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AUTHORITY OF NORWAY

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European Commission, SPA2 4/29
BE-1049 Brussels
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Oslo,
2. March 2011

Comments on the European Commission's working document on a possible framework for bank recovery and resolution

We welcome the opportunity to review the proposals put forward in the Working Document on a possible framework for bank recovery and resolution. We strongly support the work by the Commission to develop a more harmonised framework for early intervention and prevention of banking crises and new policy tools for bank recovery and resolution. We find that the proposals are broadly in line with our own views and look forward to the concrete legislative proposals later this year. However, we would stress the importance of allowing national authorities to keep or add supplementary intervention and resolution tools in their national legislation.

Since EU banking legislation is implemented in Norway as a European Economic Area (EEA) member state, Finanstilsynet and Norges Bank have the following comments on the proposed framework.

Institutional Scope
Since European banks are generally universal banks, there is not the same urgency to include investment firms in the new framework. When the new recovery and resolution framework has been implemented for banks, a review can be done on the applicability for investment firms. (Q1a)

The new framework should also be implemented for bank holding companies. (Q2a)

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Authorities
We agree that the choice of the authority or authorities responsible for resolution in each Member State should be left to national discretion. (Q3a)

Supervision
A common European policy of enhanced supervision with more frequent on-site inspections and realistic stress tests is important for the early detection of stress in credit institutions. We support the suggested option under which firms perform their stress testing based on a common framework with a subsequent supervisory review process. (Q4a)

Recovery Planning
The content of the suggested preparatory recovery plans seem adequate for timely recovery in stressed situations. The European Banking Authority (EBA) could be given the task of developing a proposal for a common framework for the further content of the plans and should be able to supplement the list of issues to be addressed. (Q6)

We also support the suggested framework for group preparatory recovery plans in the case of a banking group. Such plans will have to be developed jointly between each supervisor according to the procedure set forth in Article 129 of the CRD. EBA could play a mediation role if required. (Q7)

Intra-group Financial Support
Intra-group financial support agreements may run counter to the group concept itself and dilute the legal form of the group and the legitimate interests of host countries. As long as the contractual obligations towards depositors and other stakeholders rests with each legal entity in a subsidiary structure, the limitations imposed on asset transfers by the choice of a limited liability group structure should be respected, also for assets transfers between group members even when the group is in distress. If a group chooses to extend its activities via a subsidiary, these restrictions on asset transfers should then be seen as reasonable costs related to the benefits of limited liability for the subsidiaries. We find it important to secure the soliditity of each single institution within a group (conglomerate), and would stress that new legislation should not undermine the principle of solidity on a solo basis.

Better crisis management for such cross-border groups should rather be facilitated through proper follow-up actions on the new recovery and resolution plans, in addition to the enhanced supervisory dialogue in the colleges. (Q9)

We support the possibility of supervisors intervening if transactions are conducted in breach of an arms' length principle (Q16a)

Resolution Plans
Resolution plans should be required for all credit institutions. Obviously they would be much simpler for smaller banks. EBA could be given the task of developing a common framework for the further content of these plans. (Q21a)

We find the suggested requirements for resolution plans adequate and consider them to be essential for successful resolution, especially of larger institutions. It is important that authorities have sufficient legal powers to ensure that proper resolution plans are prepared and acted upon. All resolution plans should identify critical banking services to be preserved in a crisis. It is also important that national authorities – within the framework of the resolution plans - satisfy themselves that such critical functions can be legally and economically

separated so as to ensure continuity of essential banking services. Should the review of the living wills identify significant impediments to the application of the resolution tools or the exercise of the resolution powers, there should be sufficient powers to correct and remove these impediments. (Q22a)

Early Intervention
We strongly support the new early intervention powers proposed in the working document. The Norwegian legislation on early intervention already includes most of the powers that are proposed. Additional powers could in principle be needed in the future; thus the list should not exclude the possibility of introducing additional powers. (Q24b)

The extended early intervention powers under Article 136 should be available to supervisors long before a credit institution is likely to breach the CRD requirement. It is critical that supervisors be given the powers to intervene early in a graduated and predictable manner. This should enable converging supervisory practice across national authorities. In addition, early intervention powers should also be related to other metrics than capital. The proposed new liquidity requirements, or something similar, could be considered as a supplementary trigger for early intervention. (Q24a)

The new and improved triggers for early intervention will be a valuable addition to the ongoing supervisory dialogue under Pillar 2. It should strengthen that dialogue, by giving supervisors a clearer mandate and obligation to intervene early.

Special management
The authority to appoint a special manager to the company or to assist the management is a sensible tool. The authority to appoint a special manager should be linked up to the situations mentioned in the "Option 1". (Q25)

Recovery plans
We support the wide use of recovery plans among credit institutions. For banking groups with subsidiaries, the recovery plan should be a joint product, coordinated by the parent bank and in close liaison with the consolidated supervisor. In case of disagreements, EBA could mediate ref. above. (Q26)

Conditions for resolution
The three proposed triggers (Options 1-3) contain relevant elements, but none of them are sufficient. Option 1 includes the two standard features of insolvency, i.e. the institution is balance sheet insolvent (insufficient) and unable to pay (illiquid). By including the possibility that the institution may just be "likely" to fail one or more of these conditions, it is possible to intervene before the bank is actual balance sheet insolvent, but waiting until the banks equity is depleted will be too late.

Options 2 and 3 (both based on capital triggers) will ensure earlier resolution, but will not enable intervention if the bank is only illiquid. Both these options are also fairly vague and could be spelled out more precisely to secure clear and non-ambiguous trigger points. In addition, relying solely on capital triggers may not be sufficient, as these are typically lagging indicators and also subject to potential large valuation margins. If a capital trigger should be chosen, we would prefer to focus on the Tier 1 capital levels, or even better the new Common Equity Tier 1 ratio.

In addition, we agree with the two suggested supplementary conditions on page 47. (Q 28)

Resolution objectives and principles
The resolution objectives suggested in section F3 are quite adequate and would be appropriate to justify resolution. We also agree with the general principles governing resolution in section F4. In addition, we agree that resolution authorities should if possible seek solutions that treat creditors of the same class equally, but should also have the power to derogate from this principle in specific circumstances. However, we do see a need for thorough considerations of the legal consequences i.a. on general insolvency law before introducing this possibility. (Q29 & Q30a,b).

As for the independent valuation, this is an obvious task for the resolution authority once resolution has commenced. However, experience has shown that the challenges facing such valuations are formidable and that the time required may be longer than ideally desired. Resolution authorities will therefore often have to decide on the best course of action without having such up-to-date valuations at hand. Often, it will be impossible to know at the decision point whether in fact the institution is solvent or not. There will always be a trade-off between timeliness and accuracy and how precise the valuation estimates can be, given the short time available for resolution decisions. (Q30c)

Resolution tools, powers and mechanisms and ancillary provisions
We share the general views of the DG Internal Market and Services and support its proposals on resolution tools. We find the suggested tools sufficiently comprehensive for now, but would like to emphasize that we find it important that member States are allowed to supplement the proposed EU resolution tool kit with national tools and powers. (Q31a)

We agree with the conditions for the sale of business tool suggested in section G2. (Q32)

As for the winding up of the residual bank when a bridge bank is established, there should be an explicit requirement that the residual bank must be wound up. However, the time limit for this should not be excessively short, as this could lead to a lower recovery values than necessary. The bridge bank should be allowed to operate without complying with the CRD requirements on the basis of official guarantees to secure the ongoing business of the bank. There should be an explicit time limit for the operation of such banks, e.g. 1-2 years. (Q33)

The choice of resolution mechanism should primarily be left to the member states. However, one might consider some general requirements laid down in a common legislative framework to facilitate necessary coordination for cross border resolutions. This should also be possible between different resolution mechanisms or models, e.g. receivership and administration models. (Q39)

We support working out procedural obligations of resolution authorities and support the two core requirements proposed. Regarding the publication requirements, we find the compulsory use of newspapers or other printed media of reduced relevance for the dispersion of such information. (Q40)

We also support the proposal that the valuer should be independent from the resolution authority. Various practical arrangements can be conceived of, depending on national institutional structures. The key principle should be a valuer appointed on an arms' length basis.

Furthermore, we agree that rights to challenge the actions of resolution authorities should be restricted to a review of the legality of the action, and that remedies should be limited to

financial compensation. In particular, courts should not be able to reverse a resolution action, as stated on page 64. The suggested principles for compensation and valuation are sufficient to ensure that creditors receive appropriate compensation. (Q41)

We consider the proposed temporary suspension of rights to be essential for successful resolution. The ability to impose a temporary suspension on a wide range of obligations while the bank is being resolved will be critical if for example the viable parts of a failing bank are to be successfully transferred to a bridge bank to ensure the continuity of essential banking services. While the proposed provisions seem adequate, there may be potential conflicts between such suspensions and existing rights under various directives. These should be clarified and resolved to enable the resolution tools to work smoothly. (Q42)

Safeguards for counterparties
We find the suggested safeguards to be balanced and adequate. We consider it important that counterparties under netting agreements and with securities rights are given appropriate safeguards. At the same time these rights should not interfere with the ability of resolution authorities to secure ongoing operations of essential banking services. We note and agree that the suggested safeguards will be subject to the restrictions mentioned above (e.g. temporary stay on close-out netting rights). (Q46)

Group Resolution
Crisis coordination between national authorities will be greatly facilitated when all EU countries get a more harmonized tool kit for early intervention and resolution. This is particularly the case for large subsidiary based financial groups, where resolution must be based on separate legal entities. Closer cooperation in supervisory colleges will gradually build confidence and common understanding and will be an essential condition for good cooperation in a crisis. Rather than creating separate resolution colleges, we support the proposed resolution colleges being extensions of the supervisory colleges. This would be a useful supplement that may facilitate early intervention and resolution of cross-border banks. We believe it will be an advantage that the authorities responsible for the resolution are familiar with the activities of the group and are able to closely follow the work of the supervisory college. Guidelines for the establishment and operating of resolution colleges should be provided by EBA. (Q52)

However, we are at the same time concerned that the college model is becoming excessively large, and that core responsibility may be diluted in such a "decision by committee" model of resolution. As we have noted before, the Icelandic crisis showed that host countries need to exercise independent judgment even in branch bank structures, and further, host countries in subsidiary structure cannot be certain about the willingness and ability of the parent bank to support a subsidiary in distress.

The new process of preparing resolution plans should be used to clarify powers and responsibilities within banking groups. This could lead to a rationalization of group structures, and bring more congruence between the actual operations of local banks and their legal form. This process should lead to greater clarity about resolution responsibilities within cross-border banking groups and reduce the need for extensive consultations between authorities.

As for the balance between the mandate and powers of the resolution college and the group (home) authority, we note that it may be difficult in practice to ask the host authority to refrain from intervening before the home authority has decided on the best course of action. In practice, due to the time factor and the fact that problems will most likely be detected

locally; the host authority will most likely have taken corrective action well ahead of any resolution considerations at the home level. This underscores the need for advance planning and agreements at the group level in the context of the resolution plans. (Q53)

Group operations will not be limited to EEA-states. In this respect it seems adequate that resolution colleges also facilitate the possibility of cooperation with third country authorities, provided they meet standards for participating in supervisory colleges, in particular regarding confidentiality. (Q54)

Resolution planning should take into account the possibility of resolving all entities in a group, including entities situated in a third country. The resolution authority should be able to require changes in the organization if the assessment reveals unsuitable structures. (Q56)

Financing Arrangements
Regarding the proposal for a resolution fund, we believe that further clarification is needed about which expenses this fund would actually cover. If the new resolution framework is implemented, the cost of resolution should be borne by equity capital, risk capital and unsecured creditors. I.e. there will only be a temporary need for working capital (liquidity) to support the bank resolution process. Such a clarification is important, because any targeting of the fund size will be impossible unless there is clarity about its purpose.

If certain investment firms are to fall within the scope of the new regulation, we also believe that there should be some flexibility between the Investor Compensations Scheme and the resolution fund. Some discretion as to calculation of contribution should be left to member states. (Q57)

We support a solution with where the Deposit Guarantee Schemes (DGS) of member states have flexible mandates that allow them to finance resolution measures. If so, their funding should be adapted accordingly. The important issue is to ensure that both the resolution funds and the national DGS have the sufficient financial resources to fulfil their roles in safeguarding the deposits and bridge financing of resolution measures, and that both funds are adequately funded (both ex ante and ex post) with the financing burden falling on the financial sector and not on the tax payers. (Q60)

Debt write down as an additional resolution tool
We agree that a tool to write down certain liabilities of a large credit institution in distress would provide the resolution authorities with additional flexibility when they deem that the triggers for intervening have been met, but the institution cannot be wound up with the ordinary resolution tools. Writing down and/or converting some liabilities to equity while the credit institution is still in operation, can potentially secure ongoing operations of essential banking services also for larger institutions.

Since an independent valuation process may take some time, the resolved institution should be able to operate for some time without fully complying with the full CRD requirements. Alternatively, a conservative write-down could be imposed on all creditors to fully meet the minimum capital requirements, with the option of paying back creditors depending on the final valuation process.

We support the Commission's effort to press for progress on developing the concept of debt write down as a supplementary resolution tool. We agree that as a matter of principle, ordinary priority rules should as far as possible be preserved in a write down situation. Still, if

the failing institution has to be recapitalised and no other investors are available (e.g. due to a generalised systemic crisis), then junior and even senior creditors may have to be bailed in before all share capital has been written down.

To ensure the proper functioning of credit markets, we agree that certain exclusions from the write down will be necessary, as listed in the working document. The list seems adequate, but will have to be considered further.

Yours sincerely,

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