12/23/15

Financial Stability Board
Centralbahnplatz 2
Basel, Switzerland
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Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank ("G-SIB")

Comments on Consultative Document

Dear Sirs:

The Institute of International Finance and the Global Financial Markets Association (the "Associations") appreciate the opportunity to contribute to the discussion of the captioned Consultative Document and look forward to further exchanges with the Financial Stability Board on this important topic.

General comments

The industry welcomes the FSB's attention to the critical issue of assuring availability of temporary liquidity support to a bank in resolution. The Associations strongly support the objectives of the Consultative Document and its guiding principles and look forward to working constructively with the FSB on the issues that are raised.[1] This is a topic that has received insufficient attention, and we applaud the FSB's excellent work in setting out the issues. It is especially important to clarify the availability of liquidity backstops, should they be needed in particular resolution situations. Firms have absorbed the lessons of the 2008 financial crisis, making widespread and significant changes to their governance and business models, including enhancing liquidity and balance-sheet management, developing robust recovery and resolution plans, and improving reporting. The deep stack of resources that TLAC will make available creates a new context in which to consider the role of temporary liquidity facilities for solvent, post-resolution firms. The Associations support the FSB's conclusion at page 7 of the Consultative Document that back-up availability of public liquidity resources will be an

[1] It is also important for the FSB to pursue the development of policies to facilitate the authorities' carrying out of resolution without bail-out on a cross-border basis: the Associations thus agree with paragraph (i) citing KA 6.1.

important factor in assuring the market that resolution can be carried out in an orderly manner in all cases.

The fact that this document addresses *temporary* liquidity support is very important and should be made more prominent (it is now made in the antepenultimate paragraph on page 8). Indeed, it would be well to refer to "temporary liquidity support" rather than "temporary funding" in the title, to avoid the common confusion between necessary liquidity support – on principles recognized since Bagehot 150 years ago – and "bail-out" or solvency support.

Firms' *liquidity resources* under the post-crisis regulatory regime should be mentioned at paragraph (i) under Objectives and Principles. The industry is already building robust self-insurance in the form of HQLA resources to meet LCR requirements, amounting to hundreds of billions of USD or EUR in large firms. LCR and NSFR rules make it possible that substantial amounts of liquidity will be available in many cases, and this is worth noting to assure that the press and the public have a complete understanding of the liquidity context in which a firm may enter resolution. LCR resources constitute a kind of self-insurance that may be available in some cases substantially to alleviate the liquidity issues addressed in this paper, and can, if properly managed and with good disclosure, contribute to creating the conditions that may attract private-sector funding in the restructuring phase, or possibly even the stabilization phase.

In considering any approach to liquidity in resolution, the *costs and benefits* need to be considered. There may be tradeoffs between the costs of self-insurance or collective insurance against liquidity risks and the moral hazard that access to certain types of liquidity facilities is thought to cause.

"Constructive clarity" on issues of liquidity in resolution would contribute substantially to the orderliness of any resolution, given the importance of market reactions. The FSB should recommend to central banks and relevant authorities that they give reasonable assurances of the availability of normal or backstop liquidity facilities that would be made available on Bagehot-like terms that minimize any risk of permanent loss of taxpayer funds. Such assurances may contribute materially to attracting private-sector liquidity funding and fresh capital for a resolved entity.

As a general matter, the Guidelines should stress that planning for funding in liquidity should focus on *each firm's specific resolution strategy*, backed up by its recovery and resolution planning. It is not clear why firm-prepared resolution plans have been omitted from the definition of "resolution plan". An explanation of the intent on this point would be helpful. The final version of the Guidelines should look as realistically as possible at the full spectrum of possible ways resolution and stabilization might unroll.

While *moral hazard* is a concern in thinking about preparation for resolution, it is also possible to over-emphasize the concept. It is not the case that all forms of liquidity provision necessarily constitute credit support – indeed central bank liquidity arrangements are generally explicitly constructed in order to provide liquidity without assumption of credit risk. Access to such facilities should therefore not be regarded as creating moral hazard. There may be extreme emergency circumstances in which the provision of liquidity may involve some assumption of

credit risk by the liquidity provider, but these should be rare exceptions, and not all liquidity facilities necessarily create moral hazard.

One argument that is sometimes made on moral hazard grounds is that risk-management efforts might be compromised as a result of the existence of public-sector backstop liquidity facilities: this concern is now essentially without foundation, given the new backdrop of capital and liquidity regulations, TLAC, and enhanced prudential supervision.

Concerns about moral hazard should not obstruct planning for appropriate forms of access to public-sector liquidity (as discussed further below) for a firm that enters the stabilization period strongly recapitalized by the resources made available by bail-in of TLAC and other eligible instruments. It would therefore be helpful to make clear specifically that a recapitalized, solvent firm would have access to normal lender-of-last-resort facilities on normal terms.

A clearly available, strong liquidity backstop for crisis situations, available to a bank emerging from resolution, will strengthen the credibility of the resolution regime, and, in addition contribute to the proper pricing of TLAC to absorb the risk of failure. Planning for temporary liquidity resources for a solvent, recapitalized firm therefore *addresses* moral hazard concerns, rather than contributing to them.

Additional observation

KA 6.5 (paragraph (v)) regarding temporary public ownership is not specifically relevant to the discussion of temporary funding addressed in this Consultative Document and might better be omitted for the avoidance of possible confusion of the public.

The following comments respond to the FSB's set questions.

1. **Are the principles on temporary funding in resolution identified in the report appropriate? What additional elements, if any, should be considered for inclusion**?

It would be helpful for the FSB to highlight to the public the difference between providing a recapitalized and solvent firm in stabilization or reorganization with access to reliable sources of *temporary liquidity* and providing "bail-out" solvency reinvestment. Providing access on a secured basis with terms that create appropriate incentives may in some resolution circumstances be important to allowing the firm itself to maintain its essential functions, and return client assets or re-enter the market.

2. **What are your views on the most effective means for maximising the availability and use of private funding sources in resolution in a manner consistent with orderly resolution? Are there particular formats of private funding that should be considered?**

The Consultative Document's discussion of potential private funding is generally appropriate. Temporary public provision of liquidity for a (recapitalized and solvent) entity coming out of the "resolution weekend" will often be needed to increase the confidence of potential liquidity providers and future investors.

Existing resolution or Deposit Guarantee Scheme (DGS) funds are pools of private-sector resources contributed, whether ex-ante or ex-post, by the industry. While such pools may be controlled by the authorities, it is important not to lose sight of the fact that they are constituted of private-sector resources, drawn from the overall resources of the industry. Thus there are already sources of industry-funded liquidity available in resolution.

It is important to stress that a resolution that has been able to bail-in substantial TLAC and other resources should create a solvent firm, minimizing any risk to the public sector if it provides temporary liquidity support.

Clear communications to the market during the stabilization and immediate post-resolution periods will be very important. Confidence created by the fact that central banks or public authorities are treating the firm as solvent and providing temporary liquidity accordingly is likely to be a sine qua non of rapid rebuilding of access to private-sector liquidity sources.

The authorities should educate the public, in general terms, about their general policies on how they are likely to approach resolution events, including the provision of temporary liquidity to a firm in resolution (subject, presumably, to its being restored to basic solvency by an appropriate resolution tool).

The discussion of "super-priority" funding is unduly pessimistic. While such transactions have been rare for financial institutions in the past, all the post-crisis changes, including TLAC, recovery and resolution planning, and orderly resolution procedures, should make larger reorganizations for financial institutions possible through public debt markets or private placements in the future.

A communication strategy agreed among home and host authorities for communication to the market about resolution events and restructuring plans is essential, as noted in paragraph 1(iii) at the bottom of page 10. This will be important to make sure that both home and host authorities take actions and communicate with the market in ways that contribute to the orderly settlement of the post-resolution firm and continuity of its essential functions, without destabilizing or contradictory actions. In many cases, communication about the solvency and collateral resources of the firm will also be essential to the provision of temporary liquidity. The fact that a firm in resolution is recapitalized and solvent needs to be communicated as quickly as possible to host authorities. Timing will be important, and will need to take into account Asian and Pacific opening times.

3. **In cases where public sector backstop funding is needed in resolution, how should such funding ideally be structured so as to minimise the risk of moral hazard, reduce the need for temporary liquidity support from the public sector, and allow the firm to return to private sector funding (i.e. timing of disbursements, term of funding, pricing, collateral requirements, potential use of public sector guarantee authority where available, exit incentives, etc.)?**

It is important to say that "a recapitalized firm in resolution *should* retain the opportunity to source liquidity under a central bank's ordinary facilities …", to rephrase the third indent under paragraph 3. In addition to the considerations mentioned in that paragraph, clarity about normal-case access to lender-of-last-resort and other facilities could be critical to stabilizing the firm and paving the way for its access to the financial markets.

There is no a-priori ideal solution. Resolution authorities must be allowed to act with sufficient flexibility to negotiate rapidly and decisively a return to private-sector funding.

The Associations emphatically agree that, as said at the end of paragraph 3 and as discussed above, the abstract concept of moral hazard should not be allowed to stand in the way of decisive temporary provision of liquidity on normal terms in order to assure orderly resolution and allow the continuance of essential functions, which should in turn allow the rapid provision of private-sector liquidity. Normal discount-window terms, or terms on special facilities analogous to discount-window terms (as foreseen by Bagehot) should be sufficient to manage moral-hazard risks.

It would be helpful to make clearer that there are analytically different kinds of public-sector temporary liquidity provision, all of which should be available on appropriate terms and conditions to the newly recapitalized and solvent post-bail-in firm, *viz.:*

- Normal central bank discount-window or similar facilities made available generally to solvent firms in the market;
- Lender-of-last-resort facilities made available to solvent firms, possibly permitting a wider range of collateral than that normally specified for normal discount window transactions; and
- Emergency backstop facilities, also available to solvent firms but which may be provided by agencies other than the central bank, such as access to a resolution fund, liquidity provided by the DGS or a special facility such as the US Orderly Liquidation Fund (OLF). As noted above, although administered by the public sector, such funds are in many cases actually pools of private-sector funds, either collected ex-ante (as in the case of the EU) or representing secured claims backed up by potential assessment of the industry (as in the case of the US OLF).

It will be important for liquidity providers to have the flexibility to accept a broad range of collateral, and the valuation, risk-management, operational and legal frameworks necessary to accept it, as suggested in clause 5(i) at the bottom of page 17.

Furthermore, it may be more effective and efficient – and potentially less demanding on available resources – for liquidity access to be provided by facilities such as those just listed via

public-sector, DGS or resolution-fund *guarantees* of liquidity made available by the market (which guarantees should of course benefit from the solvency, collateral, and other terms associated with such facilities if used directly). At the bottom of page 11, reference to public-sector guarantees (which could be used to achieve much the same results as public-sector liquidity support) is helpful; however, the discussion should be made clearer that such guarantees would be equivalent to Bagehot-type emergency liquidity support and should not (under those circumstances) be conflated with bail-out or permanent public-sector intervention.

While the term of funding should aim to be as limited as possible, fixed terms should be avoided. Facilities should be temporary, with terms no longer than necessary to achieve orderly resolution and for the bank to regain access to private-sector liquidity. However, judgment is likely to be necessary to determine when those conditions can be met, under conditions that are likely to be unpredictable. Clause (iii) on page 15 should be clarified to make this point fully clear.

In calibrating terms and making facilities available, the authorities will need to balance the interest in reducing moral hazard with the equal and compelling interest in restoring public confidence in the firm in resolution and in the financial system generally.

4. **Do you agree with the suggested elements of resolution planning for temporary funding in Section 5? What additional elements, if any, should be considered for inclusion?**

Prefunding would not be without cost to society and would likely limit credit provision. Furthermore, as already mentioned, the industry is in many cases already pre-funding substantial resources for DGS funds or for existing or planned resolution funds. Clear focus needs to be kept on the fact that such funds are pools of private money, not public funds in the usual sense.

The NCWOL principle should not be interpreted to impede super-priority protection to a public liquidity provider, such as the US OLF, or to post-resolution private sector creditors.[2] Such sources of new funding provide new value intended to salvage as much going-concern value as possible and hence should not affect the recovery rights of old creditors (except to the extent that they enhance them).

Generally, the discussion in Section 5 is appropriate and helpful. A few observations:

- Paragraph (ii) on identifying assets that could be sold or collateralized is appropriate, but it should not be presumed that assets would be sold on a fire-sale basis.
- Paragraph (viii) regarding strategies for maintaining adequate liquidity in different currencies is important. Furthermore, it would be appropriate for the FSB to encourage central banks to have in place back-up currency-swap facilities to make sure that appropriate currencies can be provided (on appropriate terms) by the relevant central banks.
- In clause (ii) at the end of Section 5, consideration should be given to referring to the type of super-priority lien on the firm itself that is built into the US OLF.

[2] The language of Section 4 therefore needs to be reviewed.

5. **Do you agree with the approach outlined for cross border cooperation between home and host jurisdictions? What additional principles or procedures, if any, should be considered**?

Ex-ante transparency amongst regulators and resolution authorities, and planning and detailed understanding of firms and their resolution plans, are likely to be critical to a successful, orderly resolution, should it ever become necessary.

Home-host cooperation is clearly essential. It would be helpful for the FSB to develop, perhaps in consultation with the private sector, model MOU or even statutory provisions that could be adopted to assure cross-border adherence to the principles of the *Key Attributes* and appropriate provision of temporary liquidity.

The discussion of home-host cooperation is very good and it is to be hoped that the FSB will act decisively to foster firm commitment to such cooperation by the relevant authorities.

As mentioned above, cross-currency swap arrangements between central banks could be very helpful to assuring that currency mismatches would not disrupt the recovery or resolution process.

Lending against collateral in other jurisdictions could be facilitated by (back-up) collateral facilities for benefit of multiple central banks in each other's systems or through ICSDs. Such facilities should be able to make it possible to marshal collateral and make it available by transfer or pledge to the account of a relevant central bank seamlessly, quickly, and with few operational or legal impediments. In any case, removing any impediments to use of such facilities in other jurisdictions, especially for emergency purposes, should be a priority for the FSB.

6. **Are there any other actions that could be taken by firms or authorities with regard to the temporary funding needed to support the orderly resolution of a G-SIB**?

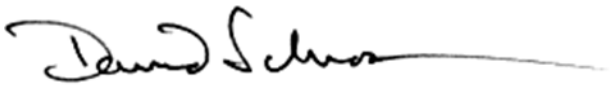
With careful attention to the issues raised in the Consultative Document and in these comments, there is no reason why temporary liquidity in resolution should ever be deemed a "material impediment" to resolvability.

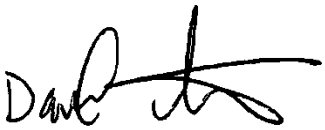
Home and host authorities should work closely with firms and relevant infrastructure entities and central banks to be certain that recapitalized and solvent firms will be able to have access to their collateral and make use of industry infrastructure utilities, in particular to create assurances that a bailed-in firm in resolution would continue to be deemed to meet the conditions of access to such facilities.

Home and host authorities should work with firms on resolution planning and to make sure that requirements can be met in an appropriate and proportionate way that makes sense in terms of its preferred resolution strategy, also taking into account the need for firms operating under business-as-usual conditions, which will be much more resilient now than before the crisis, to be able to function efficiently, without undue burdens for remote, hypothetical needs.

In conclusion, the Associations reiterate their appreciation of the analysis reflected in the Consultative Document and hope these comments contribute constructively to its finalization. The Associations would be pleased to answer any questions these comments may raise, and stand ready with their members to consult further with the FSB on these matters if that would be helpful. Please contact David Schraa (dschraa@iif.com) or Oliver Moullin (oliver.moullin@afme.eu).

Very truly yours,





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APPENDIX: Description of the Signatory Associations

GFMA

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit http://www.gfma.org.

IIF

The Institute of International Finance is the global association of the financial industry, with close to 500 members from 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks. For more information visit www.iif.com.