

Intesa Sanpaolo response to the European Commission

Consultation on a Possible Recovery and Resolution Framework for Financial Institutions other than Banks

December 2012

REGISTERED ORGANIZATION N° 24037141789-48

The Intesa Sanpaolo Group is one of the largest European banking groups with a strong presence in Italy and Central and Eastern Europe and an active participant in financial markets through Banca IMI. We welcome the opportunity to comment on the Commission consultation on a possible recovery and resolution framework for financial institutions other than banks.

Preliminary remarks

On a preliminary note, we would like to underline that our response centers only on central counterparties and securities depositors.

We very much support the Commission's efforts to set out the features of a framework for the recovery and resolution of financial markets infrastructures (FMIs). These are key institutions that enable the smooth functioning of capital markets and it is therefore crucial that there is a regulatory framework providing supervisors with an appropriate set of tools to handle problems stemming from their failure, so as to avoid any disruption in the functioning of financial markets. Moreover, ordinary insolvency law will very likely not be appropriate for managing their failure, since the main objective of that process, i.e. satisfying creditors, could conflict with that of preserving market stability and the continuity of core FMI's functions.

Assessing the impact of the resolution of a FMI on financial stability will be a difficult exercise. It is all the more important that FMIs – the importance of some of them is bound to grow as a consequence of new regulatory requirements – do not reach the situations where they need to be resolved. This is why, in our view, the new framework should emphasize the role of recovery plans and provide supervisors with powers that should go as far as requiring FMIs to make changes to FMIs' business models in order either to reduce their risk profile or facilitating their resolvability. Moreover, supervisors should also be given early intervention powers as in the proposed crisis management directive. In this perspective, we suggest the Commission to introduce also in this framework the special manager that could replace the management body of a FMI, with the aim of restoring its financial soundness and its long term viability.

We agree with the Commission (and with the G20) that the new resolution tools should minimize the reliance on taxpayers to cover losses and that the removal of the implicit guarantee of public support will reduce moral hazard and strengthen market discipline. We believe that FMIs, CCPs in particular, should be fully aware of their systemic relevance and have adequate capital requirements to cover the risks they assume. In this respect, it can be argued whether public support can be totally excluded in reality, even in the form of central

bank liquidity, which in some cases could alleviate FMI's problems and would help them managing and overcoming crisis situations, through the exercise of the lender-of-last-resort function.

We concur with the Commission that preserving the continuity of critical services, financial stability, contagion effect and unnecessary destruction of value are valuable resolution objectives that should drive any regulators' decision. In this perspective, because of the systemic relevance that FMIs can have and the difficulties that could arise in case of resolution, we stress the importance of viable business models for FMIs, where core activities are segregated from banking and ancillary ones, in order to make their resolvability easier.

Finally, since FMIs can be exposed to different types of risks and their activities can be very diverse, we believe that it would be preferable to have different resolution frameworks according to the type of infrastructure, i.e. one for CSDs and one for CCPs.

Questions

General

1. Do you think that a framework of measures and powers for authorities to resolve CCPs and CSDs is needed at EU level or do you consider that ordinary insolvency law is sufficient?

We believe that an EU framework for the resolution of FMIs is needed, since the ordinary insolvency law may not always be appropriate to manage the resolution of CCPs and CSDs, because of conflicting objectives pursued by both procedures: the former aiming at the satisfaction of creditors, while the latter at preserving market stability and the continuation of essential core services.

A specific EU fully harmonized framework is also needed in order to preserve the level playing field among FMIs within the EU and the integrity of the Single Market. The framework should provide for fully harmonized rules, so as to give the same tools to all competent authorities and avoid discretionary approaches in crisis situations, thus ensuring predictability of supervisory actions. Such an EU framework is particularly relevant in cases of interoperable links between FMIs based within the EU. For interoperability with FMIs based outside the EU, we believe it will be important to provide for a coordinated approach with third countries authorities.

2. In your view, which scenarios/events might lead to the need to resolve respectively a CCP and a CSD? Which types of scenarios CCPs/CSDs and authorities need to be prepared for which may imply the need for recovery actions if not yet resolution?

A distinction should be made between events related to the management of the CCPs that may lead to resolution, from exogenous ones. In the first case, where bad management or wrong decisions jeopardize or may jeopardize the soundness of the CCP, we believe that competent authorities should be entrusted with early intervention powers, i.e. the power to remove the management and appoint a special manager, with the task of repairing the situation well before it deteriorates up to the point of resolution.

Exogenous events that may drive CCPs into crisis situations may be the following ones: market stress; a plurality of failing market participants or facing difficult situations, i.e. being unable to post collateral when requested; CCPs that are correlated to each other, so that the difficulties faced by one CCP are transmitted to the other one; the depletion of own funds; the lack of shareholders' support and, finally, liquidity problems.

If a CCP faces a crisis situation because of its participants, attention should be paid when requiring the other participants to intervene, since the difficulties of some market participants can have repercussions on others, with a pro-cyclical effect.

For CSDs, without banking license it is difficult to envisage events that can lead to their resolution, while certainly the implementation of recovery measures should be required in the occurrence of operational glitches preventing the infrastructures to perform their activities.

3. Do you think that existing rules which may impact CCPs/CSDs resolution (such as provisions on collateral or settlement finality) should be amended to facilitate the implementation of a resolution regime for CCPs/CSDs?

We do not believe that the financial collateral and settlement finality directives should be amended in relation to FMIs' resolution. They govern the creation and transfer of collateral and define when a transaction becomes irrevocable when inserted into a settlement system, thus preserving the systems from the failure of one participant. They do not cover the failure of the infrastructure.

4. Do you consider that a common resolution framework applicable to CCPs and CSDs is desirable or do you favour specific regimes by type of FMIs?

We believe that specific regimes for CCPs and CSDs should be provided, since they perform different activities and carry different risks. In the case of vertical silos, where different FMIs are strongly integrated, sharing of roles, responsibilities and risk management models should not be allowed. It is important that each market infrastructure is totally independent and able to survive on its own in the case of the resolution of one FMI. If this were not case, there is the risk that all infrastructures part of the silo would have to be resolved.

5. Do you consider that it should only apply to those FMIs which attain specific thresholds in terms of size, level of interconnectedness and/or degree of substitutability, or to those FMIs that incur particular risks, such as credit and liquidity risks, or that it should apply to all? If the former, what are suitable thresholds in one or more of these respects beyond which FMIs are relevant from a resolution point of view? What would be an appropriate treatment of CSDs that do not incur credit and liquidity risks and those that incur such risks?

We believe that all FMIs, irrespective of their size, level of interconnectedness and/or degree of substitutability should be subject to the new regulatory framework. We also believe that banks performing services that are very close to those performed by CCPs, should be subject to this framework.

6. Regarding FMIs (some CSDs and some CCPs) that are also credit institutions, is the proposed bank recovery and resolution framework sufficient or should something in addition

be considered? If so, what should the FMI-specific framework add to the bank recovery and resolution framework? How do you see the interaction between the resolution regime for banks and a specific regime for CCPs/CSDs?

We believe that in the case of resolution of FMIs with banking license, the resolution framework applicable to FMIs should prevail and be applicable, since banking services are ancillary to the service of the market infrastructure. Finding coordination between the two frameworks could prove to be unworkable. Moreover, such an approach would also have the benefit of avoiding the use of the resources of the resolution fund by a bank belonging to a FMI. We suggest the Commission to provide for the set-up of separate resolution funds for FMIs.

Objectives

7. Do you agree that the general objective for the resolution of CCPs/CSDs should be continuity of critical services?

Yes, definitely, the continuity of critical services must be the main objective to attain.

8. Do you agree with the above objectives for the resolution of CCPs/CSDs?

We agree with the proposed resolution objectives. We would suggest adding some more, i.e. protecting client assets and minimizing the cost of resolution.

9. Which ones are, according to you, the ones that should be prioritized?

In our view, developing coordination mechanisms among different jurisdictions and authorities should be ranked higher than proposed in the consultation paper.

Recovery and Resolution Plans

11. What should be the respective roles of FMIs and authorities in the development and execution of recovery plans and resolution plans? Should resolution authorities have the power to request changes in the operation of FMIs in order to ensure resolvability?

The development and execution of recovery plans should be in the hands of FMIs. Recovery plans should clearly set out the risks incurred by the FMIs and to which participants may be exposed to and define ex ante the ways to mitigate them. Market participants – in particular clearing members – should be involved by FMIs in the definition of recovery measures, in particular when the use of participants' funds in the recovery process is envisaged. Recovery plans should be disclosed to market participants and clearing members, so that they can also delineate a strategy in the case of a FMI crisis situation.

The responsibility for drafting resolution plans should lie with supervisory authorities. We believe that also in this case, market participants should be involved in the finalization process. This would be particularly relevant in the case of interoperable links between FMIs.

As it has been proposed in the Banks' Recovery and Resolution directive, resolution authorities should have the power to request changes and suggest solutions in the operation of FMIs in order to ensure their resolvability. They should also be able to request changes in the business models, if a reduction of their risk profile is deemed necessary to facilitate the resolvability.

12. To what extent do you think that CCPs/CSDs in cooperation with their users would be able to define efficient recovery and resolution plans on the basis of amendments to their contractual laws?

FMIs, in particular CCPs, are currently developing their own recovery plans, with the involvement of the clearing members. Contractual laws between users and FMIs should define ex ante rules for loss allocation and the possible refinancing tools.

Resolution triggers

13. Should resolution be triggered when an FMI has reached a point of distress such that there are no realistic prospects of recovery over an appropriate timeframe, when all other intervention measures have been exhausted, and when winding up the institution under normal insolvency proceedings would risk causing financial instability?

Yes, we agree with the Commission proposed reasons for bringing an FMI to resolution. We believe that it is up to resolution authorities to decide whether an FMI needs to be resolved based not only on quantitative triggers but also on a qualitative judgment.

14. Should these conditions be refined for FMIs? For example, what would be suitable indicators that could be used for triggering resolution of different FMIs? How would these differ between FMIs?

Yes, different conditions should be defined and be applied according to the type of FMIs. For example, for CCPs the resolution triggers could be set when the capital of the CCP and all default waterfall resources have been depleted and the CCP is not able to fulfill its payment obligations.

15. Should there be a framework for authorities to intervene before an FMI meets the conditions for resolution when they could for example amend contractual arrangements and impose additional steps, for example require unactivated parts of recovery plans or contractual loss sharing arrangements to be put into action?

We believe that resolution authorities should be granted early intervention powers as provided for in the Banks' Recover and Resolution Directive also in relation to FMIs, when there is a need to stop bad management and decline of the FMI. In our view, the earliest authorities step in the management of the FMI the better it is. The main objective to be attained should be avoiding resolving an FMI, because of the unexpected consequences that it could entail.

Resolution powers

16. Should resolution authorities of FMIs have the above powers? Should they have further powers to successfully carry out resolution in relation to FMIs? Which ones?

We agree with the Commission that authorities should have the powers mentioned in the consultation paper.

17. Should they be further adapted or specified to the needs of FMI resolution?

Intesa Sanpaolo believes that the resolution powers should be adapted to the specific type of FMI and risks incurred and tailored to the systemic nature of the infrastructure.

18. Do you consider that temporary stay on the exercise of early termination rights could be a relevant tool for FMIs? Under what conditions? How should it apply between interoperated FMIs? How should it be articulated with similar powers to impose temporary stays in the bank resolution framework?

A temporary stay on the exercise of early termination rights of FMIs' participants would have the consequence of changing the measure of risk of the counterparties and transferring risks from the FMIs to their participants. Since this could likely have a knock on effect to other market participants there is the possibility that a risk limited to a FMI could turn into a systemic risk. On the other side, a temporary stay could assist authorities in determining the most appropriate resolution tool, in particular when the use of a bridge institution tool is envisaged. Therefore, in our view a temporary stay should be strictly limited in time and be exercised by authorities on the basis of a case by case approach, only if it does not entail a destabilization of market participants.

19. Do you consider that moratorium on payments could be a relevant tool for all FMIs or only some of them? If so, under what conditions?

The function of FMIs is precisely the ability to make payments, i.e. to settle transactions for CSDs and receiving and paying variation margins and transferring initial margins when necessary for CCPs. Therefore, ordering a moratorium on payments does not seem to have the effect of ensuring the continuity of the provision of services and should therefore not be envisaged.

Resolution tools

20. Which reorganisation tools could be appropriate for resolving different types and CSDs and CCPs? What would be their advantages and disadvantages?

Intesa Sanpaolo agrees with the Commission that transferring all or part of the operations to a healthy market player could be a convenient resolution tool, although this could prove to be difficult, for the reasons stated in the consultation paper. A further one could be added, different access criteria, in the case where an FMI provides for more stringent access criteria than the FMI in resolution.

Bridge institutions should also be envisaged as a resolution tool that would ensure the continuity of services provided.

21. Which loss allocation and recapitalisation tools could be appropriate for resolving different types of CSDs and CCPs? Would this vary according to different types of possible failures (e.g. those caused by defaulting members, or those caused by operational risks)? What would be their advantages and disadvantages?

Intesa Sanpaolo believes that the loss allocation and recapitalisation tools should be applied differently according to the causes of possible FMIs' failures. In particular, in the case of failure due to operational risks, owners should be aware that their investment is at risk and therefore should suffer the losses in the first place.

Moreover, in order to protect members' assets from being seized/used in the case of failure, we support the Commission proposal to require CCPs to issue specific capital instruments convertible into equity in case of resolution. This would make sure that the costs of FMIs' failure are not borne by clearing members and would align the FMIs resolution regime to that of banks and investment firms.

We also support the idea of using ex ante funded resolution funds, as it is provided for in the banks recovery and resolution directive. Only when the resources stemming from owners, creditors and resolution fund are depleted, it should be possible to apply bail in to margins. In particular, liquidity calls on CCP members should be capped, in order not to jeopardize their stability.

In the case of failure due to the default of a member, the FMI default procedure should be applied, with the possibility to apply a haircut on margins.

22. What other tools would be effective in a CCP/CSD resolution?

No comment.

23. Can resolution tools based on contractual arrangements be effective and compatible with existing national insolvency laws?

Resolution tools based on contractual arrangements should be structured in a way that they are compatible with national insolvency laws.

Group resolution

24. Do you consider that a resolution regime for FMIs should be applicable to the whole group the FMI is a part of? What specific tools or powers for the resolution authorities should be designed?

We are of the view that in the case of the resolution of an FMI belonging to a group of FMIs, regulators should at all cost avoid putting into resolution all infrastructures, but should rather make sure that healthy activities of the FMIs are preserved, while resolving only the

unhealthy ones. To this end, regulators should require the ring fencing of the healthy activities, in order to avoid any possible spillover effect on healthy entities. Such an approach would ensure the continuity of provision of services to the market and would avoid an unnecessary destruction of value.

For this reason, as mentioned in Q. 4, we believe that in the case of vertical silos, where functions are often strongly interrelated with one another, the different entities should be able to survive in the case of failure of one of them.

On a different note, in the case of FMIs belonging to a group and established in different Member states where all or some of them would need to be resolved, we believe that a single resolution process governed by the home country authorities should be provided for. Host authorities should agree to abide to the decisions of the home authorities. Such an approach would avoid conflicts of laws between jurisdictions and make the resolution process easier. Resolution plans should clearly define ex ante how the resolution process should be governed and managed.

Cross border resolution

25. In your view, what are the key elements and main challenges to take into account for the smooth resolution of an FMI operating cross-border? What aspects and effects of any divergent insolvency and resolution laws applicable to FMIs and their members are relevant here? Are particular measures needed in the case of interoperable CCPs or CSDs?

Resolution plans should clearly set out the law applicable to the resolution and the clear allocation of tasks and responsibilities in the case of failure. Cooperation arrangements should be entered into by competent authorities in order to ensure the smooth resolution process.

26. Do you agree that, within the EU, resolution colleges should be involved in resolution issues of cross border FMIs?

Yes, we support the idea of setting up resolution colleges.

27. How should the decision-making process be organized to make sure that swift decisions can be taken? Alternatively, do you think that responsibility for resolving FMIs should be centralised at EU-level?

The decision making process should be agreed ex ante in the resolution plans. The responsibility for resolving FMIs operating on a cross border basis should ideally be set at EU level, in the hands of ESMA.

28. Do you agree that a recognition regime should be defined to enable mutual enforceability of resolution measures?

Yes, we agree that a recognition regime should be defined to enable the mutual enforceability of resolution measures, in particular for FMIs with cross border activities.

29. *Do you agree that bilateral cooperation agreements should be signed with third countries?*

Yes.

Safeguards

30. *Do you agree that the resolution of FMI should observe the hierarchy of claims in insolvency to the extent possible and respect the principle that creditors should not be worse off than in insolvency?*

Yes.

For any further comments or questions, please contact Intesa Sanpaolo International Regulatory and Antitrust Affairs Office:

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