Unit H.4 – Financial Stability
DG Markt
Rue de spa 2,
1000 Bruxelles

21 December 2012

Dear Sirs,

**Response submission from the International Capital Market Association (ICMA)**

**Re: European Commission consultation on a possible recovery and resolution framework for financial institutions other than banks**

**Introduction:**

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of over 420 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for well over 40 years.

The ICMA notes that on 5 October the European Commission published a consultation paper seeking stakeholder-views on a possible framework for the recovery and resolution of nonbank financial institutions. The ICMA also notes that this is a further step, building upon work which lead up to the European Commission's June 2012 EU proposal of a framework for bank recovery and resolution.

**Overall commentary on proposals:**

The ICMA observes that firstly this new consultation paper looks to ascertain how and when the failure of a financial institution other than a bank can threaten financial stability. The main institutions considered in this respect are financial market infrastructures, such as central counterparties and central securities depositories, and systemic insurance companies. Secondly, it considers what arrangements could be needed to prevent their failure from compromising financial stability.

However, in this context this consultation paper does not delve into the regulation applicable to the daily operations of these institutions, which is covered in other work streams. The focus here is on the extraordinary measures which could be necessary to contain the fallout from failure, not on the regulation which is necessary to mitigate the risks and negative externalities inherent in their business. In other words, the focus is on what is variously termed crisis management or recovery and resolution, not on prudential or market conduct rules.

1 For more information regarding ICMA please go to http://www.icmagroup.org/

The ICMA notes that this European Commission consultation considers a wide range of potential measures intended to ensure that European authorities have the powers and tools necessary to provide an effective recovery and resolution framework for financial institutions other than banks. Whilst many of these potential measures are of significant interest, this ICMA response nevertheless focuses on just a few specific aspects. These are temporary stays and payments moratoria, suggested as resolution powers; and bail-in as a potential resolution tool. The ICMA acknowledges the significance of these specific elements, but wishes to highlight that there are important details which need to be carefully considered in developing any more specific proposals for their deployment

Further detail of the ICMA's views on these specific topics have already been documented in response to other similar consultation proposals. Most recently:

- on 24 September 2012 ICMA's European Repo Council ("ERC") submitted a letter of feedback commenting on temporary stays and payments moratoria in relation to the joint Committee on Payment and Settlement Systems ("CPSS") and Board of the International Organization of Securities Commissions ("IOSCO") public consultative report "Recovery and resolution of financial market infrastructures", as published on 31 July 2012 (exhibit 1): and
- on 28 September 2012 ICMA also submitted a letter focused on just one specific aspect of that same CPSS and IOSCO joint consultation – namely "bail-in within resolution (exhibit 2).

Given the degree of overlap between these consultation processes, the ICMA respectfully request that you carefully review and fully consider these earlier response letters in the context of the current European Commission public consultation process.

**Concluding statement:**

The ICMA appreciates the valuable contribution made by the European Commission through this public consultation process and would like to thank the European Commission for its careful consideration of the points made in this response, which the ICMA would be happy to discuss in a meeting with the European Commission team should they consider such to be helpful. The ICMA will continue to closely follow related developments and remains at your disposal to discuss any of the above points, or any further questions which may be relevant to the assessment of international capital market impacts as work progresses.

Yours faithfully,

David Hiscock
Senior Director - Market Practice and Regulatory Policy
ICMA

# EXHIBIT 1

**Reference copy of the ICMA ERC's 24 September 2012 response submission regarding the joint CPSS and IOSCO public consultative report "Recovery and resolution of financial market infrastructures" (as published on 31 July 2012)**

# ICMA EUROPEAN REPO COUNCIL

CPSS Secretariat
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

IOSCO Secretariat
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid
Spain

24 September 2012

Dear Sirs,

**Response submission from the ICMA European Repo Council**

**Re: Joint CPSS and IOSCO Public Consultative Report - "Recovery and resolution of financial market infrastructures"**

**Introduction:**

The purpose of this letter is to provide feedback on behalf of the International Capital Market Association's ("ICMA's") European Repo Council ("ERC"), concerning certain repo oriented aspects of the joint Committee on Payment and Settlement Systems ("CPSS") and Board of the International Organization of Securities Commissions ("IOSCO") public consultative report "Recovery and resolution of financial market infrastructures", as published on 31 July.

The repo market is one of the largest and most active sectors in today's money markets. It provides an efficient source of money market funding for financial intermediaries while providing a secure home for liquid investments. Repo is also used by central banks as their principal tool in open market operations to control short-term interest rates. Repos are attractive as a monetary policy instrument because they carry a low credit risk while serving as a flexible instrument for liquidity management, which benefits the functioning of financial markets. Central banks are also able to act swiftly as lenders of last resort (and have done) during periods of market turbulence by way of the repo market.[1] In a repo transaction securities are exchanged for cash with an agreement to repurchase the securities at a future date. The transaction is collateralised, with the cash securing the seller's securities and the securities securing the buyer's cash. Collateral and netting are key to the proper functioning of repo markets. In the event of default, the collateral can be sold and exposure to the defaulting party can be netted off.

[1] The ERC has published a White Paper on the operation of the European repo market, the role of short-selling, the problem of settlement failures and the need for reform of the market infrastructure. This paper sets out in greater detail what the repo market is and its benefits and is available, together with two subsequent published update papers, via the ICMA website at http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Repo-Markets/European-repo-market-white-paper.aspx.

Over the years the ERC has contributed to the establishment of a robust infrastructure to underpin the European repo market, including through the development of the Global Master Repurchase Agreement ("GMRA")[2]. These efforts continue unabated, current initiatives including projects to enhance the availability of high quality collateral and to boost collateral efficiency. Many current regulatory initiatives are of significance to the repo market and the ERC is actively participating in efforts to ensure that applicable regulatory objectives can be realised, whilst at the same time ensuring the continued efficacy of the repo market.

**Commentary:**

The ERC notes that this joint consultative paper considers a wide range of potential measures intended to ensure that authorities across the globe have the powers and tools necessary to achieve effective resolution of systemically important financial market infrastructures ("FMIs"). Whilst many of these important proposals are of significant interest, this response nevertheless just focuses on those specific elements of the proposals which are of particular interest from the repo market perspective. These elements are "moratorium preventing outgoing payments from an FMI (Key Attribute 3.2 (xi))", as described on page 11 of the joint CPSS and IOSCO public consultation report; "Setoff, netting, collateralisation, segregation of client assets (Key Attribute 4)", as described on page 13; and "Stays on early termination rights based upon entry into resolution (Key Attributes 4.3 and 4.4)", as described on page 14.

The ERC also notes that on 19 July 2011 the Financial Stability Board ("FSB") issued a consultative document[3] – "Effective Resolution of Systemically Important Financial Institutions", which led to the FSB's final report[4] "Key Attributes of Effective Resolution Regimes for Financial Institutions". The current CPSS and IOSCO consultative report seeks to apply these FSB Key Attributes in a manner appropriate for FMIs and consequently covers many similar points to those raised in the FSB's July 2011 public consultation. Under date of 18 August 2011 the ERC responded to this earlier FSB consultation on the specific topic of its bail-in proposals. Given the degree of overlap between these two consultations, we respectfully request that you carefully review and fully consider this earlier ICMA response letter (a copy of which is attached for ease of reference) in the context of the current joint CPSS and IOSCO public consultation process.

Consistent with this overall outline approach, the ERC has the following brief observations:

**Introductory observation regarding the use of CCPs**

The introduction to the joint consultative paper notes the G20 commitment that all standardised over-the-counter (OTC) derivatives should be cleared through CCPs (paragraphs 1.2 and 1.3). Recent developments in the repo market serve to illustrate that, notwithstanding the attractions of CCP clearing, the adoption of too aggressive an attitude to risk may very well serve to drive trades out of the CCP. The example seen in the repo market involves certain parts of the user community being allocated substantially higher haircuts/initial margin, often due to wrong way risk. This leaves these institutions having no choice other than to look for counterparties willing to trade bilaterally. Particularly in fixed income repo markets where collateral equates to cash – and where there is a squeeze on available collateral for different market requirements – this can prove counterproductive.

[2] The GMRA is the most extensively used cross border repo master agreement and has reduced the risks associated with previously poorly documented repo transactions.

[3] http://www.financialstabilityboard.org/publications/r_110719.pdf

[4] http://www.financialstabilityboard.org/publications/r_111104cc.pdf

**FMIs that take on credit risk**

The joint consultative paper notes that certain types of FMI take on credit risk as part of their services (paragraph 3.8) and that these FMIs are particularly exposed to risks from default by their participants, and perhaps also to losses on investments that the FMI holds on its own balance sheet as part of providing its services and for the return of which it is liable to participants (for example, investment of cash margin).

The ERC observes that the risk of loss on investment of cash margin should be mitigated by a requirement that any such investment be made on a secured basis. The ERC highlights that in such situations there should not then also be a restriction on the receiving party's re-use of the invested assets. Any such restriction of re-use would be duplicative of the safety achieved through the use of a secured investment strategy and would have a directly detrimental impact on future liquidity distribution in the system.

**Moratorium preventing outgoing payments from an FMI (Key Attribute 3.2 (xi))**

The ERC strongly supports the analysis of this point as described in paragraph 4.7 of the joint consultative report. Indeed, the "ability to continue to make payments is a fundamental part of the service" provided by FMIs; and a "resolution authority's decision to impose a moratorium to prevent outgoing payments by the FMI even for a short period is therefore likely to carry the risk of continuing or even amplifying systemic disruption." Accordingly the ERC concurs with the conclusion that "a moratorium on payments in a CCP, a payment system or an SSS would mean a full or partial stoppage of the system, probably defeating the objective of continuity of critical operations and services", as stated in paragraph 4.8 of the joint consultative report.

**Setoff, netting, collateralisation, segregation of client assets (Key Attribute 4)**

The ERC fully supports that the "Key Attributes require that the legal framework governing setoff rights, contractual netting and collateralisation agreements, and the segregation of client assets should be clear, transparent, understandable and enforceable"; and that "an FMI's legal basis should provide a high degree of certainty for each material aspect of an FMI's activities in all relevant jurisdictions", both as stated in paragraph 4.15 of the joint consultative report.

The importance of these points resonates with the ERC since, as already noted in the introduction to this response, collateral and netting are key to the proper functioning of repo markets. In the international market, the GMRA provides a robust legal framework for documenting repo transactions. Supervisory authorities recognise the effect of the GMRA netting provisions for regulatory capital and large exposure requirements provided, inter alia, that a reasoned legal opinion has been obtained to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would find that, where a counterparty fails owing to default, bankruptcy, liquidation or any other similar circumstance, the regulated firm's claims and obligations pursuant to the GMRA would be limited to a net sum under the law of the relevant jurisdiction(s), and meets certain other requirements. Against this background, ICMA obtains and annually updates legal opinions[5] on the GMRA, currently from over 60 jurisdictions worldwide, for the benefit of its members. These opinions cover both the enforceability of the netting provisions of the GMRA as well as the validity of the GMRA as a whole.

[5] http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/GMRA-Legal-opinions (for further details, please contact the ICMA Legal helpdesk: +44 20 7213 0330 / legalhelpdesk@icmagroup.org)

**Stays on early termination rights based upon entry into resolution (Key Attributes 4.3 and 4.4)**

Paragraph 4.16 of the joint consultative report states that "Another power available to resolution authorities is the power to stay temporarily the exercise of early termination rights that may otherwise be triggered upon entry of a firm into resolution or otherwise in connection with the use of resolution powers." As previously stated in its 2011 response (referenced above) to the FSB, "Any suspension of close out netting rights alters the measure of risk to which a party is exposed. In a repo context, this would result in a requirement for increased collateral to account for market movement during/post the period of suspension and thus has clear consequences on the cost and therefore the attractiveness of this essential form of short financing. Furthermore costs may also arise in case new measures adversely impact the efficacy or enforceability of netting, with consequent impacts on regulatory requirements and/or legal certainty. For these reasons the ERC regards the imposition of a temporary suspension of close out netting as undesirable. If there is, nevertheless, to be any form of suspension of rights it is essential that this should be both clearly defined and as limited as possible in terms of time frame." The ERC's views on these matters are further elaborated in its earlier response.

Consistent with its previously documented views, the ERC is pleased to note that paragraph 4.18 of the joint consultative report states that "The Key Attributes require, however, that this stay be strictly limited in time"; and that this paragraph also generally clarifies that any close out rights arising by reason of other termination triggers should not be impeded.

**Concluding remarks:**

The ERC appreciates the valuable contribution made by the CPSS and IOSCO through their joint examination of the issues articulated in this public consultative paper and would like to thank them for their careful consideration of the points made in this response. The ERC remains at your disposal to discuss any of the above points.

Yours faithfully,

**Godfried De Vidts**
Chairman
ICMA European Repo Council

*cc : ICMA European Repo Committee*

# ATTACHMENT

**Reference copy of the ICMA ERC's 18 August 2011 response submission regarding the FSB's Consultation Paper "Effective Resolution of Systemically Important Financial Institutions"**

## ICMA EUROPEAN REPO COUNCIL

Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

18 August 2011

Dear Sirs,

**Response submission from the ICMA European Repo Council**

**Re: FSB Consultation Paper – "Effective Resolution of Systemically Important Financial Institutions"**

**Introduction:**

The purpose of this letter is to provide feedback on behalf of the International Capital Market Association's ("ICMA's") European Repo Council ("ERC"), concerning the repo oriented aspects of the FSB Consultation Paper "Effective Resolution of Systemically Important Financial Institutions", published on 19 July.

The ERC was established by ICMA in December 1999, to represent the cross-border repo market in Europe. It is composed of practitioners in this market, who meet regularly to discuss market developments in order to ensure that practical day-to-day issues are fully understood and dealt with adequately.

The repo market is one of the largest and most active sectors in today's money markets. It provides an efficient source of money market funding for financial intermediaries while providing a secure home for liquid investments. Repo is also used by central banks as their principal tool in open market operations to control short-term interest rates. Repos are attractive as a monetary policy instrument because they carry a low credit risk while serving as a flexible instrument for liquidity management, which benefits the functioning of financial markets. Central banks are also able to act swiftly as lenders of last resort during periods of market turbulence by way of the repo market.[1]

[1] The ERC has published a White Paper on the operation of the European repo market, the role of short-selling, the problem of settlement failures and the need for reform of the market infrastructure. This paper sets out in greater detail what the repo market is and its benefits and is available via the ICMA website at http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Repo-Markets/European-repo-market-white-paper.aspx.

In a repo transaction securities are exchanged for cash with an agreement to repurchase the securities at a future date. The transaction is collateralised, with the cash securing the seller's securities and the securities securing the buyer's cash. Collateral and netting are key to the proper functioning of repo markets. In the event of default, the collateral can be sold and exposure to the defaulting party can be netted off.

In the international market, the Global Master Repurchase Agreement (GMRA or Agreement)[2] provides a robust legal framework for documenting repo transactions. Supervisory authorities recognise the effect of the GMRA netting provisions for regulatory capital and large exposure requirements provided, inter alia, that a reasoned legal opinion has been obtained to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would find that, where a counterparty fails owing to default, bankruptcy, liquidation or any other similar circumstance, the regulated firm's claims and obligations pursuant to the GMRA would be limited to a net sum under the law of the relevant jurisdiction(s), and meets certain other requirements. Against this background, ICMA obtains and annually updates legal opinions on the GMRA, currently from 62 jurisdictions worldwide, for the benefit of its members. These opinions cover both the enforceability of the netting provisions of the GMRA as well as the validity of the GMRA as a whole.

The ERC notes that on 20 October 2010, the European Commission announced its plans for an EU framework for crisis management in the financial sector. Further to this, DG Internal Market and Services then consulted on the technical details of such a framework in order to inform the preparation of a formal Commission legislative proposal scheduled for adoption in 2011.

**Commentary:**

Whilst there are many interesting issues discussed in this consultation paper, the ERC is going to restrict its focus to those aspects that bear most directly on repo. As the ERC sees it, the particularly pertinent matters are those relating to the temporary suspension of rights – as described on pages 21 – 22 of the consultation paper and in its Annex 8 "Discussion note on conditions for a temporary stay on early termination rights".

This topical focus was equally so in context of the Commission Services' consultation referenced above and accordingly we respectfully request that you carefully review and take full consideration of the ERC's 3 March response thereupon (a copy of which is appended hereto for ease of reference) in the context of this FSB consultation process. Annexed to this response there are some short, specific comments regarding questions 26 – 31 of this FSB consultation, together with some cross-references to the commentary which the ERC previously provided to the European Commission. At this stage, we do not have specific comments in respect of questions 32 – 34 of this FSB consultation.

**Concluding remarks:**

The ERC notes that the arrangements under consideration in the consultation proposals need to be carefully developed to take account of repo (and other types of financing) transactions, in addition to underlying cash securities transactions. The ERC considers that whilst it is right to seek the orderly resolution of a failing institution, this objective must be balanced against the market need for prompt closeout so as to mitigate the risk of adverse market movement during the period of suspension. The imposition of rigid or ill defined constraints could serve to impede established market practise for the efficient (repo) financing of securities positions.

---

[2] The GMRA is the most extensively used cross border repo master Agreement and has reduced the risks associated with previously poorly documented repo transactions.

The ERC appreciate the valuable contribution made by the FSB's examination of the issues articulated in this consultation paper and would like to thank the FSB for its careful consideration of the repo oriented points made in this response. The ERC remains at your disposal to discuss any of the above points.

Yours faithfully,

**Godfried De Vidts**
Chairman
ICMA European Repo Council

*cc :* *ICMA European Repo Committee*
*ICMA European Repo Operations Group*

**Annex 1**

## Specific comments regarding FSB consultation questions and cross-references to the ERC's earlier European Commission consultation response

The questions in the FSB's consultation which pertain to Annex 8 are laid out on pages 22 – 23.

**FSB Questions for public consultation:**

*26. Please give your views on the suggested stay on early termination rights. What could be the potential adverse outcomes on the failing firm and its counterparties of such a short stay? What measures could be implemented to mitigate these adverse outcomes? How is this affected by the length of the stay?*

**A.** Any suspension of close out netting rights alters the measure of risk to which a party is exposed. In a repo context, this would result in a requirement for increased collateral to account for market movement during/post the period of suspension and thus has clear consequences on the cost and therefore the attractiveness of this essential form of short financing. Furthermore costs may also arise in case new measures adversely impact the efficacy or enforceability of netting, with consequent impacts on regulatory requirements and/or legal certainty. For these reasons the ERC regards the imposition of a temporary suspension of close out netting as undesirable. If there is, nevertheless, to be any form of suspension of rights it is essential that this should be both clearly defined and as limited as possible in terms of time frame.

Our views on these matters are further elaborated in the first four bullet points under section A of the commentary in the ERC's appended response to the European Commission consultation.

*27. What specific event would be an appropriate starting point for the period of suspension? Should the stay apply automatically upon entry into resolution? Or should resolution authorities have the discretionary right to impose a stay?*

**A.** It is important to identify a clear point from which the suspension would take effect and that the market is able to clearly understand exactly what is meant by this. In addition, the methods of notification of any suspension must be accessible and clear.

Our views on this are also reflected in the 4th bullet point under section A of the commentary in the ERC's appended response to the European Commission consultation.

*28. What specific provisions in financial contracts should the suspension apply to? Are there any early terminations rights that the suspension should not apply to?*

**A.** Understanding that the purpose of the suspension is to provide the resolution authorities with the time to select and transfer assets and liabilities, any suspension should be limited to those close out rights arising solely by virtue of the use of the transfer powers of the resolution authority. Any close out rights arising by reason of other termination triggers should not be not impeded.

Our views on this are also reflected in the 5th bullet point under section A of the commentary in the ERC's appended response to the European Commission consultation.

29. *What should be an appropriate period of time during which the authorities could delay the immediate operation of contractual early termination rights?*

**A.** Any form of suspension of rights should be both clearly defined and as limited as possible in terms of time frame.

Our views on this are also reflected in the 4th bullet point under section A of the commentary in the ERC's appended response to the European Commission consultation.

30. *What should be the scope of the temporary stay? Should it apply to all counterparties or should certain counterparties, e.g., Central Counterparties (CCPs) and FMIs, be exempted?*

**A.** The exclusion of some counterparty types from the suspension would create competitive distortions; present arbitrage opportunities; and result in a misalignment with the rest of the market, which would undermine its stable functioning.

Our views on this are also reflected in the 6th bullet point under section A of the commentary in the ERC's appended response to the European Commission consultation.

31. *Do you agree with the proposed conditions for a stay on early termination rights? What additional safeguards or assurances would be necessary, if any?*

**A.** The ERC supports those safeguards which aim to prevent resolution authorities from 'cherry picking' rights and liabilities under protected market arrangements, including title transfer financial collateral arrangements, set off arrangements, netting arrangements and structured finance arrangements.

During the period of suspension, the resolution authorities may transfer covered rights and liabilities to a private sector purchaser or another entity; or decide that such rights and liabilities will remain with the residual, 'failed' bank. If the former is the case, the ERC is concerned that there are robust and transparent criteria which such transferee must meet, at the very least in terms of its solvency. The ERC is also keen to ensure that any hardening periods (in which transactions are vulnerable to being challenged) with respect to relevant insolvency procedures are not 'reset' as a consequence of any transfer.

Our views on this are as reflected section B; and also in the 7th bullet point under section A of the commentary in the ERC's appended response to the European Commission consultation.

32. *With respect to the cross-border issues for the stay and transfer, what are the most appropriate mechanisms for ensuring cross-border effectiveness?*

**A.** At this stage, we do not have specific comments in respect of this question.

33. *In relation to the contractual approach to cross-border issues, are there additional or alternative considerations other than those described above that should be covered by the contractual provision in order to ensure its effectiveness?*

**A.** At this stage, we do not have specific comments in respect of this question.

34. *Where there is no physical presence of a financial institution in question in a jurisdiction but there are contracts that are subject to the law of that jurisdiction as the governing law, what kind of mechanism could be considered to give effect to the stay?*

**A.** At this stage, we do not have specific comments in respect of this question.

# APPENDIX

## ICMA EUROPEAN REPO COUNCIL

DG Internal Market and Services
Directorate H – Financial Institutions
Unit H1 – Banking and Financial conglomerates
European Commission
SPA2, 1049 Brussels

3 March 2011

Dear Sirs,

**Response submission from the ICMA European Repo Council**

**Re: Technical details of a possible EU framework for bank recovery and resolution**

**Introduction:**

On behalf of the European Repo Council ("ERC") of the International Capital Market Association ("ICMA"), the purpose of this letter is to provide feedback primarily concerning the repo oriented aspects of the DG Internal Market and Services working document on the technical details of a possible EU framework for bank recovery and resolution, published on 6 January.

The ERC was established by ICMA in December 1999, to represent the repo community in Europe. It is composed of practitioners in the repo field, who meet regularly to discuss market developments in order to ensure that practical day-to-day issues are fully understood and dealt with adequately.

The repo market is one of the largest and most active sectors in today's money markets. It provides an efficient source of money market funding for financial intermediaries while providing a secure home for liquid investments. Repo is also used by central banks as their principal tool in open market operations to control short-term interest rates. Repos are attractive as a monetary policy instrument because they carry a low credit risk while serving as a flexible instrument for liquidity management, which benefits the functioning of financial markets. Central banks are also able to act swiftly as lenders of last resort during periods of market turbulence by way of the repo market.[1]

In a repo transaction securities are exchanged for cash with an Agreement to repurchase the securities at a future date. The transaction is collateralised, with the cash securing the seller's

[1] The ERC has published a White Paper on the operation of the European repo market, the role of short-selling, the problem of settlement failures and the need for reform of the market infrastructure. This paper sets out in greater detail what the repo market is and its benefits and is available via the ICMA website.

securities and the securities securing the buyer's cash. Collateral and netting are key to the proper functioning of repo markets. In the event of default, the collateral can be sold and exposure to the defaulting party can be netted off.

In the international market, the ICMA Global Master Repurchase Agreement (GMRA or Agreement)[2] provides a robust legal framework for documenting repo transactions. Supervisory authorities recognise the effect of the GMRA netting provisions for regulatory capital and large exposure requirements provided, inter alia, that a reasoned legal opinion has been obtained to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would find that, where a counterparty fails owing to default, bankruptcy, liquidation or any other similar circumstance, the regulated firm's claims and obligations pursuant to the GMRA would be limited to a net sum under the law of the relevant jurisdiction(s), and which meets certain other requirements. Accordingly, ICMA obtains and annually updates legal opinions on the GMRA from 62 jurisdictions worldwide. These opinions cover both the enforceability of the netting provisions of the GMRA as well as the validity of the GMRA as a whole.

The ERC notes that on 20 October, 2010, the Commission announced its plans for an EU framework for crisis management in the financial sector. Further to this, DG Internal Market and Services are now consulting on the technical details of such a framework. The ERC further notes that the objective of this consultation is to inform the preparation of a formal Commission legislative proposal scheduled for adoption in June 2011.

**Commentary:**

Whilst there are many interesting issues discussed in this consultation paper, the ERC is for now going to primarily restrict its focus to those aspects that bear most directly on repo. As the ERC sees it, the particularly pertinent matters are those relating to the temporary suspension of rights.

**A. Temporary suspension of rights:**

Section G12 of this consultation proposes a suspension of "... payment or delivery obligations pursuant to any contract". The ERC notes that it is important to clarify that such a suspension would have to operate on a reciprocal basis in order to be equitable.

At G13 this consultation proposes a "…temporary suspension of all close out rights of any party under a netting arrangement with a failing credit institution that arise solely by reason of an action or anticipated action by the resolution authority…". Whilst the ERC understands that the purpose of such suspension would be to give resolution authorities the benefit of a short time to decide which assets and liabilities should be transferred and to effect the transfers, it considers that the following observations merit detailed and careful consideration as this proposal is progressed:

- Close out netting is an important legal mechanism through which exposures (and therefore risks) may be reduced between counterparties. The importance of such a risk mitigation tool in supporting the stability and efficiency of the financial system has been consistently recognised and supported by policy makers. Any suspension of close out netting rights alters the measure of risk to which a party is exposed. In a repo context, this would result in a requirement for increased collateral to account for market movement during/post the period of suspension and thus has clear consequences on the cost and therefore the attractiveness of this essential form of short financing. In considering the implication of this, it is important to note that this extra

[2] The GMRA is the most extensively used cross border repo master Agreement and has reduced the risks associated with previously poorly documented repo transactions.

collateral cost will be borne throughout the life of all repo transactions subject to the possible application of suspension constraints, notwithstanding that the incidence of any actual exercise of the suspension power may prove to be an extremely rare occurrence.

- Furthermore, if there was any disruption to the efficacy or enforceability of netting such that institutions would be unable to reduce their regulatory capital requirement under the Basel capital regime by relying on close out netting under a master agreement such as the GMRA, the burden of finding additional collateral would be exacerbated by a need to raise additional capital. The ERC is keen to ensure that the legal certainty of such netting arrangements is protected and that there are no unintended consequences in this regard. In case it arises, this would again be an ongoing cost, regardless of the contingent nature of the legal uncertainty occasioned by the creation of a suspension power.

- For the reasons set out above, the ERC regards the imposition of a temporary suspension of close out netting as undesirable. Once a termination event occurs, a party should be able to manage its credit and market risk in relation to its positions with the relevant failing counterparty, based on its assessment of market conditions and the situation of the counterparty. It must be able to take action to mitigate market risk by closing out such positions, without delay. The risk of market movement is very real, as the suspension would act in relation to just those contracts concerned, whilst the market as a whole would remain open – and be cognisant of the imposition of the suspension.

- If there is, nevertheless, to be any form of suspension of rights it is essential that this should be both clearly defined and as limited as possible in terms of time frame. Any such suspension should not be capable of extension by the resolution authorities or otherwise. The consultation suggests that any suspension should last no longer than forty-eight hours after the time the suspension is notified; or 5pm on the business day following the day of notification (whichever period is longer). The ERC is pleased to note that the consultation recognises the importance of identifying a clear point from which the suspension would take effect. It is important for the market to understand what is meant by 'the time the suspension is notified'. In addition, the methods of notification set out in G10 of this consultation must be accessible and clear.

- Central to the GMRA's netting provisions are the Events of Default which trigger the termination and closing out of the Agreement. The consultation proposes a suspension of all close out rights that "arise *solely* by reason of an action or anticipated action by the resolution authority". The ERC is keen to ensure that this does not impede close out rights arising by reason of other termination triggers. Any disruption to such rights would further undermine the legal certainty and risk mitigation capabilities of the Agreement. It is therefore important to clarify what form of resolution action is included within this condition. If the purpose of the suspension is indeed to provide the resolution authorities with the time to select and transfer assets and liabilities then the suspension should be limited to a suspension of close out rights arising by virtue of the use of the transfer powers of the resolution authority.

- This consultation asks whether any classes of counterparty should be excluded from the scope of the suspension of close out netting. Examples given include CCPs and payment and securities settlement systems that fall within the scope of the Settlement Finality Directive. The ERC is concerned that the exclusion of some counterparty types from the suspension would create competitive distortions; present arbitrage opportunities; and result in a misalignment with the rest of the market, which would undermine its stable functioning.

- During the period of suspension, the resolution authorities may transfer covered rights and liabilities to a private sector purchaser or another entity; or decide that such rights and liabilities will remain with the residual, 'failed' bank. If the former is the case, the ERC is concerned that there are robust and transparent criteria which such transferee must meet, at the very least in terms of its solvency. The ERC is also keen to ensure that any hardening periods (in which transactions are vulnerable to being challenged) with respect to relevant insolvency procedures are not 'reset' as a consequence of any transfer.

- This consultation notes that "If the rights and liabilities covered by a netting arrangement remain with the relevant credit institution, a person may exercise all rights under that agreement". This applies on the expiry of the suspension or prior to such expiry if the resolution authority so notifies the counterparty. It is not clear whether close out netting may be enforced at this point by reason of the resolution action, or not. Further detail is again also required in respect of the method of notification.

**B. Partial transfers: safeguards for counterparties**

The ERC is pleased to note the safeguards proposed within this consultation paper which aim to prevent resolution authorities from 'cherry picking' rights and liabilities under protected market arrangements, including title transfer financial collateral arrangements, set off arrangements, netting arrangements and structured finance arrangements.

**Concluding remarks:**

The ERC notes that the arrangements under consideration in the consultation proposals need to be carefully developed to take account of repo (and other types of financing) trades, in addition to underlying cash securities trades. The ERC considers that whilst it is right to seek the orderly resolution of a failing institution, this must be balanced with the market need for prompt close out so as to mitigate the risk of adverse market movement during the period of suspension. The imposition of rigid or ill defined constraints could serve to impede established market practise for the efficient (repo) financing of securities positions.

The ERC appreciate the valuable contribution made by the European Commission's examination of the issues articulated in this consultation paper and would like to thank the European Commission for its careful consideration of the repo oriented points made in this response. The ERC remains at your disposal to discuss any of the above points.

Yours faithfully,

**Godfried De Vidts**
Chairman
ICMA European Repo Council

# EXHIBIT 2

**Reference copy of the ICMA’s 28 September 2012 response submission regarding the joint CPSS and IOSCO public consultative report “Recovery and resolution of financial market infrastructures” (as published on 31 July 2012)**

CPSS Secretariat
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

IOSCO Secretariat
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid
Spain

28 September 2012

Dear Sirs,

**Response submission from the International Capital Market Association (ICMA)**

**Re: Joint CPSS and IOSCO Public Consultation Report - "Recovery and resolution of financial market infrastructures"**

**Introduction:**

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of well over 400 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years.

The ICMA notes that this joint Committee on Payment and Settlement Systems ("CPSS") and Board of the International Organization of Securities Commissions ("IOSCO") public consultation considers a wide range of potential measures intended to ensure that authorities across the globe have the powers and tools necessary to achieve effective resolution of systemically important financial market infrastructures ("FMIs"). Whilst many of these important proposals are of significant interest, this response nevertheless focuses on just one specific aspect – namely "bail-in within resolution", as described on page 13 of the joint CPSS and IOSCO public consultation report and in its Annex under FSB Key Attributes 3.2(ix) and 3.5.

---

1 For more information regarding ICMA please go to http://www.icmagroup.org/

The ICMA further notes that on 19 July 2011 the Financial Stability Board ("FSB") issued a consultative document[2] – "Effective Resolution of Systemically Important Financial Institutions", which led to the FSB's final report[3] "Key Attributes of Effective Resolution Regimes for Financial Institutions". The current CPSS and IOSCO consultative report seeks to apply these FSB Key Attributes in a manner appropriate for FMIs and consequently covers many similar points to those raised in the FSB's July 2011 public consultation. Under date of 15 August 2011, the ICMA responded (see attachment) to this earlier FSB consultation on the specific topic of its bail-in proposals. Given the degree of overlap between these two consultations, we respectfully request that you carefully review and fully consider this earlier ICMA response letter in the context of the current joint CPSS and IOSCO public consultation process.

**Overall commentary on proposals:**

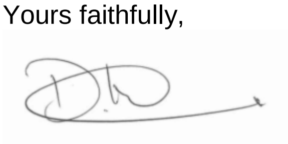
Whilst being supportive of official endeavours to establish effective resolution regimes, the ICMA continues to perceive that there are some significant overriding challenges which will need to be overcome in the final design of any unsecured creditor bail-in regime. In particular, the ICMA stresses that other applicable measures to increase the quality and quantity of capital, and the stability of the financial system should be completed before bringing in a bail-in regime; and that it is essential that equity and all other capital instruments are fully wiped out before any unsecured creditor bail-in applies. Accordingly the ICMA is particularly pleased to note that the CPSS and IOSCO acknowledge that bail-in "…would respect the creditor hierarchy…".

The ICMA is also pleased to note that the CPSS and IOSCO fully acknowledge that the capital/liability structure of FMIs is typically not like that of banks or investment firms. It is entirely proper that careful and detailed consideration therefore be given to the applicability of the bail-in concept in the context of FMIs. The ICMA observes that FMIs themselves are a diverse group of entities with varied capital/liability structures adapted to their particular circumstances. Accordingly, it seems reasonable to conclude that any introduction of the bail-in concept in respect of FMIs will need to involve a flexible framework, allowing for application, where applicable, in a suitably tailored way.

**Concluding statement:**

The ICMA appreciates the valuable contribution made by the CPSS and IOSCO through their joint examination of the issues articulated in this public consultation paper and would like to thank them for their careful consideration of the points made in this response. The ICMA remains at your disposal to discuss any of the above points.

Yours faithfully,



David Hiscock
Senior Director - Market Practice and Regulatory Policy
International Capital Market Association

2 http://www.financialstabilityboard.org/publications/r_110719.pdf
3 http://www.financialstabilityboard.org/publications/r_111104cc.pdf

# ATTACHMENT

**Reference copy of the ICMA's 15 August 2011 response submission regarding the FSB's Consultation Paper "Effective Resolution of Systemically Important Financial Institutions"**

ICMA
International
Capital
Market
Association

Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

15 August 2011

Dear Sirs,

**Response submission from the International Capital Market Association (ICMA)**

**Re: FSB Public Consultation Paper - "Effective Resolution of Systemically Important Financial Institutions"**

**Introduction:**

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of over 400 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMAõs market conventions and standards have been the pillars of the international debt market for over 40 years.

The ICMA notes that this Financial Stability Board (FSB) public consultation includes a wide range of potential measures intended to ensure that authorities across the globe have the powers and tools necessary to achieve effective resolution of systemically important financial institutions. Whilst many of these important proposals are of significant interest, this response nevertheless focuses on just one specific aspect ï namely bail-in powers, as described on pages 11 - 13 of the FSBõs public consultation paper and in its Annex 2: ñBail-in within resolution: Elements for inclusion in the *Key Attributes*ò.

The ICMA further notes that on 6 January the European Commission issued a Consultation Paper[2] ï ñTechnical details of a possible European crisis management frameworkò. This covered many similar points to those raised in this FSB public consultation, including proposals relating to ñDebt write down as an additional resolution toolò (i.e. bail-ins). Under date of 3 March the ICMA responded to these European Commission bail-in proposals. A copy of this earlier ICMA response is appended hereto and we respectfully request that you carefully review and take full consideration of this earlier ICMA response letter in the context of the current FSB public consultation process.

---

1 For more information regarding ICMA please go to https://www.icmagroup.org/home.aspx

2 http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/10&format=HTML&aged=0&language=EN&guiLanguage=en

**Overall commentary on proposals:**

As you will observe, the ICMA's response to the European Commission comprises two segments. First, it lays out some overall thoughts regarding the concept of a bail-in regime applicable to senior unsecured creditors. Moving on from this, it then sequentially addresses each of the specific questions posed in Annex A of the European Commission's consultation. Whilst being supportive of the European Commission's endeavours, the ICMA perceived that there were nevertheless some significant overriding challenges which will need to be overcome in the final design of any such senior unsecured debt bail-in regime. The response also stresses that other measures to increase the quality and quantity of capital, and the stability of the financial system should be completed before bringing in a bail-in regime; and that it is essential that equity and all other capital instruments are fully wiped out before any senior unsecured debt bail-in applies.

The ICMA considers that these key messages are equally pertinent to the FSB's current thinking on the design of an international standard for bail-in within resolution. Accordingly the ICMA is particularly pleased to note that the FSB calls for bail-in to "be applied in a manner consistent with the hierarchy of the capital structure of the institution, and respect the rights of secured creditors and the statutory ranking of senior creditors..." (Annex 2, paragraph 5.2); and that the FSB notes that there may be "an appropriate transition period before bail-in powers are exercisable in order to ensure that firms can adequately adjust to the statutory bail-in regime." (Annex 2, paragraph 12.1).

The specific questions in the FSB's current public consultation which pertain to the bail-in power are laid out on page 13 thereof.

3. *Are the elements identified in Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?*

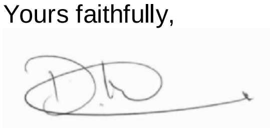
**A.** The ICMA consider that the material laid out in Annex 2 constitutes a helpful draft, but believe that it will nevertheless be important to further develop this in a manner which takes full account of all the applicable responses received by the FSB pursuant to this consultation process.

Annexed to this response is a mapping which cross references the answers which the ICMA previously provided to the European Commission to the other applicable questions (i.e. #4 – #8) of this FSB consultation.

**Concluding statement:**

The ICMA appreciate the valuable contribution made by the FSB's examination of the issues articulated in this public consultation paper and would like to thank the FSB for its careful consideration of the points made in this response. The ICMA remains at your disposal to discuss any of the above points.

Yours faithfully,



David Hiscock
Senior Director - Market Practice and Regulatory Policy

**Annex**

**Mapping of ICMA's European Commission consultation responses to FSB's current public consultation questions**

The questions in the FSB's consultation which pertain to the bail-in power are laid out on page 13.

**FSB Questions for public consultation:**

3. *Are the elements identified in Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?*

**A.** As this question is specific to the content of this consultation it was not directly addressed by the ICMA's earlier response to the European Commission and is hence directly commented upon in the body of the letter above.

4. *Is it desirable that the scope of liabilities covered by statutory bail-in powers is as broad as possible, and that this scope is largely similarly defined across countries?*

**A.** Please see ICMA's response to question 63b. of the European Commission consultation.

It is clearly highly desirable that the scope of such provisions is largely similarly defined across countries; and the ICMA is strongly supportive of the FSB in its role of helping to develop internationally applicable standards.

5. *What classes of debt or liabilities should be within the scope of statutory bail-in powers?*

**A.** Please see ICMA's response to question 62a. of the European Commission consultation.

6. *What classes of debt or liabilities should be outside the scope of statutory bail-in powers?*

**A.** Please see ICMA's response to question 62a. of the European Commission consultation.

7. *Will it be necessary that authorities monitor whether firms' balance sheet contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring minimum level of bail-in debt? If so, how should the minimum amount be calibrated and what form should such a requirement take, e.g.,:*

   *(i) a certain percentage of risk-weighted assets in bail-inable liabilities, or*

   *(ii) a limit on the degree of asset encumbrance (e.g., through use as collateral)?*

**A.** Please see ICMA's responses to questions 62d. and 63a..of the European Commission consultation.

8. *What consequences for banks' funding and credit supply to the economy would you expect from the introduction of any such required minimum amount of bail-inable liabilities?*

**A.** Please see ICMA's "Overall remarks" and its response to question 63b. of the European Commission consultation.

# APPENDIX

DG Internal Market and Services
Directorate H – Financial Institutions,
Unit H1 – Banking and Financial conglomerates
European Commission
SPA2, 1049 Brussels

3 March 2011

Dear Sirs,

**Response submission from the International Capital Market Association (ICMA)**

**Re: European Commission Consultation Paper – Technical details of a possible European crisis management framework**

**Introduction:**

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of 400 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years.

The ICMA notes that this Commission consultation includes a wide range of potential measures intended to ensure that authorities across the EU have the powers and tools to restructure or resolve (the process to allow for the managed failure of a financial institution) all types of financial institution in crisis, without taxpayers ultimately bearing the burden. Whilst many of these important proposals are of significant interest, this response nevertheless focuses on just one specific aspect – namely the consultation's Annex 1: "Debt write down as an additional resolution tool" (i.e. bail-ins).

This response has been compiled in light of a range of inputs provided by ICMA's member firms, including representations made from both Issuer and Investor perspectives. As such it presents a synthesised view informed by both ends of the value chain – i.e. those firms that issue the senior unsecured debt potentially impacted by the contemplated bail-in regime; and those firms that invest in such debt instruments. The ICMA consider that this provides a well informed, broadly based view of the proposals and, consequently, respectfully requests that the Commission give careful consideration to the points that this response raises.

[1] For more information regarding ICMA please go to https://www.icmagroup.org/home.aspx

**Commentary:**

This response comprises two segments. Firstly it lays out some overall thoughts regarding the concept of a bail-in regime applicable to senior unsecured creditors. Moving on from this, it then sequentially addresses each of the specific questions posed in Annex A of this consultation.

**A. Overall remarks**

The ICMA welcomes the opportunity to contribute to the Commission's examination of the topic of senior unsecured debt bail-in, as articulated through the text and questions laid out in Annex A of this consultation paper. Through its publication of this Annex A the Commission is taking an important step forward to properly frame and inform a public debate on an important topic, which although much discussed in financial market circles over the past year has thus far lacked an adequate common frame of reference. The ICMA recognise the Commission's objectives and the ambitious goal it seeks to reach through the potential development of a senior unsecured debt bail-in regime.

Whilst being supportive of the Commission's endeavours, the ICMA perceives that there are nevertheless some significant overriding challenges which will need to be overcome in the final design of any such senior unsecured debt bail-in regime. Concretely, the ICMA considers that:

1. Whilst investors appreciate the capital risks of investing further down the bank capital structure, they invest in senior bank debt principally to match their liability structure; not to add risk. If bail-in extends to senior unsecured bank debt it will either:
   - Restrict investment criteria; and/or
   - Make other asset classes more attractive on a relative value basis; and/or
   - Justify a significant premium over current senior unsecured levels.
2. Under pressure to find other attractive sources of funds banks will face increased competition for retail deposits and make increased use of various forms of secured funding and/or securitisation. This will encumber (typically higher quality) assets, to the detriment of other creditors – including depositors. Such increased competition for retail deposits is likely to drive up rates for depositors (so decreasing bank interest margins), but will also induce increased deposit shifting (i.e. funding becomes less stable).
3. The risk of runs is likely to increase, as senior unsecured creditors are incentivised to ensure that they exit their debt investment ahead of any triggering of a senior unsecured bail-in.

These effects are incongruous with the Basel proposed NSFR (Net Stable Funding Ratio) and LCR (Liquidity Coverage Ratio). They will also lead to higher bank lending costs; and/or reduced bank lending. This is particularly pertinent as this point in the cycle, with the price and availability of bank funding (especially for smaller/weaker entities) already significantly pressurised by events.

For these reasons, the ICMA consider that it would be best to restrict explicit loss absorption features to capital instruments and not to extend them to senior unsecured debt. The ICMA believe that it is important to consider this viewpoint in context of a number of other very significant changes, which have already been agreed or are already well under way. In particular there are several important measures which will dramatically increase both the quality and the quantity of capital being held against banking sector risks, in consequence of which the impact of any future crisis will be much reduced in comparison to that experienced over the last few years. At the same time other important measures will occasion a marked increase in the stability of the financial system, thereby concurrently decreasing the risk of future crises. The ICMA consider that this reduction in both the probability and the severity of future crises affords the public authorities the opportunity to take stock of the aggregate impact achieved and to calibrate incremental steps in regulatory reform accordingly. Complete phasing in of these other changes should precede any new senior unsecured debt bail-in regime.

## B. Responses to specific questions

In case there is to be a bail-in provision related to senior unsecured debt, the ICMA is keen to play a constructive role in debating the applicable detailed considerations. Accordingly the ICMA proposes the following further comments and responses that it believes could be valuably taken into account.

The overall senior unsecured debt bail-in concept should be developed based on consideration of the outcome that might reasonably be expected in case there was sufficient time to negotiate a debt work out, allowing that the entity be sustained as a going concern. In evaluating this scenario, it should be assumed that the alternative is a disorderly failure leading to liquidation – regardless of the fact that the entity is question is likely to be considered to be too significant (for whatever specific reason) to fail. In other words the intention is to mimic the normal process that would be applicable in a private sector corporate insolvency restructuring, where creditors negotiate amongst themselves regarding the distribution of loss. This general concept is followed in formulating the answers to the consultation questions that follow:

*62a. What classes of debt (if any) would need to be excluded from a statutory power to write down senior debt?*

The Consultation paper quite correctly identifies the need to exclude swap, repo and derivatives counterparties (including claims that are covered by master netting agreements – even if uncollateralised) and other trade creditors; short-term debt (defined by a specified maximum maturity); retail and wholesale deposits and secured debt (including covered bonds). The exclusion in respect of secured debt should relate to the amount which is secured.

*62b. Is it desirable to undermine the principle that creditors of the same ranking should be treated similarly? Should a discretionary power allow authorities to discriminate within classes of debt?*

The Consultation paper quite correctly identifies that, as a matter of principle, the design and exercise of a debt write down power should preserve as far as possible the ranking of claims on insolvency. In particular, equity and all other capital instruments should be fully wiped out before any senior unsecured debt bail-in. This specific point is of fundamental significance to the acceptability of any senior unsecured debt bail-in regime, as it assures the full potential utilisation of the capital structure and correctly respects the fundamental distinction between “capital” (in all its forms) and senior debt.

Any discretion to discriminate within a class of debt should proceed from an identification of the rights which parties would hold in the negotiation of a debt restructuring, including whether they are subject to a debt bail-in regime or not. Any discrimination should then reflect the hypothetical negotiated outcome of a debt restructuring, reasonably arrived at in light of such rights; and it is hence acceptable that debt subject to a bail-in regime be treated differently than otherwise equivalent debt.

*62c. What are the consequences of the fact that this approach may result in the ranking of creditors in the context of resolution being different to that in normal insolvency? Is further provision needed to address this?*

It is precisely the fact that the outcome of a normal insolvency may be different (i.e. worse) which explains why it is that different stakeholders will be prepared to reach reasonable agreement in a negotiated restructuring. It is maybe helpful to consider that it is not really the ranking which a bail-in regime would change, but rather the quantum of the claim – which is reduced by the bailed-in amount. In other words, the bail-in regime represents one factor leading to effective structural subordination, as distinct from any form of legal subordination.

*62d. What measures would be appropriate to reduce debt restructuring and regulatory arbitrage? For example, would it be necessary to require a minimum amount of debt remains in scope at all times?*

It should not be necessary to require that an absolute minimum amount of debt remains in scope at all times, but there may be a case for developing a form of encumbrance ratio – designed to limit how much excluded senior debt may be permitted in relation to the amount of debt that remains in scope. Rating and market pressures have always provided an element of constraint to the encumbrance of too large a portion of the balance sheet and will continue to do so, but the reality is that the distinction between debt covered by a bail-in regime and that which is exempt will increase the pressure to maximise the use of exempt forms of funding – which may dictate the need for regulatory authorities to articulate their tolerance for encumbrance.

*63a. What factors should authorities take into account when determining the correct amount of 'bail-in debt' that should be issued acknowledging the need to ensure that institutions are 'resolvable' while avoiding single market distortions?*

In this case, periodic capital stress tests offer a logical tool for identifying how much bail-in debt should be issued. These tests need to be robust, with the chosen confidence level being suitably increased in order to size the amount to hold in addition to the "normal" required capital buffers (this should not however involve targeting zero failure – i.e. 100% confidence).

*63b. Would a market for large amounts of such debt exist at a cost which is lower than equity?*

There are various arguments for and against the adoption of the targeted approach. One important consideration in its favour is that it allows investors to express their investment preferences more precisely. Those investors unwilling to buy senior unsecured debt that is subject to a bail-in regime will still provide a source of funds, rather than being precluded from investing in banks; whilst those willing to price the incremental risk of the regime will be able to charge for such instruments accordingly. By virtue of allowing investors to explicitly appreciate, and be compensated for, the bail-in risk associated with prospective investment decisions, this approach also appears to provide a fairer transition to a new regime than simply imposing bail-in on existing investors.

Though subject to a conceptual upper limit, the size of the market will be a function of price. Price will inevitably reflect the strength of the entity in question, with those least in need of such an incremental layer of potential capital support able to raise the largest/cheapest amounts. For any entity where there is real concern that the bail-in feature could be triggered price will escalate rapidly and will soon exceed that of further equity. Raising and maintaining required minimum amounts may only prove to be possible in case an entity already has sufficient capital that the bail-in debt is arguably not needed – which may demand incremental equity raising and/or de-risking.

*63c. As an alternative to a statutory requirement to issue certain instruments with specified terms, might institutions be permitted to insert a write down term in any debt instrument they deem appropriate to meet the fixed requirement for 'bail in' debt? Would there be any drawbacks to such an approach?*

This alternative seems iniquitous; since it threatens to arbitrarily and retrospectively impact the rights of the holders of whichever debt instruments are "deemed appropriate".

*64a. Would the trigger be sufficiently clear and predictable (i.e. will instruments be rateable and will markets be able to price them) if linked to the failure of an institution?*

The answer to this question is necessarily ambiguous as it depends on precisely how "failure of an institution" is defined. This is not as obvious as it might be, given the reality that the bail-in tool can only prove of use in case activated before an actual 'failure' has finally occurred.

The ideal triggers would be transparent and objectively measurable, but the inclusion of some discretionary element in the operation of the bail-in appears unavoidable. This inevitably increases uncertainty, thus reducing demand and/or increasing pricing. Nevertheless, there is one crucial building block upon which a solid foundation for a senior unsecured debt bail-in regime can be established. As already noted in response to question 62(b) above, equity and all other capital instruments should be fully wiped out before any senior unsecured debt bail-in. The bail-in trigger can thus be thought of as being the full satisfaction of this pre-condition. This builds upon the embedded notion that a senior unsecured bail-in regime should be a "gone concern" resolution tool; and is not just another layer of "going concern" capital. This approach avoids many, potentially complex, valuation, accounting and other concerns, by simply focussing on the future state outcome – in other words post bail-in all the former capital providers of the entity in question will have no remaining stake derived from their capacity as such.

*64b. Are market participants likely to have an appetite for such instruments? Why or why not? If you consider that the pool of likely investors would be small, are there any adjustments which could be made to make such instruments more attractive without undermining the objectives of the tool?*

It is likely that the aggregate investment pool for such instruments will prove to be significantly constrained (see also the answer to 63(b) above). This will be associated with falls in ratings (as "systemic support" is derecognised by credit rating agencies); increases in pricing; and increased differentiation across the issuer credit spectrum. It is expected that these factors will outweigh any improved bondholder sentiment relating to increases in bank capital (pursuant to agreed revisions to requirements). There is no doubt that transition will be difficult to manage, so that it is important to respect concerns related to the timing of implementation of any bail-in regime. Failure to do so is likely to significantly disrupt funding access, particularly for any but the strongest of credits.

Without necessarily undermining the objectives of the bail-in tool, there are two conceptual approaches which may be considered to mitigate investor concerns over the introduction of bail-in. The first is a provision allowing for subsequent restoration of written down amounts, through payments out of retained earnings – with priority over any payments to other classes of capital provider. The second is to compensate the written down amounts through an allocation of common equity. In either case what is under consideration is the allocation of rights as between the affected debt holders and other providers of new (shareholder) capital, pre-existing capital providers having been fully wiped out. The deployment of a well designed mitigation mechanism should be considered as a pre-requisite for the establishment of any senior unsecured bail-in regime.

*64c. What are the most likely classes of investor: e.g. other banks or investment firms, insurers, pension funds, hedge fund and other high yield investors, retail? Should certain types of investor be restricted from holding such instruments?*

Each class of investor may conceptually participate, though the different classes will have different levels of appetite – which will vary over time for each class dependant on investment alternatives and the economic situation. Normal considerations should dictate the imposition of any restrictions, including limiting contagion through cross holdings; appropriateness; and, in case of an equity conversion feature, bank ownership constraints.

*65. Under what circumstances would additional compensation mechanisms be needed and what form might they take?*

As noted in the consultation paper and in the answer to questions 62(b) & (c) above, there ought not to be a need for additional compensation. In case there is, this should take one of the two forms discussed in answer to question 64(b) above.

*66. Should a regime of the kind discussed in this Annex allow flexibility in where within the group 'bail in debt' issue or held? What are the relative pros and cons of such an approach and what mechanisms would there be for ensuring all resolution authorities have viable resolution tools?*

As this is contemplated as an EU regime, there ought in principle to be the flexibility to issue at the EU holding company level within a group, or at individual entity levels beneath this. Intra-group supervision and regulatory requirements should be reviewed to ensure their coherence with whatever bail-in arrangements are established. This would be consistent with the single market.

*67. Is there a case for giving some creditors of a newly bailed in institution 'super senior' status? Should such a status be discretionary or a rule? What sorts of claim should be included and what mechanisms for transition back to a normal state should be considered?*

On the face of it the existing practice of agreeing priority status for certain IMF advances works quite effectively. It may then be reasonable to conclude that this same notion could be extended to certain other situations where new money is being provided to effect resolution. Cases of priority status should nevertheless be limited and it should be made clear to which extent this is contemplated; whilst retaining some flexibility through staying with a discretionary approach to application.

*68. Is it necessary to design a 'bail-in' mechanism for non-joint stock companies? How might this be achieved without unduly benefitting the members at the expense of creditors?*

If any requirement is imposed only on a discrete population of systemically important financial institutions there should be few non-joint stock companies in scope. If there are non-joint stock companies that supervisory authorities determine to need ‘bail-in’ debt there would be a need to design such a mechanism. One possible solution could be to require a conversion to joint stock company status – with the normal mechanism for bail-in then being followed. If this is not feasible it may be possible to use a write down mechanism, akin to that recently deployed by Rabobank.

**Concluding remarks:**

The ICMA appreciate the valuable contribution made by the European Commission’s examination of the issues articulated in this consultation paper and would like to thank the European Commission for its careful consideration of the points made in this response. The ICMA remains at your disposal to discuss any of the above points.

Yours faithfully,

David Hiscock
Senior Director - Market Practice and Regulatory Policy