Feedback on the Discussion Paper on Domestic Systemically Important Banks ("D-SIBs") (including recovery and resolution) ("D-SIB DP")

1 Introduction

1.1 Feedback received was generally positive, with support for the need to develop resolution regimes in the Crown Dependencies ("**CDs**"), and the requirement to identify D-SIBs being noted. Key themes arising from the feedback were the need to ensure consistency across the CDs, have full consultation in due course, and, for D-SIBs, ensure the approach to assessment is transparent and objective.

D-SIB Sections

2 Assessment - scope of application (Questions 3.3 and 3.6):

- **Do you agree that the scope of application of the framework should apply both to banks incorporated in the CDs (subsidiaries) and branches?**
- **Do you agree that the relevant resolution authority should be given flexibility re the scope of application of recovery and resolution measures?**

2.1 Feedback

2.1.1 Generally, there was consensus with the broad concept of including both subsidiaries and branches within the scope of being classified as D-SIBs.

However, some banks provided more specific comments in relation to the application of the framework to branches, including (1) requirements to produce local recovery and resolution plans (RRPs), (2) how to include a branch in host resolution regimes, (3) HLA requirements and (4) whether conversion to a subsidiary would be a requirement / tool (helpful for the CD supervisors to confirm if this is not envisaged).

2.1.2 There was agreement that there should be flexibility for resolution measures between the host country (the CD) and the resolution authority responsible for the group (or bank). Respondents stated that it will be important for the authorities in the CDs to work closely with the home authorities, to agree the responsibilities of each party depending on the agreed resolution strategy.

2.2 Response

2.2.1 The consultative paper will confirm that the concept of a D-SIB will apply to a subsidiary and a branch. The specific areas for branches covering (1) RRPs, (2) resolution regimes, and (3) HLA requirements are addressed in ***sections 9 and 10*** of this document.

2.2.2 The point (4) raised about whether a CD supervisor would require a branch that was assessed as a D-SIB to convert to a subsidiary will be considered further as part of the consultative paper. At this stage, due to the lack of clarity over cross border resolution (including deposit preference and bail-in regimes) and specific bank / group RRPs, the CD supervisors are not in a position to confirm that such a scenario can be disregarded.

2.2.3 The CD supervisors note the comments made by the industry on the flexibility wanted for resolution between jurisdictions, and will continue to work towards that goal when wider work on resolution regimes in the CDs commences.

3 Assessment - criteria to identify D-SIBs (Questions 4.4 and 4.6):

- **Do you agree with the proposed factors, or do you have any others that you consider would be important to include?**

- **Do you think it would be reasonable to apply a subjective approach for assessing whether a bank is a D-SIB? If not, do you consider that a more formal scoring system should be implemented? If so, do you have any suggestions as to measurement?**

3.1 Feedback

3.1.1 There was broad agreement that the factors specified in the D-SIB DP are appropriate (in the domestic context). Some additional suggestions were made in relation to factors that may be relevant, these were: (1) off balance sheet footings (with reference to local GDP), (2) nature of client relationships (is there a retail bias?), and (3) overall size of a firm's activities in the jurisdiction (including outside of banking) and what impact a banking failure would have on local GDP.

3.1.2 With regard to the factors, one group made the comment (4) that any definition should ensure it captures all clearing banks (in the CDs). Another respondent suggested that (5) cross border business should not be included in local considerations but be tackled through cross border cooperation, noting however that any weaknesses in the home country resolution regime could be an important factor locally. Finally, there was a suggestion (6) that "complexity" should include reference to the up-streaming business model (in the context that this can influence the impact of failure and may reduce the probability of a successful resolution).

3.1.3 With regard to the concept of using a subjective approach for the assessment of whether a bank is a D-SIB (based on the factors), there was a mixed response, with over half of respondents suggesting they favoured a more formal system (whether that be scoring for individual factors, or more general weightings / materiality thresholds). The key points arising from the feedback were that the assessment process needs to be transparent (clear) and applied equally and consistently, noting that additional guidance would be beneficial to supplement the process.

A smaller bank also expressed concern with the concept of "substitutability" in terms of specialist services, and that this alone should not force such a bank to be classified as a D-SIB.

It was clear that the industry generally would not be satisfied with a purely subjective approach (e.g. just publishing the factors, and then arriving at decisions without a clearer assessment methodology being in the public domain), but does recognise that some subjectivity may be required (where objective measures are not easy to define).

3.1.4 Some banks also raised the point, in relation to assessment, that a more formal weighting / scoring system could be linked to HLA requirements (see ***section 6*** of this document). Examples provided included the higher the assessment score, the higher the HLA calibration (subject to home / host discussions). Other banks also suggested that some dominant factors that could drive a bank being assessed as a D-SIB such as, for example, significant employment, should not necessarily mean increased HLA levels.

3.2 Response

3.2.1 Points 1 to 3 will be considered as part of the consultative paper.

3.2.2 With regard to (4) the CD supervisors consider that the list of factors included in the D-SIB DP, subject to their relevant weightings (see ***section 3.2.3*** below), would adequately capture all clearing banks. For (5), the comments are noted but the focus on cross border activity in relation to the factors specified in the D-SIB DP were in the context of <u>downstream</u> subsidiaries and branches (of the CD bank) only; not cross border activity arising from the bank / group in the home state. In relation to (6), this will be considered further as part of the consultative paper, noting that there will be wider considerations of up-streaming through cross border resolution regimes, including bail-in.

3.2.3 It is acknowledged that further work is required to refine the approach to assessing banks and this will be developed as part of the consultative paper. It is recognised that the assessment methodology needs to be transparent, objective (where possible), and applied consistently to help banks plan and to avoid disputes. One concept that the CD supervisors might develop is to better define the materiality / importance of each factor (for example, grading factors in levels of importance, perhaps in tiered groups, with tier 1 factors being the most important).

3.2.4 See also ***section 6*** of this document.

4 Assessment - frequency of assessment (Question 5.2):

- **Do you have any issues with the proposed frequency of assessment (which may include seeking specific data / information from certain banks)?**

4.1 Feedback

4.1.1 The proposed frequency of assessment (annually) was generally considered appropriate, as it coincides with the process for other requirements (e.g. ICAAP and supervisory review, intra-group exposure / concession limits and annual reporting such as financial statements). It was also noted that group RRPs are updated at least annually. The industry's support of an annual assessment process was, however, predicated on the basis of understanding the burden (if any) of providing data / other information to the supervisor.

4.1.2 There were a few additional comments made: one respondent suggested (1) a triennial assessment unless there is a material change, another proposed (2) that the frequency should be determined on a risk based approach with higher impact, higher probability banks being assessed more frequently. A third noted that (3) major changes in a bank's profile (in the context of the domestic economy over a 12 month period) are likely to be rare and that there could be merit for short form re-assessments to be undertaken, or by using trigger events (e.g. notification of material business changes).

4.2 Response

4.2.1 The CD supervisors do not envisage that there will be significant increased reporting required from banks; it will be the supervisors' own internal processes that will need to be updated. For example, it is expected that information already provided by banks and held by the supervisors (e.g. prudential returns[1], deposit insurance information, annual submissions, file records maintained, risk assessments etc) will mostly be sufficient for assessments to be undertaken (of whether a bank is a D-SIB). Further clarification will be made in the consultative paper.

4.2.2 As the consensus view was that an annual assessment process appeared to be reasonable, point (1) is not going to be progressed. However, the CD supervisors will consider further points (2) and (3) in the development of their own approach to the assessment process (and the extent of any additional data requirements from, or dialogue with, banks).

[1] These will be subject to change via wider work on Basel III, and in the Isle of Man work is commencing on obtaining more information on banks' credit books, including local lending.

5 Assessment - transparency (Question 6.4):

- **Despite the above [*refer D-SIB DP section 6*], do you think the CDs should publish a list of D-SIBs?**

5.1 Feedback

5.1.1 There were more responses in favour (or not having an objection) (60%) of the publication of a list of D-SIBs than against, partly due to the fact that it would help with transparency for peer banks due to the proposals to adopt a subjective approach to assessments (see ***section 3*** of this document). Within this 60%, the one caveat was that the CDs should only publish a list if the relevant home jurisdictions do so too (separately from the published G-SIBs).

5.1.2 Some of the respondents who objected to the publication of a list considered that the focus should be more on being transparent about the criteria, and assessment process / methodology, and expressed concern that publishing a list could result in a two tier banking system, and potentially a false ranking in the eyes of consumers.

5.2 Response

5.2.1 As explained in ***section 3*** of this document, the CD supervisors are to develop further the assessment methodology. It is a requirement that the methodology will be published and this should provide transparency.

5.2.2 As there was not a broad consensus in the CDs that a list should be published, it is proposed to hold off on that proposal until there is a clearer picture of the international approach, especially the UK and the EU. This will be clarified in the consultative paper.

6 HLA requirements – a calibration framework (Question 8.3):

- **Would you have any issues with a range of HLA requirements between 1% and 3.5%, subject to greater detail to be developed on how the calibration framework would link to the approach outlined in section 4 [*of the D-SIB DP*]?**

6.1 Feedback

6.1.1 Comments received effectively covered three key issues which banks wish to obtain further clarity on:-

- Local HLA requirements should take into account the reason for the bank being assessed as a D-SIB and whether capital is the right mitigant

(also see ***section 3.1.4***). The start point could be from 0% to highlight that point.

- It is important that the framework is clear so that banks understand why the level of HLA is applied to them. In this respect, the more objective the measures in the assessment process (see ***section 3*** above) the more transparent this could be made.

- Any HLA requirement locally should only be set after taking into account the wider group position (where HLA may be held) and the resolution strategy for the group (e.g. single point of entry vs multiple of entry model).

6.2 Response

6.2.1 It is acknowledged that further work is required to refine the approach to HLA requirements and this will be developed as part of the consultative paper, taking into account the three core points raised by respondents above. It is recognised that the framework needs to be transparent, objective (where possible), and applied consistently in line with the assessment methodology (***section 3*** of this document).

7 HLA requirements – application to banks incorporated in the CDs (Question 9.5):

- **Would you have any objection to a framework that would take into account the relationship between the subsidiary and parent, as per the scenarios in section 7.2 [*of the D-SIB DP*], and the comments above [*section 9 of the D-SIB DP*]?**

7.1 Feedback

7.1.1 There was general agreement that a framework for HLA should take into account the relationship between the subsidiary and parent, especially as to whether the parent / group is a G-SIB (and holds additional capital for the group as a whole) and also the type of resolution strategy in place for the group (single point of entry vs multiple point of entry model).

7.2 Response

7.2.1 The framework for HLA will be developed / expanded in the consultative paper to cover the principles laid out in the D-SIB DP (*particularly sections 7 and 9*).

8 HLA requirements – HLA requirement to be met by Common Equity Tier 1 (CET1) capital (Question 11.4):

- **Should the HLA requirement be incorporated within the outcome of the SREP? If not, please provide your suggested alternative.**

8.1 Feedback

8.1.1 There was consensus with the proposed approach. One bank commented that the outcome of the SREP should be communicated in such a way that individual capital guidance (ICG) should be clear as to what is required for pillar 2 and what is required for HLA purposes (as a D-SIB).

8.2 Response

8.2.1 Incorporating the HLA framework into the SREP will be undertaken by each CD supervisor once a final framework is in place. This will include the requirement to be clear to banks on how ICG is made up.

9 HLA requirements – branches (Question 12.3):

- **What are your views on the potential for the licensing of branches that would be or are assessed as D-SIBs to be limited to situations where the bank itself is a D-SIB or part of a G-SIB group?**

9.1 Feedback

9.1.1 The majority of respondents understood the rationale for the question and over half agreed with the proposition. There was, however, some confusion that any such proposed approach would limit <u>all</u> branches in the CDs to having to be a branch of a D-SIB or part of a G-SIB group (1).

9.1.2 Some banks, although not dismissing the potential to limit the licensing of a branch assessed locally as a D-SIB, raised additional points for consideration, most notably: (2) potential impact on business competition locally, (3) would such a policy result in an existing branch (assessed as a D-SIB locally but not meeting the criteria) having to become a subsidiary in order to continue to be licensed? (4) If there is a clear local recovery and resolution framework then the wider systemic nature of the bank / group should not necessarily matter.

9.2 Response

9.2.1 It is recognised that licensing policy for branches (including those that are assessed as D-SIBs) will be a matter for each CD to consider, and that the key issues that can adversely affect a branch model (insured deposit preference in

home state, lack of clear resolution plan or local resolution tools) are in a state of flux.

With regard to (1) the proposition is not to limit the licensing of branches per se; it is merely to limit the licensing of a branch which is assessed as a D-SIB locally to be constrained to those banks / groups that are themselves D-SIBs / G-SIBs (subject to any impact that UK Banking Reform may have on structures in the CDs). Currently, it is considered that any branches that probably would be D-SIBs now (on a subjective assessment) would meet such a criteria for licensing.

9.2.2 Any changes to licensing approach would take into account (2) the effect on competition. With regard to (3), our current position is explained in ***section 2.2.2*** above.

We agree that the adequacy of recovery and resolution tools (4) locally is important to address, and could have a bearing on the approach to the licensing policy for branches. However, one of the key aspects of the D-SIB framework is the concept of HLA; if the branch is a D-SIB but the bank is not, and the group is not a G-SIB, the adequacy of capital at the bank / group level may not be sufficient to deal effectively with an orderly local resolution.

Recovery and Resolution Sections

EXPLANATORY NOTE: Throughout the D-SIB DP and this feedback we have referred to recovery and resolution plans / planning (RRPs), most notably in sections 10 and 11 below. RRP has been used as a general term to cover both recovery plans / planning and resolution planning / tools. For clarity, the core differences are as follows:-

Under the EU Bank Recovery and Resolution Directive (BRRD) ***banks*** *are required to prepare plans for recovery from financial distress (****recovery plans****). Similarly, under the current UK regime, banks must produce recovery plans which identify options to recover financial strength in stress situations.*

Under the BRRD ***authorities*** *will take the lead in preparing plans (****resolution plans****) setting out modalities for resolving failed banks in a way that preserves their most critical functions and avoids bail out by taxpayers. Authorities must have powers to achieve resolution. Under the current UK regime it is also the authorities who are responsible for resolution planning but banks are also required to produce resolution packs which are designed to provide information to the authorities to aid resolution planning.*

10 Recovery and resolution – recovery and resolution planning (Questions 14.3 and 14.4):

- **Do you envisage any issues with providing information in due course on group recovery and resolution plans, including how the local subsidiary / branch would fit into such plans?**

- **Do you have your own recovery and resolution plan for the CD operation(s)? If not, when do you plan to commence work on this? Please indicate if you currently have not considered such plans to be necessary or for any other reason do not intend to create such a plan.**

10.1 Feedback

10.1.1 The majority of respondents indicated that group recovery and resolution plans (RRPs), or extracts thereof as relevant to the operations in the CDs, should be sought by the supervisors in the CDs directly from the home regulator with responsibility for lead oversight of the group. Alternatively, some respondents thought they could provide them, subject to agreement from the group's home regulator.

10.1.2 Generally, specific RRPs for the CD operations (whether for branches or subsidiaries) are not in place, partly because there has not been guidance issued locally to require this. Some banks are, however, part of wider group RRPs, or their groups are starting to push down high level plans to other parts of the organisation, including the CDs. Banks also referred to other policies and frameworks they do have in place locally such as liquidity funding plans, and

limiting up-streaming under certain conditions (albeit these tools would only be part of any local RRP).

Many respondents expressed the view that they do not consider it should be necessary for a specific local RRP to be in place.

This was particularly the case for (1) branches, where the wider consensus was that a branch is intrinsically part of the wider legal entity and should only be part of the legal entity plan. This was predicated on the basis that the legal entity is itself a D-SIB and subject to RRP (or part of a wider group plan) and that the home authority takes responsibility for the resolution of that bank's overseas branches (subject to the framework in the CDs permitting such responsibility, in the best interests of the local position).

Even (2) subsidiaries rejected the idea for a specific local RRP to be a requirement. Rather, they suggested the focus should be on the group plan, how the subsidiary fits into that, and whether the plan is on a single or multiple point of entry model. The importance of being clear as to how the subsidiary fits into the group plan was, however, noted and agreed.

10.2 Response

10.2.1 For banks identified as D-SIBs in the CDs it will be important for the CD supervisors to obtain the necessary information on group RRPs. We note that the quickest and most robust route to obtaining this information is likely to be via requests to the home regulator under appropriate gateways.

10.2.2 With reference to (1) and (2), as part of the consultative paper, the CDs will clarify the expectations for relevant banks (branches and incorporated banks) to have a RRP, noting that this does not necessarily mean a specific local RRP will be required in every case.

11 Recovery and resolution – recovery and resolution measures (Questions 15.8 and 15.9):

- **Do you consider that a review of the recovery and resolution framework in the CDs should take place against the KAs?**

- **Do you have any comments on any of the specific issues noted in 15.4 [of the D-SIB DP], including on whether or not it is desirable to meet the KAs in specific areas or conversely if there are specific areas where not meeting the KAs might be desirable?**

11.1 Feedback

11.1.1 Respondents agreed that a review should take place and that the KAs should be used as the relevant standards. There was also support for necessary action to be taken, as may be required, to aid cross border resolution.

11.1.2 There was broad support for work to commence on recovery and resolution planning with reference to meeting the KAs (as the international standard). Specific comments included:-

KA1 – no comments.

KA2 – one bank suggested a single resolution authority across the CDs may simplify administration and funding of the authority [in respect of D-SIBs], whereas others explicitly stated that each CD should have its own resolution authority but work together to ensure a harmonised approach.

KA3 – banks which commented agreed that current bankruptcy laws need to be reviewed alongside any implementation of new resolution powers and that consultation (including across the CDs and with UK) is paramount. One bank referred to other jurisdictions which have developed or are developing new regimes (Bermuda, Singapore and Hong Kong). Comments were also made that any bail-in rules (if applied) must be consistent between the CDs (and UK) to avoid arbitrage (and be consistent in the approach to LAC – see ***section 12*** below). Final remarks suggested any powers to be introduced must not disrupt the decisions of another resolution authority (e.g. in the branch model) and should ideally not conflict with those actions.

KA4 – one bank provided additional comments that, although they agree with the principle (temporary measures) it will be important not to unfairly undermine contracts that have been written with right of set off.

KA5 – no comments.

KA6 – one bank suggested that a combination of the funding sources should be looked at [note that this would be the intention for a resolution in any case]. Another commented that they would not favour a pre funded resolution fund at the CD level.

KA7 – one bank emphasised the importance of the role of the lead authority for cross border banks and that they should conduct the resolution by seeking cooperative solutions with the host authorities (i.e. the CDs).

11.2 Response

11.2.1 A review will be undertaken in 2015.

11.2.2 The introduction of resolution powers in the CDs will need to be considered by the relevant Governments and would be subject to full consultation. The CD supervisors, as part of this process, will take into account the comments above as part of developing a future regime. It was evident that banks are supportive of the need for the KAs to be met and that cooperation, and where possible harmonisation, across the CDs and UK is paramount. On the specific point raised in KA2, it is not expected that there would be one resolution authority across the CDs but this will not preclude a desire to achieve a consistent harmonised framework.

12 Recovery and resolution – LAC requirements (Question 16.7):

- **Do you consider that the creation of a LAC requirement for CD incorporated D-SIBs, along the lines set out in Section 16 [*of the D-SIB DP*], would be likely to have a significant adverse impact on your business? If so, please provide feedback on both the anticipated impact and on any measures that you feel would limit the impact.**

12.1 Feedback

12.1.1 Some banks commented that they did not have enough information at the present time to consider the full implications of a local LAC requirement, but that a consistent approach would be key to help avoid issues that may arise.

12.1.2 Specific comments were as follows:-

- Any LAC should not be so onerous that it would result in a D-SIB withdrawing from providing corporate banking services.

- Likely that LAC requirements would impact depositor behaviour if they are eligible for “bail-in”, as the pricing for such depositors may need to be adjusted and impact cost of funds. The method of up-streaming and term of up-streaming may also need to be considered.

- A higher capital base may be required locally whereas a branch that is a D-SIB (but not a G-SIB group) would not be impacted (refer ***section 9*** of this document on the potential for limiting licensing of branches which are D-SIBs locally). Believe that LAC should be held at a single point within a group and not through individual subsidiaries.

- All debt that can be bailed in should qualify as LAC but uncoordinated imposition of local LAC requirements could lead to issues in cross border groups.

- How intragroup liabilities will be considered in terms of LAC will need to be addressed.

- A clear distinction between liabilities that can be bailed in and minimum LAC requirements has not been made. Under the EU BRRD certain liabilities can be bailed in, including uninsured depositors and senior debt of any maturity (plus capital instruments), but the minimum LAC requirement can only include qualifying regulatory capital and senior debt with residual maturity of more than 1 year. Therefore, any bail-in and LAC regime needs to be very clear to understand how it might impact a bank and its customers.

- Deposits from high net worth customers and intermediated deposits from underlying retail customers should be distinguished from true wholesale deposits and excluded from local bail-in (noting this approach may, however, create an arbitrage for subsidiaries if a home state regime, applied to branches locally, did not make that differentiation).

- Local LAC should be firm specific and not general.

- Higher LAC can create instability in the markets (increased issuance required) and local higher LAC could cause damage to returns and make global firms less able to respond to stresses in different parts of the group.

- Finally, in order to meet a LAC requirement a firm might deleverage which could damage the economy.

12.2 Response

12.2.1 The introduction of any LAC requirement locally will be subject to full consultation, take into account any powers to be introduced for “bail-in”, and also the wider position for groups that will be required to hold LAC (for the group as a whole). The comments provided by banks will be useful in determining policy in this area.