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The Secretariat to the Financial Stability Board
Bank for International Settlements
Basel
SWITZERLAND

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Dear Sir/Madam

Please find below the comments of the Bank of Uganda on the policy proposals issued by the Financial Stability Board on the "Adequacy of loss-absorbing capacity of globally systemically important banks in resolution".

Yours faithfully

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GOVERNOR

Mission: *To Foster Price Stability and a Sound Financial System* ***Vision:*** *To be a Centre of Excellence in Upholding Macroeconomic Stability*

Comments from the Bank of Uganda on the policy proposals for "Adequacy of Loss-absorbing capacity of globally systemically important banks in resolution"

The Bank of Uganda welcomes the approach set out in the FSB's policy proposals for ensuring that globally systemically important banks (G-SIBs) can be resolved in a manner which minimizes the impact on financial stability, ensures the continuity of the G-SIB's critical functions and avoids exposing taxpayers to loss. We believe that the strategy set out in the FSB's proposals, whereby each G-SIB is organised into one or more resolution groups, with each group containing a single resolution entity, combined with the requirement that each resolution entity should hold a minimum level of total loss absorbing capacity (TLAC), offers a feasible strategy for tackling what is an extremely complex challenge of large resolving cross border banks.

Our main concern with the FSB's proposals pertains to the composition of the resolution groups of each G-SIB. Many G-SIBs operate, through subsidiaries, in multiple jurisdictions including small developing economies. Furthermore, in many small developing economies, the subsidiaries of G-SIBs are among the largest banks and are often domestically systemically important banks (D-SIBs). As such, institutional arrangements which ensure that these subsidiaries of G-SIBs can be resolved in an orderly manner, in the event of financial distress in either the subsidiary itself or elsewhere in the G-SIB group, which protects the domestic (host) economy from financial instability and its taxpayers from losses, while maintaining the critical functions of the subsidiary, would offer potentially major benefits for small developing economies. However, this will only be possible under the FSB's proposals if the subsidiaries of G-SIBs in these economies are

defined as material subsidiaries and, therefore, are included in the applicable resolution group.

Unfortunately the proposals, in section 21 of part 2 (pages 19-20) of the Consultative Document, for defining material subsidiaries would appear to exclude most of the banking subsidiaries of G-SIBs in small developing economies, given that each of these subsidiaries is very unlikely to hold more than five percent of the G-SIB group's risk weighted assets, generate more than five percent of its revenues, etc. This would leave both the subsidiaries and the host regulators of these subsidiaries in a very difficult position. Clearly, the fact that a subsidiary of a G-SIB in a small developing economy is not classified as a material subsidiary of the G-SIB will not protect the former from contagion in the event that the latter suffers financial distress.

The subsidiary itself would risk being perceived by creditors as being in some respects a second class member of the G-SIB group, because its liabilities, unlike those of the actual material subsidiaries of the group, would not enjoy the protection afforded by the TLAC held by the resolution entity. This could lead to a situation where creditors shift their funds from subsidiaries which are not classified as material subsidiaries to those which are. It might also damage public perception of the G-SIB if its liabilities in its subsidiary in country A are protected at the group level whereas its liabilities in its subsidiary in country B are not.

From the host regulator's standpoint, the lack of guaranteed support for a domestic subsidiary from the resolution entity implies that the regulator would need to treat that subsidiary as a stand-alone entity and, if it were a D-SIB, impose a TLAC requirement on

the subsidiary itself in order to achieve the objectives of minimizing financial stability, ensuring continuity of critical functions and avoiding loss to taxpayers in the event of its failure. Furthermore, given that a subsidiary of a G-SIB in a small developing economy is likely to be less diversified than the G-SIB group and also operates in both a more volatile economic and a weaker institutional environment, the TLAC requirement of a D-SIB on a stand-alone basis in a small developing economy should be higher than that for the resolution entity or entities of the G-SIB. Because domestic capital markets are shallow in many small developing economies, mobilizing TLAC from these markets will prove very difficult for many banks. In particular it is unlikely that they would be able to mobilize debt instruments that would qualify as TLAC from domestic markets. As such, it is likely that banks which are subject to TLAC requirements as stand-alone entities in small developing economies would have to rely on liabilities issued to their parent bank or to entities within the parent bank group to comply with the TLAC requirements.

A further complication pertains to the treatment of the claims by a subsidiary of a G-SIB on banks in the G-SIB group in the event that the latter are put into resolution. This is relevant because subsidiaries of G-SIBs in small developing economies often hold substantial deposits in banks in the G-SIB group. This would not be an issue if the subsidiary in the small developing economy were to be treated as a material subsidiary, because in the event of a bank failure in the G-SIB group, the subsidiary would be protected by the TLAC of the applicable resolution entity. However, if the subsidiary of the G-SIB is not treated as a material subsidiary and is thus not protected by the TLAC of the resolution entity, the host regulator will need to be assured, by the G-SIB and its home regulator, that claims by a non material subsidiary on its parent

group will be fully honoured and not written down in the event that the G-SIB has to be resolved.

Given the potential problems highlighted above, we take the view that all of the banking subsidiaries of a G-SIB should be treated as material subsidiaries and included in the applicable resolution group of the G-SIB.

BANK OF UGANDA

KAMPALA

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