GUERNSEY FINANCIAL SERVICES COMMISSION
ISLE OF MAN FINANCIAL SUPERVISION COMMISSION
JERSEY FINANCIAL SERVICES COMMISSION

DISCUSSION PAPER ON:

DOMESTIC SYSTEMICALLY IMPORTANT BANKS ("D-SIBS") (INCLUDING RECOVERY AND RESOLUTION)

Issued: 17 January 2014

GLOSSARY OF TERMS

The following table sets out a glossary of terms used in this paper.

Basel Committee	Basel Committee on Banking Supervision
Basel II	"*International Convergence of Capital Measurement and Capital Standards*", re-issued in comprehensive form in June 2006 by the Basel Committee
Basel III	collectively, a series of documents issued by the Basel Committee that either revise Basel II or establish new international standards regarding the financial management of international banks
Basel III capital adequacy standard	"*A global regulatory framework for more resilient banks and banking systems*", issued in December 2010 by the Basel Committee and revised in June 2011
Basel III liquidity standard	"*Basel III: International framework for liquidity risk measurement, standards and monitoring*", issued in December 2010 by the Basel Committee
CDs	Crown Dependencies – Guernsey, Isle of Man and Jersey
CET1	Common Equity Tier 1 capital
D-SIBs	domestic systemically important banks
FSB	Financial Stability Board
GFSC	Guernsey Financial Services Commission
G-SIBs	global systemically important banks
HLA	Higher Loss Absorbency
ICAAP	Internal Capital Adequacy Assessment Process
ICB	Independent Commission on Banking
IOMFSC	Isle of Man Financial Supervision Commission
JFSC	Jersey Financial Services Commission
KAs	twelve Key Attributes, from the FSB paper "*Key Attributes of Effective Resolution Regimes for Financial Institutions",* issued October 2011
KPs	seven Key Principles, from the Basel Committee paper "*A framework for dealing with domestic systemically important banks*", issued October 2012
LAC	loss absorbing capacity: debt or equity subject to bail-in powers
PLAC	primary loss absorbing capacity: debt or equity subject to bail-in powers under the UK ICB related proposals
BRRD	proposed EU Bank Recovery and Resolution Directive
Tri-Party Group	comprises the GFSC, IOMFSC and JFSC

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EXECUTIVE SUMMARY

Overview

This paper raises, and proposes outline solutions to, issues relating to "too-big-to-fail" banks (referred to herein as "**D-SIBs**") in the Crown Dependencies ("**CDs**"). It uses as its basis recent papers issued by two international bodies: the Basel Committee on Banking Supervision and the Financial Stability Board. In so doing, it addresses related international developments, including the EU/UK proposals that would see a "bail-in" approach replace "bail-out" for such banks.

The paper has been issued as part of the work of the CD supervisors (the "**Tri-party Group**") on applying Basel III in the CDs. Some of the areas covered overlap with work already underway on responding to the UK's implementation of the Independent Commission on Banking's proposals, in particular regarding ring-fenced banks' operations in the CDs.

What is proposed?

It is proposed that the Tri-Party Group:

- develop a consistent high-level framework for the identification of D-SIBs. This would be flexible and allow for local supervisory judgement; and
- within this framework, provide a flexible mechanism for increasing capital requirements for such banks, similar to that envisaged internationally for globally systemic banks.

It is also proposed that each supervisor will:

- work with home regulators to ensure that all D-SIBs develop appropriate resolution plans in case of failure; and
- review local recovery and resolution regimes, in conjunction with local stakeholders, to ensure that they are fit for purpose.

Who would be affected?

Banks that are systemically important in the CDs would be impacted by these proposals. Unlike most elements of Basel III, resolution planning is highly relevant to branches, as well as banks incorporated in the CDs.

Feedback and next steps

Feedback should be sent to the local supervisor by 17 April 2014. This will be shared within the Tri-Party Group unless the submitter objects. The Tri-Party Group will develop and publish a draft high-level framework following assessment of feedback to this paper. Work on individual resolution plans will be managed on a bank-by-bank basis.

The review and development of local recovery and resolution processes will commence in 2014 and dovetail with work on addressing related EU/UK changes.

INTRODUCTION

1 Background

1.1 The Basel Committee on Banking Supervision ("**Basel Committee**"), has latterly published several documents, collectively referred to as "**Basel III**", which are intended to build on and in part replace the "**Basel II**" framework, established in 2006. In October 2012 the Basel Committee published a document on "*A framework for dealing with domestic systemically important banks*" (hereinafter referred to as "**the framework**"). This followed the work that had already been done on the policy measures designed for global systemically important banks ("**G-SIBs**"), to enhance their loss absorbency capacity over and above Basel III requirements.

1.2 The framework promulgated by the Basel Committee is focused on the ***impact*** a bank may have on the domestic economy if it fails (rather than the risk of failure), and therefore not only covers consolidated groups, but also subsidiaries. Jurisdictions may also classify a branch as a domestic systemically important bank ("**D-SIB**").

1.3 The framework has twelve key principles ("**KPs**") covering two aspects:

(a) assessment methodology, set out in KP1 to KP7, which defines what makes a bank a D-SIB;
(b) requirements for D-SIBs to have higher loss absorbency ("**HLA**"), set out in KP8 to KP12.

1.4 KP12 also states that other tools, such as more intensive supervision, might play a part in the regulatory architecture, together with the development of a more appropriate framework for recovery and resolution.

1.5 Although the framework is part of Basel III, unlike Basel III, it specifically applies at the subsidiary / domestic level[1] .

1.6 Whilst the application to branches of the KPs regarding the assessment of systemic importance should not pose specific problems, the range of policy measures and responses that a host authority has available to deal with systemic branches may be more limited than in the case of a locally incorporated bank.

1.7 In considering the issue of recovery and resolution, the paper "*Key Attributes of Effective Resolution Regimes for Financial Institutions*", issued by the Financial Stability Board ("**FSB**") in October 2011, along with supporting documents, has

[1] The Basel III capital adequacy and liquidity standards are stated to be applicable to all internationally active banks on a consolidated basis, but may also be used by supervisors for domestic banks and for any subset of entities that form part of an internationally active bank where this would ensure greater consistency and apply a level playing field between domestic and cross-border banks.

been considered to be guidance on best international practice. These key attributes are referred to (both in that paper and herein) as "**KAs**".

1.8 In addition, the UK Special Resolution Regime has been considered as a relevant example of implementation of a recovery and resolution framework for **D-SIBS.** In a similar vein, the UK proposals connected with the Independent Commission on Banking ("**ICB**") report, and the EU proposals regarding a new Bank Recovery and Resolution Directive ("**BRRD**") are considered as examples of recovery and resolution measures that reflect many of the KAs.

1.9 The Guernsey Financial Services Commission ("**GFSC**"), the Isle of Man Financial Supervision Commission ("**IOMFSC**") and the Jersey Financial Services Commission ("**JFSC**"), jointly the "**Tri-party Group**", consider that some banks incorporated in the CDs fall within the scope of the framework in their own right and potentially also some branches.

1.10 It is therefore proposed that each CD put in place a regime that is compliant with the framework. Aspects of this will include:

- identification of D-SIBs, with appropriate transparency;
- working with home supervisors;
- appropriate supervision of D-SIBs; and
- being able to resolve D-SIBs appropriately, in the event of failure.

1.11 Further, because of the current interdependencies of larger groups across the CDs, it is considered appropriate that the three CDs initially work together in order to achieve a consistent high level framework, alongside the work being undertaken by the Tri-Party Group on Basel III.

1.12 The Tri-Party Group is distributing this paper to all banks and other relevant stakeholders, including the three governments of the CDs, to provide information on the proposed approach to D-SIBs and solicit feedback. This forms part of the wider work of the Tri-Party Group on Basel III. A period of three months to 17 April 2014 has been set aside for this. Banks are asked to submit feedback to their supervisor but be aware that the content of feedback will be made available to the other CD supervisors on a no-names basis.

1.13 The aim, once feedback has been received, will be to establish, where appropriate, a joint implementation path alongside the approach to Basel III, which is expected to entail further consultation prior to the implementation of any specific proposals.

1.14 This paper is divided into sections covering the assessment methodology, HLA requirements and recovery and resolution, where the main features are explained and considered in the context of the CDs. The initial thoughts of the Tri-Party Group are also provided and questions raised in order to prompt feedback on these matters.

ASSESSMENT – APPLICATION TO THE CROWN DEPENDENCIES

2 General

2.1 There are seven KPs that focus on the assessment methodology.

2.2 KP 1 states that "national authorities should establish a methodology for assessing the degree to which banks are systemically important in a domestic context", and "***that all national authorities should undertake an assessment of banks to consider their systemic importance***". The assessment, under KP 2, should be based on the impact of failure, not risk of failure, and under KP 3 the reference point for assessing impact is the domestic economy.

2.3 Further KPs cover the scope of the assessment at home and host levels, the factors to consider when assessing D-SIBs, the frequency of assessments, and public disclosure.

2.4 Of the twelve KAs, the first KA, "**Scope**", is relevant to such assessments. This states that "*Any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime that has the attributes set out in this document*". It is therefore considered that all D-SIBs should be subject to a regime that meets the KAs. Non D-SIBs that have been identified as part of a G-SIB or D-SIB group by the home regulator might also be subject to such a regime in certain circumstances (see Section 3).

2.5 Further detail of how the KPs and the KAs may be applicable in the CDs is covered in sections 3 to 6 below.

3 Scope of application

3.1 The Tri-Party Group proposes that locally incorporated banks, and branches of overseas banks, should be included when assessing which banks may be classified as D-SIBs. This starting point is considered appropriate based on the policy in all three CDs of hosting branches or subsidiaries of larger banking groups.

3.2 It is noted that there could be some overlap in application between home and host authorities, especially where the home authority has assessed the parent bank to be a D-SIB. Under the framework, the home authority is required to assess banks for their degree of systemic importance at the consolidated group level. The Tri-Party group proposes that each host authority should assess subsidiaries in their country on a consolidated basis[2]. The reference point for the assessment remains the local economy, even when considering downstream subsidiaries.

[2] Downstream subsidiaries to be included in the assessment would be limited to those included in regulatory consolidation.

3.3 ***Question: Do you agree that the scope of application of the framework should apply both to banks incorporated in the CDs (subsidiaries) and branches?***

3.4 It is envisaged that there may be circumstances where it is agreed between the home and host supervisors that a bank (not necessarily a local D-SIB) that is identified as a D-SIB or G-SIB by the home supervisor should be subject, if it failed, to either:

- the local recovery and resolution measures proposed in this paper; or
- the home recovery and resolution process. For example, it might be agreed that local operations of UK ring-fenced banks (under ICB proposals) would be subject to the UK's recovery and resolution processes.

3.5 This would reflect work already being seen in connection with work on recovery and resolution plans by home jurisdictions. In these cases, the bank and relevant supervisors would normally agree on whether the local operation was "in scope", as part of such planning but, ultimately, it is proposed that the decision over whether the operation was in scope would rest with the relevant resolution authority.

3.6 ***Question: Do you agree that the relevant resolution authority should be given flexibility re the scope of application of recovery and resolution measures?***

4 Criteria to identify D-SIBs

4.1 The assessment criteria will be based on impact of failure, not risk of failure, on the domestic economy of each CD as applicable.

4.2 It is recommended that the assessment should have regard to the following bank-specific factors:-

(a) Size;
(b) Interconnectedness;
(c) Substitutability / jurisdiction's financial institution infrastructure (including the concentrated nature of the banking sector); and
(d) Complexity (including the additional complexities from cross-border activity).

4.3 In the context of the Crown Dependencies, the following factors are considered to be relevant in assessing whether a bank would be classified as a D-SIB:-

4.3.1 Size (with reference to local GDP

- Employment (compared to domestic economy / banking sector employment);
- Eligible deposit liabilities under the relevant deposit compensation scheme (a measure of retail deposits and impact on resources),

compared to total eligible deposits across the system and each scheme's funding resources[3];
- Value / number of local resident (individual) deposits (compared to total deposits from local resident individuals); and
- Balance sheet footings / assets.

4.3.2 Interconnectedness

- Clearing facilities / agents for other banks;
- The extent to which it provides specialist services to other key sectors in the economy (for example custody of funds, government banker).

4.3.3 Substitutability / jurisdiction's financial institution infrastructure (including considerations related to the concentrated nature of the banking sector)

- Value/number of local residential mortgages and current activity in that market (compared to total local mortgages) (*a measure of market share*);
- As above but in relation to lending to local businesses;
- Provision of core retail and business banking services (full transactional current accounts, overdrafts and loans, cheque facilities); and
- Is it the sole or dominant provider of specialist services to other key sectors in the economy (for example custody of funds, government banker)?

4.3.4 Complexity (including the additional complexities from cross-border activity)

- Materiality of any downstream subsidiaries (spill-over risks of their failure); and
- Materiality of any overseas branches (spill-over risks, including cross border claims of branch depositors and differing local regulations on insolvency).

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

4.5 It is proposed that the local supervisor should have full discretion in assessing the factors identified in 4.3. There will, therefore, be an element of subjectivity as to how much importance is placed on each factor. However, as a general principle, the more factors that a bank reflects and the greater extent that it does, the more domestically systemic a bank is likely to be. This is more flexible than a

[3] For example, a benchmark could be 1.3% of total eligible deposits, being the amount proposed in the EU for deposit guarantee scheme funds (0.5%) and national resolution funds (0.8%). Another benchmark could be any funding cap or similar contained in current CD deposit compensation schemes.

system based on fixed weightings, i.e. which allocates points or importance to different factors, and allows local judgement to be made.

4.6 ***Question: Do you think it would be reasonable to apply a subjective approach to 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?***

5 Frequency of assessment

5.1 It is proposed that the assessment of banks will be undertaken on an annual basis by each supervisor.

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

6 Transparency

6.1 The framework recommends that national authorities should publicly disclose information that provides an outline of the methodology employed to assess the systemic importance of banks in their domestic economy.

6.2 The Tri-Party Group members propose to publish their final individual methodologies for the assessment of banks once the high level framework has been agreed. As set out in section 4, it is currently proposed that this would establish a list of criteria but otherwise rely on the judgement of the supervisor. The outcome (whether a bank is a D-SIB or not) will then link to the supervisory approach, licensing policy, and capital requirements.

6.3 Unlike the framework for G-SIBs there is no requirement to publish a list of those banks assessed as being D-SIBs.

6.4 ***Question: Despite the above, do you think the CDs should publish a list of D-SIBs?***

6.5 Information on which banks have been determined to be D-SIBs, together with relevant factors taken into account, would be shared with the relevant authorities in each CD, including any resolution authorities established in due course, and other relevant (typically, home and host) supervisors.

HLA REQUIREMENTS – APPLICATION TO THE CROWN DEPENDENCIES

7 Scenarios and general observations

7.1 Before discussing in detail the application of HLA requirements, and the supervisory approach to D-SIBs in the Crown Dependencies, it is important to outline the different structural scenarios that could arise.

7.2 The scenarios for subsidiaries are as follows:-

7.2.1 D-SIB in CD, parent bank also D-SIB or G-SIB in its home country;
7.2.2 D-SIB in CD, but parent bank not D-SIB or G-SIB in its home country or part of a G-SIB group; or
7.2.3 D-SIB in CD, parent bank not D-SIB or G-SIB but is part of a G-SIB group.

7.3 The scenarios for branches are as follows:-

7.3.1 D-SIB in CD, bank also D-SIB or G-SIB in its home country;
7.3.2 D-SIB in CD, but not D-SIB or G-SIB in its home country or part of G-SIB group; or
7.3.3 D-SIB in CD, but not D-SIB or G-SIB in its home country, though the bank is part of a G-SIB group.

7.4 The regulatory response and tools to be utilised will differ depending on which of the scenarios in 7.2 and 7.3 apply, noting that local capital requirements are not applicable for branches. Licensing policy for new entrants may also need to be reviewed by each CD.

8 HLA – a calibration framework (commensurate with degree of systemic importance)

8.1 The level of HLA capacity for each D-SIB would, according to the KPs, be based analytically on the degree of systemic importance. For G-SIBs, the HLA ranges from 1% up to 3.5% (common equity as a percentage of risk weighted assets), depending on which "bucket" a G-SIB falls into. The HLA is calibrated in 0.5% increments and added to a bank's minimum RAR.

8.2 It is proposed to use a similar incremental regime to determine HLA requirements for D-SIBs that are incorporated in the CDs. The increments required would be linked to the criteria and approach specified in section 4.

8.3 ***Question: 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?***

9 Application of HLA requirements to banks incorporated in the Crown Dependencies

9.1 The Tri-party Group members already have the legal powers necessary to set and impose additional capital requirements on subsidiary banks within the CDs, through the use of Pillar 2 of the Basel II framework. Under Basel III, which is subject to a separate, but linked, piece of work by the Tri-Party Group, the HLA requirements can be considered as part of an extension to the "capital conservation buffer" tool (part of CET1 capital).

9.2 It is proposed to outline the local process for determining HLA requirements imposed on D-SIBs within the published framework (see Section 6).

9.3 The application of HLA requirements at the subsidiary level needs to be considered in the context of the wider group of which a subsidiary is a part. It is envisaged that the final framework will provide for the Tri-Party Group to make such distinctions based on the scenarios shown in section 7.2. For example, if a bank follows the "up-streaming" model, increased capital locally may not be the most appropriate tool to use.

9.4 How proposed group resolution plans are constructed will also have a bearing on where additional capital should be held within a group. Under the scenario in 7.2.1, HLA requirements set in the home jurisdiction might, coupled with appropriate recovery and resolution planning, mitigate the need for additional HLA locally.

9.5 ***Question: 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, and the comments above?***

10 Home / host coordination

10.1 In setting any HLA requirement on a subsidiary, the Tri-Party Group authorities will need to coordinate with the relevant home authorities before taking action. This is a follow on from section 9 above; the upshot being that if the home authority is already setting HLA requirements at the parent level (and for the consolidated group too) that a requirement at subsidiary level may not be appropriate. The position of the subsidiary in recovery and resolution plans will also play a part in considering where capital needs to be retained (see sections 13 to 16).

11 HLA requirement to be met by Common Equity Tier 1 (CET1) capital

11.1 Any HLA requirement set at the subsidiary level in the CDs will need to be met by CET1 capital. The HLA requirement for systemic importance is not designed

to replace / absorb identified Pillar 2 risks, which may be quite separate, although capital should not be held twice for the same risks.

11.2 It is therefore proposed that the HLA requirement is taken into account by each supervisor in its SREP, when setting minimum capital requirements i.e. the individual minimum is set at the level required under Pillar 2 (excluding any increase due to systemic importance) plus the HLA requirement.

11.3 Further information on how the CET1 capital requirements are proposed to be applied in the CDs is contained in the Tri-Party Group discussion paper "*Basel III: Capital Adequacy*", issued December 2013.

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

12 Branches

12.1 The position of branches is such that each CD will need to consider its policy on hosting branches that are assessed as being D-SIBs. If the bank of which the branch is a part is also a D-SIB in its home state or a G-SIB, this could provide additional comfort (albeit see sections 13 to 16 covering recovery and resolution), as HLA requirements will be applied to the bank as a whole.

12.2 However, if a branch in the CDs is assessed as a D-SIB but the bank as a whole is not, and is not subject to HLA requirements, the policy on licensing and conditioning such businesses may need to be considered.

12.3 ***Question: 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?***

13 More intensive supervision

13.1 In the aftermath of the global financial crisis, much attention has been focused on SIBs, and the regulations and supervisory powers needed to deal with them effectively. It is generally considered that SIBs should be subject to a greater intensity of supervision and that the expectations on, and of, supervisors need to be of a higher order for SIBs, commensurate with the risk profile and systemic importance of these banks.

13.2 An effective system of banking supervision, as reflected in the recently revised Basel Core Principles for Banking Supervision, now requires the supervisor to:

- develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance;

- identify, assess and address risks emanating from banks and the banking system as a whole;

- have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.

13.3 The Tri-Party Group already have in place supervisory practices that include on and off site supervision of banks, risk assessment methods, participation in regulatory colleges and dialogue with the home authorities and parent groups. However, a key area that needs to be developed further is that pertaining to recovery and resolution.

13.4 The supervisory framework in each CD will need to be developed to explicitly refer to D-SIBs in due course, and to better address the developing area of recovery and resolution. More detailed information regarding the proposed approach to recovery and resolution is provided in sections 14 to 16. However, it is not envisaged that the general approach to supervision will materially change.

RECOVERY AND RESOLUTION

14 Recovery and resolution planning

14.1 The Tri-party Group authorities will need to discuss [with home supervisors] the following:-

14.1.1 the resolution regimes (including recovery and resolution plans) in both jurisdictions;

14.1.2 the available resolution strategies and any specific plan in place for individual groups / banks; and

14.1.3 the extent to which these arrangements should influence HLA requirements (for example, where capital should be held to aid an orderly resolution).

In practice, elements of this work have already started but the Tri-Party Group will also need to undertake further discussions with local management and home supervisors on how subsidiaries and branches fit into group resolution plans, as part of any approach to supervising D-SIBs.

14.2 With respect to the KAs, this work would target KAs 8 to 12, which deal with the necessary work to be undertaken by banks and supervisors in respect to banks' resolution plans i.e.:

8. Crisis Management Groups (CMGs);
9. Institution-specific cross-border cooperation agreements;
10. Resolvability assessments;
11. Recovery and resolution planning; and
12. Access to information and information sharing.

14.3 ***Question: 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?***

14.4 ***Question: 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.***

15 Recovery and resolution measures

15.1 Group and local plans can only achieve what is readily achievable under local law. Barriers may exist or powers may not exist to enable appropriate measures to be taken.

15.2 There are seven relevant KAs:

1. Scope;
2. Resolution authority;

3. Resolution powers;
4. Set-off, netting, collateralisation, segregation of client assets;
5. Safeguards;
6. Funding of firms in resolution; and
7. Legal framework conditions for cross-border cooperation.

15.3 It is considered that existing legislation and supporting framework for resolution should be reviewed to ensure that generally it is consistent with the KAs (in particular KAs 1 to 7).

15.4 A full review of compliance with the KAs, in concert with the relevant authorities and stakeholders in each CD, would be necessary to identify and address all gaps but an initial review has highlighted the following concerns:

KA1. Scope: As noted in Section 2, a KA compliant regime is required for D-SIBs. The current regimes in the CDs do not provide for such a bespoke approach to be used for D-SIBs and the generally applicable regimes do not meet all the KAs.

KA2. Resolution authority: A single resolution authority or body should be identified. In the absence of a central bank in any of the CDs, there is no obvious singular authority. One alternative would be to designate a collective body; in Jersey, the Crisis Planning Group[4] seeks to undertake this role.

KA3. Resolution powers: A range of powers are identified that should be in place. A detailed review would be required to ascertain if such powers are lacking or where the use of existing powers, perhaps not as currently envisaged, might suffice. Four areas are highlighted here:

- Temporary stay of termination rights i.e. power to stop creditors taking actions;
- Transfer of assets i.e. power to split a bank's assets (and liabilities) without triggering a default or other creditors action;
- Bridge Institution i.e. the power to set up a bridge bank, transfer assets/liabilities to it, run it and then sell it or wind it down; and
- Bail-in actions i.e. the power to write down or convert eligible debt (including deposits) and equity instruments ("**loss absorbing capacity**" or "**LAC**"), typically in order to enable a transfer or bridge bank to succeed, avoiding a default, whilst preserving the creditor hierarchy. This would only apply to a locally incorporated bank.

[4] Members of the CPG are the JFSC, Viscount, Treasury, Chief Minister's office and the DCS Board.

KA4. Set-off, netting, collateralisation and segregation of customer assets: The main power lacking, in this area, is a power to temporarily stay contractual and statutory rights to trigger set-off, collateral and netting provisions in contracts.

KA5. Safeguards: Any changes to implement the KAs should ensure creditors are no worse off (than in a normal insolvency process), which might include provisions for compensating any that are found to be worse-off. Directors of banks should be protected against law suits from shareholders challenging actions taken.

KA6. Funding of firms in resolution: Any KA compliant regime would need to be funded. Three sources are identified in the KAs, the first two of which are not obviously available (at all) in the CDs, placing undue reliance on the third, which cannot necessarily be relied upon:

- LAC: a bail-in could provide a source of funding, but only if the power exists and banks hold sufficient LAC. The latter could be achieved if the definition of LAC was wide but the introduction could lead to depositors being more concerned regarding the safety of deposits with CD banks. For branches of UK/EU banks, the UK/EU proposals might apply to a CD branch and it might, perhaps, be sensible to set LAC rules that are similar to any final UK/EU rules, both so that an EU/UK resolution would not be impeded by differences in local law and so as to avoid any perception of regulatory arbitrage.

- Deposit Compensation Scheme: In the UK, the FSCS has been used as a source of funding for resolutions. A similar mechanism in the CDs would allow scheme funding to be used to fund alternative resolution processes where it is determined that the cost of the alternative is likely to be lower than the likely cost to the scheme of a normal insolvency process. An alternative would be a separate resolution fund with the triggering of one precluding the triggering of the other.

- Government funding: In the UK, the Treasury can provide funding (liquidity and capital). Such a decision is not, usually, made far in advance of the need being identified as the specific circumstances usually drive the decision to provide or withhold support. As such, this funding could not always be relied upon.

KA7. Legal framework conditions for cross-border cooperation: The legal basis should be established to allow recovery and resolution plans to be established by supervisors across the group. This would include both:

- enabling co-operation by recognising foreign resolution schemes, on a mutual recognition basis; and

- removing barriers to cooperation. In particular, it is recognised that national preference for creditors would form a barrier to mutual recognition.

15.5 KAs 8 to 12, as noted in Section 14, address the five areas relevant to banks' recovery and resolution plans.

15.6 A review is proposed, which will be undertaken separately by each supervisor, and focus on the resolution process that might apply for a D-SIB. This review would involve other stakeholders, including the CD governments. It is anticipated that resolution measures would only be applied in the case of the failure of a:

- D-SIB identified in the CDs; and
- banks incorporated in the CDs that are part of a group identified by the home supervisor as a D-SIB/G-SIB.

15.7 The expectation is that this work would complement work on enabling UK authorities to resolve CD operations of ringfenced banks. That is likely to address many of the above issues for those operations and a subsequent fuller review would be intended to ensure that these issues were addressed for any remaining D-SIBs incorporated in the CDs.

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

15.9 ***Question: Do you have any comments on any of the specific issues noted in 15.4, 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?***

16 LAC requirements

16.1 The ICB Report recommended that a PLAC requirement of 17% of risk weighted assets be set for ringfenced banks i.e. UK D-SIBS. This has been overtaken, to some extent at least, by EU BRRD proposals. These have not been finalised at the time of writing, but on 16 July 2013, the EU Presidency published a compromise proposal[5]that would, if established, be based around two principles:

- All instruments other than covered deposits (i.e. deposits that are, to any extent, insured under an EU deposit compensation scheme) and short term borrowings (those under 7 days, with certain exceptions) would be eligible LAC, with authorities being given limited flexibility to exclude other classes at their discretion; and

[5] http://register.consilium.europa.eu/pdf/en/13/st11/st11148-ad01.en13.pdf

- Eligible LAC or capital would be required to form at least 8% of the balance sheet; implied by the requirement that the contribution from the bail-in of eligible instruments and capital must be at least 8% (calculated on full value of assets ie not after risk weighting).

16.2 This can be compared to the minimum leverage ratio, which under Basel III, is proposed to be 3% of the (adjusted) balance sheet; much lower than the proposed minimum of 8% of the balance sheet for capital plus LAC.

16.3 Most, if not all, D-SIBs in the CDs are either incorporated in the CDs or in the EU and, as such, these proposals would establish a level playing field and work in line with resolution provisions for an EU headquartered CD D-SIB operation. This might help in addressing cross-border issues that could arise in resolving a CD branch of an EU/UK bank.

16.4 Most larger CD banks have a liability base that predominantly consists of deposits which include significant levels of LAC eligible liabilities (principally, non-retail deposits). It might be possible, therefore, to fund a recovery and resolution process using a write-down of such liabilities (commonly referred to as a bail-in). Creating a requirement to have LAC eligible liabilities equal to a specific percentage of the balance sheet might tend to increase the likelihood that sufficient liabilities existed at a point of failure. Such requirement could be either generally applied to D-SIBs or be bank specific.

16.5 The introduction of LAC rules might impact customer behaviour. However, customers would see limited differentiation if all CDs imposed rules that were similar to EU/UK rules.

16.6 It is therefore proposed that the introduction of rules enabling the potential write-down of LAC and minimum requirements for LAC are considered as part of the work suggested in Section 15, duly informed by the final EU position. The EU proposals are expected to be finalised in 2014.

16.7 ***Question: Do you consider that the creation of a LAC requirement for CD incorporated D-SIBs, along the lines set out in Section 16, 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.***