments suddenly became illiquid.

Recommendation 9 – Transfer of contractual relationships

We support the concepts expressed in this recommendation strongly. It is, nonetheless, important to ensure that the principle of 'short delay' is not interpreted or implemented in such a manner as to jeopardise the stability and soundness of other institutions. A 'short delay' could lead to uncertainty for netting relationships and also to delayed settlement both of which outcomes have enormous implications for regulatory capital requirements as opinions on legal certainty of netting agreements are a pre-requisite for transactions to be treated on a net basis for regulatory capital and delayed settlement can lead to outright deductions from capital.

Moreover it is clear that the power to apply restriction of termination rights could undermine contractual relationships, and consequently impair firms' business and business relationships by impeding their ability to undertake transactions that form part of their regular business activities.

Specific provisions would need to be made to ensure that no creditor was worse off (as a result of the resolution tools being applied) and that counterparties' existing netting and set-off arrangements are protected (moved in the entirety to a new bank or left with the old bank).

In practice, therefore, we recommend that risk mitigation techniques should be exempted from any restriction on termination rights. Rather such techniques, whether enforceable netting agreements, repos and collateral (including rehypothecation), should be safeguarded and further developed (cf. Recommendation 1). Cherry picking by administrators must be prevented as this would be a huge setback in relation to progress that has been achieved in the security of law and contract. As the example in the UK in connection with the Safeguards Order (Restriction of Partial Property Transfers Order 2009) has shown, legislation must be drafted very carefully so as not to affect risk mitigating techniques.

Recommendation 10 – Exit strategies and market discipline

We consider that this recommendation is directed at public authorities and do not offer comment. We agree that clear exit strategies from public intervention are important to restore market discipline and promote the efficient operation of financial markets. Exit strategies and practices should be coordinated to protect the level playing field.