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November 25, 2014

Mark Carney
Chair
Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel, Switzerland
Attention: fsb@bis.org

Re: *Cross-Border Recognition of Resolution Action*

Dear Mr. Carney:

ICI Global[1] appreciates the opportunity to provide comments on the consultative document issued by the Financial Stability Board ("FSB") on cross-border recognition of resolution action.[2] The Consultative Document provides guidance to member jurisdictions regarding (i) elements to include in statutory provisions recognizing foreign resolution regimes ("Resolution Regimes") for systemically important financial institutions ("SIFIs") and (ii) interim contractual approaches to facilitate cross-border implementation of foreign Resolution Regimes pending adoption of legislation. The Consultative Document follows other guidance provided by the FSB and other global regulatory groups, beginning in 2009, to identify SIFIs and develop frameworks to allow "public authorities to . . . take measures to lessen the impact and reduce the moral hazard associated with public sector interventions and the distress or failure of such financial firms."[3]

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[1] The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of U.S. $18.7 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, D.C.

[2] Consultative Document, Cross-border recognition of resolution action (September 29, 2014), *available at* http://www.financialstabilityboard.org/publications/c_140929.pdf ("Consultative Document").

[3] *See* International Association of Insurance Supervisors, *Global Systemically Important Insurers: Policy Measures*, 18 July 2013 at 3. The Consultative Document is intended to support the FSB's *Key Attributes of Effective Resolution Regimes*, published in October 2011 and supplemented with sector-specific guidance in October 2014, which provide guidance and policy recommendations for development of resolution regimes for SIFIs. *See* Key Attributes of Effective Resolution Regimes, *available at* http://www.financialstabilityboard.org/publications/r_141015.pdf ("Key Attributes"). The

Our members – US funds that are regulated under the Investment Company Act of 1940 ("ICA") and similar non-US regulated funds publicly offered to investors, such as UCITS (collectively, "Regulated Funds") – use over-the-counter ("OTC") derivatives in a variety of ways. OTC derivatives are a useful portfolio management tool in that they offer Regulated Funds flexibility in structuring their investment portfolios. Uses of OTC derivatives include, for example, hedging positions, equitizing cash that a Regulated Fund cannot immediately invest in direct equity holdings, managing a Regulated Fund's cash positions more generally, adjusting the duration of a Regulated Fund's portfolio, or managing a Regulated Fund's portfolio in accordance with the investment objectives stated in a Regulated Fund's prospectus. To employ OTC derivatives in the best interests of fund investors, our members strongly support ensuring that the derivatives markets are highly competitive and transparent. ICI Global members, as market participants representing millions of investors, generally support the goal of providing greater oversight of the derivatives markets.

We appreciate the FSB's concerns regarding the need to reduce systemic risk by providing for an orderly resolution of SIFIs that operate across borders. We agree with the FSB that the permanent solution for the orderly resolution of a SIFI with global operations is for FSB members to adopt statutory or regulatory frameworks to give effect to foreign resolution measures in their respective jurisdictions. Because the adoption of comprehensive statutory or regulatory regimes by all FSB members may take quite some time, we understand the need to address some uncertainties regarding (or to affirm) the application of a Resolution Regime across borders through contractual means to which all counterparties would be required to adhere. The reliance on contractual solutions for the recognition of foreign Resolution Regimes and related actions should be, however, only an interim measure and sunset after a specified period of time and should be relied on only to enforce "critical prerequisite" provisions of the foreign Resolution Regime.

One area that the FSB describes as a "critical prerequisite for orderly resolution" is the enforcement of stays on early termination rights in financial contracts, such as those governing OTC derivatives. ICI Global believes that it is essential to establish a transparent and predictable process to allow market participants to understand their rights and minimize the time period during which they are delayed from employing their negotiated creditor rights.[4] As a result, we believe that legislative/regulatory and interim contractual measures should be narrowly tailored to enforce the essential provisions of the foreign Resolution Regimes but not seek to change the domestic framework. Moreover, we would have significant concerns if the contractual approaches to cross-border recognition create stays on termination rights that are not provided for in a Resolution Regime or insolvency statute. We discuss our concerns in more detail below.

Consultative Document also references the FSB's report on *Progress and Next Steps Towards "Ending Too Big to Fail,"* September 2013 *available at* http://www.financialstabilityboard.org/publications/r_130902.pdf ("TBTF Report").

[4] *See* Key Attributes, *supra* note 3, at 3 ("An effective resolution regime … should (vi) provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution").

Background

The FSB has previously stated that contagion risks to the global market due to insolvency of SIFIs should be mitigated through adoption by jurisdictions around the globe of Resolution Regimes that contain the principles set forth in the Key Attributes. The Key Attributes were designed to allow for resolution of financial institutions in an orderly manner without taxpayer support while maintaining continuity of vital economic functions and services.[5] Six countries have currently adopted Resolution Regimes that are consistent with the Key Attributes.[6]

Notwithstanding these developments, in the Consultative Document, the FSB noted that there are currently no means of ensuring that such Resolution Regimes are enforceable on a cross-border basis. The FSB also warned that, unless stays and other actions under foreign Resolution Regimes can be given prompt effect in relation to assets that are located in or liabilities or contracts that are governed by the laws of a foreign jurisdiction, resolution authorities are likely to face obstacles in implementing group-wide resolution plans effectively for cross-border groups. Because of concerns regarding the length of time that could be involved for FSB members to adopt necessary statutory or regulatory powers, the FSB has been working to implement contractual arrangements that could be an interim solution until comprehensive statutory or regulatory regimes are adopted in all relevant jurisdictions. Under a contractual approach, counterparties would agree to be bound by specified resolution actions taken pursuant to an established Resolution Regime. In that regard, the FSB has been working with the International Swaps and Derivatives Association ("ISDA") to develop a protocol ("ISDA Stay Protocol"), which would support the cross-border enforcement of a temporary stay of early termination rights in relation to resolution-based defaults.[7] We note that the ISDA Stay Protocol currently would only apply to transactions between certain globally systemically important banks ("G-SIBs") and not to other counterparties.[8]

Cross-Border Recognition of Foreign Resolution Regimes is Best Implemented by Statute or Regulation

ICI Global supports FSB's preferred goal of encouraging adoption of "effective statutory cross-border recognition processes consistent with the Key Attributes"[9] to address the issue of resolution of

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[5] *See* Key Attributes, *supra* note 3, at 1.

[6] These countries are: the United States, United Kingdom, France, Germany, Switzerland and Japan.

[7] *But see infra* note 20 and accompanying discussion.

[8] Section 1 of the ISDA Stay Protocol will become effective between certain G-SIBS upon the later of (i) acceptance of a party's adherence by ISDA and (ii) January 1, 2015, and Section 2 will become effective upon the later of (i) acceptance of a party's adherence by ISDA and (ii) the compliance date for prudential regulations enforcing and making mandatory for regulated entities and their counterparties the stay provisions set forth in Section 2. Adhering parties are entitled to opt out from Section 1 provisions if appropriate foreign resolution regimes have not been adopted by designated dates and from Section 2 if the counterparty is not subject to prudential regulation imposing the designated stay provisions.

[9] Consultative Document, *supra* note 2, at 1.

global entities and cross-border recognition of resolution actions. We also support the seven elements discussed in the Consultative Document that jurisdictions should consider including in their frameworks to enhance the effectiveness of cross-border resolution. As FSB acknowledges, financial contracts with SIFIs implicate competing legal regimes of multiple jurisdictions including the jurisdiction of each of the counterparties and/or the jurisdictions in which the assets, liabilities or contracts of the counterparty are located. Although we believe orderly resolution of SIFIs is important to reduce systemic risk, the means for achieving orderly resolution must be subject to safeguards such as recognition of creditor hierarchies, equitable treatment of creditors across countries, and grant to local authorities of a right not to enforce a foreign Resolution Regime that would have an adverse effect on the economy of a country, material adverse fiscal implications for the country, or be contrary to national law. This approach should provide legal certainty to financial markets and allow parties to enter into effective risk management measures relating to counterparties whose resolution will be subject to foreign law.

FSB Should Encourage Members to Adopt Recognition Statutes rather than Support Mechanisms

We believe that the adoption by FSB members of cross-border recognition statutes[10] is preferable to "support mechanisms"[11] to enforce and recognize actions under foreign Resolution Regimes. Although the FSB appears to be indifferent between these two mechanisms, we do not believe reliance on "support mechanisms" premised on a domestic legal framework would achieve the same or equivalent result as a law or regulation that makes expressly enforceable a foreign Resolution Regime or actions by a foreign resolution authority. According to the FSB, supportive measures would involve actions by local authorities to help implement and support a foreign Resolution Regime or actions by a foreign regulatory authority in reliance on authority in a local Resolution Regime. One concern we have with reliance on supportive mechanisms is that the end results will be unpredictable and depend on the local laws of the host countries. Moreover, reliance on local resolution powers to enforce a foreign law may not be recognized by courts of law in the host country.

In the cross-border enforcement of an insolvency, one of the first issues typically raised is with respect to stays on termination of qualified financial contracts, including those relating to OTC derivatives. To the extent that host country laws were relied on to enforce a foreign stay provision under a "supportive measure" theory, the length of stay may be different under the host country law than under the foreign Resolution Regime. For example, if supportive measures were used to enforce a 48-hour stay under the Bank Recovery and Resolution Directive ("BRRD") of the European Union

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[10] Under a recognition procedure, a jurisdiction would accept the commencement of a foreign resolution proceeding domestically and empower the relevant domestic authority to enforce the foreign resolution measure or grant other forms of domestic relief, such as a stay on domestic creditor proceedings.

[11] Supportive measures would involve a domestic resolution authority taking resolution measures that help implement and support resolution measures taken by a foreign home resolution authority.

("EU") by applying US law, a 24-hour stay under the US Orderly Liquidation Authority ("OLA")[12] may be imposed. Conversely, if EU authorities or EU member state courts were directed to impose the US stay with respect to financial contract counterparties of an EU affiliate of a US entity going through resolution by using the BRRD (with a stay longer than under OLA), financial contract counterparties of a US affiliate of the same US entity going through resolution arguably would be advantaged as compared to those trading with the EU sister company. The financial contract counterparties of the US affiliate would be allowed to close out exposure with the counterparty a full day prior to the financial contract counterparties of an EU affiliate. This result would be contrary to basic equitable principles.

For these reasons, reliance on supportive measures for cross-border recognition of foreign Resolution Regimes or resolution actions is not appropriate. We recommend instead that FSB encourage its members to adopt legislation that enforces foreign Resolution Regimes, subject to appropriate safeguards such as equitable treatment of creditors. Given the importance of providing certainty during times of financial turmoil, the FSB should encourage jurisdictions to adopt recognition procedures that rely on a combination of cooperation agreements between authorities and statutory provisions because they would ensure predictability and fair treatment of creditors in connection with enforcement of established foreign Resolution Regimes. FSB should encourage members to seek to adopt these statutory solutions as soon as possible and, in any event, within specified time frames. In our view, implementation of cross-border recognition statutes (such as Articles 94, 95 and 96 of the BRRD) are the only viable means over the long term to provide the legal certainty needed in this critical area to maintain market stability during times of crisis.

Cross-Border Recognition Statutes Should be Limited to Established Resolution Regimes that are Consistent with the Key Attributes and be Subject to Appropriate Safeguards

ICI Global believes that the statutory and regulatory frameworks also should only recognize and enforce actions by foreign authorities taken pursuant to an established Resolution Regime that complies with the Key Attributes. We would have significant concerns if the recognition statutes or regulations resulted in market participants being forced to waive contractual and legal rights based upon administrative actions that have not been subject to the rigor of a robust legislative or regulatory process. We believe this approach would not be in the best interest of the global markets and could undermine public confidence in the fairness of the markets. Moreover, reliance on established Resolution Regimes provides market participants with a level of predictability that could assist in appropriately managing risk in their commercial dealings.

In addition, although we agree that general principles of comity as well as the practical need to resolve global entities in an orderly fashion require cross-border recognition of Resolution Regimes, any

[12] *See* Title II of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Section 210 (c)(10)(B)(i).

statute or procedures should incorporate appropriate safeguards.[13] At a minimum, safeguards, such as those set forth in Article 95 of the BRRD, should be incorporated into any recognition mechanism.[14] We also would urge the FSB to incorporate safeguards for interested parties, including creditors of the entity subject to the foreign Resolution Regime, to appeal to a local court decisions by local resolution authorities to enforce the foreign Resolution Regime.

Contractual Solutions to Cross-Border Recognition Should Be Temporary and Narrowly Tailored

Although the FSB recognizes that adoption of comprehensive statutory or regulatory frameworks should be the long term solution to the cross-border resolution of a SIFI, the FSB has been working to implement contractual arrangements that could be an interim solution to cross-border recognition of resolution action.[15] ICI Global believes that the use of contractual measures on an interim basis may be appropriate if properly designed and implemented. First, all counterparties must be required to comply with such contractual measures to the same extent. As fiduciaries, asset managers cannot voluntarily give up contractual rights that are for the benefit of their clients (*e.g.,* Regulated Funds) and therefore would not be able to waive termination rights voluntarily.[16] Second, restrictions on close-out and exercise of other default rights should be short-lived and applied consistently with guidance regarding how the provisions would be interpreted.[17] This will allow parties to plan appropriately and adopt appropriate risk management measures.

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[13] Similarly, any agreement for the recognition of a foreign Resolution Regime should be subject to appropriate safeguards, which we discuss below.

[14] EU resolution authorities may refuse to recognize or to enforce third-country resolution proceedings if they find (a) that the third-country resolution proceedings would have adverse effects on financial stability of the EU Member State in which the resolution authority is based or that the proceedings would have adverse effects on financial stability in another Member State; (b) that independent resolution action in relation to an EU branch of the entity is necessary to achieve one or more of the resolution objectives; (c) that creditors, including EU depositors, would not receive the same treatment as third-country creditors and depositors under the foreign resolution proceedings; (d) that recognition or enforcement of the third-country resolution proceedings would have material adverse fiscal implications for the Member State; or (e) that the effects of such recognition or enforcement would be contrary to national law.

[15] We note, for example, that the US does not currently have such a recognition statute or regulation. Neither OLA nor the implementing regulations provide for recognition of foreign Resolution Regimes although they do contemplate cooperation between US and foreign resolution authorities. In the case of normal insolvency proceedings, however, Chapter 15 of the US Bankruptcy Code, which incorporates the Model Law on Cross-Border Insolvency, provides for recognition of foreign regimes in a clear, transparent manner that includes appropriate safeguards.

[16] We understand that, beyond the 18 G-SIBs, other counterparties would not be asked to adhere voluntarily to the ISDA Stay Protocol. The FSB members intend to propose and adopt national regulations that would prohibit their prudentially-regulated entities from entering into derivatives contracts with counterparties that do not agree to terms similar to those included in the ISDA Stay Protocol.

[17] Resolution Regimes that comply with the Key Attributes would meet this criteria.

Third, contractual cross-border recognition must provide for equitable treatment of creditors and recognize creditor hierarchies. As acknowledged in Key Attribute 7.5, the benefits of a Resolution Regime depend upon equitable treatment of creditors.[18] The possibility of disturbing creditor rights and priority may be greater if contractual approaches override local laws. An approach under which contractual measures override local laws also would not be consistent with the purpose of an effective Resolution Regime, which is described by FSB as allowing authorities to resolve SIFIs in an orderly manner without destabilizing the financial system or increasing taxpayers' exposure to loss.[19] In implementing any contractual measures, the FSB must be extremely careful and fully comprehend the consequences of altering any creditor rights and priority under domestic law.

Finally, we urge the FSB to tread cautiously in adopting a contractual solution in areas beyond the Resolution Regimes and then, only with respect to essential elements of the Resolution Regimes, to ensure that important negotiated rights are not overridden.[20] We urge the FSB and the US regulators that participate in FSB not to create a new regime under which existing contractual and legal creditor rights can be unwound through contractual measures. We would be gravely concerned if the contractual approach could impede the ability of parties to manage the risk of their positions through credit checks and contractual protections.

We expect that more details regarding the scope of the contractual approach will be forthcoming in proposed rules by prudential regulators, which would prohibit prudentially-regulated entities from transacting with counterparties that do not agree to terms similar to those included in the ISDA Stay Protocol for derivatives and other similar financial contracts. We intend to review and comment in more detail when the FSB jurisdictions propose those prudential regulations.

Conclusion

ICI Global agrees that it is important for legislative bodies and regulators globally to develop Resolution Regimes for SIFIs that reflect the principles established by the Key Attributes, including a focus on transparency, respect for creditor hierarchy, and protection of netting and collateral arrangements that are necessary for the functioning of the capital markets. For the orderly resolution of SIFIs with global operations, we also believe that jurisdictions should adopt laws and regulations that recognize and enforce foreign Resolution Regimes. Moreover, we understand the necessity of relying

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[18] *See* Key Attributes, *supra* note 3, at 13 ("Recognition or support of foreign measures should be provisional on the equitable treatment of creditors in the foreign resolution proceeding").

[19] *See* Key Attributes, *supra* note 3, at 1.

[20] For example, section 2 of the ISDA Stay Protocol goes beyond cross-border recognition of foreign Resolution Regimes and requires parties to waive standard cross-default and close-out rights included in the ISDA Master Agreement that are eligible for special safe harbor treatment under the US Bankruptcy Code. In our view, these provisions go beyond cross-border recognition of Resolution Regimes and seek to make substantive changes to negotiated contract provisions. The ISDA Stay Protocol provisions prevent financial participants from enforcing contractual rights that are eligible for special treatment under the US Bankruptcy Code and that would otherwise allow counterparties to mitigate risk by terminating financial contracts upon insolvency of a guarantor or affiliate.

on tailored contractual measures, as an interim solution that would sunset after a specified time period, to recognize and enforce "critical prerequisites" of established foreign Resolution Regimes if all counterparties are required to comply with such measures. With both approaches, recognition of the foreign Resolution Regime should, consistent with Key Attribute 7.5, provide for "transparent and expedited processes to give effect to foreign resolution measures" and be conditioned on "equitable treatment of creditors in the foreign resolution proceeding."

ICI Global believes, however, that contractual measures should not be used to enforce foreign resolution actions taken outside of an established Resolution Regime or relied on broadly to enforce all aspects of a foreign Resolution Regime. Similarly, ICI Global would not support contractual solutions that would create stays or permanent overrides that do not exist under a Resolution Regime or domestic law and significantly alter the protections of market participants or do not otherwise provide adequate creditor protections.

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We appreciate the opportunity to respond to the Consultative Document. If you have any questions, please feel free to contact the undersigned, Susan Olson at +1-202-326-5813, Sarah Bessin at +1-202-326-5835, or Jennifer Choi at +1-202-326-5876.

Sincerely,

/s/ Dan Waters

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