31st December

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

The Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Ms Hüpkes and Mr Krimminger

Report and Recommendations of the Cross Border Bank Resolution Group

The Association for Financial Markets in Europe[1] (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.

Rescue & Resolution plans
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. 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.

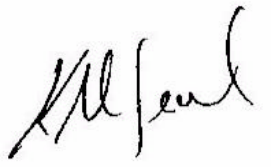
[1] AFME was formed on 1st November 2009 by the merger of the London Investment Banking Association (LIBA) with the European operations of the Securities Industry and Financial Markets Association (SIFMA).

Scope of application of requirements
Documents such as Rescue and Resolution plans (or "Living Wills") 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 an 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.